BlackRock

In partnership with RISA

A reimagined approach to funding retirement income:

Defining individual styles and solutions using the RISA® framework

Executive summary

Currently, more than 10,000 Americans are reaching the traditional retirement age of 65 each day — a number that is expected to peak in 2024 at more than 12,000 per day.[1] These individuals are facing longer life expectancies while also having an increasing responsibility to manage their own retirement with the transition from defined benefit to defined contribution (DC) plans.

These challenges are further compounded by the new market regime marked by increased volatility, inflation, interest rate uncertainty, geopolitical risk and energy shocks — a far cry from the steady growth, low inflation and falling interest rates of recent periods. This new market paradigm, along with the rate at which Americans are reaching retirement age and the increase in average life expectancy, has made it even more critical for retirees to ensure their retirement income strategy matches their needs.

While solutions to address the needs of individuals are beginning to evolve, retirees have a range of preferences about how they'd like to source retirement income — preferences that can dictate the strategies they may be more inclined to follow.

The Retirement Income Style Awareness® (RISA®) framework[2] was developed to help individuals approaching retirement understand their retirement income preferences and translate those preferences into a retirement income style and strategy that resonates. Defining retirement income styles through a combination of preferences, and then matching strategies to these styles, provides an important step forward in aligning individuals with retirement income strategies that may best resonate and drive better outcomes. The RISA framework uses a simple four-box matrix with four associated retirement styles.

In a joint research study conducted in summer 2022,[3] RISA and BlackRock sought to identify retirement income preferences across a representative sample of individuals, with an overweight toward those approaching or at traditional retirement ages ("the RISA/BlackRock study").

Within this whitepaper, we will:

- Illustrate how the RISA framework can help individuals approaching retirement understand their retirement income style preferences
- Explore the way style preferences translate to certain retirement income strategies
- Share the distribution of retirement income styles among the population surveyed in the RISA/BlackRock study
- Highlight the characteristics of solutions in a DC plan that were most attractive to the greatest number of respondents in the study

1 Fichtner, Jason J. (2021) The Peak 65 Generation: Creating a New Retirement Security Framework. Alliance for Lifetime Income whitepaper. **2** The Retirement Income Style Awareness® (or RISA®) framework is a psychology-backed, research-driven income personality assessment. Developed by retirement planning specialists Dr. Wade Pfau and Dr. Alex Murguia, RISA is based on the notion that every person has a unique retirement income style influenced by their specific circumstances and preferences. It was released for use by financial professionals in 2022. **3** RISA® and BlackRock survey was administered by RISA between June 27-July 7, 2022. 2,023 U.S. savers participated with 1,155 respondents between the ages of 50 and 75, and 1,840 of the total participants self-reported to be invested in an employer-sponsored retirement plan.

Defining retirement income styles within a two-step framework

The RISA framework identifies a collection of retirement income preferences that translate into retirement income styles, which address how one wishes to source spending for essential needs in retirement.

First, individual retirement income preferences are assessed regarding two primary factors to determine retirement income style. Next, these preferences are plotted within a matrix to identify the style most likely to resonate with individual retirees.

Factors

01 **Probability-Based vs. Safety-First** details how individuals prefer to source their retirement income from assets.

02 **Optionality vs. Commitment** details the degree of flexibility individuals seek from income strategies.

Probability-Based vs. Safety-First

Those with a preference for Probability-Based retirement income sources are comfortable relying on the potential for market growth to source their income stream. They understand that while market growth is not 'guaranteed,' markets have historically grown over time, and the probability of cumulative growth tends to rise along with longer time horizons. Simply put, in spite of market returns offering no guarantees, some retirees are comfortable betting on historical probability.

Those with a preference for Safety-First retirement income sources seek contractual obligations to better secure their safety, so that the income provided is less exposed to market movement. While no strategy is completely safe, contractual protections imply a relative degree of safety as compared with the unknown market outcomes of Probability-Based income sources. Those who choose a Safety-First approach are willing to forego the upside potential of Probability-Based income sources for the relative assuredness and perceived safety of a contractual guarantee.

Optionality vs. Commitment

Optionality reflects a preference for keeping one's investment options open and maintaining the flexibility to respond to economic developments or changing personal situations. This preference aligns with retirement solutions that can be easily adjusted, without predetermined holding periods.

Conversely, Commitment, as the name suggests, indicates a preference for committing to one solution. This refers to retirees who do not feel the need to keep their options open and are willing to select a particular retirement income solution, even one that itself may require an irrevocable commitment, such as lifetime annuitization or similar contractually binding guarantees. Those that subscribe to this particular preference may find satisfaction from planning in advance and not leaving difficult decisions for later, when the ability to make decisions could be impacted by stress or cognitive decline.

The RISA matrix then lays out how the preferences for each RISA factor can be utilized and matched to appropriate retirement income styles, creating four distinct retirement income quadrants, each of which is based on an individual's scores for the two RISA factors. Investment and insurance solutions are aligned with the four RISA styles.

RISA matrix

Time Segmentation	**Total Return**
Income Protection	**Risk Wrap**

Translating factors into retirement income strategies

The upper-right quadrant of the RISA matrix includes individuals whose preferences lean toward both Probability-Based and Optionality. Typically, individuals with these characteristics identify with drawing income from a diversified investment portfolio rather than using contractual sources to fund their retirement expenses. Investors rely on portfolio growth to sustainably support their spending. We call this **Total Return**.

Those that identify with the Total Return style seek to maximize risk-adjusted returns from the perspective of the total portfolio, using traditional diversified portfolios, along with other assets that have the expectation of growth. Asset allocation during retirement is generally defined in the same way as during the accumulation phase — using the tools of modern portfolio theory to identify a portfolio on the efficient frontier in terms of single-period trade-offs between risk and return. Different asset classes that are not perfectly correlated are combined to create portfolios with lower volatility, and investors aim to maximize wealth by seeking the highest possible return given their capacity and tolerance for short-term market volatility. Retirees in total return strategies generally take on as much risk as they can tolerate to minimize the probability of not meeting their objectives. This asset allocation approach is of primary importance for total return portfolio construction. Other styles may draw on this approach around asset allocation to build their investment components, but only after first seeking out other financial products to provide sufficient reliable income.

The lower-left quadrant includes individuals with a Safety-First and Commitment orientation. These characteristics align with retirement income strategies traditionally referred to as essential vs. discretionary, or income flooring. We call this **Income Protection**. The primary objective of income protection is to deliver the greatest protections from experiencing shortfalls for essential expenses, which are generally available through fixed annuities providing lifetime income protections. Assets are positioned to match the risk characteristics of a spending goal. There is a preference for first using contractually protected lifetime income, such as single-premium immediate annuities (SPIAs) and deferred income annuities (DIAs), to cover essential retirement expenses. After covering basic expenses, a more diversified portfolio invested for total returns is used for discretionary expenses.

Shifting to the lower-right quadrant of the RISA matrix, the individuals that identify with this style have both a Probability-Based and Commitment orientation. While these individuals maintain a Probability-Based outlook with a desire for market participation, they also have a desire to commit to a solution that provides a structured income stream. We call this style **Risk Wrap**. These individuals may prefer the opportunity to grow their asset base through market appreciation but with the comfort of having a guaranteed income source to support lifestyle costs in retirement. Options for building protected income here generally involve the use of variable annuities that may provide more upside potential from the underlying assets but have weaker guarantees as defined by having less protected spending in the worst-case scenarios.

Moving to the upper left-hand quadrant, the individuals that identify with this style may be those with Safety-First and Optionality preferences. These individuals prefer contractual protections, but also desire optionality, looking for retirement income solutions that provide contractually driven income, while still maintaining a high level of flexibility to accommodate ongoing changes. We call this style **Time Segmentation**, also referred to as a bucketing strategy. This is often accomplished not through the use of lifetime income products, but rather front-end protections from holding instruments like short-term bonds to cover nearer-term expenses. With short-term protections in place, other assets earmarked for longer-term expenses can be invested for growth and optionality.

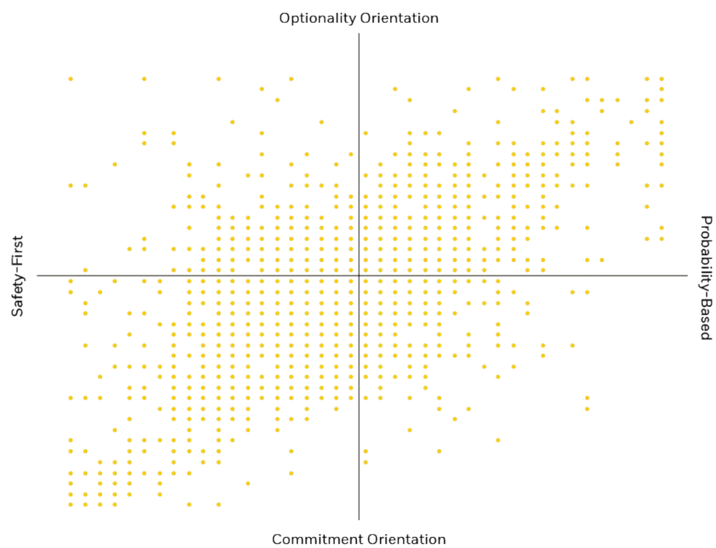
Retirement income styles distribution across survey participants

Full sample (2,023 participants)	Style distribution %	Subsample (ages 50 – 75)	Style distribution %
Total Return	35%	Total Return	33%
Income Protection	36%	Income Protection	38%
Time Segmentation	15%	Time Segmentation	16%
Risk Wrap	14%	Risk Wrap	13%

In spite of the primary factors being statistically distinct from one another and reflecting unique characteristics, they do share a correlation in which Probability-Based and Optionality preferences tend to appear together, as do Safety-First and Commitment preferences, leading to a stronger occurrence of the Total Return and Income Protection styles. Risk Wrap and Time Segmentation include hybrid strategies that are less common in practice.

RISA conducted two previous studies. The first included a sample of readers from RetirementResearcher.com[4] and the second was performed in conjunction with the Alliance for Lifetime Income.[5] While the sample of individuals from the RetirementResearcher.com study tend to have greater knowledge of and interest in retirement income topics, the sample of individuals surveyed in the Alliance for Lifetime Income and BlackRock studies are more representative of the broader U.S. population.

Distribution of RISA profile scores



Style distribution percentages in the RISA/BlackRock study and two additional studies

Style	BlackRock study (Full sample)	BlackRock study Subsample (ages 50 – 75)	Retirement Researcher.com	Alliance for Lifetime Income
Total Return	35%	33%	35%	33%
Income Protection	36%	38%	35%	35%
Time Segmentation	15%	16%	15%	17%
Risk Wrap	14%	13%	15%	15%

4 Retirement Researcher: Murguia, A., and W. D. Pfau. "Selecting a Personalized Retirement Income Strategy: A Model Approach." Retirement Management Journal, Vol. 10, No. 1 (2021), 46-58. This study used a convenience sample of 1,478 participants who are readers of RetirementResearcher.com and generally more knowledgeable about retirement topics than the general population. The survey was administered to the same individuals on March 27, 2020, and September 10, 2020. **5** Alliance for Lifetime Income: Murguía, A., and W. D. Pfau. (2022). How Retirement Income Preferences Inform Retirement Income Styles. Alliance for Lifetime Income's Retirement Income Institute Whitepaper. This study used a representative sample of 2,863 Americans between the ages of 50 and 80. It was administered in the fall of 2021.

Importantly, the distribution among different styles indicated in the RISA/BlackRock study is consistent with findings from previous studies. The similar distribution of findings between the RetirementResearcher and the RISA/BlackRock studies indicate consistent preferences are seen across those with more or less retirement knowledge. Further, the consistency of findings across the Alliance for Lifetime Income study and the RISA/BlackRock study suggests that one's retirement income style reflects underlying personality traits that don't change in response to external factors, such as the broader financial market environment. For example, the financial market outlook was much stronger in fall 2021 than in summer 2022. The research indicates that the RISA framework captures a set of stable preferences with regard to the way an individual prefers to source retirement income, rather than transitory states that can be attributed to excitement, fear or other emotions.

Balancing distinct retirement needs within DC plans

DC plan fiduciaries are faced with the challenge of identifying and selecting plan menu solutions that meet the needs of a heterogeneous population. The RISA/BlackRock study also tested individuals' interests for in-plan solutions. The study reveals that nearly two-thirds of respondents are clustered in styles evoking some combination of total return and income protection. One area tested in the study was the attractiveness of a retirement income solution that combined investments and insurance with additional optionality to choose a lifetime protected income stream at the point of retirement. Among the total respondents, 84% found this type of solution appealing if it was offered in their DC plan, indicating the broad appeal, which is critical for DC plan fiduciaries who are seeking to offer solutions that meet the retirement spending preferences of the greatest number of people. Meanwhile, 60% of respondents indicated that they either intend to or may choose to take the lifetime protected income stream at retirement. From an asset allocation perspective, when respondents were asked about how they would allocate across equity, fixed income and lifetime income at retirement, the average allocation to lifetime income was 36%, consistent with findings from other RISA and third-party academic studies.

A logical next step is to consider the distinctive product features that will best satisfy the objectives of the broader retiree population within a DC plan, including daily liquidity and cost efficiency. Further, any product needs to be accompanied by clear communication that enables participants to make more informed decisions best optimized for their particular circumstances. While 68% of survey participants between ages 50 and 75 indicated that professional guidance on how to spend down from savings in retirement would be valuable, 59% did not find their 401(k) plan to be a useful source of that guidance — rather, they turned to their investment advisors for such direction. This points to an opportunity for plan sponsors to do even more in providing clear communication that enables participants to make more informed decisions on how to optimize their retirement assets to sustain their personal income objectives.

84%

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36%

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Conclusion

Extensive research shows that retirees' attitudes about safety, flexibility, and the form and timing of income are grouped in four distinct styles. Some recognize that the market can deliver outsized growth over time and, despite the volatility that can accompany a diversified portfolio, are willing to balance a bumpier ride with the opportunity for greater asset growth. A second segment believes income protection is vital and is willing to forego the opportunity of greater asset accumulation in lieu of protecting income at all costs. Others are more comfortable with an approach that blends the opportunity for asset growth through an investment in underlying market-linked portfolios and a guaranteed income benefit. A fourth group prefers a safe and dependable income stream in the short-term, but seeks to keep their options open by maintaining a degree of flexibility assets earmarked to cover longer-term expenses.

Retirees recently have witnessed the effects of extreme volatility in their portfolios, and some may not be as comfortable relying on market growth to fulfill their income needs. Others have different preferences for the flexibility with which they wish to approach generating income during their retirement years. Together, these factors create a massive opportunity for the retirement industry to work together to develop solutions and educate retirees about how to meet their evolving needs.

Perhaps most importantly, research indicates that these preferences seldom change. They appear instead to be instinctive, remaining constant despite vastly different market conditions. While there may be individual products that tend to align with the different retirement income styles, solutions that address the preferences of the broadest number of individuals can improve overall efficacy of retirement planning within a diverse DC plan context.

Authors

Alejandro Murguía, Ph.D.
Cofounder, RISA LLC

Wade D. Pfau, Ph.D., CFA, RICP
Cofounder, RISA LLC

Rebecca Meskin
Managing Director, BlackRock

Cara Reisman
Director, BlackRock

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