Understanding Annuities and More

HOSTED BY TOM DICKSON
FINANCIAL EXPERTS NETWORK
DEC. 10, 2019

E: TOM@FINANCIALEXPERTSNETWORK.COM

C: 412.580.5954

Financial Experts Network

Introducing Tom Dickson’s Financial Experts Education Program for Financial Advisors

New Members-Only Program for Financial Advisors and Planners

Background: Tom Dickson has hosted over 300 webinars, starting in 2008, that have drawn over 130,000 financial advisors. Tom's live ***Financial Experts*** webinars have featured nationally-recognized experts like Wade Pfau, Harold Evensky, Larry Kotlikoff. And "Undiscovered" experts like Aaron Zolbrod (Medicare) and Tom Riekse (LTCi) whose excellent ratings were 96% and 90%, respectively. In 2019, our webinars have **an 86% excellent rating.**

What's unique about Tom's Financial Experts program?

A: Our mission is to educate financial advisors so they may better serve their clients. Our formula is to use **true experts** to deliver the education you need to advise clients on topical (e.g. new tax law) and common challenges (e.g. Social Security to college financial aid). 90% of 1,865 webinar attendees when surveyed responded: "I learned something on Tom's webinars that will help me better serve my clients."

Who attends your webinars? Do you provide CE credits?

A: 43% of our attendees are fee-only financial planners, 46% are dually registered advisors. Yes, we automatically submit CE credits for CFPs, and certificates are provided for those with the American College designations (CLU, RICP or ChFC). We expect to offer a minimum of 24 CE-eligible programs in 2020, to include Ethics CE.

What's it cost?

A: You can join for $9 a month and quit any time. There is a $25 termination fee, if you quit after taking the Ethics CE.

The EXPERT in Specialized Area

National Figures and **Undiscovered EXPERTS**

The **"Dean"** of Financial Planning

Bob Keebler
TOP CPA

Kurt C.
Mr. Social Security

Aaron Zolbrod
Medicare Specialist

Webinar Series Comparison

FINANCIAL EXPERTS

1. LIVE Webinars with Lots of Q&A
2. Range of Topics: Planning-Centric
3. Team of National-Level Experts
4. Edited Transcripts + Tip Sheets
5. Study Groups
6. Client Invites
7. > 24 CE-Eligible Programs

OTHER PLATFORMS

1. May be Replays Only
2. Narrow Focus: News or Product
3. Limited or 1-2 Experts
4. Few provide transcripts
5. No Study Groups
6. No Client Invites
7. CE: Not all provide for American College designations.

Financial Advisor Feedback

86% Excellent Rating for 2020 Webinars

90% of Advisors* surveyed "I learned something on Tom's webinars that will help me better serve my clients."

*1,865 advisors surveyed.

Member Benefits

$9 per Month
$99 Annual

www.financialexpertsnetwork.com/subscriptions

25 CE Credits

		Members
Webinars		
Access to **all live** webinars.		Yes
Access to **study group sessions.**		Yes
Ethics CE for CFP and American College designations.		2 Classes
Automated CE Reporting to CFP Board		Yes
Certificates for self-reporting		Yes
Replays of **all webinars**		Yes
Edited Webinar Transcripts with must-know facts		Yes
Financial Expert Tip sheets; ***12 Fafsa Tips.***		Yes
Submit questions, **in advance**, for experts to answer.		Yes
Community Forum		Yes
Submit Case Studies to be considered as part of webinars.		Yes
1-click webinar registration		Yes
Opt-in control		Yes

March 18
Sept. 9

2020 Live Webinar Calendar

January
- Medicare (Jan. 7)
- IRAs and More with Ed Slott (Jan. 14)
- Must-See FinTech (Jan. 21)

February
- ETF Trends (Feb. 5)
- 529 Plans

March
- Modeling Annuities in Financial Planning
- Ethics CE (March 18)
- Mortgage Planning

April-August
- Life Insurance
- HSAs
- Financial Planning Software Tools
- Direct Real Estate Investments
- Alternatives: REITS, MLPS. Metals
- Divorce Planning
- End-of-Life Planning
- Modeling Mortgages
- Portfolio Construction
- Asset Allocation
- ESG Investing

Green means BOOKED

Sept
- Ethics (Sept. 9)
- Medicare

Oct.
- Fafsa
- College Funding

Nov.
- Long Term Care Insurance

Dec.
- Year-End Tax Strategies

Sample Edited Medicare Transcript
provided to Members

93%
Excellent Rating

Understanding Medicare Plan Choices
With Aaron Zolbrod, CEO of The Health Insurance Store

What’s covered by Medicare Parts A and B:
Part A covers hospitalization. If you're hospitalized for any period of time, up to 60 consecutive days, your bill will be $1,364. To be clear, you will be responsible for $1,364 regardless of whether you were hospitalized for one day, 21 days or 60 days; your bill is $1,364. So that's kind of a strange dynamic of Medicare. But it is what it is. That doesn't change until the 61st consecutive day in the hospital. And at that time, it would go up to $335 per day, from day 61 through 90 and $682 per day from days 91 through 150. I did have two clients in 2017 that were we're in the hospital over 100 consecutive days. I'm going to talk about one in case as we move on with the presentation.
Part B covers your medical. This is your common outpatient procedures and services. So, your doctor visits and your specialist visits. And testing… blood tests, x-rays, CAT scans, MRIs, outpatient surgical procedures, cataract, carpal tunnel, and colonoscopy.

Members receive Financial Aid Expert Mark Kantrowitz's ANSWERS to 58 Fafsa and Financial Aid questions

Mark Kantrowitz with Suze Orman

Question & Answer Session: Answered during Webinar

Divorce Question from Eric: When parents are divorced, if the divorce agreement allows that the child can put down the address of the parent with the lower income, are there any other records that parents would need to provide to prove that that residents school records driver's license to FAFSA or college asked for custody agreement to close?"

> **Mark's Answer:** Some colleges are going to want to see a copy of the child custody arrangement. So, if you do change from what's in the original divorce decree, go back to court and get it modified so that when you can show them that it actually reflects the arrangement that was agreed to in court. Also, colleges will be very suspicious However, if your child is theoretically living with a parent in a different

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www.financialexpertsnetwork.com

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Upcoming Webinars

Tom Dickson's 2020 Webinar Calendar + Members-Only Program
Presented by Tom Dickson
Friday, December 20, 2019
Register »

Tom Dickson's 2020 Webinar Calendar + Members-Only Program
Presented by Tom Dickson
Friday, December 13, 2019
Register »

LIVE educational webinars for Financial Advisors!

Financial Experts' live webinars have drawn over 130,000 financial advisors with financial experts like Wade Pfau, Michael Finke, Larry Kotlikoff delivering “actionable” advice to help you better serve your clients. ***90% of webinar attendees surveyed “learned*** *something that will help them better serve their clients.”** Not surprising, **83%** of our webinars have been rated **excellent!**

We are excited to announce our Members-Only program that features **LIVE webinars with 24 CE-eligible programs, includings Ethics CE**. Members receive special access to **experts with deep expertise** in fields like college planning, Medicare, Social Security, Taxes and much more. Plus, you get access to all webinar replays, transcripts, Experts Guides and Case Study Groups.

To learn more, click here to register for an info session. To subscribe, use the button below.

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Upcoming Webinars

WWW.FINANCIALEXPERTSNETWORK.COM

Year-End Tax Planning Your Clients Should Do Presented by Bob Keebler	Tuesday, December 17, 2019 at 4:00 PM ET
Today's Mortgage Options for Millennials to Centennials Presented by Phil Chenier	Wednesday, December 18, 2019 at 4:00 PM ET
Must-See FinTech for Financial Advisors	Tuesday, January 21, 2020 at 3:30 PM ET

Members Only:

Last Minute Fafsa Questions on Dec. 12: **Members Only**

Medicare on Jan. 7 at 4:00 ET **CE+ for Members Only**

Ethics CE on March 18 and Sept. 9 **CE+ for Members Only**

Financial Experts Network

Today's Speaker

WADE D. PFAU
PhD, CFA®

Professor of Retirement Income

RICP® Program Director

Co-Director of the New York Life Center for Retirement Income

Areas of Expertise:
Annuities, Financial Planning, Investments, Life Insurance Planning, Life Insurance Practices, Portfolio Management, Retirement Planning

BA, University of Iowa
BS, University of Iowa
MA, Princeton University
PhD, Princeton University

Requirements to obtain CE

CFPs

1. Must attend entire session
2. Must use unique URL to login

NO CE for Phone Only

3. Must input CFP ID # in survey

RICPs, CLUs and ChFCs

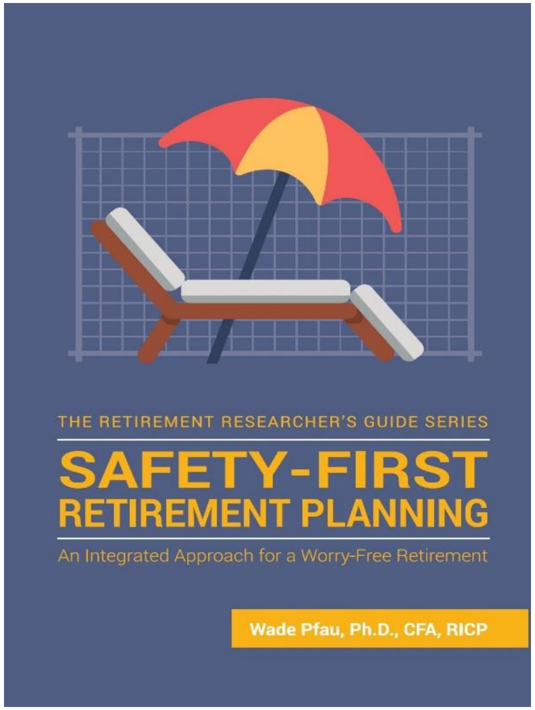
1. Must attend entire session
2. Must use unique URL to login

NO CE for Phone Only

3. Must note self-report in survey

Financial Experts Network

Free Copy of Wade's Book



Courtesy of DPL Partners

Schedule a 15-minute Intro Call:
https://bridge.dplfp.com/schedule-your-call-with-dpl-for-free-wade-pfau-book

Retirement Researcher

RETIREMENT BEGINS WITH A PLAN[TM]

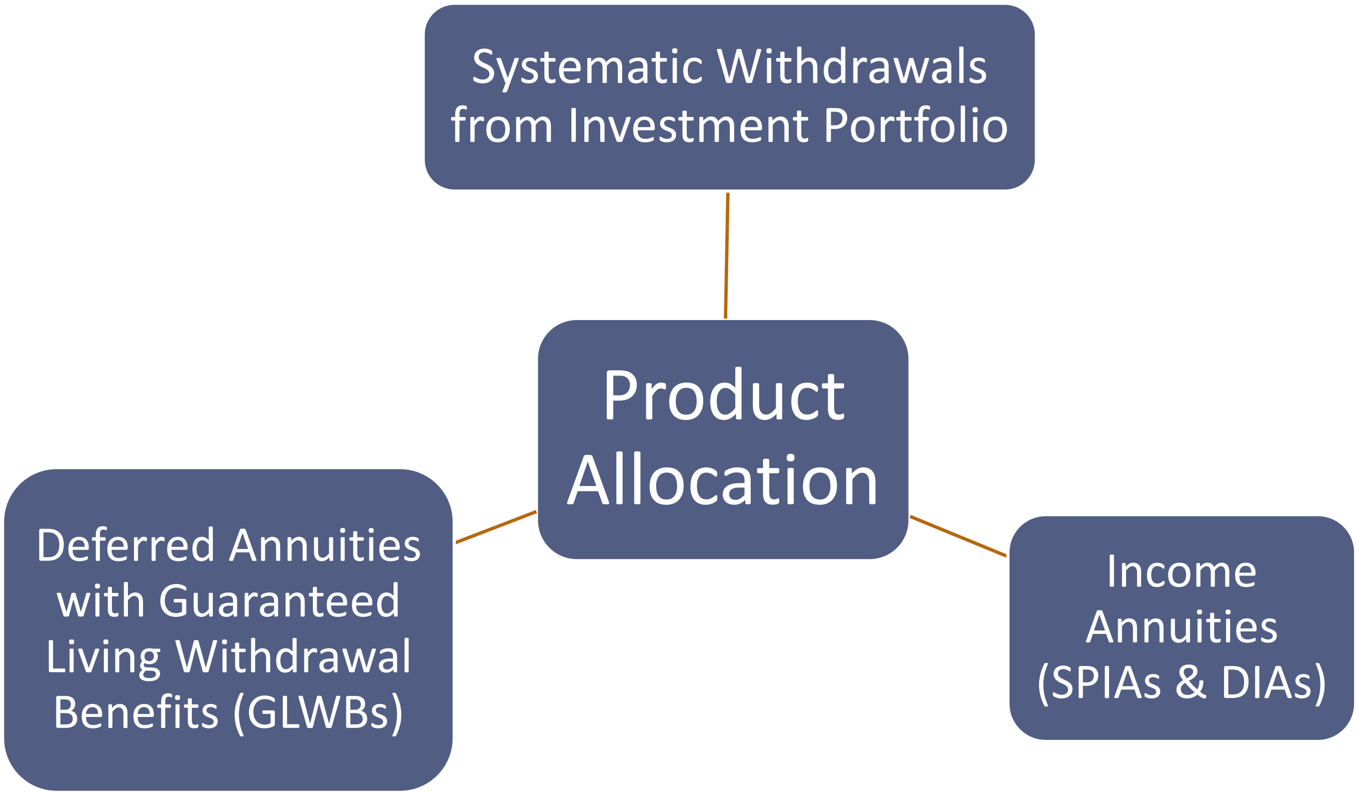
Understanding How Different Types of Annuities Work

Presented by:

Wade Pfau, Ph.D., CFA, RICP
RICP Curriculum Director
The American College for Financial Services & RetirementResearcher.com

THE AMERICAN COLLEGE OF FINANCIAL SERVICES

Retirement Researcher


Systematic Withdrawals from Investment Portfolio
Product Allocation
Deferred Annuities with Guaranteed Living Withdrawal Benefits (GLWBs)
Income Annuities (SPIAs & DIAs)

Caveat

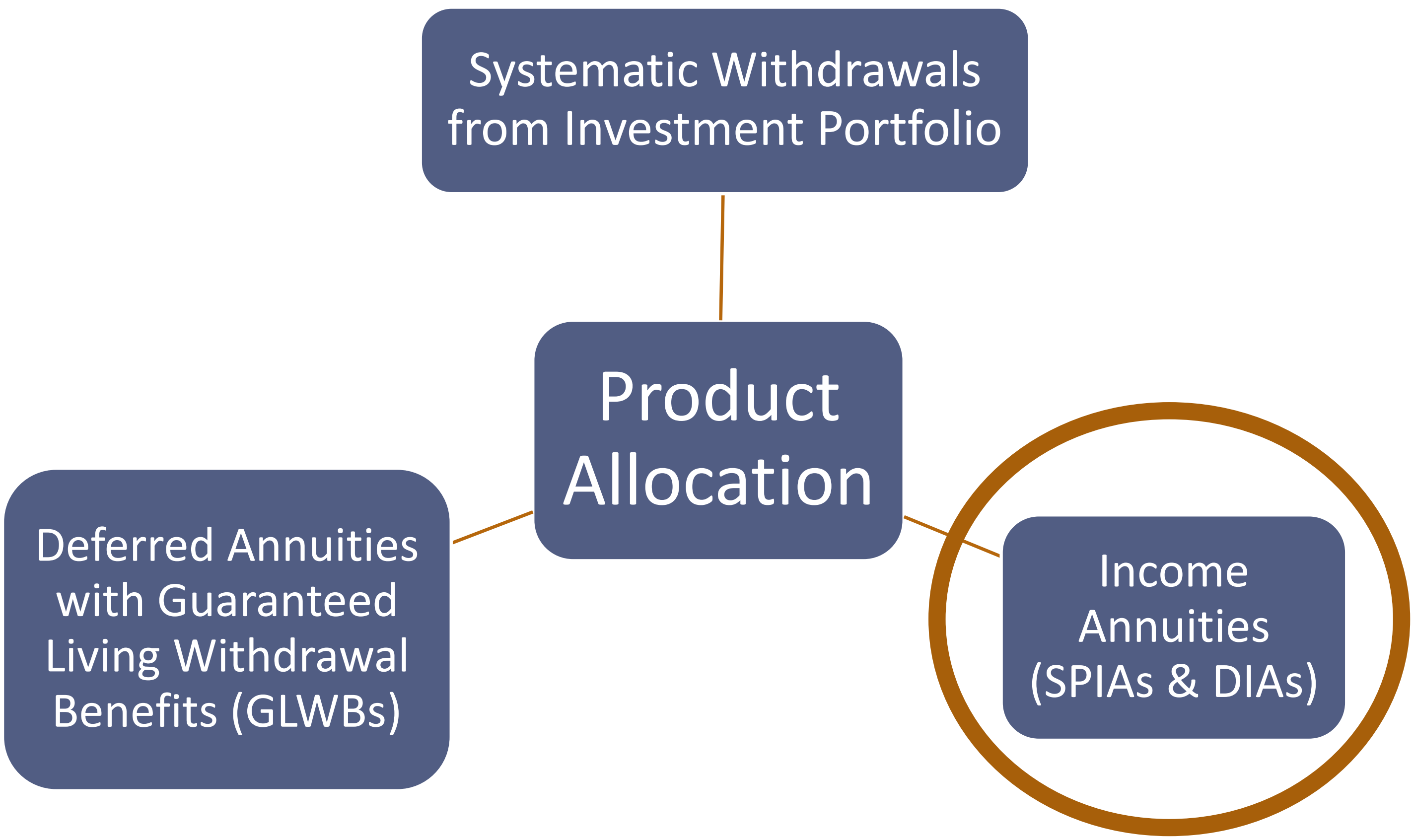
Assuming **“Good”** Annuities

i.e., Competitively Priced

Annuity Vocabulary

Fixed vs. Variable

Immediate vs. Deferred


Systematic Withdrawals from Investment Portfolio
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Income Annuities (SPIAs and DIAs)

Who is covered by an annuity?

owner, annuitant, beneficiary

When do income payments start?

immediate or deferred

Do income annuities cover one life or two?

What are the different flavors of payouts?

Life only, life with period certain, life with cash refund, life with installment refund, period certain (not linked to mortality)

Are payments fixed or do they grow over time?

Level payments, cost-of-living adjustments, inflation-indexed (CPI)

Pricing an Income Annuity

1) Mortality rates (which vary by age and gender) impact how long payments will be made.

2) Interest rates impact the returns the annuity provider can earn on the underlying annuitized assets.

3) Overhead costs relate to extra charges an annuity provider seeks to cover business expenses and to manage risks related to the accuracy of their future mortality and interest rate predictions.

Pricing an Income Annuity – Life Only for 65-Year Old Female

Discount Rate:	3.00%				
Age	Income	Discount Factor	Discounted Value of Income	Survival Probabilities	Survival-Weighted Discounted Value
65	$10,000	100.0%	$10,000	100.0%	$10,000
66	$10,000	97.1%	$9,709	99.4%	$9,646
67	$10,000	94.3%	$9,426	98.7%	$9,302
68	$10,000	91.5%	$9,151	98.0%	$8,965
69	$10,000	88.8%	$8,885	97.2%	$8,637
70	$10,000	86.3%	$8,626	96.4%	$8,315
71	$10,000	83.7%	$8,375	95.5%	$8,000
72	$10,000	81.3%	$8,131	94.6%	$7,691
…	…	…	…	…	…
95	$10,000	41.2%	$4,120	30.2%	$1,245
96	$10,000	40.0%	$4,000	25.7%	$1,029
97	$10,000	38.8%	$3,883	21.5%	$835
98	$10,000	37.7%	$3,770	17.5%	$660
99	$10,000	36.6%	$3,660	14.0%	$512
100	$10,000	35.5%	$3,554	10.8%	$384
Cost of Bond Ladder (Through Age 100):			$224,872		
Sustainable Withdrawal Rate:			4.45%		
Cost of Annuity (Survival-Weighted Present Discounted Value of the Income Stream Through 104):					$172,915
Annuity Payout Rate:					5.78%
*Survival Probabilities are calculated from the Society of Actuaries 2012 Individual Annuitant Mortality Tables with improvements through 2019.					

Bond Ladder through age 100 costs 30% more!

Other Income Annuity Pricing Dynamics

Reduced payment for:

1) increased certainty of payments (period certain, cash refund)

2) Joint life instead of single life

3) Cost-of-living adjustments on payments

Income Annuities and Investment Returns

Payout rate ≠ Rate of return

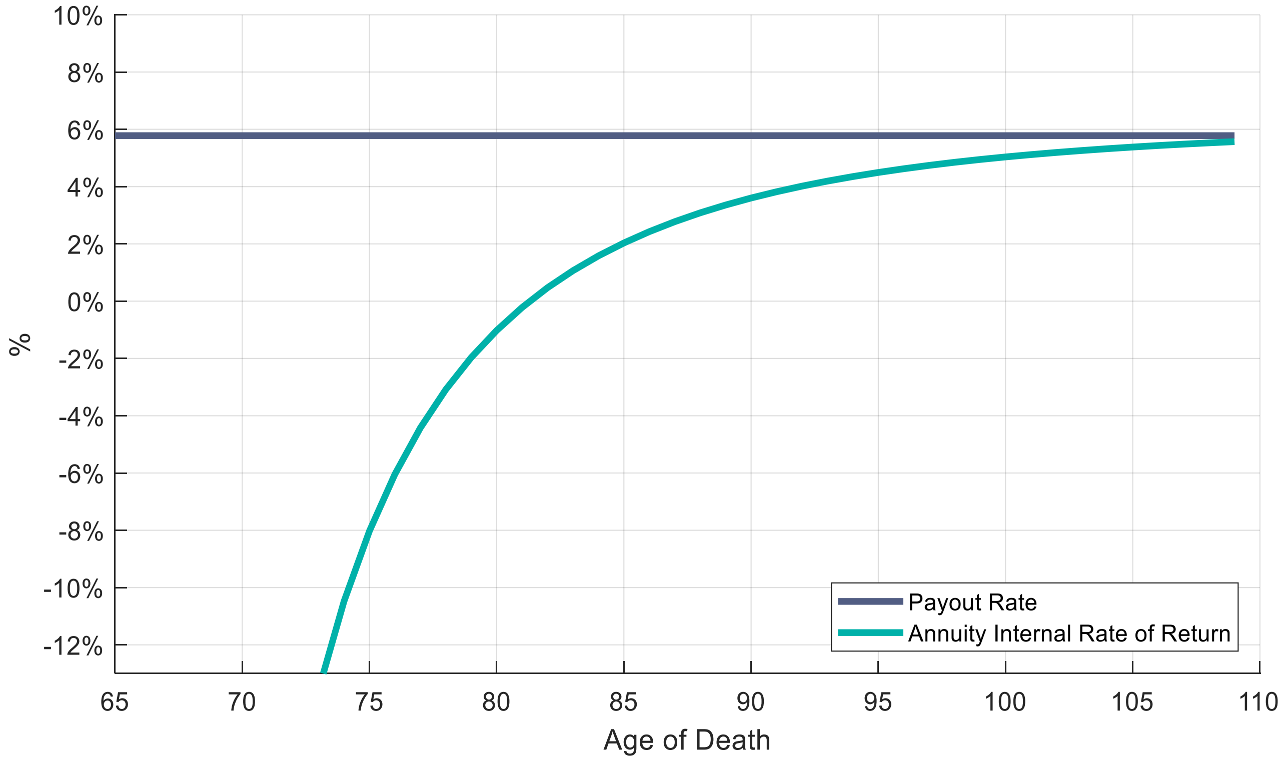
payout rate includes return of principal

payout rate is comparable to “4% rule” style portfolio withdrawal rates

Payout rate includes an underlying return assumption linked to performance of insurance company’s general account

- Primarily fixed income
- Asset-liability matching
- Higher fixed income yields than households might earn – longer maturity, more diversified credit risk, less need for liquidity, institutional pricing on trades

Mechanics of a Single-Premium Immediate Annuity Payout Rate and Internal Rate of Return by Age of Death for Purchase by a Female at Age 65



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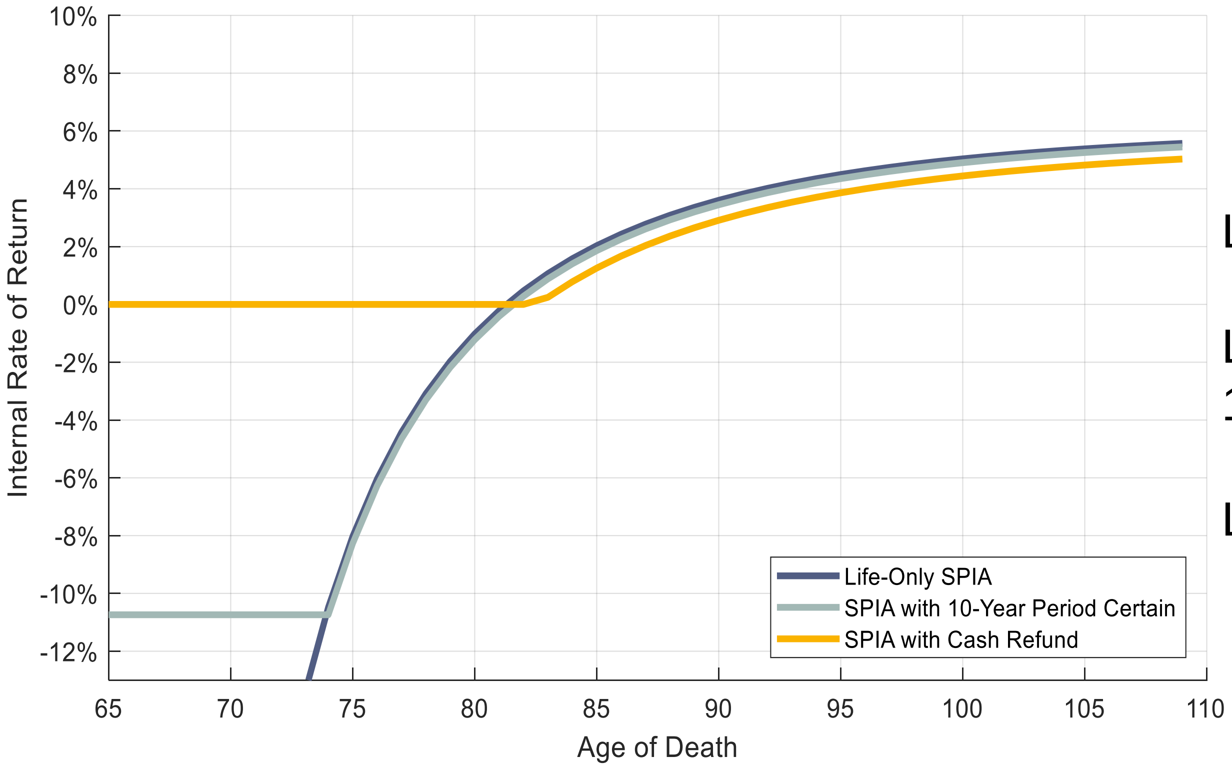

Life Only: 5.78%

Life with
10-Year Period Certain: 5.6

Life with Cash Refund: 5.38

Fees vs. Money's Worth
for Income Annuities

Discount Rate:	3.00%				
Age	Income	Discount Factor	Discounted Value of Income	Survival Probabilities	Survival-Weighted Discounted Value
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96	$10,000	40.0%	$4,000	25.7%	$1,029
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Cost of Annuity (Survival-Weighted Present Discounted Value of the Income Stream):					$172,915
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Deferred Income Annuities

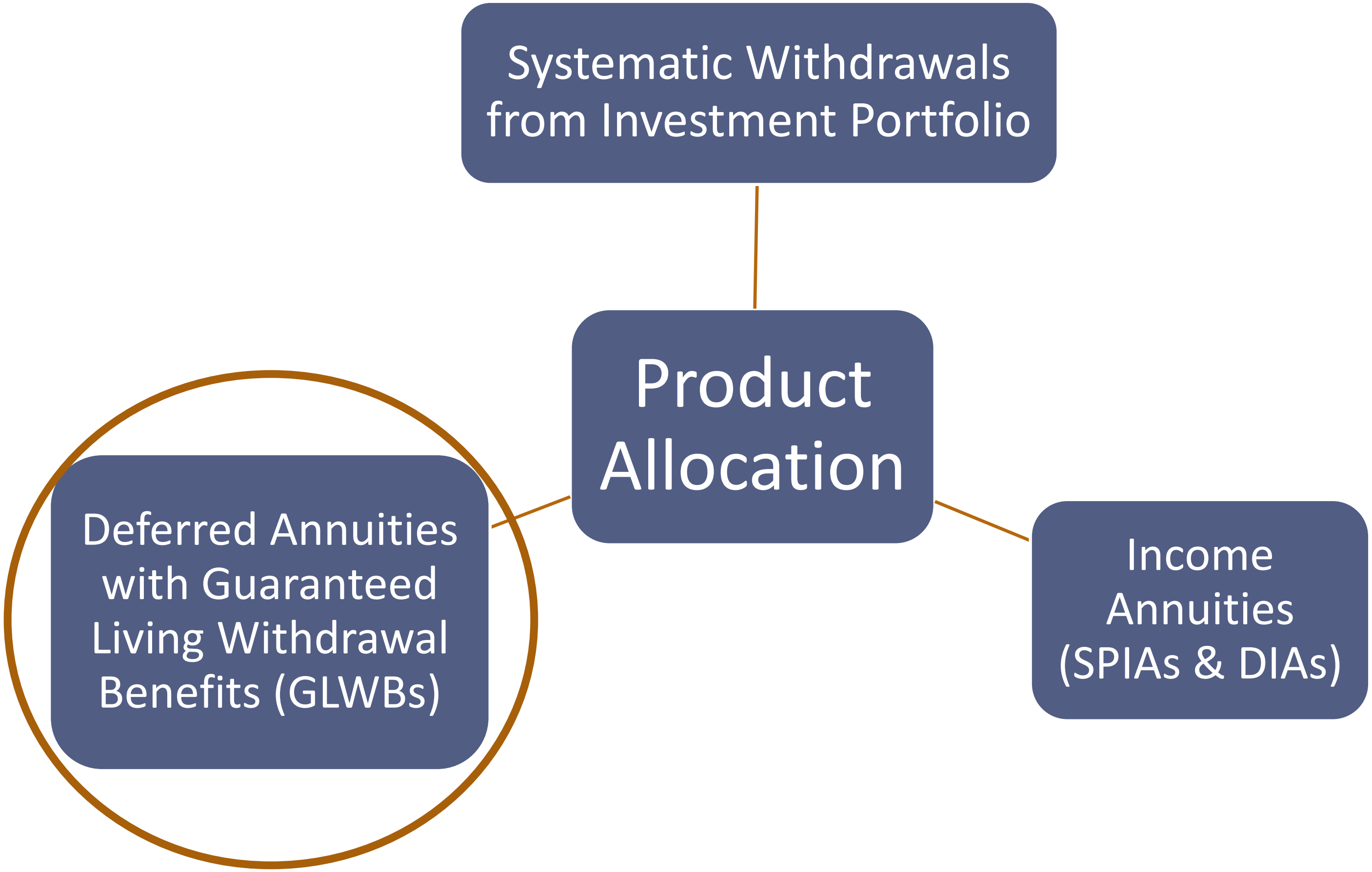
Including a deferral period for an income annuity increases the payout rate for two reasons:

1) Reduced probability of survival for receiving payments

2) Opportunity for investment growth on premiums in insurance company's general account

What Age to Buy an Annuity? Implied Longevity Yield

Current Age	$1,000 of Lifetime Income with SPIA today	$1,000 of Lifetime Income with SPIA in 5 Years	Implied Longevity Yield
65	$17,291	$15,197	3.75%
70	$15,197	$12,920	4.09%
75	$12,920	$10,493	4.68%
80	$10,493	$8,105	6.08%
85	$8,105	$6,045	9.25%


Systematic Withdrawals from Investment Portfolio
Product Allocation
Deferred Annuities with Guaranteed Living Withdrawal Benefits (GLWBs)
Income Annuities (SPIAs & DIAs)

Variable Annuities

Deferred Variable Annuity – General Features

Downside spending protection through optional guaranteed lifetime withdrawal benefit (GLWB)

Upside potential through asset growth and income step-ups

Liquidity – contract is not annuitized

Tax deferral

Deferred Variable Annuity – Behavioral Aspects

Obtain risk pooling without "sacrificing" asset

Can still see assets on the balance sheet

Comfort with investing aggressively because of guarantee

Help to stay the course with market volatility

Variable Annuity Vocabulary

Guaranteed Lifetime Withdrawal Benefit

Benefit Base

Rollup Rate

Contract Value

Step-up opportunities

Guaranteed Withdrawal Rate

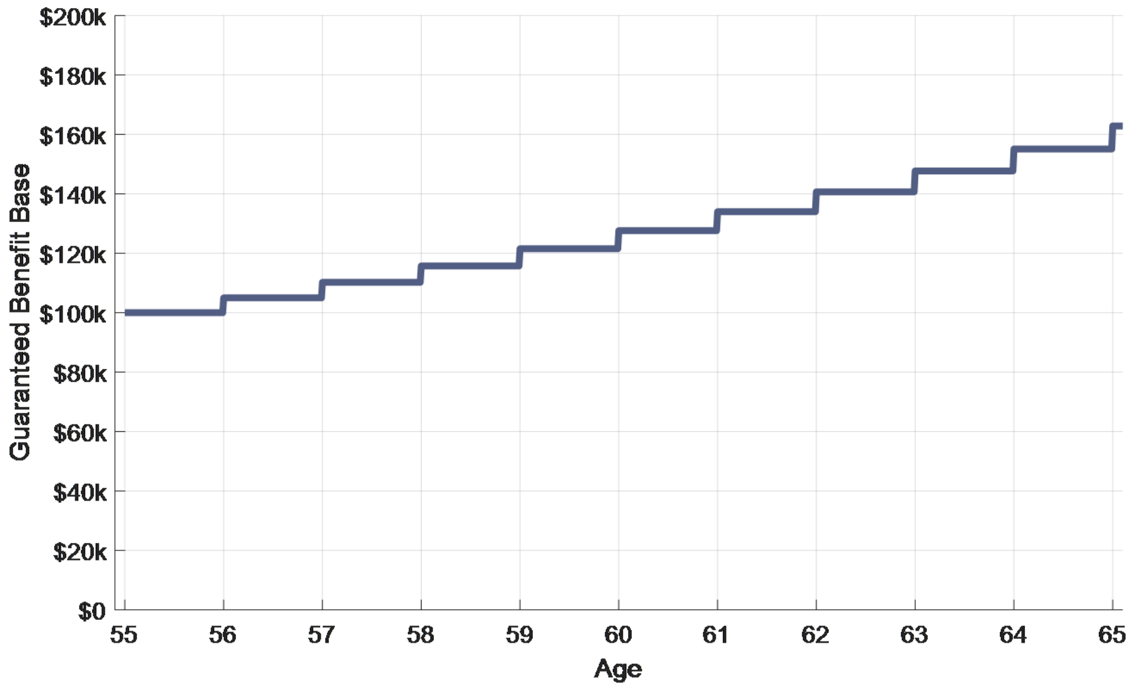
Key Issues

1. Living benefit: How do guarantees grow during the deferral period?
2. Living benefit: How are guaranteed withdrawals determined?
3. What is the death benefit?
4. How does the insurance company manage its risks?

VA with $100,000 premium, 10-year deferral

Roll-up Type	Benefit Base
5% Simple	$150,000 -- $100,000 x (1+0.05 x 10)
5% Compounded	$162,890 -- $100,000 x (1.05 ^ 10)
6% Simple	$160,000
6% Compounded	$179,080

Guaranteed Benefit Base for $100k with 5% Annually Compounded Rollup Rate



Rollup Rate

NOT a guaranteed rate of return!!!

Other compounding frequencies

When are rollups vested?

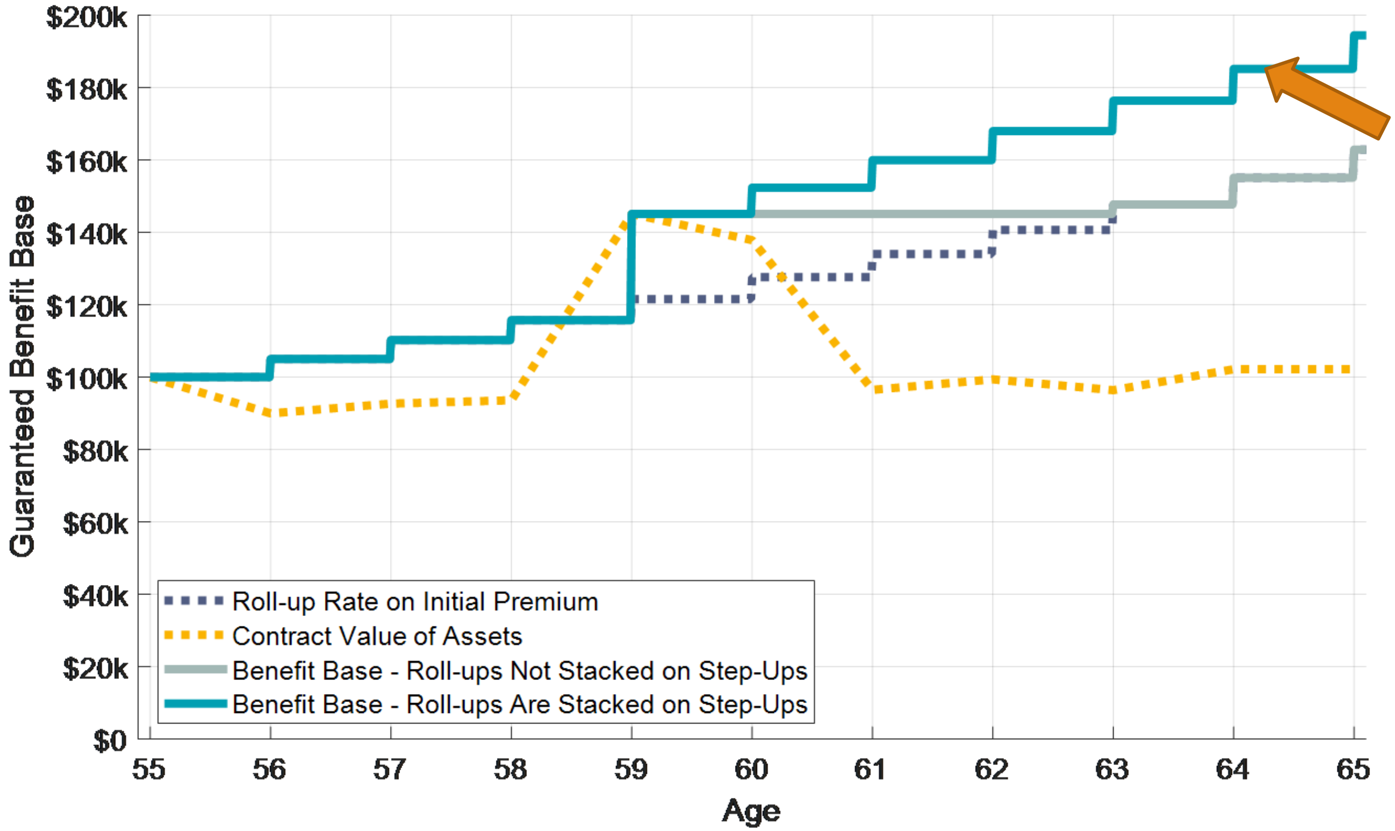
Step-up Opportunities

New high watermarks

Frequency (daily, monthly, quarterly, annual)
Vesting

Do rollups stack on step-ups?

Benefit Base: Stacking vs. No-Stacking for Step-ups



19% More
With Stacking
(in this exampl

Guaranteed Withdrawal Amount

GLWB

Age-based Withdrawal Rate **x** Benefit Base

No more rollups

Step-ups are still possible

Types of Living Benefits

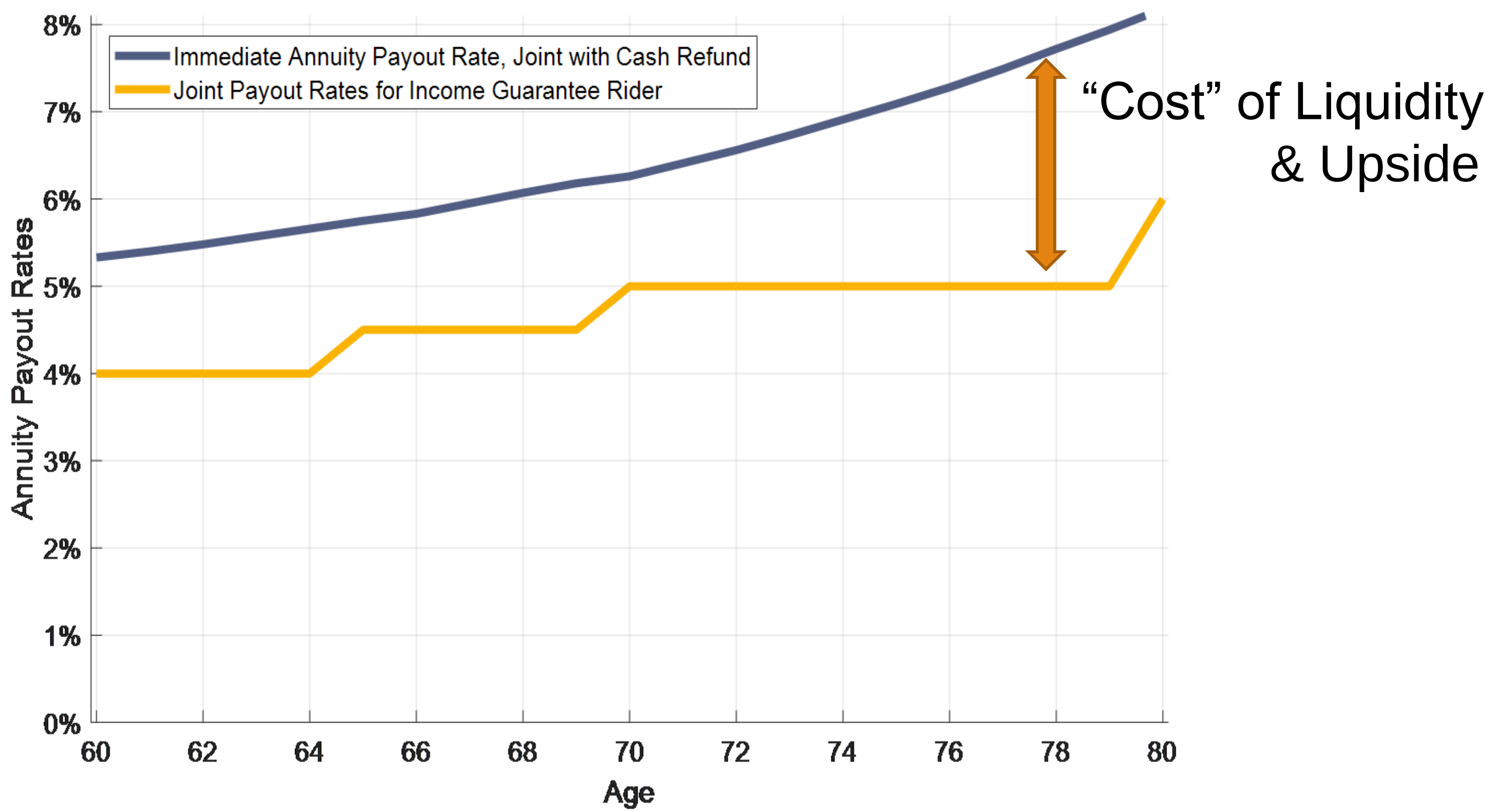
GLWB: supports lifetime income without annuitization

Guaranteed Minimum Income Benefit: requires annuitization, providing age-based guaranteed payout rates applied to benefit base. Lifetime income with annuitization.

Guaranteed Minimum Accumulation Benefit: Protects contract value growth to a minimum value. No link to income.

Guaranteed Minimum Withdrawal Amount: Guarantees certain amount (such as return of premium or value of benefit base). No lifetime income.

Guaranteed Withdrawal Rates: VA/GLWB vs. SPIA



Guaranteed Income for a $100,000 Premium

After 10-Year Deferral Period

		Withdrawal Rate				
	Rollup Rate	**4.0%**	**4.5%**	**5.0%**	**5.5%**	**6.0%**
Compounded	**4.0%**	$5,921	$6,661	$7,401	$8,141	$8,881
	4.5%	$6,212	$6,988	$7,765	$8,541	$9,318
	5.0%	$6,516	$7,330	$8,144	$8,959	$9,773
	5.5%	$6,833	$7,687	$8,541	$9,395	$10,249
	6.0%	$7,163	$8,059	$8,954	$9,850	$10,745
	6.5%	$7,509	$8,447	$9,386	$10,324	$11,263
	7.0%	$7,869	$8,852	$9,836	$10,819	$11,803
Simple	**5%**	$6,000	$6,750	$7,500	$8,250	$9,000
	6%	$6,400	$7,200	$8,000	$8,800	$9,600
	7%	$6,800	$7,650	$8,500	$9,350	$10,200
	10%	$8,000	$9,000	$10,000	$11,000	$12,000

Guaranteed Income for a $100,000 Premium

After 10-Year Deferral Period

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	7%	$6,800	$7,650	$8,500	$9,350	$10,200
	10%	$8,000	$9,000	$10,000	$11,000	$12,000

"In the Money"

Contract value
is less than benefit base

Increases the value of the GLWB

Death Benefits

Death benefit	What are the death benefit provisions?

Basic death benefit provisions

Optional death benefit riders may be incompatible with living benefit riders

GLWB and Deferred Annuitization

Annuity owner is spending own money until contract value depletes

Insurance company is only on the hook for the guarantee after account depletion

Managing Risks for the Income Guarantee

Strong company culture for financial performance and risk management

Adjust parameters to lower guaranteed amounts

Choose high quality managers for investment subaccounts

Limit the allowed volatility in subaccounts

- Cap on allowed allocation to “risky” assets
- Use volatility-controlled funds
- Require cash positions

Increase variable annuity fees

Variable Annuity Fees

1. Underlying fund expenses
2. Mortality and expense charges
3. Surrender charges (for excess distributions in early contract years)
4. Charges for optional living benefits (i.e. the GLWB) or death benefits

New fee-only annuities:

do not pay commissions, which can reduce (2) and (3) dramatically

Framing Variable Annuity Fees

Ongoing **fee drag**
vs. **required assets** to meet goal

Ongoing **fee drag**
vs. **asset allocation** choice

Fixed Index Annuities

Fixed Index Annuity – General Features

Principal protection for contract value

Lifetime spending protection through optional guaranteed lifetime withdrawal benefit (GLWB)

Some degree of upside potential

Liquidity – contract is not annuitized

Tax deferral

Fixed Index Annuity – Behavioral Aspects

Obtain risk pooling without “sacrificing” asset

Can still see assets on the balance sheet

Principal protection – not at risk of loss in market downturn -> more investing comfort elsewhere

Fixed Index Annuity Vocabulary

Interest Crediting Method
Guaranteed Lifetime Withdrawal Benefit
Benefit Base & Rollup Rate or Deferral Credit
Contract Value
Step-up opportunities
Guaranteed Withdrawal Rate

Key Issues

1. How is interest credited to the contract value?

2. Living benefit: How are guaranteed withdrawals determined?

3. What is the death benefit?

4. How does the insurance company manage its risks?

Crediting Method

FIA "returns" = **interest crediting**

Fixed interest or
linked to external index performance

Ex. S&P 500, MSCI EAFE, Low-Volatility Index

Linked Index

FIAs **do not** invest in the index

Interest is based index performance through **financial derivatives**

This means price returns **without** dividends!

Principal Protection

FIAs are fixed annuities

Contract value does **not** decrease when index experiences losses

Fixed Index Annuity Fees

1. ~~Underlying fund expenses~~
2. ~~Mortality and expense charges~~ } "no fees"
3. Surrender charges (for excess distributions in early contract years)
4. Charges for optional living benefits (i.e. the GLWB) or death benefits
5. Unobserved internal spread

   (like a single-premium immediate annuity)

New fee-only annuities:

do not pay commissions, which can reduce (3) and (5)

One-year Term Point-to-Point Crediting Method with Annual Reset

Most common method (more competition on pricing)

One-year: length of term; could be longer

Point-to-point: compare value of market index at the start and end of year/term

Credit interest for the year based on index price return (excluding dividends)

Annual reset: Comparisons start fresh for each term – no need for cumulative gains to make up for previous losses

Basic idea – FIA Interest Crediting

1. Buy enough bonds to protect principal after interest is received
2. From remainder, keep enough to cover company expenses (i.e. internal fees)
3. Use remaining funds to purchase financial derivatives (call options) providing upside exposure to linked index

Crediting Interest -- Translating Price Return into FIA "Return"

Floor

Participation Rate

Cap

Spread

Buffer

FIA Parameters

Variable Index Annuity
i.e. variable annuity

FIA Parameters Depend on…

Level of **interest rates**

How much is needed for principal protection?

What is the options budget?

Cost of **financial derivatives**

Factors for Options Pricing

Factor	Impact of Increase on Call Option Price
Implied Volatility	Increased volatility = more expensive option; most important factor
Current Index Price & Option Strike Price	Increased Strike Price = less payoff potential = cheaper option
Risk-Free Interest Rate	Increased interest rate = slight increase in price (But more than offset by larger options budget)
Term to Maturity	Increased term = more expensive option (but not linear)

Parameter Renewals for Each Term

Same process each term for insurance company

Buy bonds to protect principal
and buy derivatives for upside

Degree of upside depends on interest rates and option pricing factors – conditions change

Parameter Renewals for Each Term

Insurance companies must maintain the right to change parameters each term

Good companies will not take advantage of this (recommendation: examine renewal history)

Especially during the surrender charge period

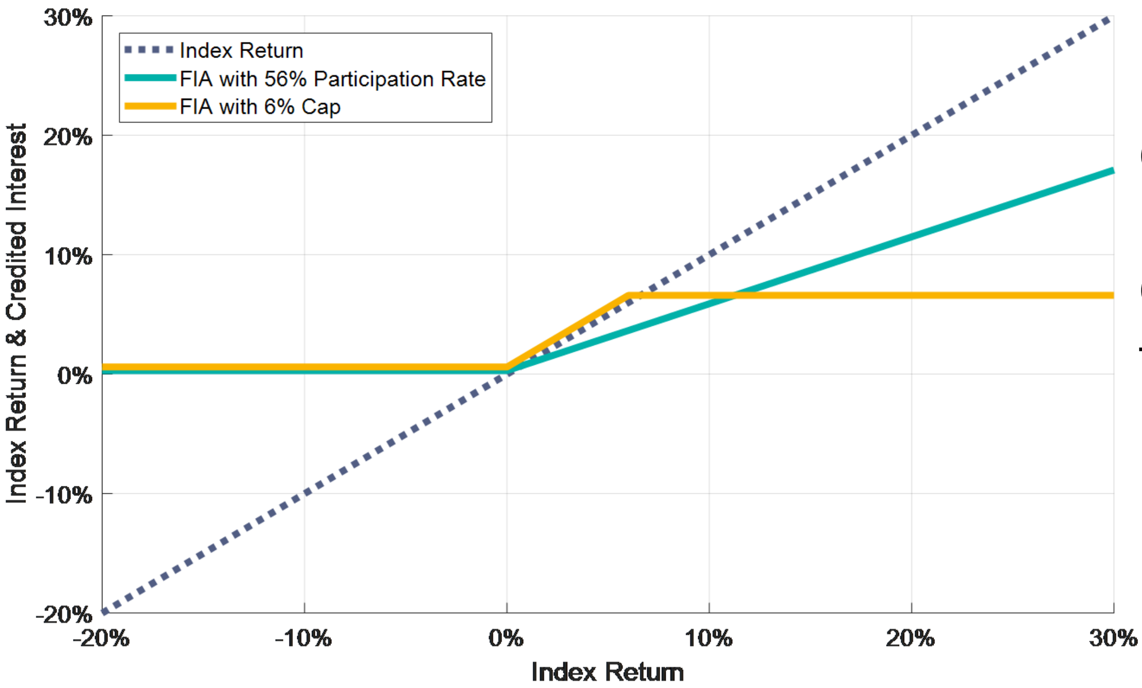
What is the best crediting method?

Once index returns are known, one method will perform best

But with competitive pricing,
the choice of crediting method should not matter
(can’t predict market returns)

Most important: how has the company treated its customers?

Comparing Crediting Methods: Cap Rate vs. Participation Rate



Participation Rate: 56%

Cap Rate: 6%

Cap rate is better for index price return between 0% and 10.7%. Participation rate is better if price return > 10.7%

Longer Term Length

(+) Current parameters locked in for longer

(+) More upside from financial derivatives

(-) No interest credited until term end

Step-up Opportunities

New high watermarks

Could be less common for FIAs

(Especially if cap rate is less than rollup or distribution rate)

Thus, focus on guaranteed income

Guaranteed Withdrawal Amount

GLWB

Withdrawal Rate **x** Benefit Base

Age at contract issue + deferral credit x length of deferral

Ex. 4.5% payout at issue; increases by 0.3% for each deferral year (i.e. 7.5% after 10 years)

Provides an alternative to using rollup rate
Step-ups are still possible (they may not be likely)

Guaranteed Withdrawal Amount

FIAs with GLWBs

can be **competitive** with SPIAs

Managing Risks for the Income Guarantee

With principal protection, longevity risk must be managed; not market risk

Adjust guaranteed payout rate

Adjust parameters to keep more reserves and provide less upside exposure

Adjust parameters at each new term to reflect market conditions

Increase optional living benefit rider fees

FIA as an Asset Class

FIA for accumulation without living benefits:

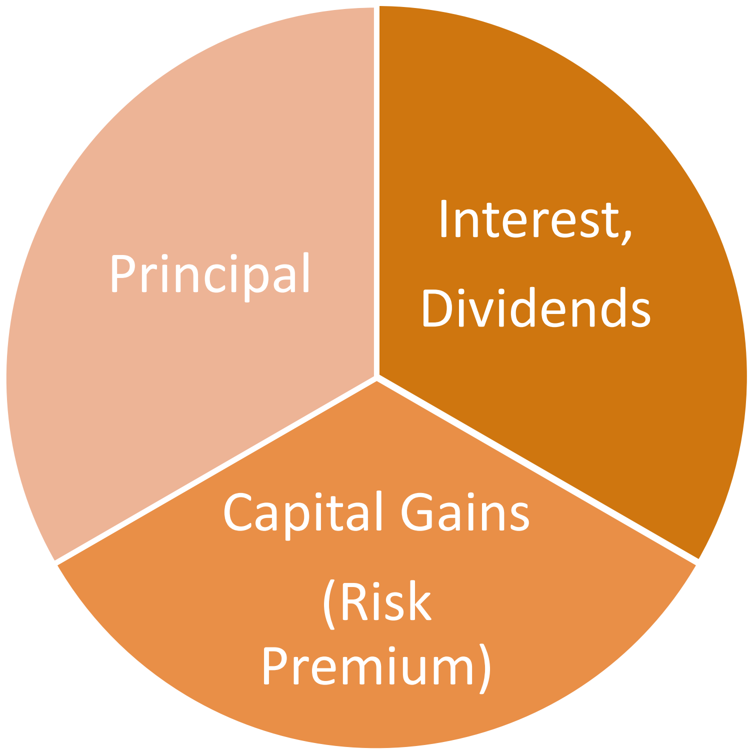
Principal protection

Competitive with bonds net of taxes

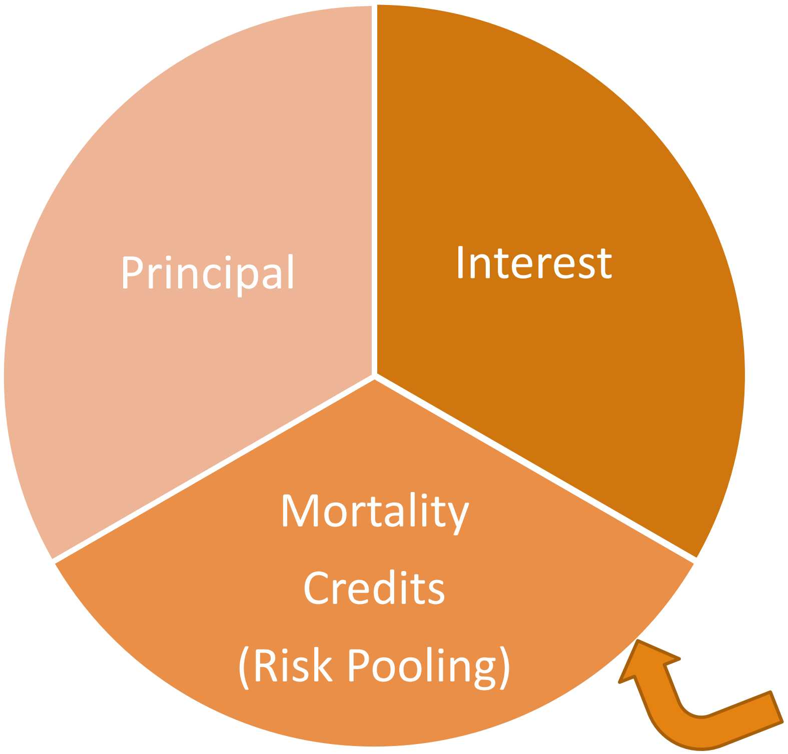
Not a stock replacement

Fitting Annuities into a Financial Plan

Sources of Investment Spending

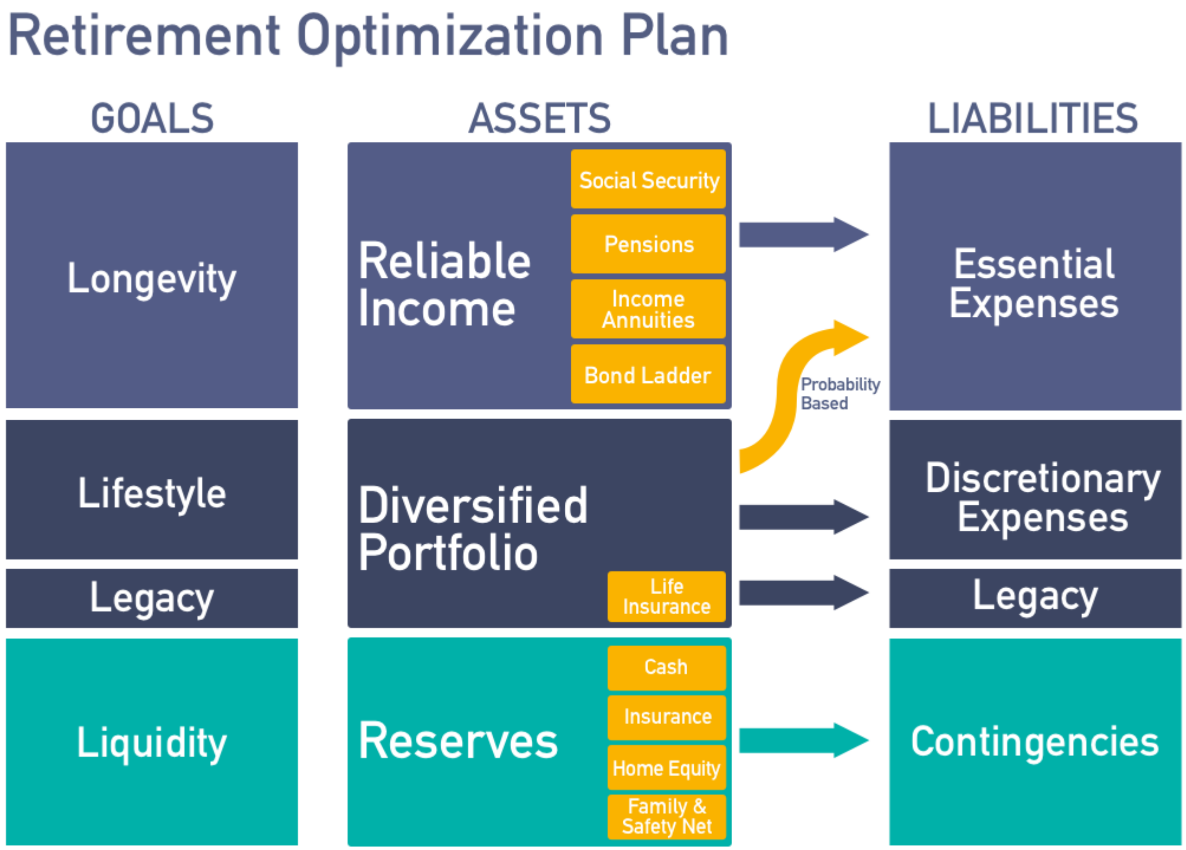


Sources of Annuity Payments



Survival-Weighted
Present Value of Cash Flows

How much to put into the Annuity?

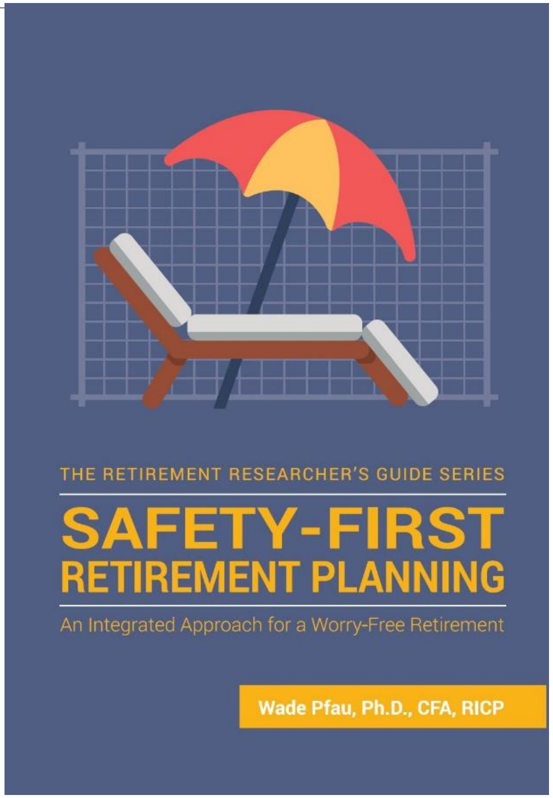


THANK YOU!
ANY QUESTIONS?

wade@retirementresearcher.com

@WadePfau (Twitter)

www.RetirementResearcher.com



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