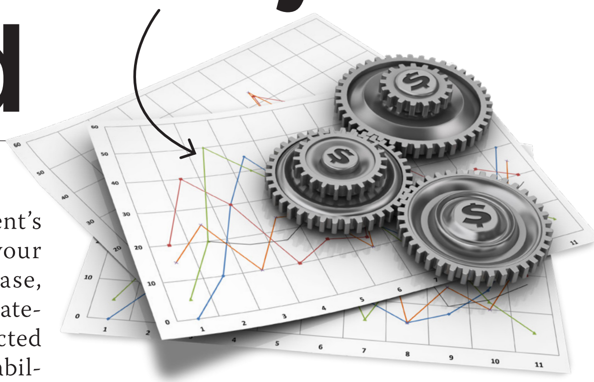
How To Match An Annuity To A Retirement Need



Securing a reliable source of protected lifetime income is one way to help manage retirement risks and help clients alleviate a major retirement concern.

By Bryan Pinsky

Much is written about the need to accumulate money for retirement, but accumulation is only part of the retirement equation. Clients also must think about how to protect their income in retirement while considering the financial risks they face as they get older.

Securing a reliable source of protected lifetime income is one way to help manage retirement risks and help clients alleviate a core retirement concern — outliving their savings. In a recent AIG survey, we found that 59 percent of Americans say they fear running out of money more than death — a startling fact that underscores the importance of protected lifetime income.[1]

To start the income planning discussion, ask your client three basic questions:

1. How much have you accumulated for retirement?

2. How much income will you need in retirement?

3. What are your expected sources of protected lifetime income?

The answer to the first two questions will vary widely, but the answer to the third will likely be some combination of Social Security, pensions and lifetime income products such as annuities. If your client doesn't have enough protected lifetime income to cover their essential or discretionary expenses in retirement, they could be facing an income gap and may need your help.

Addressing Key Risks

Here is why eliminating your client's income gap is important: Once your client is in the decumulation phase, they likely won't have additional material sources of income. An unexpected turn of events could reduce their ability to meet their basic needs. Of course, although each client will have their own risk factors, there are three main risks that will affect most retirees:

1. Longevity

Thanks to medical advances and healthier lifestyles, Americans are living longer. Consider that the Society of Actuaries estimates nearly one out of three females aged 65 will live to 95, while more than one out of five males aged 65 will live to 95.[2] Given those odds, you want to be sure your clients have their bases covered for what could be a lengthy retirement.

2. Low interest rates

Historically low interest rates in recent years have made it difficult for retirees to generate sufficient income from investments like CDs and bonds. This has put some retirees in the position of taking on perhaps more risk than they should to help meet their income needs.

3. Stock market volatility

Although we are in the midst of the longest bull market for stocks in history, this likely won't go on forever. Market downturns can come unexpectedly and can be severe, especially with markets at such historically high levels. Retirees who are heavily invested in stocks at the wrong time risk putting their retirement income in jeopardy.

Rethinking The "4 Percent Rule"

One additional point to keep in mind is that traditional rules of thumb such as the well-known "4 percent rule" recommended safe withdrawal rate may no longer hold up in the current interest rate environment — especially when considering today's longer life expectancies. According to retirement income expert Wade D. Pfau, the 4 percent rule today is more like the 3 percent rule.[3] And even this reduced rule cannot guarantee your clients won't outlive their money.

Meeting Diverse Client Needs And Risk Tolerance Levels

When developing a strategy to help protect your client's retirement income, consider allocating a portion of their overall retirement portfolio to a protected lifetime income source such as an annuity. The different types of annuities available allow you to provide clients with a solution that best matches their risk tolerance. With an annuity, you can ensure your clients receive an income stream they cannot outlive, and potentially generate even more income, depending on the type of annuity they choose.

Annuities can also help address retirement income gaps. For example, one of your clients has saved $1 million for retirement. This particular client is looking to maximize long-term growth potential. Your income planning analysis has determined that they need $70,000 annually to meet their needs. However, they have only $50,000 coming from Social Security and a pension. The resulting $20,000 income gap could be covered by allocating $250,000-$400,000 to a variable annuity with a guaranteed lifetime withdrawal benefit, providing the client with long-term growth potential while securing additional guaranteed income to cover the income gap.

This strategy also allows the balance of the client's overall portfolio

($600,000-$750,000) to be invested with less worry because their identified income needs are now covered with guaranteed income. Of course, the actual amount to be allocated to an annuity will depend on the type of the annuity product purchased, features of the product elected, client age and how long your client intends to wait before starting income from the annuity.

Let's walk through examples of two more conservative clients:

Gary is a single 62-year-old who wants to retire in five years. He wants his retirement income to be protected from market downturns, but also have the opportunity for growth. He allocates a portion of his retirement savings to purchase an indexed annuity with a guaranteed living benefit rider (also referred to as a guaranteed lifetime withdrawal benefit). Once withdrawals begin at age 67, Gary's income can continue to grow with annual income credits that match his interest earned (if any). Even if his contract value becomes completely depleted, Gary's income is locked in for life, providing him the security he's looking for.

Certain fixed annuities are also available with guaranteed lifetime withdrawal benefits. For example, Doris is 65 and wants to retire at 72. She wants income that will last for the rest of her life when she retires, and is looking to generate more income without the risk of a market downturn. She also wants access to her money for unexpected situations. Doris uses a portion of her savings to purchase a fixed annuity with a guaranteed lifetime withdrawal benefit. By waiting seven years before taking any withdrawals, Doris can automatically grow her future lifetime income with an income credit every year withdrawals are not taken — with the assurance that her principal is protected from market volatility.

Annuities can also be helpful for those who have to retire unexpectedly. For example, if a client is laid off from their job or has to take care of an ill spouse or parent, protected lifetime income from an annuity can help address retirement needs, despite an unexpected turn of events. Guaranteed living benefits riders and guaranteed lifetime withdrawal benefits are generally available for an additional cost and are backed by the claims paying ability of the insurer. Age restrictions and other limitations apply.

A More Secure Retirement Experience

Ultimately, the goal is to help your clients retire without the worry of outliving their money. Of course, you'll also want to consider other important factors like their age, time horizon and liquidity needs. By incorporating your client's risk profile into their retirement income strategy and utilizing a protected lifetime income solution such as an annuity as part of their overall portfolio (when appropriate), you can help clients address their retirement income goals and retire with confidence.

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1 AIG 2019 Plan for 100 Survey, conducted online within the United States by Dr. Michael Finke of The American College of Financial Services in December of 2018 and January of 2019 among 1,012 U.S. adults ages 45-74 who have at least $50,000 in retirement accounts.

2 Society of Actuaries 2012 Individual Annuitant Mortality Tables – Age Nearest with Scale G mortality improvement.

3 https://www.wsj.com/articles/forget-the-4-rule-rethinking-common-retirement-beliefs-1518172201