SOLVING THE DECUMULATION DILEMMA

What if there was a way to bring together managed accounts and income protection—all without changing the way you do business?

David Blanchett, PhD, CFA, CFP®

Managing Director, Portfolio Manager and Head of Retirement Research for PGIM DC Solutions

David is currently an Adjunct Professor of Wealth Management at The American College of Financial Services, and a Research Fellow for the Alliance for Lifetime Income.

The Retirement Income Challenge

As the wave of retirees swells, with an average of 11,000 Americans turning 65 each day and an anticipated 30% surge in the senior population by 2030[1], the urgency for retirement income solutions intensifies. Amid this demographic shift, managed accounts have also witnessed explosive growth in recent years. Growing from $2.8 trillion in 2012, projections now point to the number exceeding $15.6 trillion by 2026. In fact, managed accounts growth has outpaced that of mutual funds for the first time[2]. However, this expansion casts a spotlight on a critical shortfall: the lack of income protection for these assets.

Currently, just 2% of the $34 trillion of retail retirement assets are safeguarded against longevity risk. Most financial advisors rely on unprotected systematic withdrawals, a precarious stance underscored by a Prudential Market Research survey* where 81% of advisors said they preferred this strategy. This presents an undeniable challenge—how to deliver protected, sustainable income to a growing number of future retirees without upending the foundational practices of financial advisors' businesses.

** Withdrawal Rate Survey, Research Among Financial Advisors, January 2024*

~$1T Assets with Income Protection

Source: Cerulli 2023 Distribution Intermediary report, Investment Company Institute, 2Q23, Prudential Analysis

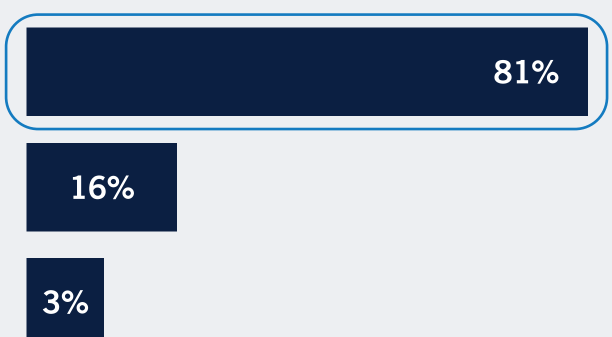
Among advisors who implement decumulation strategies for their clients' retirement savings, most (81%) use a systematic withdrawal program with a customized investment strategy developed by them.

Retirement Savings Decumulation Strategy Used Most Often:

A systematic withdrawal program with a customized investment strategy developed by you:

A systematic withdrawal program customized to meet your clients' needs using a target date fund strategy:

Other systematic withdrawal program strategy:



A New Approach: Insurance Overlays

For decades, financial experts have recognized the benefits of allocating a portion of retirement savings to strategies that can potentially generate longevity-protected income. Yet, adoption of annuities products remains low, especially within the managed money space. A solution that addresses the most common concerns about traditional annuity products is a Contingent Deferred Annuity (CDA).

One way to think about a CDA strategy is as an insurance overlay covering part or all of a managed account portfolio. For an additional fee, an insurance overlay brings the potential of lifetime income and protection to retirees, helping them manage the risk of outliving their assets or to more freely spend what they've saved. Unlike a traditional annuity, an insurance overlay does not require a retiree to sell all or part of their managed account portfolio to transfer to an insurance company. The retiree simply pays an annual fee for the overlay. If the protected portion of the portfolio is depleted during their lifetime, they continue receiving income for life, depending on the terms of their insurance overlay.

While some investment advisory platforms offer overlay strategies that provide tax efficiency or environmentally focused portfolio positions, this insurance overlay concept addresses longevity risk and does not turn over any discretionary investment authority to the insurance company. Portfolio discretion remains with the advisor — though they may be subject to certain restrictions.

Though the CDA structure has been around for more than a decade, the technology platforms that make implementation faster and easier have evolved. It is these technology innovations that now make overlays an exciting and viable option in the field of longevity protected income.

They also address a number of the concerns financial advisors have shared over the years about some lifetime income products, as we will discuss later in the article.

The Decumulation Problem

While some advisors embrace annuities as a way to generate protected income for clients, there are a number of potential barriers. For example, an advisor may feel they don't have the same investment flexibility or that the investments available in an annuity are unfamiliar than what they typically use. There could be concerns regarding the tax implications of generating income from an annuity along with additional expenses. And there may well be other considerations regarding technology, aggregation, and tracking. Additionally, the advisor may not be able to easily bill for their services in some annuity structures; for example, if they are fee-only.

Yet the unprotected nature of systematic withdrawals leaves clients open to various risks in retirement, notably longevity risk and sequence of returns risk.

Insurance overlays have the potential to directly address most, if not all, of these challenges. They offer a protected systematic withdrawal strategy that adds a layer of protection onto their managed account during decumulation. The assets do not have to be transferred to the insurance company: they remain custodied with the financial advisor, who is able to continue to manage and bill the portfolio as they have always done.

While the income generated from insurance overlays — and the associated fees — varies by product, the income benefit can be generalized such that if the portfolio is exhausted while the retiree, or retirees, is still alive, the retiree would continue receiving income for life, based on the provisions of the particular product. The insurance overlay income benefit could be structured as a Guaranteed Lifetime Withdrawal Benefit (GLWB). Even newer approaches allow the income to evolve throughout retirement based on the ongoing performance of the portfolio, a strategy referred to as a "Protected Lifetime Income Benefit" (PLIB) in some recently released research.

Some of these products will offer spousal benefits that can cover income for two lives[3].

Generally, there will be some restrictions on the underlying portfolio allocations as part of an Insurance Overlay, especially for income products with more explicit guarantees (e.g., GLWBs). While most investments and asset classes used by financial advisors are likely to be fine within a CDA structure, more exotic assets classes that challenge the insurance company's ability to hedge may not be available (for example, no crypto). Regardless, the structure can create significantly more freedom around the investments than a more traditional approach to lifetime income for some financial advisors by enabling them to remain in their investment models and maintain a more scalable investment approach.

Certainly the fee associated with an insurance overlay creates its own drag on portfolio longevity. But the features for Insurance Overlays come at a cost, which is fundamentally different than other expenses like investment management[4], and the fee is an ongoing expense compared to a one-time decision.

Insurance Overlays...

WHATS NEXT?

Creating efficient retirement income strategies will of course require greater access to a variety of insurance overlay products and solutions. Today, technology innovations have brought exciting new advances to the world of protected lifetime income, and soon it may make adding overlay protection to a managed account as easy as clicking a button to add trip insurance to a vacation reservation. The good news is that we are beginning to see overlays appear within broker-dealer managed account programs, and on familiar distribution platforms such as Envestnet and FIDx.

The largest hurdle in the past was that financial advisors had to jump through hoops to secure protection for their clients. But now that there are APIs, middleware, and end-to-end digital experiences available in the marketplace. In the not-too-distant future, insurance overlays could help financial advisors easily bring longevity protection options to their clients.

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[1] The Peak 65(R) Zone is Here-Creating a New Framework for America's Retirement Security" Jason J Fichtner, PhD. Executive Director, Retirement Income Institute, Alliance for Lifetime Income. January 2024

[2] Cerulli Report U.S. Managed Accounts 2023 https://www.cerulli.com/reports/us-managed-accounts-2023

[3] November/December 2022, Investments and Wealth Institute, Investments & Wealth Monitor, Protected Lifetime Income Benefits:The Future of Longevity Protection by David Blanchett, PhD, CFA®, CFP®

[4] Alliance for Lifetime Income, Lifetime Income Guarantees Aren't Free: Understanding the Value of Lifetime Income Insurance. By David Blanchett and Michael Finke January 2024

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