

## T. Rowe Price Reopens the Market for Payout Funds

By Kerry Pechter Thu, Jun 29, 2017

*Managed payout funds haven't gotten much traction in the last decade. But T. Rowe Price hopes that its target-date fund/payout fund hybrid, the Retirement Income 2020 Fund, will help it retain money that rolls out of its retirement plans.*



During a presentation at T. Rowe Price's investor day in February, Sebastien Page, the Baltimore-based publicly held fund family's head of Asset Allocation, displayed a slide showing that between 2016 and 2020, \$2.7 trillion in new money would flow into global multi-asset products.

T. Rowe Price's strengths—strategic portfolio design, tactical asset allocation, and active security selection—would enable it grab a big chunk of that flow, allow it to overcome heavy competition in its “core U.S. retirement franchise,” and give customers the one-stop retirement solutions they need, Page told investors.

This week, T. Rowe Price and Page followed through on that promise by announcing the firm's first entry into the managed-payout fund market. Called the Retirement Income 2020 Fund, it retools the company's existing institutional 2020 target date fund (TDF) into a fund for individual investors. It pays out a 5% endowment-like income each year.

Asked why T. Rowe Price was just now entering the small, stagnant (\$3.5 billion) payout fund market that Fidelity and Vanguard pioneered a decade ago, Page (right) told *RIJ*, “We're focusing on the demographics and the demand for retirement income solutions. This product is a first step in the direction of a liquid solution, and over time we will introduce a suite of solutions. We ask what is best for participant and individual rather than how the category is doing.”



Here are the basics on this new income vehicle:

The Retirement Income 2020 Fund, which is designed for people to buy at age 65 and start taking income immediately, will issue payments in the middle of every month based on its 5% annual distribution rate, according to a T. Rowe Price release this week.

The fund's annual payout will be calculated September 30 of each year as 5% of the average monthly net

asset value over the trailing five years. The calculation is intended to reduce the effects of market volatility on the income payments. The minimum initial investment is \$25,000.

The fund's net expense ratio is 0.74%, according to the prospectus, and will initially be offered only with an Investor Class, which can be purchased direct from T. Rowe Price or through a financial advisor.

At the target date, the fund's allocation to stocks is anticipated to be approximately 55% of its assets. The fund's exposure to stocks will continue to decline until approximately 30 years after its target date, when its allocation to stocks will remain fixed at approximately 20% of its assets and the remainder will be invested in bonds.

"Shareholders generally will receive notice of the anticipated fund-level monthly payout amounts for the upcoming calendar year prior to year-end. The fund not intended at this time to be used in defined contribution retirement plan accounts," according to the fund [prospectus](#).

T. Rowe Price is hoping that investor familiarity with its TDFs will help ease them into its managed payout fund. "In theory, people want a salary replacement product with payments as high as possible, with no risk, for life. But that can't be achieved in one product," Page told [RIJ](#).

"Our solution is to extend our TDF and keep it fully liquid, so that people can get out of it and come back into it if they want, and to offer simplicity. What will happen I think is that when people reach retirement, they'll say, 'Do I want to stay in the TDF and withdraw from it myself, or do I want to get this payout version of a TDF and go on auto-pilot?'"

"Think of it as an endowment model. In certain years, we might have to include some decumulation of principal in order to deliver the 5% payout. But if the underlying portfolio has an average return of 5%, then over time you will preserve your capital. It's more likely than not that there will be minimal decumulation. In theory it could be a perpetuity, but the payout may be too high for that."

Current Asset Allocation of <b>T. Rowe Price Retirement Income 2020 Fund</b> (61% equities, 39% fixed income)		
Sector	Neutral allocation*	T. Rowe Price fund(s) components
Domestic Large-Cap	31.50%	Equity Index 500, Growth Stock, and/or Value
Domestic Mid-Cap	4.90%	Mid-Cap Growth, Mid-Cap Index, and/or Mid-Cap Value
Domestic Small-Cap	4.50%	New Horizons, Small-Cap Index, Small-Cap Stock, and/or Small-Cap Value
International Developed Market Stocks	14.90%	International Stock, International Value Equity, and/or Overseas Stock
International Emerging Market Stocks	2.63%	Emerging Markets Stocks
Inflation-Focused Stocks	3.07%	Real Assets
Domestic Investment Grade Bonds	22.05%	New Income
Domestic High-Yield Bonds	3.15%	High Yield
International Bonds	3.15%	International Bond
Emerging Market Bonds	3.15%	Emerging Market Bond
Inflation-Focused Bonds	7.0%	Limited Duration Inflation Focused Bond

Source: T. Rowe Price product prospectus, June 23, 2017.  
\* Neutral allocations are strategic and do not reflect tactical decisions to over- or underweight an asset class or sector. Tactical changes are not expected to move the strategic allocations by more than +/- five percentage points.

T. Rowe Price is an active TDF manager, so this is not a TDF where the manager is simply allocating among index funds. “Two things are happening behind the scenes,” Page said. “First, the glidepath is downward sloping during retirement, with a declining equity allocation. So we will on average be selling appreciated equities.”

“Second, we’ll be engaging in valuation-based tactical asset allocation over a six to 18-month time horizon. If equities are expensive we will rebalance into other assets. In addition, these are actively managed portfolios, so there will be security selection alpha.”

**Mysterious category**

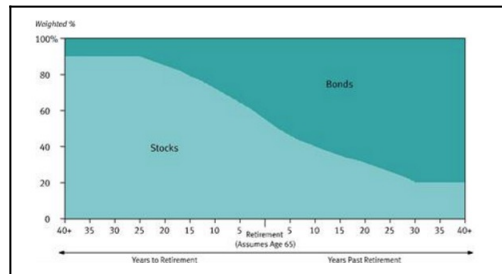
Managed payout funds, created by target-date fund providers as a logical way to retain the assets of participants after they retired from TDFs in 401(k) plans, were first introduced by Fidelity in 2007. Vanguard followed in 2008 and has since become the leader in this space with almost \$1.7 billion in assets. Fidelity has \$154 million.

Fidelity’s series of Income Replacement Funds and Vanguard’s Managed Payout Fund aren’t based on their TDFs. One online example shows a Fidelity funds that makes payments over 20 years, starting at 5.4% a year. Vanguard’s Managed Payout Fund, a fund of index funds, has a 4% per year income target and an expense ration of 34 basis points.

It’s something of a mystery why managed payout funds haven’t been more popular. Vehicles that create annuity-like streams of monthly checks in retirement without the stifling illiquidity or the expensive guarantees of annuities would seem to match a growing need. But their initial marketing push was interrupted by the financial crisis and the products never really took off. The whole category has only about

\$3.5 billion, according to Morningstar.

American Funds' Retirement Income Portfolios have attracted about \$921 million in assets, second to Vanguard. Other players in the managed payout space are Voyage (\$464 million), Schwab (\$185 million), Franklin (\$19 million) and BlackRock (\$55 million).



The Retirement Income 2020 Fund will invest in other T. Rowe Price funds that represent various asset classes and sectors. It will have the same asset allocation, glide path, and underlying funds as the existing T. Rowe Price Retirement 2020 target date fund. Its allocation between T. Rowe Price stock and bond funds will change over time in relation to its 2020 target retirement date.

The Retirement Income 2020 Fund will be co-managed by Jerome Clark and Wyatt Lee, who currently co-manage many other T. Rowe Price Retirement Funds. Clark has 25 years of investment experience with T. Rowe Price; Lee has 18 years of investment experience with the firm.

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