A New Cylinder for Financial Engines

By Kerry Pechter *Wed, Feb 2, 2011*

Income+, a process-driven, product-neutral income program for 401(k) managed account clients, could alter the competitive landscape of the retirement industry.

It's new, it's free, it's easy and it requires almost no action on the part of 401(k) managed account participants. But the income isn't necessarily guaranteed and it's still not clear exactly how the program is financially engineered.

On Monday, to an audience of stock analysts in New York, Financial Engines, Inc. (FE) announced "Income+"—an retirement income enhancement to its 401(k) managed account program, which is an enhancement to FE's advice program for plan participants.

With Income+, FE wants to beat the annuity companies—but perhaps to join them too.

"First generation solutions have largely failed to get any traction in the marketplace," FE CEO Jeff Maggioncalda said—apparently referring to Prudential's IncomeFlex, Genworth's ClearCourse, and MetLife's SponsorMatch. But Income+ also offers clients an option to buy an immediate annuity with their plan assets at any time until age 85.

"Income+ is the first retirement solution designed for the 401k market," Maggioncalda said. "It's an extension of our managed account program. It keeps the money in the 401(k) plan. It provides a monthly payment from the 401k plan to the client's checking account." There's no rollover involved, no departure from the plan, no consolidation of household assets.

"Clients can start and stop their payouts whenever they want. They can take withdrawals up to the full account balance whenever they want. The payout stays steady, even if the market goes down. There's growth potential and the option of guaranteed income. We have a lot of confidence that this is what you must do to succeed in this market," he added.

"For employers, there's income without adding an annuity to the plan and without change to their investment lineup. We remain an independent fiduciary without conflicts of interest, and our managed account is a QDIA (qualified default investment alternative). So there's no waiting for the government to rewrite the regulations. There's no additional fee for the employee or the employer at any time."

Whether Income+ will capture the imagination of plan participants remains to be seen. But it already has traction with plan service providers. FE claims buy-in from big plan providers like Aon Hewitt Live, Mercer, ING, JP Morgan Retirement Plan Services and ACS, a Xerox company, "who've committed to offering Income+ in the next year or so."

FE currently serves about 400 large plan sponsors, including 100 members of the S&P 500. It provides product-neutral advice to some 4.5 million plan participants via desktop and phone. Of those, about

460,000 have managed accounts, which have an average balance of about $140,000 and a median balance of about $80,000.

Financial Engines shares, which had declined steadily from January 20 to January 31, jumped five percent on Tuesday, to $23.67, before closing at $23.30.

"I like the concept: Managed account morphs into a glide path then an option in retirement to buy an annuity," said Ron Surz, president of Target Date Solutions and an advocate of zero-allocation to equities in target date funds at retirement.

But, he added, "I'm afraid the bonds will not do what the description intends them to do, not in this [rate environment]. The [bonds] might not avoid the volatility in stocks and are likely to decrease in value regardless of what stocks do. Also, some stocks are not even close to being an inflation hedge. Quite the contrary."

In a statement that was issued to *RIJ* after a request for comment on Income+, Jamie Kalamarides, Prudential Retirement's senior vice president for Retirement Strategies and Solutions said:

"Prudential Retirement is a strong supporter of the need to provide guaranteed retirement income options to all DC plan participants. We've offered an in-plan solution since 2006 and continue to expand our offering, announcing distribution agreements with Hewitt and Mercer in 2009 and launching a solution for the 403(b) market that same year. We believe that participants want and deserve institutional pricing; principal protection in the years prior to retirement; and access to guaranteed lifetime income while still retaining control of their principal."

How Income+ works

As described by FE's Chris Jones in Monday's live presentation and [webcast](), Income+ works like this:

Five years before retirement, a plan participant who has an FE managed account would see his or her money put on a "glide path" so that the account is "payout ready" at the retirement date.

At retirement, 65% of the account value would be allocated to a bond fund containing short, intermediate and (if available) long-term bonds. Twenty percent of the money would be allocated to equities. The last 15% of the money, also in bonds, could be used to buy an income annuity outside the plan.

"We use the investments early in retirement, and the insurance option later in retirement," said Maggioncaldo.

Starting at retirement, the bond fund would start paying out between 4% and 5% of the account value each year. Every year, about one percent of the equity fund would be transferred to the bond fund, thus enhancing the annual payout. At any point up to age 85, the client can use all of the money, including the 15% reserve, to buy an annuity that locks in the current income for life. If no annuity is purchased, all of the assets would be in bonds at age 85.

This appears at first glance to be a kind of bucket/systematic withdrawal system where the bond fund—the first bucket—provides a floor of safe but not guaranteed income, thus protecting the client against market risk. The equity fund, as the second bucket, feeds the first and protects against inflation risk. The reserve, as the third bucket, stays invested in bonds as a hedge against longevity risk—either as a conservative "granny fund" or to be used to help buy a life annuity.

A hypothetical scenario

As an example, FE offered a retiree named "George" with $100,000 in his retirement fund. With Income+, George would start getting transfers of $4,166 a year ($347 a month) from his 401(k) account to his checking account. He'd continue to pay the same annual fees he paid as an active employee—20 to 60 basis points for the managed account service and about 30 bps for fund management.

The annual income would never dip below that $4,166, said Chris Jones, FE's chief investment officer, and it could go up a lot or a little over time, depending on the future performance of the financial markets.

Under average historical conditions, Income+ clients would see their initial 4% to 5% payout go up by two to three percent per year, he said. He calculated that an increase of 5% in the value of equities in a year would boost the payout by 1.7%while a 15% market decline would still result in a 0.3% increase in the payout.

"We would expect normal 2% to 3% raises on average," Jones said. "Most people will keep up with inflation."

Regarding the administration of the program, Jones said it would be personalized for every client with weekly updates. Clients with questions would be able to get counseling from phone reps. Before retirement, clients would get a personalized plan estimating how much their income would be when they started receiving payments, and what their income from other sources, such as Social Security and/or a defined benefit pension, might be. The system can also show clients how their payouts would change if they took a lump sum distribution.

Maggioncalda said that FE's process-oriented program will be hard for others to duplicate, either because they're tied to specific insurance or investment products and have conflicts of interest or because they don't have the technical capabilities to provide personalized account administration for hundreds of thousands of people with relatively small account balances.

"If you're not independent and you don't have the technology to create personalized solutions at cost-efficient scale, then it will be difficult to duplicate what we're doing here," he said.