How to Use No-Load Annuities in a Fee-Only Practice

dpl

Today's Conversation

1. Realities of retirement planning today
2. How annuities have changed
3. How insurance is being used to address client needs
4. 4 steps to implementing insurance in your practice
5. Key takeaways and questions

Realities of Retirement Planning

"The nastiest, hardest problem in finance."

— Nobel Laureate William Sharpe on the challenge of turning savings into retirement spending.

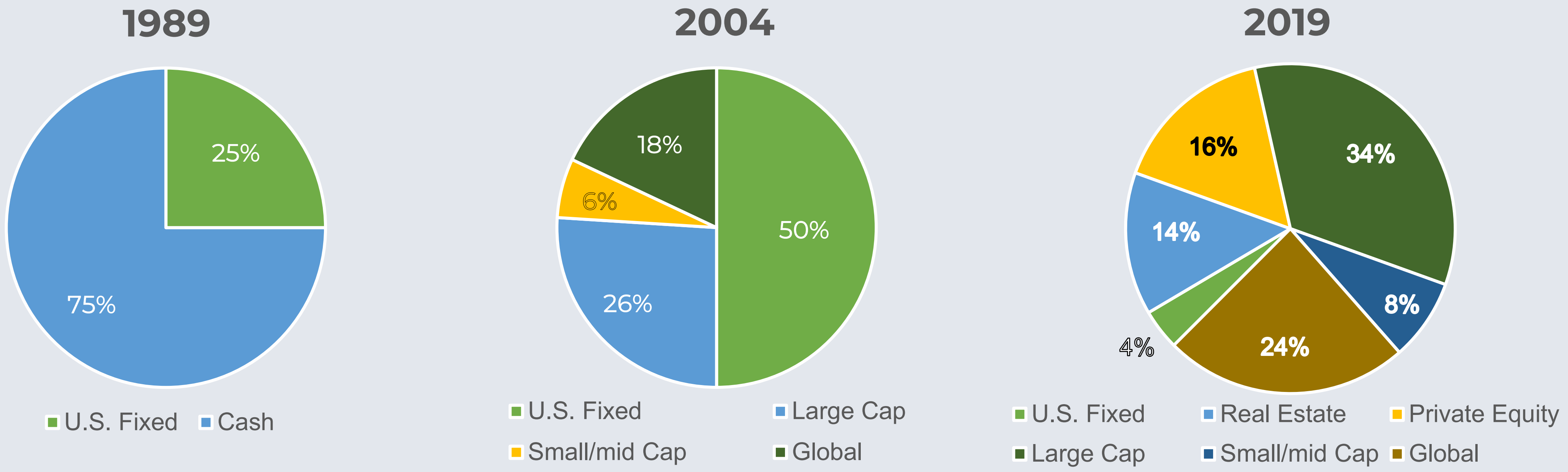
The Challenge of Providing Secure Income

- **Unprecedented market situation**
  - Low yields, high volatility, still high equity valuations
- **Traditional "safe assets" can no longer fund retirement**
  - Historically low interest rates
  - Pensions are disappearing
- **60/40 Portfolio + 4% Withdrawal Rate no longer effective**
  - Total return portfolio increases Sequence of Returns Risk
- **Clients are living longer, retiring earlier than expected**
  - Almost 50% probability that one 65-year-old spouse will live to age 95[1]

> ***"The fact of an aging population is this is a full one-third of your adult life that still lays ahead of you at age 65."***
>
> *—Joseph Coughlin, Director Massachusetts Institute of Technology's AgeLab*

[1]Society of Actuaries, 2012 Individual Annuity Mortality Tables with projections for 2020

Increasing Risk to Generate Income



	1989	2004	2019
Return:	7.5%	7.5%	7.5%
Risk:	3.1%	8.9%	18%

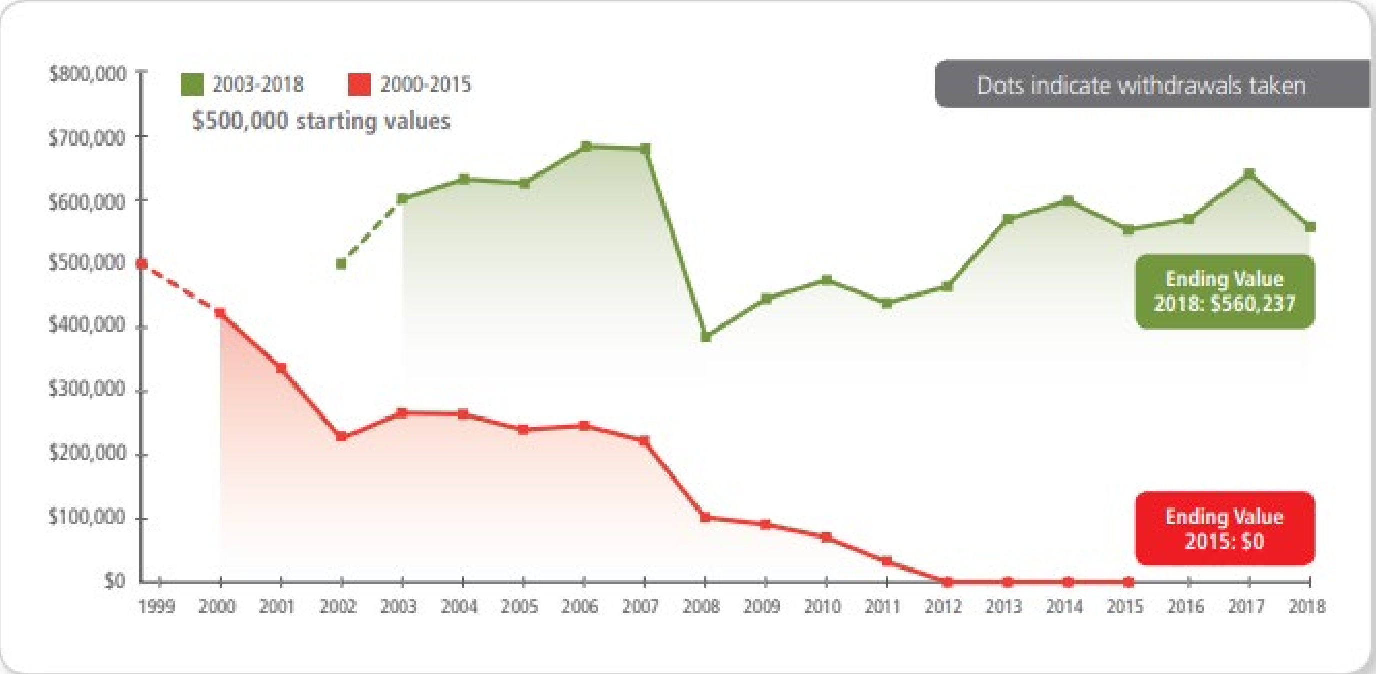
Increasing Risk + Increasing Complexity

Source: Callan Institute, 7.5% Expected Returns Over Past 30+ Years

- Primary role of the RIA: "Providing a secure retirement"[1]

[1]DPL Financial Partners RIA Retirement Planning Survey

The Reality of Risk in Retirement Portfolios



This hypothetical example is for illustrative purposes only and is not representative of the future performance of any product. Past performance is no guarantee of future results.

"What happens if your client picks up -30% the first year of retirement?

The probability of success falls from 94% to 48%. *This is the equivalent of setting off on a road trip and encountering a 50-car pileup."*

—***Michael Finke***, *PhD, Professor of Wealth Management at The American College of Financial Services*

Source: Jackson National, CMX22636 (06/19)

APPROACHES COMPARED:

Which is better for retirement income: insurance or investments?

- Total return approach— requires aggressive asset allocation, which increases risk
- Bond-only — least efficient method, limited upside, fixed spending level
- Annuities — provide a guaranteed source of spending that investments don't provide[1]

Hear David Lau & Wade Pfau's conversation about allocating to an annuity at: www.dplfp.com

[1]In comparison, referring to annuities that have guaranteed income features. Not all annuities have an income component or a guarantee, so it is important to understand all product details before purchasing an annuity for income.

Annuities Have Changed

Academic Support for Annuities is Extensive

- **Moshe Milevsky:** "There have literally been thousands of academic papers written on the value of annuities."
- **Michael Finke:** "Increase in guaranteed income results in higher life satisfaction even among those who have more than enough wealth in retirement."
- **Harold Evansky:** "The annuity is the single most important investment vehicle in the next 10 years."
- **Wade Pfau:** "Annuities offer sound spending support while also fortifying a larger legacy."

Addressing Annuity Misconceptions

- **Common advisor misconceptions about annuities**
  - Your client must annuitize in order to receive income from an annuity.
  - All annuities have surrender periods.
    - Surrenders are inherently bad for clients
  - All annuities have commissions.
  - When your client purchases an annuity, they turn their money over to an insurance company.
  - Your client will lose their money if the insurance company fails.

Evolution of the Annuity Marketplace

	2015	2020
Industry	Served by commissioned insurance agents	Served by fiduciaries
Cost	Commission-based, expensive	Commission-Free, lower-cost
Carriers	4 carriers serving RIA market	20 carriers serving RIA market
Technology	Underdeveloped	Sufficient and evolving
Advisor Sentiment	Products to be sold	Powerful tools within financial plans

Annuities Address Client Concerns

Annuities in the Portfolio: Retirement Income

Address Sequence of Returns Risk

- Use products with downside protection to protect against market losses
- Fund retirement income with an annuity rather than the portfolio
- Client peace of mind and increased happiness in retirement[1]

Address Longevity Risk

- Create an income stream clients cannot outlive
- Replace underperforming assets such as traditional fixed income
- Reduce overall risk in a client's portfolio

Increase probability of success of financial plan

- Leverage academic strategies for efficient income generation
- Optimize equity allocations

1 "The 4% Rule is Not Safe in a Low-Yield World" - Wade Pfau, Ph.D., CFA, Michael Finke, Ph.D.,CFP and David Blanchett,CFA,CFP

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Annuities Provide Numerous Client Benefits

- Protection against long periods of market downturns
- Ability to invest more in equities
- Potential for increased spending in retirement
- Potential improvements in the financial plan
  - Increased Monte Carlo score
  - Decreased shortfall
- Increased client peace of mind

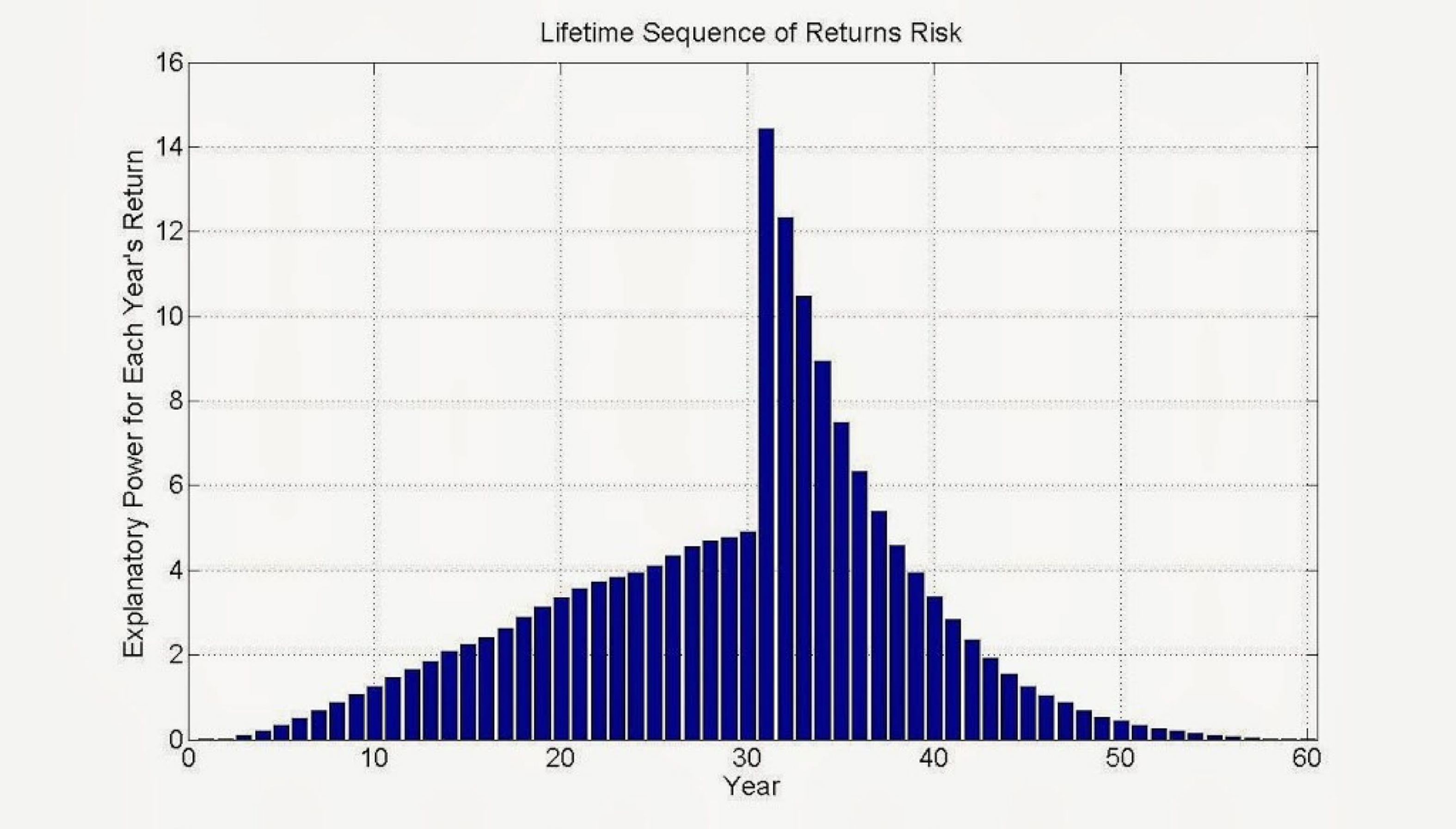
"Annuities create certainty, and that has a value that is often hard to quantify."

-David Blanchett, Head of Retirement Research, Morningstar

Annuities Help Solve for the "Fragile Decade"

- The five years before and five years after retirement determine 80% of retirement success

- Annuities can provide downside protection from unexpected volatility along with guaranteed income

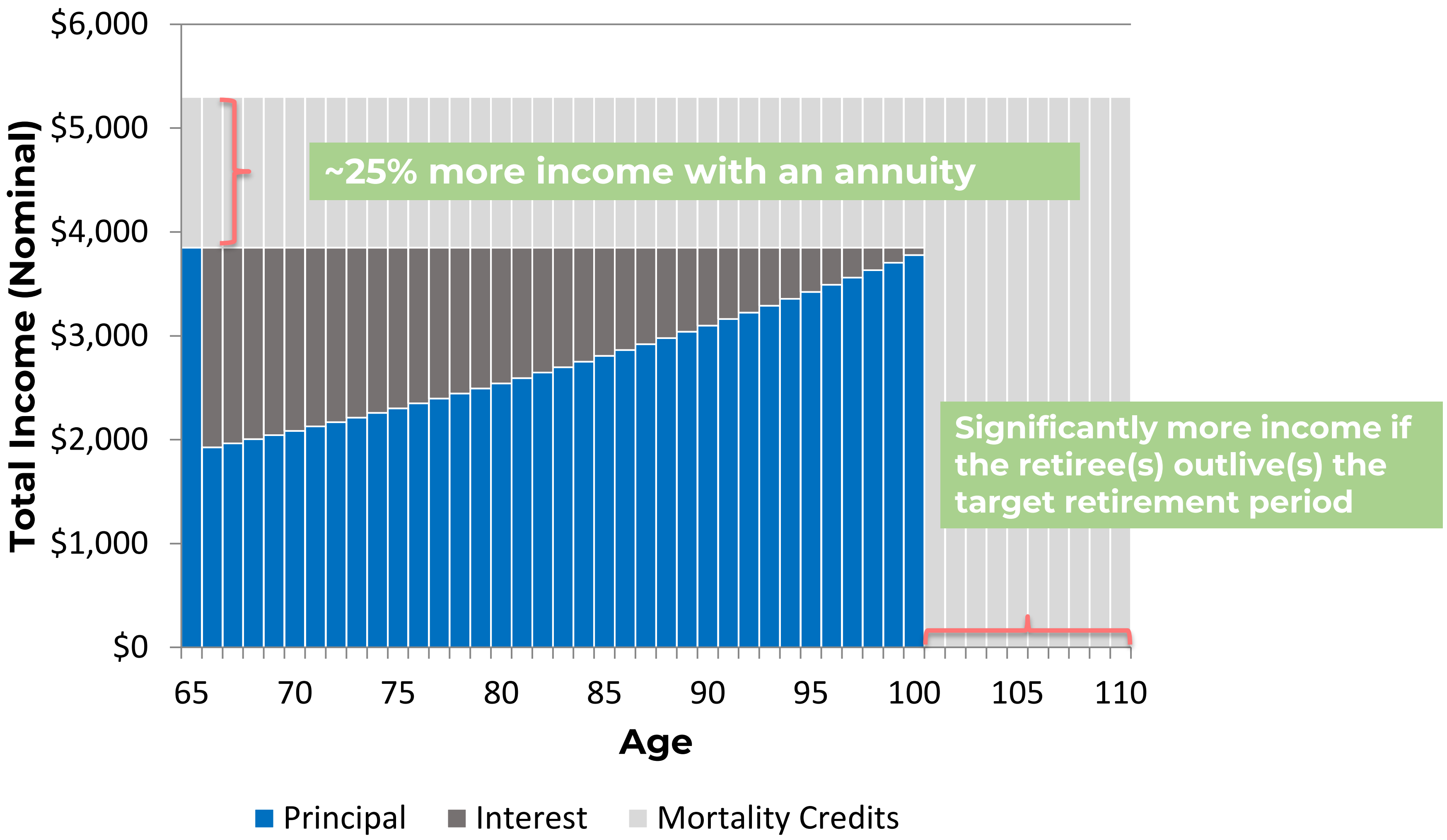


Source: Wade Pfau, The American College of Financial Services

Annuities Address Longevity Risk

One of the largest client concerns in retirement is outliving their money, or not having enough to enjoy it.

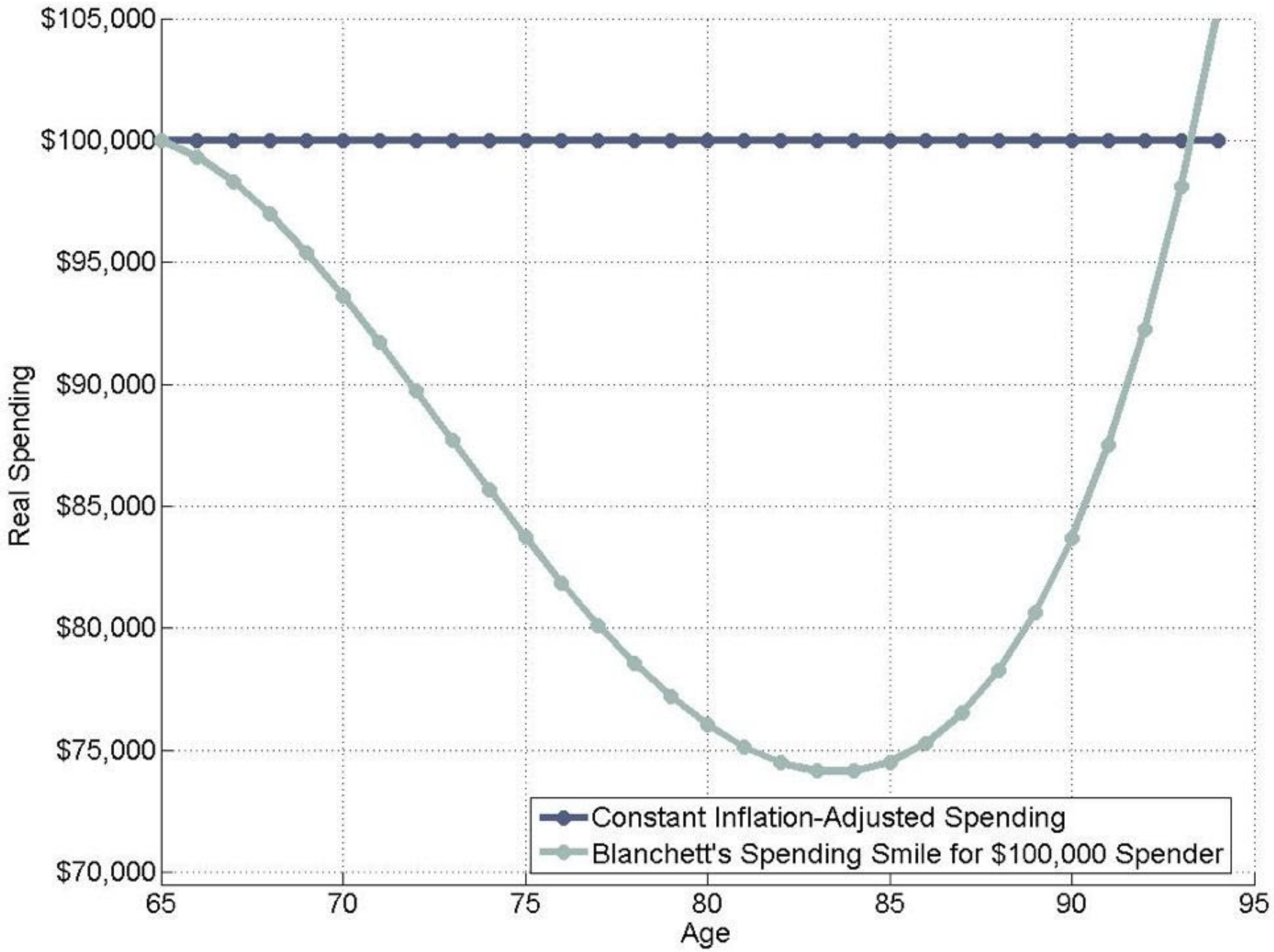
- Annuities are uniquely built to address this risk



Source: David Blanchett, Morningstar

The Retirement Income Smile

- Clients tend to spend more in the beginning of retirement and at the end, and less when they should be enjoying it.
- When secured income is provided, clients are given a “license to spend”



Source: David Blanchett, Morningstar

4 Steps to Implementing Insurance

4 Steps to Integrating Annuities into your Practice

1. Identify Clients Who Can Benefit from an Annuity
2. Determine the Right Annuity to Meet Client Need
3. Determine the Annuity Allocation within the Portfolio
4. Technology & Billing Integration

Identifying Clients Who Can Benefit from an Annuity

Identifying Clients Who Could Benefit from an Annuity

- Clients who will be taking withdrawals from their portfolio to fund retirement
- Clients with underperforming fixed income positions
- Clients who are in danger of outliving their assets
- Clients who self-identify

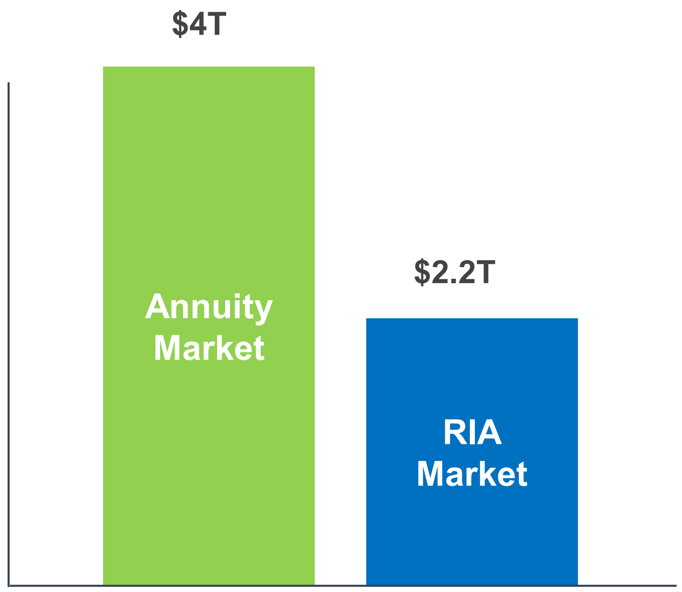
"Ideally, I can envisage an advisor sitting down with a client and saying, "We talked about doing a 4% withdrawal for retirement income. Here's what would happen. And if you bought an annuity, here's what would happen."

--Bill Sharpe (Nobel Prize Winner)

Many of Your Clients Have Self-Identified

- Commission-Free annuities provide the opportunity to give clients the benefits they want and need
- Provide opportunity to increase AUM while potentially lowering costs and increasing benefits

The annuity market is $4T (nearly double the size of the RIA market)[1]



1 – Morningstar & IRI
2 – LIMRA, Secure Retirement Inst. Study, 10/16

2 Ways to Leverage the Power of Annuities for Clients

1. **Annuities in the portfolio** – consider when your client could benefit from:
   - Efficient, secure retirement income
   - Fixed income alternatives (replace bonds)

2. **1035 Exchanges**[1] – consider when your client could benefit from:
   - Lower fees on existing annuity policies
   - Repurposing an existing annuity to better meet a need in the financial plan
   - For advisors moving to independence to transition annuity book to fee model

[1]Before advising a client to purchase or redeem a variable annuity, clients should be advised to consider the investment objectives, risks, fees, charges and expenses of both the legacy variable annuity and the proposed commission-free annuity and the investment options available with both. Client's should always be advised to read the product's prospectus or summary prospectus carefully before making a decision to purchase or exchange a variable annuity.

Identifying the Right Annuity for a Client’s Need

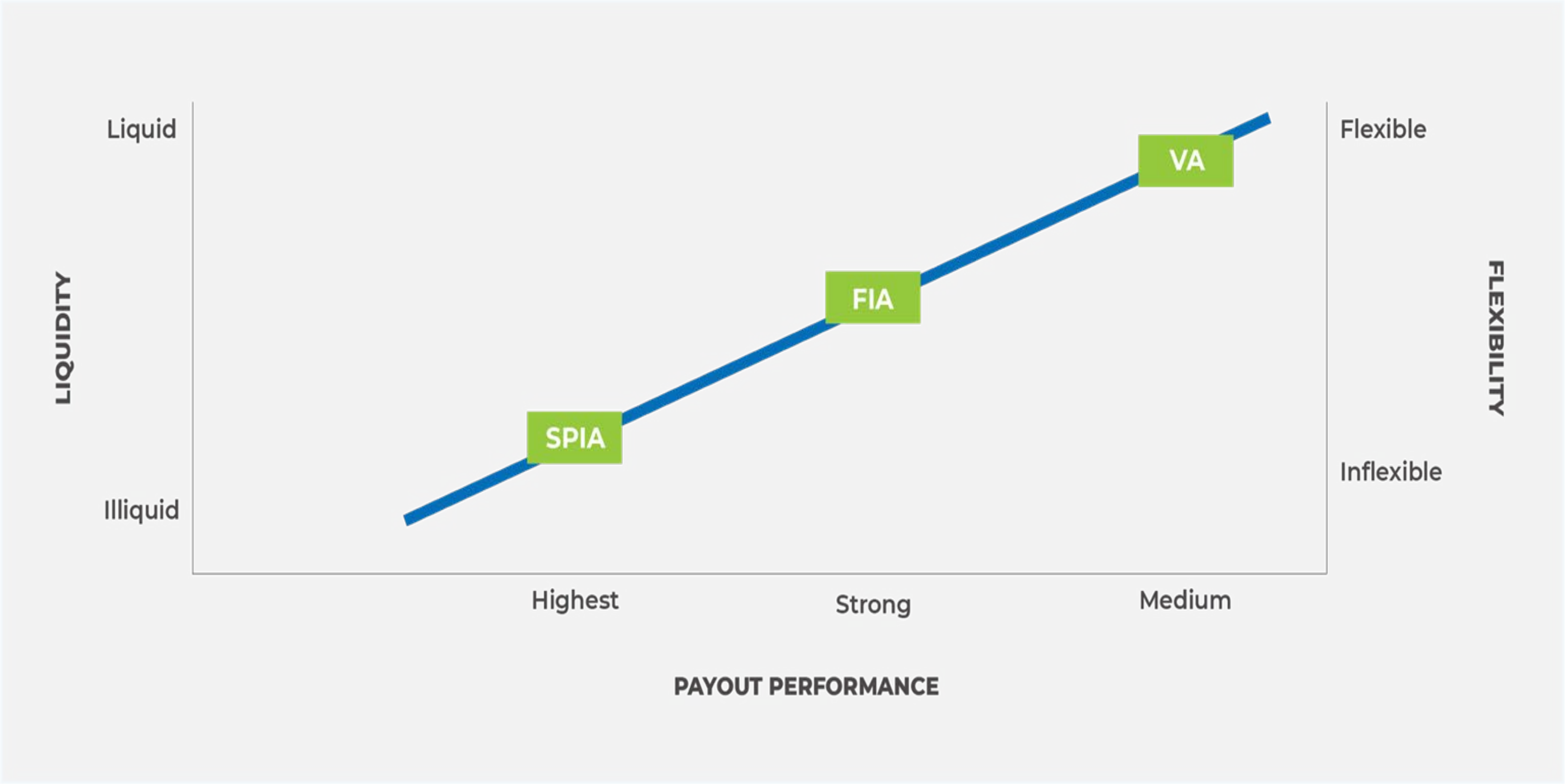
Annuity Mechanics

PRODUCT	ACCUMULATION	DECUMULATION (PAYOUTS)
Fixed Annuity / MYGA	Fixed accumulation rate	- Annuitization - Income rider
Fixed Indexed Annuity	Blended rate through index	- Annuitization - Income rider
Indexed Variable Annuity (Structured, Buffer)	Blended rate through index	- Annuitization - Income rider
Variable Annuity	Investment in funds	- Annuitization - Income rider
Single Premium Immediate Annuity	None	- Annuitization
Deferred Income Annuity	Fixed account managed by insurance carrier	- Annuitization

Which Type of Annuity is Best for My Client?

- There are different types of annuities for different client scenarios and needs
- In order to provide your client with the best options, you have to start thinking about retirement income before your client needs it
- Annuities can provide benefits during accumulation that can positively impact the amount of income your client can receive in retirement

Different Annuity Types For Income



Graphic above is owned and developed by DPL Financial Partners to reflect common features of depicted Commission-Free annuity product categories. Annuities should be fully comprehended prior to purchase.

Fixed Income Alternative

Fixed Indexed Annuities

- Higher rates than traditional fixed income
- Provide market upside and principal protection
- Optional benefits can convert accumulated values to income when needed

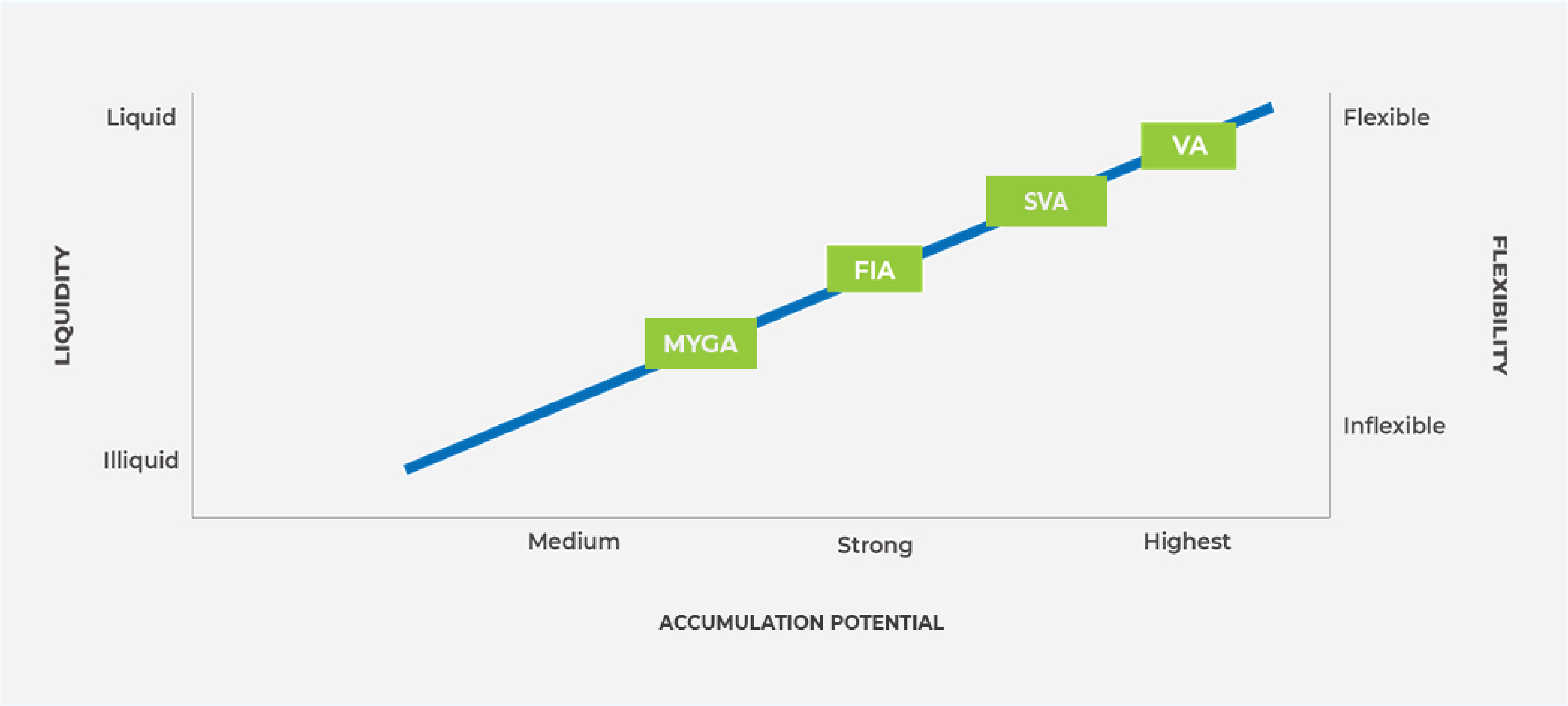
Carrier	Product	Rate	Eff. Date
Great American	Index Protector 4	2.35% - 2.45%	4/7/2020
Great American	Index Protector 5	2.55% - 2.65%	4/7/2020
Great American	Index Protector 7	2.70% - 2.80%	4/7/2020
Allianz	Retirement Foundations	2.7%	4/7/2020
Security Benefit	ClearLine	2.75% -2.85%	4/6/2020

Understanding Income Product Trade-offs

- Products should be evaluated based on their respective strengths.
- When evaluating annuities to solve for efficient retirement income, there are several product types to compare.

Guaranteed Income Option	SPIA	FIA	VA
Investment Phase	Decumulation	Decumulation or Transition	Accumulation
Income Source	Annuitize	Rider or Annuitize	Rider or Annuitize
Payout Performance	Highest Payout	Strong Payout	Medium Payout
Liquidity	Illiquid	Somewhat Liquid	Most Liquid

Different Annuity Types For Accumulation



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Understanding Accumulation Product Trade-offs

- Products should be evaluated based on their respective strengths.
- When evaluating annuities to solve for efficient retirement income, there are several product types to compare.

Guaranteed Income Option	MYGA	SVA	FIA	VA
Investment Phase	Accumulation	Accumulation	Decumulation or Transition	Accumulation
Protection Level	High	Medium	High	Low
Accumulation Potential	Moderate	Medium	Strong	Medium Payout
Liquidity	Low	Medium / High	Somewhat Liquid	Most Liquid

Determining a Client’s Annuity Allocation within the Portfolio

Determine the Appropriate Allocation

- The allocation into an annuity product should be based on the specific client situation
- Two allocation strategies advisors use:
  - **Solving for essential expenses**—an annuity typically fills the **gap in income** to ensure essential expenses are covered
  - **Percentage of portfolio**—often funded by fixed income assets, the allocation is typically **25-40%** to an annuity, depending on the specifics of the client situation

Determining Portfolio Allocations

1 Solving for Essential Expenses

- To arrive at an annuity income target, subtract a client's social security and pension income from the amount required to fund their desired retirement lifestyle

Essential Expenses

− Social Security Income

− Pension Income

Annuity Income

Example: Annuity to Cover an Income Gap[1]

- **Client:** 65-Year Old Female with $1 million
- **Spending Goal**: $70,000 total ($45,000 of essential expenses)
- **Social Security:** $30,000
- **Income Gap for essentials:** $15,000

- **Life-only income annuity:** 5.78% payout, $259,516 needed to close gap
- **Allocation to annuity:** 25.9%

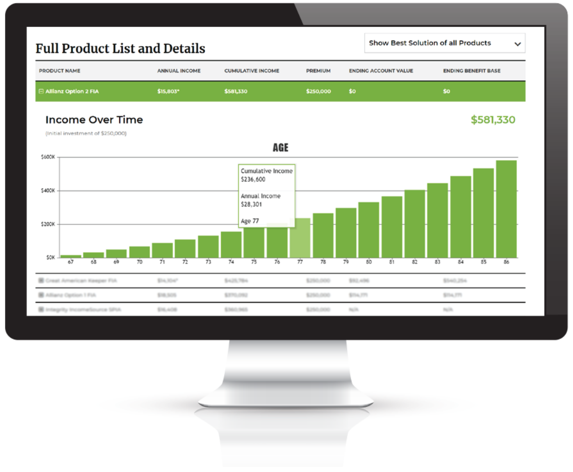
(1) Wade Pfau, Retirement Researcher

2 Percentage of Portfolio

- Asset location suggests that fixed income investments perform better in a tax-advantaged account
  - A variable annuity allows for advisor selection of fixed income investments
  - A FIA provides a packaged solution that enables an advisor to leverage the scale and fixed income expertise of the carrier
- Tax deferring investments that generate ordinary income provide the potential for higher accumulation
- This strategic location of fixed income can be turned into guaranteed income streams in retirement

Source: 2017 SBBI Yearbook, Roger G. Ibbotson, Duff & Phelps, Zebra Capital; AnnGen Development LLC

Determining Portfolio Allocations



The calculator at **dplfp.com** allows you to run the numbers to see how no-load products can produce guaranteed income to meet your client's specific goals.

Full Product List and Details

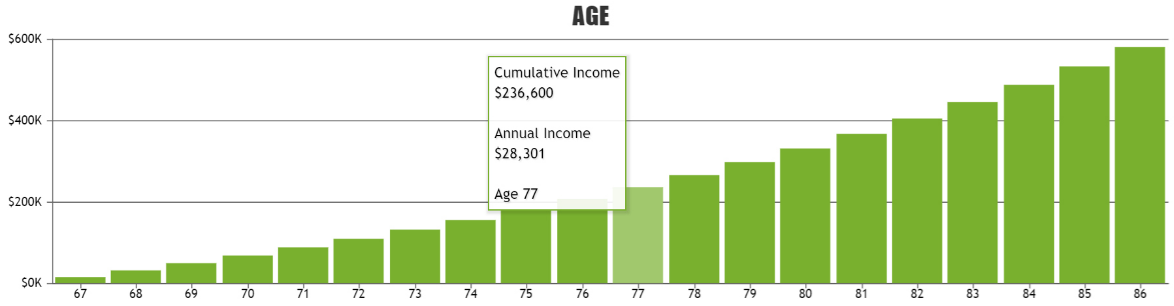
Show Best Solution of all Products

PRODUCT NAME	ANNUAL INCOME	CUMULATIVE INCOME	PREMIUM	ENDING ACCOUNT VALUE	ENDING BENEFIT BASE
Allianz Option 2 FIA	**$15,803***	**$581,330**	**$250,000**	**$0**	**$0**
Great American Keeper FIA	$14,104*	$425,784	$250,000	$92,496	$540,254
Allianz Option 1 FIA	$18,505	$370,092	$250,000	$114,171	$114,171
Integrity IncomeSource SPIA	$16,408	$360,965	$250,000	N/A	N/A
Great American Defender FIA	$15,282	$305,631	$250,000	$219,944	$293,876
Great West Foundation VA	$13,764	$301,032	$250,000	$217,393	$269,880
Great West Max VA	$14,786	$295,726	$250,000	$196,233	$268,842
Great West Plus VA	$13,781	$276,935	$250,000	$203,968	$275,625

Income Over Time

$581,330

(Initial investment of $250,000)



*increases annually by crediting rate %

Technology & Billing Integration

Integrating Annuities into the Planning Process

- There are three main ways to integrate annuities into your current planning process:

1. **Planning Software**
2. **Portfolio Management**
3. **Billing**

1 Planning Software

- "Am I going to hit my goals?"
- Show impact of an annuity on the financial plan through software including:

Sample Scenario: Annuities & Monte Carlo Scores

Designed to deliver retirement income last a lifetime

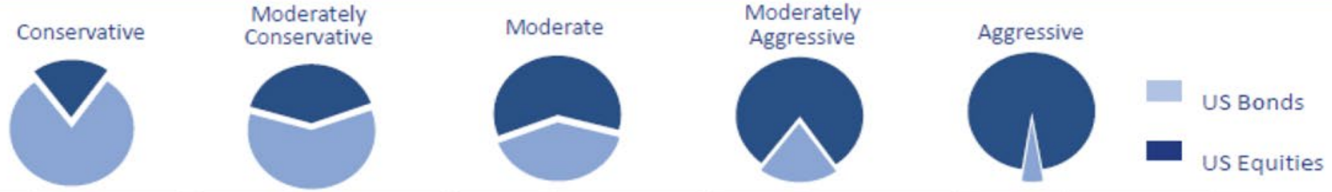
Monte Carlo Simulations-Projected Returns

Retirement Foundation ADV Annuity

Annuity represented by Retirement Foundation ADV

Simple Portfolios

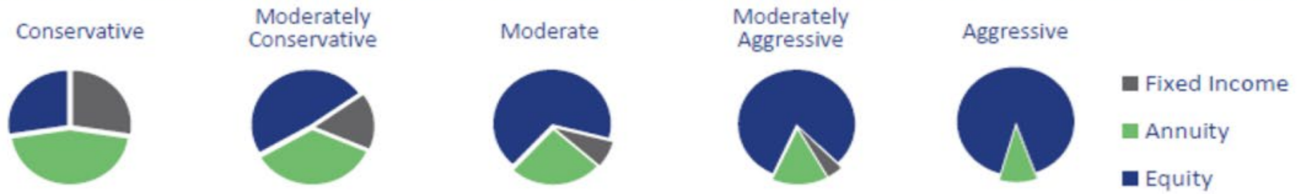
US Equities & Bonds



	Conservative	Moderately Conservative	Moderate	Moderately Aggressive	Aggressive
Worst	($896,592)	($1,101,605)	($1,364,591)	($1,241,021)	($1,215,027)
Average	$384,600	$600,226	$859,295	$974,666	$921,810
Best	$3,302,130	$4,954,607	$7,912,572	$8,197,076	$10,242,680
	62% success[1]	63% success[1]	65% success[1]	66% success[1]	68% success[1]

Model Portfolios[2]

Traditional Portfolio incl. insurance component (Retirement Foundation ADV – Option 2 [Increasing Income])

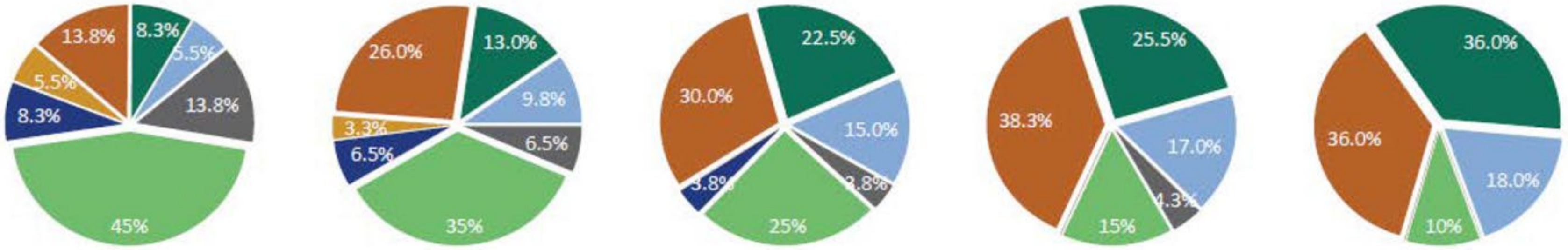


	Conservative	Moderately Conservative	Moderate	Moderately Aggressive	Aggressive
Worst	$48,138	($358,790)	($807,853)	($946,093)	($1,024,030)
Average	$769,397	$752,726	$872,650	$945,880	$901,473
Best	$2,378,047	$3,581,289	$6,162,771	$7,085,480	$9,288,506
	92% success[1]	80% success[1]	71% success[1]	69% success[1]	69% success[1]

Source: Allianz Life - Retirement Foundations ADV Product FactSheet 2018

Sample Scenario: Annuities & Monte Carlo Scores

Five holistic portfolios offered along the risk/ return spectrum for lifetime income...



Conservative	
Annuity	45%
Equity	27.5%
Fixed Income	27.5%

Moderately Conservative	
Annuity	35%
Equity	48.8%
Fixed Income	16.2%

Moderate	
Annuity	25%
Equity	67.5%
Fixed Income	7.5%

Moderately Aggressive	
Annuity	15%
Equity	81%
Fixed Income	4%

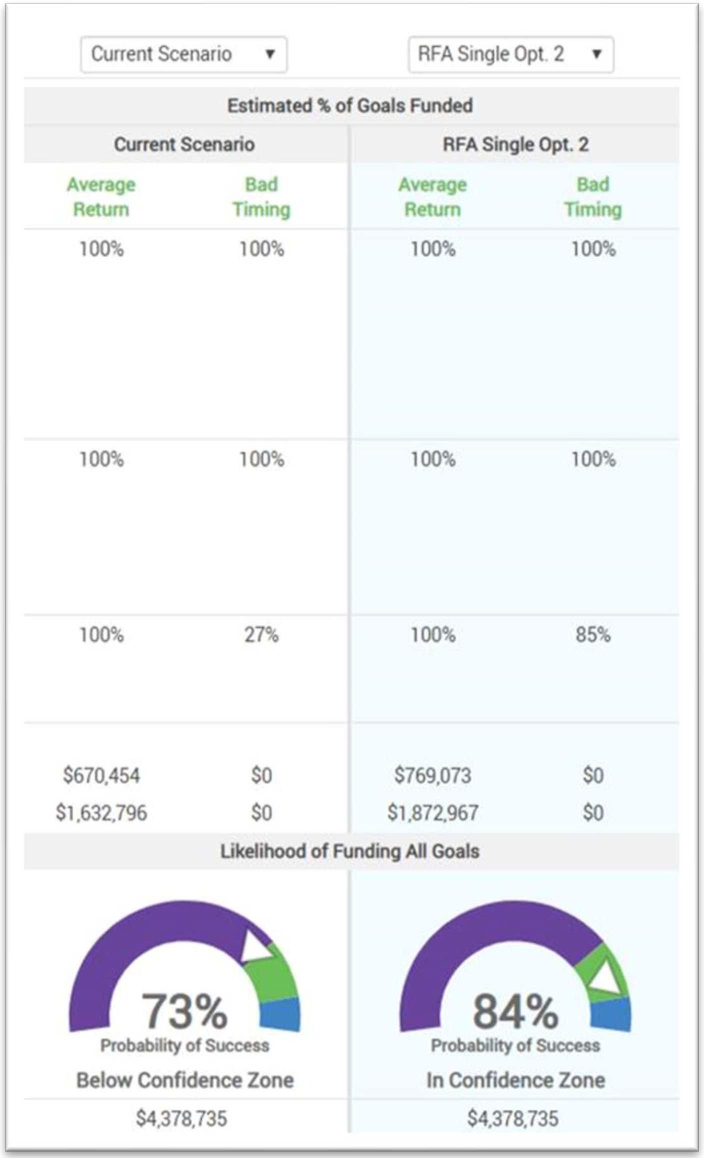
Aggressive	
Annuity	10%
Equity	90%
Fixed Income	0%

Allocation to Equity and Fixed Income includes a broad spectrum of asset classes, including:

- Global Bonds
- Corporate Bonds
- International
- Alternatives
- Large Cap
- Small Cap

Source: Allianz Life - Retirement Foundations ADV Product FactSheet 2018

Sample Scenario: Annuities & Monte Carlo Scores



Current Scenario ▾ | RFA Single Opt. 2 ▾

Estimated % of Goals Funded			
Current Scenario		RFA Single Opt. 2	
Average Return	Bad Timing	Average Return	Bad Timing
100%	100%	100%	100%
100%	100%	100%	100%
100%	27%	100%	85%
$670,454	$0	$769,073	$0
$1,632,796	$0	$1,872,967	$0
Likelihood of Funding All Goals			
73% Probability of Success		84% Probability of Success	
Below Confidence Zone		In Confidence Zone	
$4,378,735		$4,378,735	

- 60 yr. old client
- $500,000 in an annuity
- Defer income 7 years
- Planning horizon age: 95
- $2M portfolio: 60/40

- Probability of success increases with inclusion of income FIA by removing sequence of returns risk.
- Potential for a larger legacy when utilizing the annuity for income rather than just the portfolio.

Source: MoneyGuidePro, Monte Carlo Simulation Output, July 2019

Sample Scenario: Annuities & Monte Carlo Scores

The table below shows an upside case, the median case, and a downside case from the 1000 trials.

Case	Percentile	Total Portfolio Assets
Upside (Outperform)	97.5	$14,020,077
Median (Moderate)	50.0	$6,577,521
Downside (Underperform)	2.5	$1,937,633

This Monte Carlo simulation is successful in **100%** of the trials.

SUMMARY

Upside Case
$14,020,077

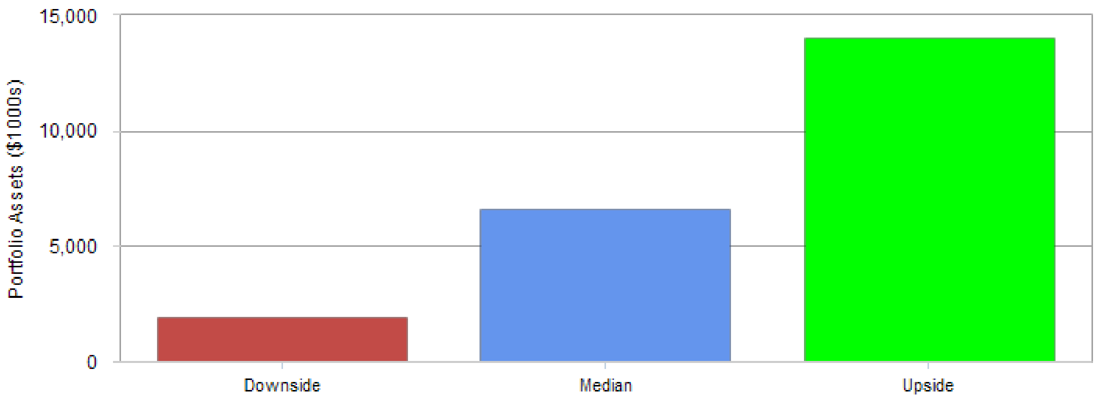
Median Case
$6,577,521

Downside Case
$1,937,633

Probability of Success
100%

Portfolio Asset Comparison

The chart below illustrates an upside case (97.5 percentile), the median case (50 percentile), and a downside case (2.5 percentile) from the 1000 trials.



This Monte Carlo analysis illustrates the potential results of your financial plan using up to 1000 randomly generated market returns and volatility called trial runs. In each trial run, the mean and standard deviation of a selected benchmark index for each account or portfolio is used for a randomly chosen year. This hypothetical investment performance is combined with the detailed cash flow and tax calculations for your plan. The trial runs produce a range of potential results and are one way of illustrating and evaluating the statistical probability of your planning strategies.

IMPORTANT: The projections or other information generated by this Monte Carlo simulation regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. Results may vary with each use and over time. Calculations are based upon market index and growth rate assumptions in your financial plan. Other investments not considered might have characteristics similar or superior to those analyzed in this report. Refer to the Assumptions Summary and Monte Carlo Assumptions reports for additional assumption details.

The table below shows an upside case, the median case, and a downside case from the 1000 trials.

Case	Percentile	Total Portfolio Assets
Upside (Outperform)	97.5	$13,355,122
Median (Moderate)	50.0	$5,379,501
Downside (Underperform)	2.5	$107,037

This Monte Carlo simulation is successful in **94%** of the trials.

SUMMARY

Upside Case
$13,355,122

Median Case
$5,379,501

Downside Case
$107,037

Probability of Success
94%

Portfolio Asset Comparison

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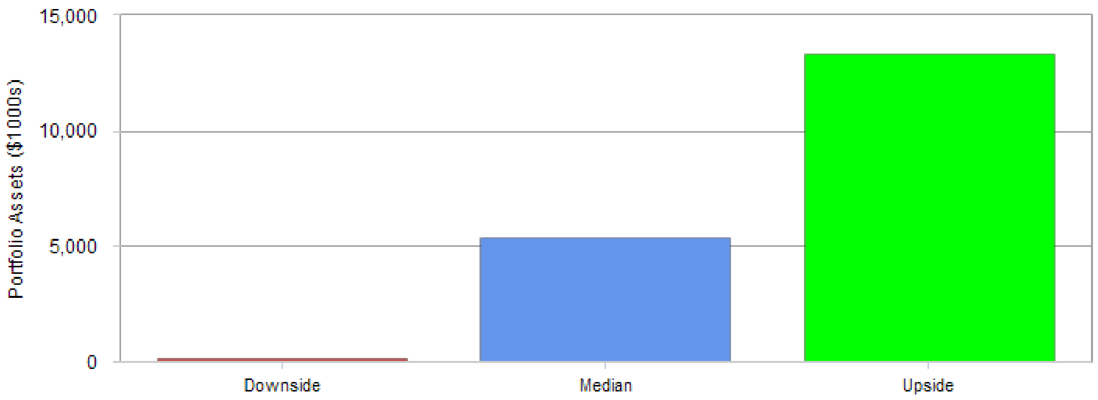

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Technology & Billing Integration

2 Portfolio Management

- "How is my portfolio performing?"
- Populate annuity values in portfolio management system via:
  - Direct Feeds
    - Orion
    - Tamarac
    - Morningstar Office
  - 3rd Party Vendor
    - DST
    - ByAllAccounts
    - BlackDiamond
    - Quovo

Technology & Billing Integration

3 Billing

- "What do advisors charge for an annuity?"
  - Answer: Charge the same fee you do on other assets you manage
- Important to bill on annuities as you would any other asset. Doing this eliminates a conflict of interest.
- Billing can occur through your portfolio management system through data feeds or through the carrier directly out of the product.

Key Takeaways

Key Takeaways: Important Annuity Concepts

1 Annuities have changed dramatically

- Now fee-based, RIAs can use them
- Better value for the client because commissions have been removed

2 Annuities are powerful solutions for both accumulation and income

- Supported by extensive academic research
- Guaranteed income for life and principal protection

3 Annuities address a variety of risks other financial instruments cannot

- Sequence of Returns Risk and Longevity Risk are minimized

4 Implementation in a fee-only practice couldn't be easier

Things to Do Now

- **STEP 1:** Identify clients who could benefit from a guaranteed income solution
  - Clients who are 5-10 years from retirement
  - Run an income calculation
    - If Monte Carlo score is <80%, likely a great candidate
- **STEP 2:** Contact your DPL Consultant to determine the right solution for your client
- **STEP 3:** Show financial plan with and without the annuity

The calculator at **dplfp.com** allows you to run the numbers.

Questions

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Fixed indexed annuities are contracts purchased from a life insurance company that are designed for long-term retirement goals. While the interest rate credited to an indexed account is linked to the performance of an underlying index, premium payments made to a fixed index annuity are never directly invested in the stock market. All guarantees are based on the financial strength and claims-paying ability of the issuing insurance company. The purchase of an annuity within a retirement plan that already provides tax deferral under sections of the Internal Revenue Code results in no additional tax benefits. An annuity should be used to fund a qualified plan based upon the annuity's features other than tax deferral. All annuity features, risks, limitations, and costs should be considered prior to recommending the purchase of an annuity within a tax-qualified retirement plan.

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Commission-Free Insurance

Join the Revelation