American Academy *of* Actuaries
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Retiree Lifetime Income: Product Comparisons

The following is intended to give a high-level perspective on a few risks or aspects related to lifetime income. The American Academy of Actuaries' Lifetime Income Risk Task Force recognizes that not only is there no singular solution to the lifetime income risk challenge, even for a specific individual there could be several reasonable solutions.

Retirees can use many different insurance and investment products and strategies to create lifetime income. These products are categorized in the pages that follow into three groups: insured solutions, investment solutions, and hybrid solutions. Within each category are several available options.

For most individuals, no single option provides a complete solution. As such, the Lifetime Income Risk Task Force makes no recommendation for specific application to any reader's individual circumstances. Rather, those who are examining retirement options are encouraged to consider the range of existing lifetime income options currently available.

To better appreciate the relative advantages and disadvantages, we have created a rudimentary scoring grid with a scale of effectiveness from 0 to 4. Using this scale we have assessed five key components: longevity, inflation, credit/market, liquidity, and fees/expenses. Please bear in mind that the scoring is subjective and should be considered in light of comparison effectiveness.

Product Solutions	Examples	Longevity Guarantee	Inflation Protection	Credit Risk/ Market Risk Protection	Liquidity (access to funds)	Fees/ Expenses
Insured Solutions	Single Premium Immediate Annuity, Longevity Insurance (Qualified Lifetime Annuity Contracts)	Exceptional	Poor	Exceptional	Poor	Fair
Investment Solutions	Managed Payout Strategy/ Funds, Dividend Income Strategy, Bond Ladders	Good	Good	Good	Very Good	Good
Hybrid Solutions	Fixed or Variable Annuity with Guaranteed Living Benefits (GMIB, GLWB)	Very Good	Good	Very Good	Good	Poor

Exceptional   Very Good   Good   Fair   Poor

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Longevity Risk

Insured Solutions: (Grade: 4/4) – Insured solutions (mainly Single Premium Immediate Annuities (SPIAs) and Longevity Insurance, also called Deferred Income Annuities (DIAs)) are designed to provide protection against longevity risk for individuals. They have a very simple structure and provide policyholders an income for the remainder of their lifetimes, in exchange for an upfront premium. Longevity risk from the policyholder's perspective is completely transferred to the insurance company (this protection is proportional to the amount of coverage bought by the individual). Individuals concerned about longevity risk for themselves as well as for their spouses have different options, including joint survival options or simply buying an additional separate insured lifetime income solution policy for their spouse.

Investment Solutions: (Grade: 2/4) – Investment solutions encompass a wide array of possibilities. Broadly speaking, this methodology consists of buying different financial securities and establishing a withdrawal strategy to provide income during retirement. This category receives an overall 2/4 grade, but individual solutions can vary widely.

At one extreme, a retiree who put his or her funds in a savings account, accruing interest income every year and making high withdrawals of a fixed amount, runs a significant risk of running out of money before he or she dies and, consequently, faces high longevity risk. Such a strategy would get a grade of 0/4 in the longevity risk category.

At the other extreme, a retiree who put funds in a portfolio of securities and plans to live off the investment income generated by the securities in the portfolio (coupons of bonds, dividends from stocks, etc.) and never plans to deplete its capital, faces virtually no longevity risk. Such a strategy would get a grade of 4/4 in the longevity risk category.

In the middle, as mentioned above, there is a wide array of strategies. The key point to remember is that depletion of capital can be very tricky given the unknown variable of life span. Living standards and bequest goals need to be established, addressed and readjusted periodically.

Hybrid Solutions: (Grade: 3/4) – Hybrid solutions (mainly Guaranteed Lifetime Withdrawal Benefits (GLWB) attached to variable or indexed annuities, or Contingent Deferred Annuities (CDA) wrapped around mutual funds) are designed to provide a traditional "mutual fund" type investment solution for retirees with an added benefit that generally works as follows: a policyholder makes predetermined fixed systematic withdrawals from his or her account, and if the account value of the fund goes to zero, the policyholder is still entitled to receive the specified withdrawals until he or she dies. This solution provides good protection for individuals against longevity risk (of course this protection is proportional to the amount of coverage bought by the individual).

Inflation Protection

Insured Solutions: (Grade: 0/4) – Insured annuities are usually sold without a cost-of-living increase feature. However, some insurers offer annuity income for an additional premium that increases by a fixed percentage per year or based upon a cost-of-living adjustment factor. The additional premium in the case of a cost-of-living increase in the annuity could be expensive because the insurers need to hedge against unfavorable experience if high inflation occurs.

Investment Solutions: (Grade: 2/4) – The ability to secure increases in lifetime income streams will depend upon the composition of the portfolio. To the extent that the portfolio is weighted more heavily with Treasury Inflation-Protected Securities (TIPS), real estate, and growth equities, the portfolio may be better positioned to keep up with inflation.

Hybrid Solutions: (Grade: 2/4) – Alternative products will provide for different hedges against inflation. Guaranteed Lifetime Withdrawal Benefits (GLWBs) and Guaranteed

Minimum Income Benefits (GMIBs) can provide increasing income in return for starting with a lower income. If the underlying investment portfolio is weighted more in equities than fixed income, it should have more protection against loss of value as a result of high inflation; consequently, there can be greater income if the GLWB or GMIB is not exercised.

Credit Risk / Market Risk

Insured Solutions: (Grade: 4/4) – Insured annuities are issued by insurers and provide guaranteed payments. There is risk of non-payment or reduced payment, but that risk is mitigated by the strength of the insurer (its ability to pay claims) as well as requirements from regulators. There is no downside market risk associated with these guaranteed payments because the terms are fixed at issue.

Investment Solutions: (Grade: 2/4) – The composition of the portfolio largely determines the ability to secure stable continuous payments in lifetime income streams. To the extent the portfolio contains securities that could default or are exposed to market conditions, the resulting lifetime income stream is at risk of decreasing or stopping altogether. This risk can be mitigated by investing in high-quality bonds and stocks and by limiting market exposure. Additionally, if the strategy relies on liquidating part of the portfolio, the timing of any market movements (sequence of returns) could impact the resulting income stream or the length of the time the payments could be made.

Hybrid Solutions: (Grade 3/4) – The hybrid solutions issued by insurers provide the same level of credit risk as the insured solutions. These hybrid solutions can have market risk on the underlying portfolio; however, the income guarantees mitigate some of the risk.

Liquidity / Access to Funds

Insured Solutions: (Grade: 0/4) – These products are designed to maximize the amount of the guaranteed lifetime income by offering little to no liquidity benefits. An insurance premium is paid to the insurance company to purchase the product, which generally has no cash value.

Investment Solutions: (Grade: 3/4) – The investor generally maintains full access to the market value of the assets purchased, and can generally redeem that full market value on short notice.

Hybrid Solutions: (Grade: 2/4) – The investor generally has access to the cash surrender value, which is the market value of the underlying assets less a surrender charge if the assets are in an annuity. The guaranteed lifetime income benefit will be reduced or eliminated if the investor chooses to withdraw more than a predetermined amount of the underlying assets.

Fees and Expenses

Insured Solutions: (Grade: 1/4) – These products are sold through insurance agents and brokers, and typically include embedded fees for sales, marketing, and administrative expenses.

Investment Solutions: (Grade 2/4) – The products can be purchased directly from product manufacturers with relatively low fees. Alternatively, the products can be purchased from some financial advisers and may have potentially larger fees.

Hybrid Solutions: (Grade 0/4) – These products are available for purchase from insurance agents and brokers and typically involve implicit or explicit fees for sales, marketing, administrative expenses, and costs associated with managing the underlying assets. Additionally, there are fees associated with providing the lifetime income benefit guarantee.

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