Moving From Inertia to Income: Insights Into Delivering Successful Retirement Outcomes

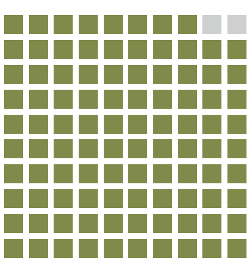
One of the most complex tasks people face today is financial planning for retirement. With the well-documented transition from state- and company-sponsored pension plans to individual IRA and 401(k) plans, much of the burden has shifted from financial professionals to individual investors. Recent research from Wells Fargo and Gallup, Inc., shows that few investors understand the key steps needed to plan for the retirement they desire and deserve.

New research from Wells Fargo and Gallup explores investor perspectives on retirement income and ESG investing

Wells Fargo Asset Management (WFAM) regularly sponsors research in partnership with Gallup as part of the Wells Fargo/Gallup Investor and Retirement Optimism Index survey. Fourth-quarter 2017 findings revealed crucial insights on retirement income and environmental, social, and governance (ESG) investing, which we present to you in a two-part research paper series.

In this part, we show retirement income is key to financial well-being in retirement and crucial to plan success.

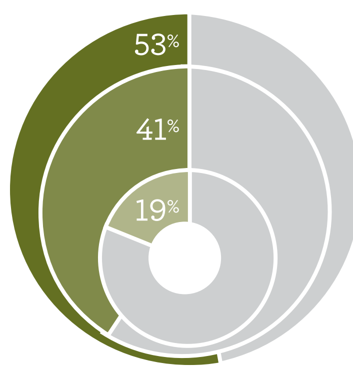
Guaranteed income in retirement



98%

of investors surveyed want a guaranteed, sustainable income stream in retirement in addition to Social Security

Shrinking realism about savings and income



53% have a specific savings goal in mind

41% have a savings number and an annual retirement income estimate

19% have a savings number and a realistic annual retirement income estimate, equivalent to 1% to 5% of total savings

Help from employers

Almost half

of investors surveyed wish their employers would help manage their investments to last throughout retirement

Participant inertia:

A plan participant's inclination toward doing nothing, or maintaining the status quo

Contents

Read on to dig deeper into our findings and learn about the actionable takeaways that plan sponsors can use immediately.

Why begin a discussion about retirement income by defining this term? When channeled correctly, participant inertia is fundamental to plan sponsors' ability to guide participants toward successful outcomes.

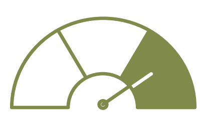
Making decisions is hard. Studies suggest that the average person makes thousands of decisions a day, and going with the status quo is usually an easier—and sometimes better—strategy than trying to analyze every choice.

Plan sponsors, intermediaries, and asset managers are harnessing this facet of behavioral psychology to help participants accumulate assets in their defined contribution plans. For example, automatic enrollment pushes participants to save early, while automatic escalation helps them increase savings rates, nearly imperceptibly in many cases, without having to take any action. In addition, target date funds as the default investment option allow participants to automatically diversify, minimize risk, and rebalance their portfolios. All of these tools are successful because they channel participant inertia.

Tools that channel participant inertia

Automatic enrollment encourages participants to save early.

Automatic escalation helps participants increase savings.



Target date funds enable participants to grow savings in a diversified, risk-balanced way.

Unfortunately, participant inertia also can be a major barrier to successful outcomes.

A successful retirement plan includes income

A successful financial retirement outcome encompasses the accumulation of sufficient assets for retirement and, equally important, an effective decumulation, or spend-down phase, in which those assets are not outlived.

Participants' inertia may work against them on the cusp of retirement—a time when they typically are faced with numerous challenging decisions. For many participants, there is no default income option. While much financial professional effort has been dedicated to addressing the accumulation phase, fewer steps have been taken to solve for decumulation.

As we will see, this is particularly problematic because participants often are unaware of important retirement income generator trade-offs, such as between liquidity and the security of income. Many participants also are unclear about the rate at which they can safely draw down their savings each year in retirement.

Should plan sponsors, intermediaries, and asset managers resign themselves to this state of affairs? We say no.

With defined contribution plans on track to surpass defined benefit plans as the primary retirement vehicle, millions of participants are relying on us to help them generate the ongoing income necessary for them to live fulfilling lives through their retirement years.

In collaboration with Gallup, WFAM set out to study the needs and preferences of investors around retirement. We discovered an overwhelming desire among survey respondents for retirement income beyond Social Security.

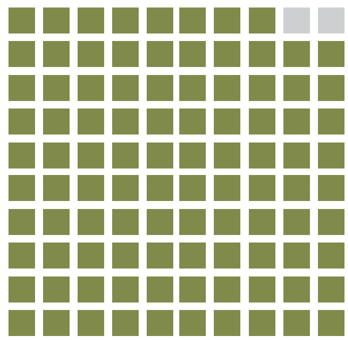
Read on for more on this and for actionable takeaways that plan sponsors can use immediately.

Income in retirement

Investors want a guaranteed, sustainable income stream in addition to Social Security

Nearly all of the nonretired investors surveyed agreed with the statement, “It is important to have a guaranteed income stream in retirement in addition to Social Security.”

Guaranteed income in retirement



98%

of investors surveyed want a guaranteed, sustainable income stream in retirement in addition to Social Security

While investors want security in the form of guaranteed income, they also value liquidity that provides them with flexibility on how to spend their money. In fact, 75% of the investors surveyed want the freedom to spend their retirement savings, even if that means running out of money too soon.

Implications for plan sponsors

There is a clear desire for guaranteed income by *nearly all* investors surveyed. Our research also reveals that when planning for retirement, investors want security in the form of guaranteed income, along with a degree of liquidity that provides flexibility on how to spend their money. Yet, they need help in understanding how to attain it.

Plan sponsors have an opportunity to include income options in 401(k) plans to meet the demand from participants and provide the additional resources, research, and education to help participants better understand and plan for a successful retirement.

Shrinking realism about savings and income

Investors are unrealistic about how much to save and how much can be withdrawn from their nest eggs in retirement

While financial planning for retirement is a daunting task for many, we asked investors some simple questions about their retirement objectives and found surprising results.

On savings goals

We asked survey respondents if they had a savings number in mind—47% did not.

Of those surveyed, 51% expect to come very close and 38% expect to come somewhat close to reaching their number by retirement. Perhaps not surprisingly, women and lower-income individuals are less confident about reaching their targets.

Those with a specific number in mind say that $1 million (median) is the right objective, with some estimating that under $500 thousand is enough and others estimating wanting more than $5 million.

Retirement savings goal	% of respondents
$500,000 or less	**29%**
$500,000–$999,999	**10%**
$1.0 million–$1.9 million	**22%**

Retirement savings goal	% of respondents
$2.0 million–$2.9 million	**13%**
$3.0 million–$4.9 million	**6%**
$5.0 million or more	**14%**

6% didn't know their savings goal or didn't answer.

Nearly half do not have a retirement savings goal

47%

of nonretired investors surveyed do not have a savings number in mind

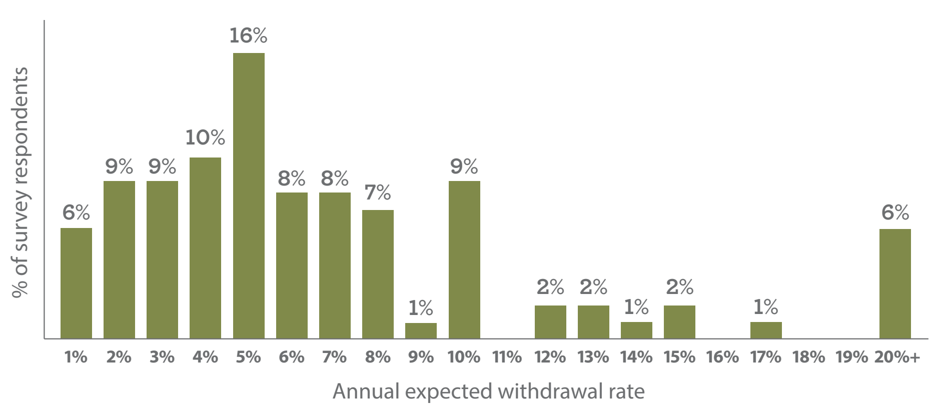
On income in retirement

We asked surveyed investors how much they expect to withdraw annually from their nest eggs in retirement. A long-standing rule of thumb has been that 4% of an investor's savings is sustainable, depending on variables such as market conditions.

Almost half (48%) of nonretired investors surveyed estimate that they will be able to withdraw more than 5% in annual retirement income, with some expecting more than 20%!

Expected annual withdrawal from savings

Nonretired U.S. investors with a retirement savings goal who are able to estimate the amount they will withdraw annually in retirement



Nearly half are unrealistic about how much their savings will yield in retirement

48%

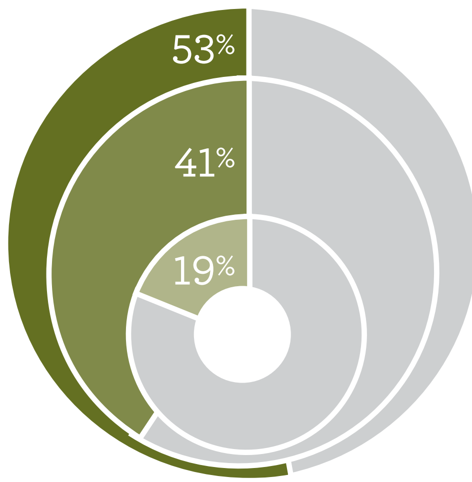
of nonretired investors surveyed expect to be able to withdraw more than 5% in annual retirement income

Understanding the link between savings and income

When we analyzed surveyed investors' savings goals alongside the income they expect to need in retirement, we discovered that the majority of investors are unrealistic about and financially unprepared for retirement.

Shockingly, only 41% of those surveyed have a savings goal and can estimate withdrawal rates in retirement. More shockingly, only 19% have a savings number in mind and a realistic withdrawal estimate that is equivalent to 1% to 5% of their total savings.

The retirement sieve: Investors show a shrinking realism about savings and income



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Those thinking they need to save $1 million or more expect to draw 5% per year, while those thinking they need to save less than $1 million expect to draw 7% per year. The latter are in double jeopardy. They probably aren't saving enough and they are likely overly optimistic about what their nest eggs will generate in retirement income.

Implications for plan sponsors

There is much confusion around retirement financial planning tasks such as having a savings goal and estimating how much income is needed in retirement. Plan sponsors can help simplify this daunting challenge for plan participants by breaking it down into tangible, actionable steps.

Plan sponsors also can partner with asset managers to provide guidance and education to participants on what withdrawal rates are reasonable given their savings targets. Given that only 19% of investors surveyed are able to reasonably estimate and link these two crucial numbers, a little bit of effort here from plan sponsors could make a big impact.

SPOTLIGHT

Helping participants take action

Sample action steps: Planning for a financially secure retirement

- ☐ Make a plan to begin saving through options like 401(k) accounts or IRAs if you're not saving yet.
- ☐ Review your savings goals and potentially increase your savings rates if you're already saving.
- ☐ Review your investment allocations and rebalance or reposition if needed.
- ☐ Assess your current spending habits and estimate how much income you'll need in retirement.
- ☐ Educate yourself on various retirement income solutions, taking advantage of your employer's financial education resources and planning tools.
- ☐ Seek help from a financial advisor.

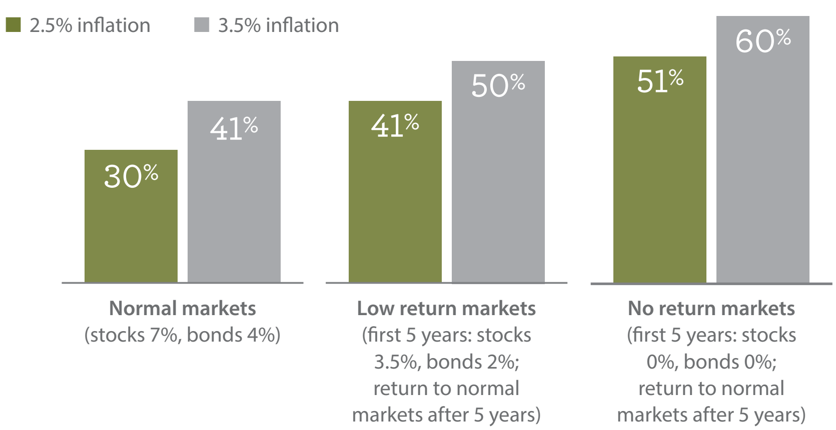
SPOTLIGHT

The risk of running out of money

WFAM's research team estimates that in order to achieve $42,000 to $56,000 in annual income (inclusive of Social Security income), investors need to save $1.2 million by retirement.

The following hypothetical chart illustrates how a 5% withdrawal rate could result in a savings shortfall for a woman who retires at the age of 65 with $1 million in her 401(k) account. To assess the likelihood of her running out of money in retirement, our research team looked at three hypothetical market scenarios during her first five years in retirement: normal markets, low return markets, and no return markets. Even at a 5% withdrawal rate, there is a greater than 30% chance of running out of money.

Probability of a hypothetical 65-year-old female investor outliving her $1 million 401(k) savings with a 5% withdrawal



Source: Wells Fargo Funds Management, LLC. This chart focuses on the probability of a hypothetical 65-year-old female investor outliving her 401(k) savings with 5% withdrawal. IMPORTANT: The projections or other information generated by Wells Fargo Funds Management regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Probabilities are estimated using a monthly Monte Carlo simulation from age 65 to age 100, based upon model capital market assumptions. The simulation attempts to replicate real-world uncertainty by estimating how a given portfolio is likely to perform. Each Monte Carlo simulation involves 4,000 individual forecasts based on a specific set of modeling assumptions, including the model average return and model standard deviation of the asset class and the investor's projected portfolio holding period. All portfolios are based upon the model return characteristics of fixed-income and equity asset classes, assuming a multivariate log-normal distribution with an equity return of 7%, a bond return of 4%, an equity risk of 16%, a bond risk of 8%, and an equity/fixed-income correlation of 0.1. The balanced portfolio is represented by calculating a blend of one-third stocks and two-thirds bonds rebalanced monthly. The 401(k) drawdowns of $50,000 annually (prorated monthly) are modeled with the portfolio rebalanced monthly (one-third equity), drawdowns increased monthly by the inflation rate, and the lifespan sampled using life tables from the National Center for Health Statistics. The probability of running out of money is estimated from the percentage of participants that do so in the simulation. The equivalent probabilities of outliving one's savings are lower for men due to their shorter life expectancy. A Monte Carlo simulation illustrates how a portfolio might look in the future based upon specific assumptions, including that future capital market returns have similar statistical properties. Because simulations are based upon forecasts and assumptions, they could prove incorrect. Results may vary with each use and over time. The data shown does not include the deduction of any fees; had fees been reflected, they would have a material impact on the results shown.

Almost half want help from employers

48%

of investors surveyed wish employers would help manage their investments to last throughout retirement

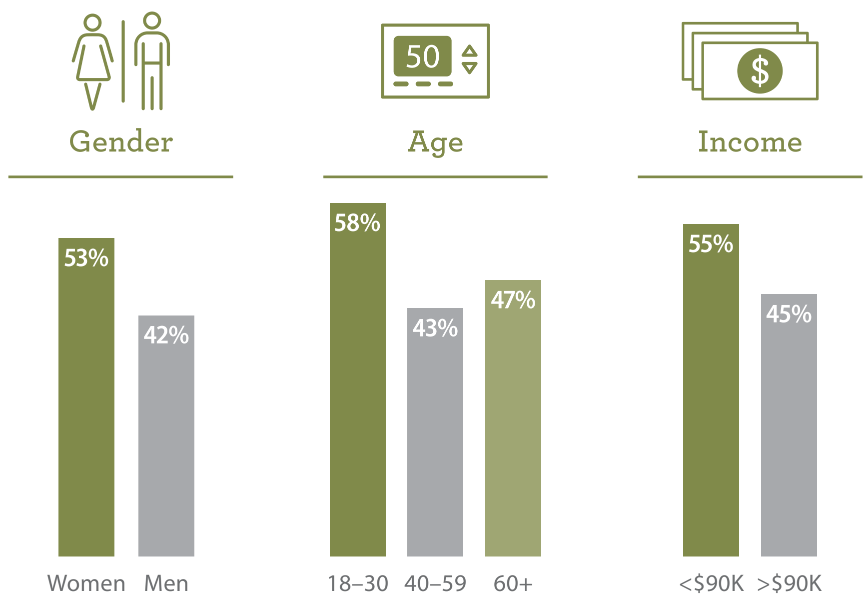
Help from employers

Investors look to employers for help in managing investments throughout retirement

Nearly half of the investors surveyed would like to get help from their employers in managing their investments throughout retirement.

Of those surveyed, 49% are unsure about what products are available to help them achieve the guaranteed income stream they want. Additionally, more help is desired among key demographics—women, younger investors, and lower-income individuals. Our results also show that among those having a savings goal in mind, women and lower-income individuals are less confident about reaching those goals.

Women, younger, and lower-income investors want more help from employers



Percent of nonretired U.S. investors who want help from their employers in managing their investments during retirement

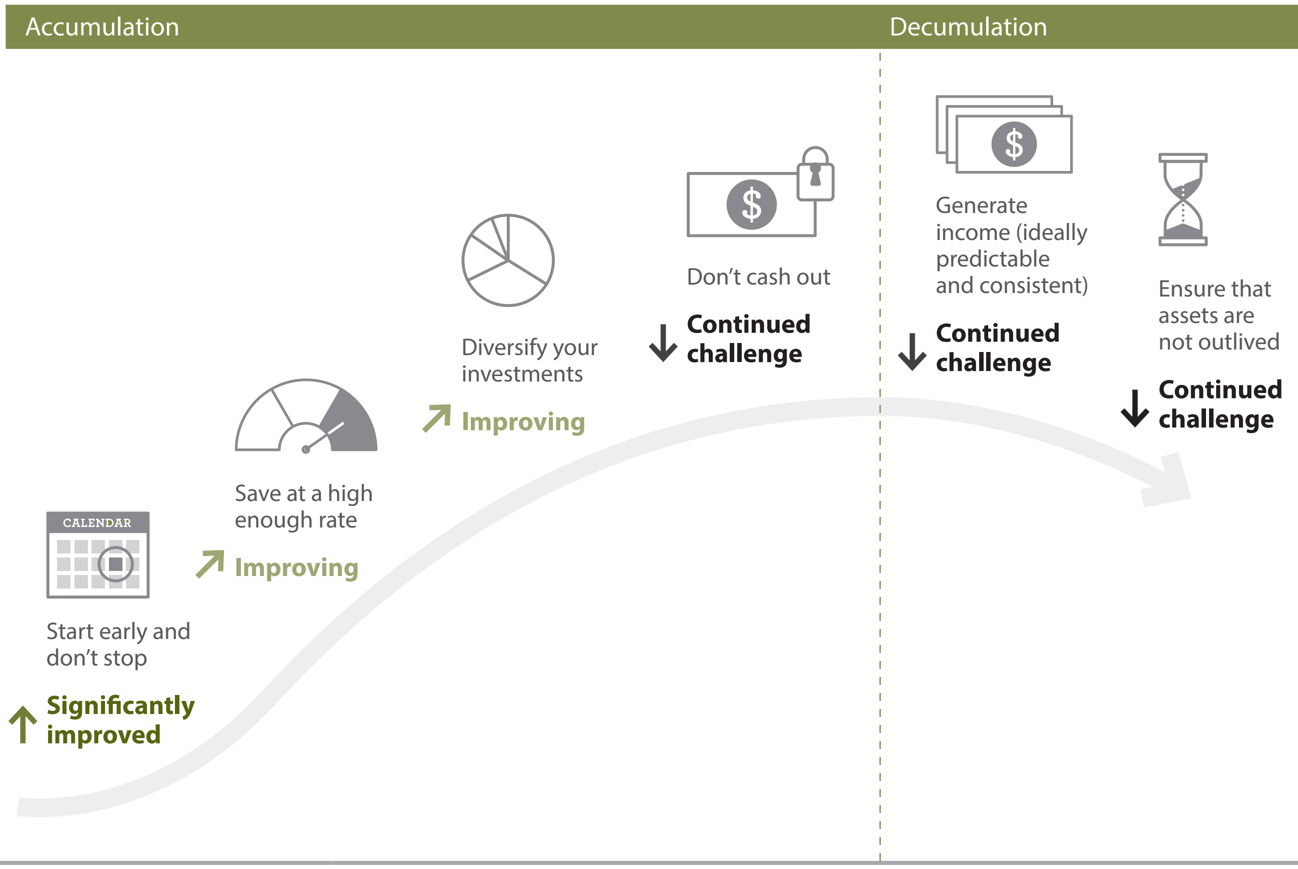
Implications for plan sponsors

Nearly half of the investor population surveyed say they want help from their employers, with the numbers rising among key demographics, including women, younger, and lower-income investors. In addition to financial education, plan sponsors can offer a range of solutions that help address participants' varied financial needs, including, most importantly, retirement income solutions.

SPOTLIGHT

The evolution of defined contribution plans

Defined contribution plans have evolved to become the primary retirement vehicle for many. While substantial progress has been made to help plan participants accumulate wealth, challenges remain in providing income for retirees and ensuring that they do not outlive their assets.



Three key takeaways and action items

Financial planning for retirement can be a daunting task for individuals. Some plan sponsors can provide features, including retirement income, that may be of interest to *nearly all* plan participants. These features allow plan participants to generate a more predictable income in retirement. They also can help plan participants better understand how much to save for retirement and how much can be withdrawn from their nest eggs to help them live the retirement they want and deserve.

Below are key takeaways and action items to help defined contribution plan sponsors begin incorporating retirement income in their plans.

1 Determine if retirement income is right for your plan

New research shows that plan participants have a strong preference for guaranteed income but are unsure of how to attain it.

- ☐ Evaluate the potential benefits of retaining postretirement assets in your plan.
- ☐ Ask your recordkeeper about dynamic drawdown options.
- ☐ Determine whether qualified longevity annuity contracts have a place in your plan.
- ☐ Review the DOL Field Assistance Bulletin 2015-2 safe harbor guidance.

2 Help participants set realistic expectations and better prepare for retirement

Plan sponsors can help participants with retirement planning by providing them with additional resources that can help them pursue their goals.

- ☐ Implement automatic enrollment and automatic escalation, if this hasn't been done already.
- ☐ Provide ongoing education on the adequacy of participants' savings to replace a given fraction of their preretirement income in retirement.
- ☐ Educate participants about optimal Social Security claiming strategies.

3 Decide on the objectives for your plan and the solutions and capabilities consistent with these objectives

Plan participants, depending on their personal circumstances, have different retirement goals, which plan sponsors can help address through their defined contribution plans.

- ☐ Offer robust income options in the plan's core menu.
- ☐ Review managed accounts as possible tools in the toolkit.

Partner with WFAM on defined contribution solutions

At WFAM, we put clients first in everything we do. For retirement plan clients, we strive for deep consultative relationships that are built on plan needs and improved participant outcomes.

Long history and broad reach in retirement	We have more than 20 years of experience in managing defined contribution assets, with more than $100 billion in assets under management worldwide as of December 31, 2017. As pioneers, we colaunched the industry's first target date mutual fund series in 1994. We also offer operational expertise via Wells Fargo's large market recordkeeper, Wells Fargo Institutional Retirement and Trust.
Dedicated and experienced team	The 20+ industry experts that support our retirement efforts are well resourced to effectively partner with our clients.
Information advantage from deep consultative relationships	The depth of our partnerships with plan sponsors, consultants, advisors, and participants and breadth of our businesses yields key insights that allow us to help clients comprehensively address their most pressing challenges.
Focus on solutions	Everything we do is focused on improving participants' financial well-being. Our holistic approach spans plan design, participant communications support, insightful thought leadership, multi-asset investment solutions, and public policy.

Get started today

Working together is key to success for our shared mission of helping employees achieve the retirement they want and deserve. We invite you to a dialogue on these critical matters. To continue the discussion, contact Nathaniel Miles, WFAM's head of Defined Contribution, at **nathaniel.s.miles@wellsfargo.com** **or** **wfaminstitutional@wellsfargo.com**.

Methodology

About the Wells Fargo/Gallup Investor and Retirement Optimism Index

These findings are part of the Wells Fargo/Gallup Investor and Retirement Optimism Index that was conducted via telephone November 1–5, 2017. The index includes 1,015 investors age 18 and older that were randomly selected from across the U.S. with a margin of sampling error of +/- 4 percentage points. For this study, the American investor is defined as an adult in a household with total savings and investments of $10,000 or more. About two in five U.S. households have at least $10,000 in savings and investments. The sample size consists of 67% nonretirees and 33% retirees. Of total respondents, 41% reported annual income of less than $90,000; 59% reported $90,000 or more. The Wells Fargo/Gallup Investor and Retirement Optimism Index is an enhanced version of Gallup's Index of Investor Optimism, which provides the historical trend data. The median age of the nonretired investor is 47 and the retiree is 68.

For target date funds, the target date represents the year in which investors may likely begin withdrawing assets. The funds gradually seek to reduce market risk as the target date approaches and after it arrives by decreasing equity exposure and increasing fixed-income exposure. The principal value is not guaranteed at any time, including at the target date.

Stock values fluctuate in response to the activities of individual companies and general market and economic conditions. Bond values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. Changes in market conditions and government policies may lead to periods of heightened volatility in the bond market and reduced liquidity for certain bonds held by the fund. In general, when interest rates rise, bond values fall and investors may lose principal value. Interest-rate changes and their impact on the fund and its share price can be sudden and unpredictable. High-yield securities have a greater risk of default and tend to be more volatile than higher-rated debt securities. The use of derivatives may reduce returns and/or increase volatility. Securities issued by U.S. government agencies or government-sponsored entities may not be guaranteed by the U.S. Treasury. Certain investment strategies tend to increase the total risk of an investment (relative to the broader market). This fund is exposed to foreign investment risk, mortgage- and asset-backed securities risk, new fund risk, regulatory risk, and smaller-company investment risk. Consult the fund's prospectus for additional information on these and other risks.

Carefully consider a fund's investment objectives, risks, charges, and expenses before investing. For a current prospectus and, if available, a summary prospectus, containing this and other information, visit wellsfargofunds.com. Read it carefully before investing.

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