CAPCO

THEY'VE EARNED IT, LET'S HELP THEM SPEND AND ENJOY:

HOW TO SERVE RETIREES BEST

1. AN INTRODUCTION TO DECUMULATION

While the growth of client assets and accumulation of wealth remain a crucial focus for financial advisors, retirees make up a large and growing segment of the population and are seeking better ways to manage their assets as they enter the decumulation stage[1]. With the uncertainty of adequate savings, retirees need more help than ever to ensure they draw down assets effectively – but more importantly, where can they start?

Today, baby boomers are retiring and need help planning and executing an effective decumulation strategy. The fact is many clients in retirement still feel undereducated on what exactly they should do during the 'decumulation' part of their lives. According to Nobel Prize-winning economist William Sharpe, retirement income planning is "the hardest and nastiest problem in finance.[2]" While the individuals in the ultra-high net worth (UHNW) markets are typically catered to with a personal concierge service and can self-fund their retirement needs, all other segments of retirees such as mass affluent and high net worth do not have access to the same tailored service and to address their concerns.

With the rise of advanced tools and technology and numerous strategies to choose from, clients not only feel lost but overwhelmed about how to consolidate these assets best and make them last, among other concerns. Solving this problem is where advisors become the differentiator. While there has been plenty of financial planning technology introduced to end consumers, they are limited in their ability to plan distribution and withdrawal plans heading into and throughout retirement. With their client's best interest in mind, the responsibility of solving this dilemma sits squarely with the advisor.

Not only does the advisor need to bring awareness to existing services, but they also need to educate their clients on how to use them and provide advice on any gaps in plans not addressed by these existing services. Currently, you can't solve this problem easily since most advisor tools can't guide clients through their decumulation phase accurately.

Throughout this paper, we explore the challenges faced by retirees today, and the potential opportunities for both the firms and advisors on how to serve the retirement population best.

1. https://www.census.gov/newsroom/press-releases/2018/cb18-41-population-projections.html
2. https://www.barrons.com/articles/william-sharpe-how-to-secure-lasting-retirement-income-51573837934

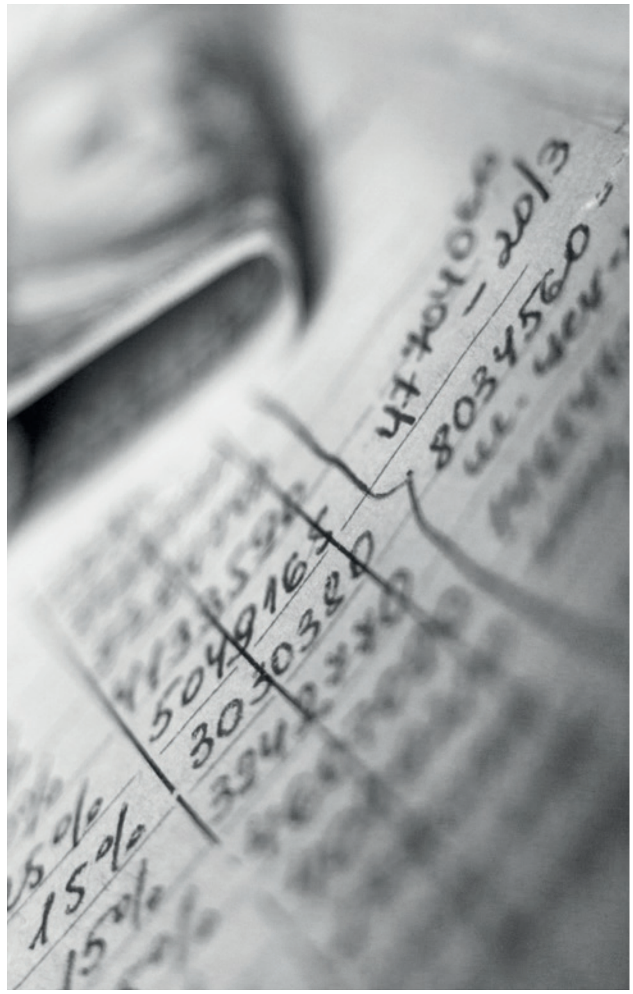
2. THREE CURRENT CHALLENGES FOR RETIREES

Approximately 34 million baby boomers are currently retired, and another 38 million expected to retire in the coming years[3]. In a BlackRock study, it was reported from 1992–2014, retirees “mostly refrained from spending down assets and lived off of other sources of income instead[4].” As retirement balances grow, retirees are becoming increasingly fearful of taking distributions. They are unsure of the best way to spend down to achieve goals while also making their wealth last through retirement.

The retirees could greatly benefit from increased education and financial planning services heading into retirement. Almost one-third of employed baby boomers between the ages 67-72 have already postponed retirement[5]. With uncertainty around the future market and economic conditions, retirees should prepare to adapt **and** challenge a few key concepts:

1. Future returns might disappoint

While we saw a bull market in the last decade, market volatility due to COVID-19 has elevated the uncertainty on future market returns. Usually, significant declines follow big bull markets due to the natural economic cycle. Retiring in a bear market recalls the trials of 2008, where many underprepared retirees had to delay retirement and continue working. The full impacts of COVID-19 are unknown, as it remains unclear whether we have seen a peak in diagnosed cases.



3. https://www.cnbc.com/2019/04/09/baby-boomers-face-retirement-crisis-little-savings-high-health-costs-and-unrealistic-expectations.html
4. https://www.blackrock.com/us/individual/products/variable-insurance-funds/decumulation-challenges-and-potential-solutions
5. https://www.cnbc.com/2019/04/09/baby-boomers-face-retirement-crisis-little-savings-high-health-costs-and-unrealistic-expectations.html

2. Traditional four percent distribution rule

The traditional four percent distribution rule states that individuals should withdraw no more than four percent of their retirement savings annually to ensure that they do not outlive their assets. This general rule of thumb has served as a valid benchmark for retirees for decades. As today's retiree needs become more complex, the four percent distribution rule should be challenged and modernized. For instance, the four percent rule is based on returns from 1926 through the mid-1990s and assumes a portfolio mix of 60 percent equities, 40 percent bonds, and is designed for the retiree's savings to last them 30 years[6]. These requirements do not allow flexibility for the rule to be applied to unique situations, which is unhelpful for most retirees who need individualized planning service. Instead of treating the four percent rule as an absolute, you should use it as a guideline. It's a useful tool that can aid retirees from depleting their assets, although retirees should remain cautious about blindly following it.

According to Forbes contributor Robert Pagliarini, creating a safe retirement income distribution plan is not as simple as following the 4 percent rule[7]. Retirees and advisors alike must recognize that the order of investment returns matters a great deal in retirement. A modernized approach should be combined with common sense, goals-based investing, and behavioral finance to create an executable strategy[8].

3. Low client literacy among new tools and platforms creates a heavy reliance on financial advisors

Investors nearing retirement, or those already in retirement, are among the most challenging clients for advisors due to the complexities in dealing with situations such as:

- When to take social security
- How and when to tap into tax advantage saving accounts
- Healthcare costs
- Inflationary concerns
- Typical day-to-day expenses

In today's landscape, there are numerous tools available to assist with accumulation, but a lack of tools that specialize in decumulation strategies for the retiree market. Decumulation strategies can be intimidating for many retirees, as they struggle to implement them effectively. Many clients look to financial planners for assistance, but advisors have traditionally focused on essential tasks like asset allocation to grow and protect their clients' nest eggs. As a result, some advisors may be overlooking a valuable aspect of growing and servicing their book of business.

6. https://www.marketwatch.com/story/the-4-rule-desperately-needs-to-be-modernized-2018-07-20
7. https://www.forbes.com/sites/robertpagliarini/2020/01/22/the-stunning-problem-with-the-4-retirement-income-rule-in-one-chart/#1d3768e221cb
8. https://www.marketwatch.com/story/the-4-rule-desperately-needs-to-be-modernized-2018-07-20

3. WHAT DOES THIS MEAN FOR ADVISORS?

By bridging the gap between technology and their clients' needs, advisors can position themselves as a critical differentiator. Advisors can offer tailored services to provide improved client experience, enabling firms to retain a more significant number of assets, and even attract new business from retirees planning to decumulate. Today, there is a clear opportunity for firms to provide bespoke retirement services to retirees (except for the UHNW segment) to prepare for a healthy retirement appropriately. Advisors will be able to articulate a compelling value proposition, serving clients leading into and throughout the retirement phase of their lives by holistically planning to achieve specific goals in retirement.

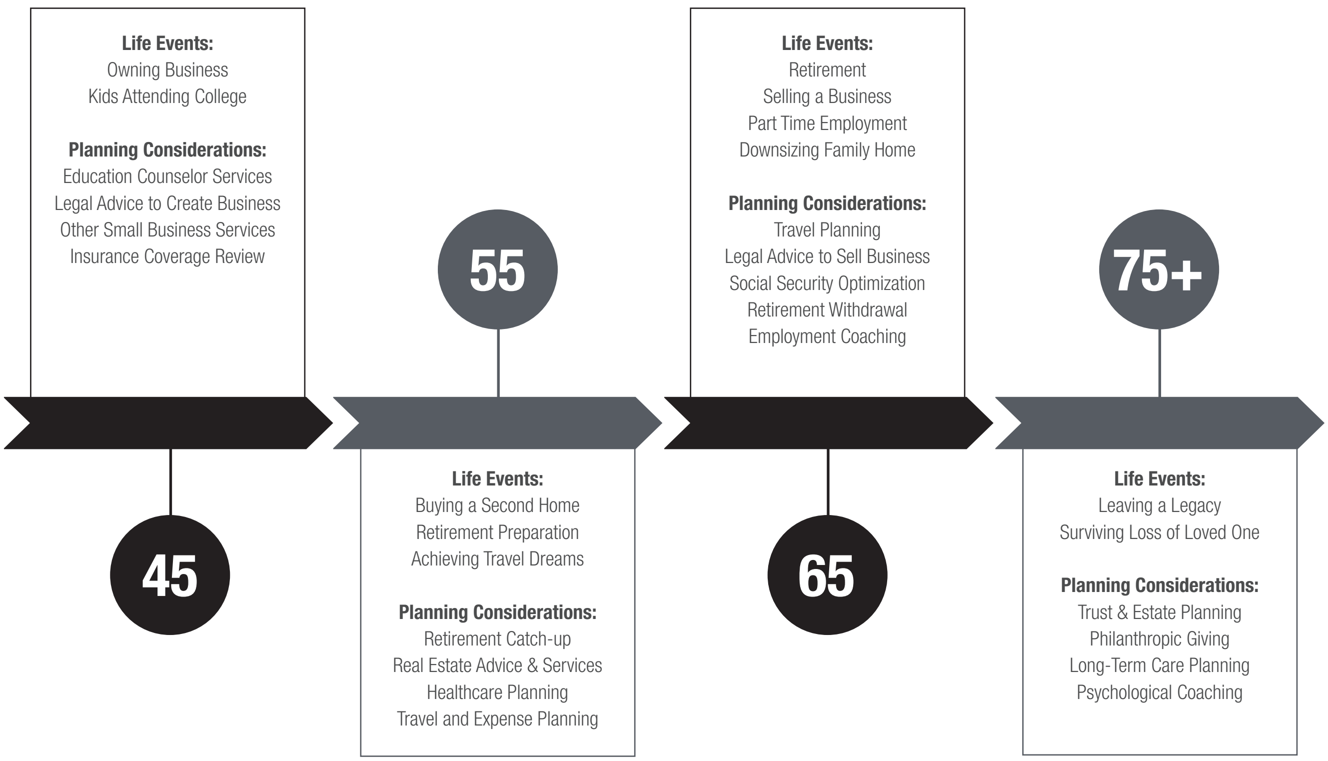
Providing retirement services to retirees

Individuals in the ultra-high net worth (UHNW) markets are typically catered to with a tailored level of service without any problem. However, retirees in all other segments, such as the high net worth, mass affluent market, are critically underserved by financial institutions, despite their large size (roughly 84.8 million households) and the potential upside (total assets of $70.4 trillion) these segments brings. While adopting new compensation models could help advisors better serve the retirement-age population, advisors should look to offer services tailored to the retirement age population (65 plus) to attract and retain customers.

In the current wave of goals-based planning experiences, advisors can differentiate themselves to clients in retirement by addressing specific retirement population goals. Advisors should approach the unique considerations retirees face – like working part-time in retirement, the timing for claiming social security, and the burden of increased healthcare costs, etc. – with structured service and education to more effectively serve Americans approaching or in retirement. By framing the conversation around these goals, advisors can create custom plans and gamification experiences such as goal trade-offs and vacation options, that allow retirees not just to accomplish their retirement objectives, but do so in a favorable manner.

As shown in the diagram below (*Life Events and Financial Planning Considerations Timeline*), advisors can take planning a step further by breaking retirement plans into different phases, guiding clients to allocate funds to goals aligned to those phases. Not only will it be necessary for advisors to help clients identify their goals throughout different stages of retirement, but it will also be essential for advisors to help clients understand how expenses will change over time to meet those goals. For instance, a long-term plan may allocate more funding towards travel in the early years of retirement but may shift to allocate more funding towards healthcare costs in later years as the cost of care increases. Throughout retirement, advisors can continue to strengthen relationships by serving as a coach or mentor to their clients during confusing and potentially unsettling times. In this way – by discussing and planning around the holistic goals of retirees – advisors can deliver tailored plans to coach their clients through the complicated transition into retirement and beyond.

Life Events and Financial Planning Considerations Timeline



Providing account consolidation services

As clients move into retirement, they will look to consolidate financial accounts to minimize fees and streamline the process of managing multiple decumulating accounts. Combining accounts is mutually beneficial to both clients and advisors in the following ways:

- Simplification for both the client and advisor – e.g., fewer accounts to monitor
- A full macro-level view of the portfolio – e.g., 401(k), banking, brokerage, retirement, etc.
- Keeps cost at a minimum – e.g., clients may qualify for breakpoints when aggregating assets
- Avoid potential conflicts with outside portfolios – e.g., duplicating investment strategies
- Improves tax efficiency

Benefits of effectively serving the mass retiree market: retaining assets during the coming wealth transfer

The coming decades will continue to see a sizeable intergenerational wealth transfer, with an estimated $68 trillion shifting over the next 25 years to heirs and charities.[9] Successfully retaining these assets in motion will likely continue to be a priority for firms and advisors, but also a challenge. Providing high-touch services to older clients will allow advisors to maintain relationships throughout their clients' retirement years while also creating opportunities to forge stronger bonds with the clients' potential younger beneficiaries.

While firms will undoubtedly need to create strategies that incorporate younger generations into the client base, it is essential not to overlook all market opportunities. The millennial generation will be an important one to capture, but firms cannot ignore young baby boomers (children of the silent generation) and Gen X investors. Estimates say that "Gen X and Baby Boomers… stand to inherit the most significant share of transferred wealth in the coming decades."[10] By identifying the most attractive market segments, firms can better position innovative technology-focused products and solutions to serve the beneficiaries of the coming wealth transfer. Advisors who holistically look at opportunities in all parts of the market will be able to bridge the gap between age groups and maintain an advantage as wealth transfer across generations begins.

9. https://www.wealthmanagement.com/high-net-worth/great-wealth-transfer-wake-call
10. http://info.cerulli.com/rs/960-BBE-213/images/Cerulli-HNW-Generation-X-2019.pdf

4. CONSIDERATIONS FOR FIRMS AND THEIR ADVISORS: A CAPCO PERSPECTIVE

While there are precise services and considerations financial advisors can bring to their clients, firms need to ensure that their advisors are well equipped to deliver on these services effectively. Currently, firms lack the proper technology tools to equip advisors to bring forth complex decumulation services to their clients successfully. Furthermore, compensation models within the industry may not align with the decumulating accounts of retirees. Looking forward, firms need to invest in sophisticated technology to provide tailored services to retirees and ensure that their advisors' compensation is appropriately aligned to provide these services.

Technology considerations

Traditionally, asset accumulation has been the primary driver of digital advisory platform innovation. Yet, as generations such as baby boomers and Gen X get closer to retirement, with a lack of clarity on how to manage drawdowns/pay-outs cost-effectively, the industry should look to put an increased focus on retirees, providing more tools and platforms to assist with clients in the decumulation phase.

Providers have been rapidly adapting to capture this overlooked market segment and are expanding their service offerings to decumulation driven clients to include[11]:

- Drawdown strategies aligned with the retirement plan, based on lifetime income, social security maximization, legacy goal, income volatility, etc.
- Modernized withdrawal features that factor in required minimum distributions (RMDs), tax efficiencies, account withdrawal sequencing, and when to start drawing social security, etc.

Clients must consider the overall complexity of the financial situation and the level of support regarding ongoing investment decisions when considering a hybrid model for decumulation. Therefore, current robo-advisor capabilities might align better to individuals with simple portfolios, accounts, and planning requirements.

As digital advisory platforms continuously evolve, they will need to incorporate a wide range of data and analytic requirements to best cover the holistic scope of financial planning (from accumulation to decumulation), including, but not limited to:

- Collaborative tools that seamlessly integrate with different service providers/platforms
- Holistic household assets and liabilities management (i.e., bank accounts, 401(k)s, IRAs, pensions, mortgages, loans, etc.)
- Concierge services to address ad-hoc household needs (i.e., travel planning, bill payments, legal advice, philanthropic/charitable donations management, etc.)
- Long-term care and medical/dental/vision insurance-related advice and services

11. https://pensionresearchcouncil.wharton.upenn.edu/wp-content/uploads/2018/12/WP-2018-18-Polansky-et-al.pdf

Innovations in technology hold a lot of promise, but retirees and firms alike must collaborate more on how to design tools to serve this growing segment better. It is important to note; decumulation is more challenging but no less important than helping clients accumulate and grow their assets. A few industry leaders have taken the leap to tackle this challenge.

Current landscape and evolving tools ecosystem:

Charles Schwab has recently launched Schwab Intelligent Income, a modern solution designed to project, manage, and automate multiple retirement income streams from an individual's investment for no additional fee[12]. The design of Schwab Intelligent Income aims to help with critical and complex retirement income-related topics, including efficient smart withdrawal combinations from taxable, non-taxable and Roth accounts.

Some large institutions have opted for acquiring promising fintech start-ups within the pre/post-retirement space. In 2019, Capital One acquired United Income, a growing financial planning, and investment management digital platform, targeted for individuals nearing or transitioning into retirement.

Digital platforms and online tools can help guide investors to act in ways in their best interest - such as online and mobile app platforms that offer frequent investor notifications to monitor budgets, spend rates, and progress towards set goals. Though guiding investor behavior has typically been a strength of most digital providers, they must ask themselves if the solution offerings are meeting the investors' full suite of needs. As digital platforms begin offering both accumulation and decumulation advice at an affordable price, advisors will have to adopt these technologies to meet the growing demands of the changing investor landscape.

Comp models – service fee-based considerations

Serving the retiree market demands value-added services beyond investing, such as exploring part-time working opportunities, dealing with a health issue and more. These value-added services help advisors develop healthy relationships, thereby helping firms with opportunities to generate more revenue. However, despite a strong business case, not all advisors pursue this route because only a few of the current advisor compensation models are well suited to work in the best interest of both advisors and retirees.

Unlike accumulation, where an advisor is incentivized based on assets under management (AUM), decumulation services present a more difficult alignment problem, as clients start drawdowns resulting in lesser AUMs, and potentially decreasing compensation to advisors. There is a demand for decumulation services, and some financial advisors provide those services if only to stand out in the market for financial advice. Therefore, firms may want to consider re-evaluating their current comp models to encourage more advisors to serve retirees better thereby developing and maintaining strong relationships throughout their

12. https://www.businesswire.com/news/home/20191218005159/en/Schwab-Announces-Launch-Schwab-Intelligent-Income%E2%84%A2-Modernize

clients' retirement years, while also creating opportunities to forge stronger bonds with the clients' potential younger beneficiaries.

Depending on client circumstances, advisors and firms may want to consider alternative comp models – for example, a 100 bps AUM fee for a client with $250K may require a more advisor work than the $2,500 in fees received thus some services provided may need an extra fee; but a client with $2M+ and paying $20K in fees likely believes they should get all these services. There are several other comp models to choose from, for example, a fee-for-service subscription model that provides retirees with a 'pay as you go' option, allowing them to use a variety of value-added services on an 'on-demand' basis. Given the demand for value-added services coupled with the alignment challenges decumulation presents, firms and advisors need to be more flexible in their approach to meet the needs of the retirees.

Regulatory pressures: how they impact financial planning for retirees

In response to the inaction of the DOL regulation, the SEC adopted Regulation Best Interest (under the Securities Exchange Act of 1934). This rule is effective June 30, 2020, and will require broker-dealers and associated persons to have a general obligation of best interest when providing investment recommendations to their clients. While not quite as stringent as adopting a fiduciary standard, this higher level of care will precipitate a change in how advisors service their clients. Brokers will need to rethink their approach in serving clients as revenue-sharing agreements, high-cost investment options, and other forms of conflict-filled arrangements decrease.

Further complicating matters, advisors will also need to consider the implications of the SECURE Act, signed in December 2019, on behalf of their clients. The SECURE Act will affect clients in different ways, as it pushes RMDs from 70 ½ to 72 years of age, introduces annuities into retirement accounts, and beneficiaries face a shorter timeframe to liquidate inherited accounts[13]. All aspects of the SECURE Act will impact clients in unique ways. With the advisor's newly defined role under Regulation Best Interest and movement toward a fiduciary standard, advisors will need to ensure they factor all aspects of the SECURE Act into clients' retirement and lifestyle planning.

Regardless of the compensation model, an advisor falls under regulatory concerns affect the entire industry. Between the SECs adoption of Regulation BI and the DOLs Fiduciary Rule (though never materialized), the movement from commission-based revenue and into fee-based arrangements for retirement advice represents a tectonic shift in how advisors conduct business with their clients. The SECURE Act adds another layer of complexity, and people should consider it within the lens of Regulation BI and fiduciary standards. Inevitable increases in regulatory scrutiny and complexity will force Advisors to evolve to meet these ongoing demands continually.

13. https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SECURE%20Act%20section%20by%20section.pdf

THE PATH FORWARD

Retirees today, except those who are UHNW and can self-fund, face challenges that require a new skill set to help them spend and enjoy their money during retirement. This market segment can benefit from increased education and specialized planning to achieve retirement dreams. Firms must consider adopting new technology, compensation models, and concierge services to serve retirees. Incorporating these changes will require thoughtful consideration around the impacts on the existing culture, technology and processes employed within firms. Financial institutions that recognize and implement changes quickly will have a competitive advantage. Implementing these changes will not only result in a competitive advantage but will enable firms to serve retiree clients more holistically and effectively. If executed well, this creates a 'win-win-win' for firms, advisors and clients alike.

Additionally, given the imminent intergenerational wealth transfer, we see an opportunity ahead of the wealth management firms to redefine the way to serve a market that is dominated by retirees. To retain and gain assets as clients move into retirement, firms must incorporate factors like regulatory considerations and multi-generational planning into a strategic vision to offer improved services.

At Capco, our team can provide extensive industry experience that will support firms as they evolve to meet the needs of the retirees. Our team can provide end-to-end expertise from collaboratively defining a strategic vision to technology package integration and transformation delivery. We have proven capabilities and accelerators to strategize products and services to win in this market, advise on digital solutions, implement solutions within your ecosystem, and drive adoption of applications by both advisors and clients. Contact us to learn how we can help you throughout your transformation journey. Together, we will modernize the way the industry serves retirees.

AUTHORS

Bryant Fuller, Partner, Bryant.Fuller@capco.com
JJ Jeffries, Principal Consultant, JJ.Jeffries@capco.com
Nikhil Sharma, Principal Consultant, Nikhil.Sharma@capco.com
William Horne, Consultant, William.Horne@capco.com
Alan Smith, Principal Consultant, Alan.Smith@capco.com

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

To learn more, visit our web site at **www.capco.com**, or follow us on Twitter, Facebook, YouTube, LinkedIn and Instagram.

WORLDWIDE OFFICES

APAC
Bangalore
Bangkok
Hong Kong
Kuala Lumpur
Pune
Singapore

EUROPE
Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
London
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA
Charlotte
Chicago
Dallas
Houston
New York
Orlando
Toronto
Tysons Corner
Washington, DC

SOUTH AMERICA
São Paulo

WWW.CAPCO.COM

CAPCO
THE FUTURE. **NOW.**

JN_1820