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# NAIC Center for Insurance Policy and Research Symposium

## Lifetime Income Insurance Products and Emerging Issues

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June 16, 2015



# American Academy of Actuaries

The American Academy of Actuaries is a 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.



# Agenda

- Background
- Products
- Implementation
- Recent Regulations
- Initiatives to Consider
- Academy Lifetime Income Resources



# Background



# Insured Solutions History

- Historically, retirement plans used insured products (e.g., 412(i) plans)
- 401(k) plan growth empowered individuals to invest
- Individuals lacked an appreciation of the distinction between accumulation and decumulation strategies
- Financial advisor community favored investment solutions
- Insurers added variable annuities to their product mix
- Traditional insured income products lost favor; therefore, newer products were developed



# Insured Versus Invested

- Guaranteed or Predictable (assumption based)
- Counter Risk Party
- Automatic payout via insurance product design vs. payout managed by advisor
- Varying Downside Protection or Upside Potential
- Coexisting and Working Together



# Insured Lifetime Income Product Advantages

- May eliminate retiree longevity risk
- Eliminate retiree investment risk
- Incorporates longevity risk pooling
- Paycheck replacement
- Provides peace of mind



# Resistance to Using Insured Lifetime Income Products

- Die early the insurer “wins”
- Registered Insurance Advisors (RIAs) seldom recommend
- Fear of insurer failure
- High commissions
- Investment strategies are superior
- Impact on legacy goals





# Whether or Not To Use Insured Products

- Alternative product options now exist
- Relative strengths and weaknesses
- Individually driven decision
- Each retiree should consider alternatives
- Can complement investment strategies



# Products



# Single Premium Insured Annuities (SPIA)

- Also referred to as a fixed income annuity (FIA)
- Fixed amount payable for life
- Options for a minimum guaranteed payout period
- Options to provide a contingent (secondary) annuitant benefit
- Options reduce value of longevity risk pooling
- Can include a cost of living increase
- Not as attractive when interest rates are low
- Becomes more attractive with age



# Deferred Income Annuities (DIA)

- Also referred to as longevity insurance or longevity annuity
- Single premium annuity purchased at a specific age with the lifetime income starting far into the future at a longevity age (e.g., purchase at age 65, income starts at 85)
- Can provide a pre-longevity age death benefit
- Current products on market may not be competitively priced on an actuarial basis due to marketing costs and adverse selection concerns
- Attractive for those with strong family history of longevity or expectation for individual long life
- Relatively new product with several carriers in the market



# Other Annuities

- Deferred, variable, and fixed index
  - Differ based on investment return and guarantee
  - Primarily investment-oriented products
  - Have tax advantages when outside qualified retirement plan
  - Can be converted into a fixed income annuity



# Guaranteed Lifetime Withdrawal Benefit (GLWB) Rider

- Add-on to variable annuities
- Guarantees a minimum lifetime income amount, regardless of the performance of the policyholder account value
- Guaranteed income amount is a percentage of “benefit base”
- Benefit base determination varies by product
- Benefits paid regardless of how long annuitant lives



# Challenges With GLWB Riders

- Can be complicated to explain and understand
- Unscheduled withdrawals can reduce the guarantee
- May be restriction on underlying portfolio asset allocation
- Cost of rider can be considered expensive by some
- Some insurers have left the market due to the richness of the guarantee; most remaining insurers have introduced new product designs with less risk for insurer



# Guaranteed Minimum Income Benefit (GMIB) Rider

- Add-on to certain annuities (e.g., variable)
- Guarantees a future minimum fixed income
- Annuitant entitled to actual account value
- May be restriction on portfolio asset allocation
- Cost of rider can be considered expensive by some
- Some insurers have left the market due to the richness of the guarantee; most remaining insurers have introduced new product designs with less risk for insurer





# Contingent Deferred Annuities (CDA)

- Also referred to as a stand along living benefit, a wrap annuity, or other similar names.
- Similar to GLWB, but policyholder does not purchase a base annuity contract
- Written on a managed pool of investments
- There will be restrictions on assets wrapped or guaranteed in the portfolio
- Pricing depends on risk profile of investments
- Not widely available



# Implementation



# Advisors

- Many advisors are focused on investment advice
- Compensated based on the assets under management (AUM)
- Could be fee or commission-based
- Many lack skill in the retirement decumulation phase
- Fixed income annuity or deferred income annuity purchases reduce AUM
- This could lead to inadequate or biased advice



# FIA Incorporation With an Investment Strategy

- Common approach to generating retirement income is the 4% rule
- Does not guarantee sufficient lifetime income
- Based on systematic withdrawals from a portfolio
- Portfolio is based on an asset allocation (e.g., 60/40)
- FIAs can be used as the fixed income portion
- This can enhance the probability of success
- Success is achieved if payouts last a predetermined period



# DIA Incorporation With an Investment Strategy

- Investment strategy requires projecting life expectancy (LE)
- DIAs can be used to replace the uncertain LE with a fixed period
- This simplifies the investment approach
- Retirement financing is thus viewed in two phases
- Up to and following the DIA “longevity age”



# Recent Regulations



# Qualified Longevity Annuity Contracts (QLAC)

- Longevity annuities may violate RMD rules (age 70½)
- IRS published final QLAC regulations on 7/1/14
- QLACs permitted under DC plans and IRAs
- Cannot have longevity age beyond 85
- Must be a fixed life annuity, no surrender value
- Can have a joint/survivor or return of premium provision
- Premium must be lesser of \$125k or 25% of balance



# Deferred Annuities (DA) Under Target Date Funds (TDF)

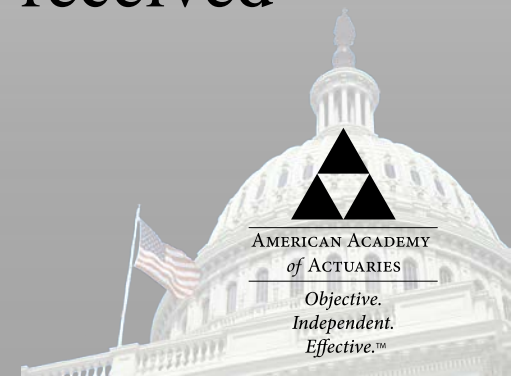
- Qualified plans may not discriminate in favor of highly compensated employees (HCEs)
- Older employees tend to be more HCE concentrated
- TDFs at older age bands are more inclined to incorporate DAs
- This could create discrimination by providing an additional benefit to more HCEs
- IRS Notice 2014-66 provides limited relief from this discrimination issue





# U.S. Dept. of Labor (DOL) Proposed Regulation on DC Plan Employee Statements

- No current requirement to show a retirement income
- This could affect how much employees contribute
- This could affect investment selections
- Might also affect how long an employee plans to work
- DOL has proposed requiring a lifetime income projection
- DOL is currently assessing the comments received



# Challenges to DOL Proposed Regulations

- Issues include whether to use a current or future balance
- Issues include selection of assumptions
- Should projections be based on insured or investment income
- Legislation has been introduced in Congress that would require lifetime income projections on employee statements
- Such legislation would require that the DOL issue final regulations



# DOL Proposed Regulation on Advisor Conflict of Interest

- DC and IRA participants seek financial advice
- Professional standards differ between RIAs & brokers
- DOL regulations would alter this inconsistency
- All advisors serving plan and IRA clients would be fiduciaries
- Goal – to enhance advice and reduce fees/commissions
- Would lifetime income advice be enhanced?
- Academy Lifetime Income Task Force comment letter expected



# Initiatives To Consider



# Improvement in Retiree Financial Literacy

- Employers, DOL & Consumer Financial Protection Board
- Better understanding of available products and approaches
- Improved appreciation of longevity risk
- Improved understanding of risk pooling
- Enhanced public awareness of insurance product security (e.g., existence of state guaranty associations)
- Clearer understanding of adviser qualifications or biases



# Lifetime-income Friendly DC Plan Changes

- DOL, IRS & Congress should consider action
- Safe harbors covering lifetime income options
- Safe harbors provide employers with fiduciary relief
- Plans offer expertise and buying power
- Elimination of unisex requirements in qualified plans
- Sex-distinct annuities may be more competitively priced than unisex annuities



# Secret Sauce Research

- Is there an optimal insured/investment combo?
- No universal one exists
- Competing goals: satisfy spending needs & preserve assets
- Must consider individual circumstances & preferences
- Modeling solutions require assumptions: longevity, asset returns, fees, etc.
- Challenge represents an area for growing research
- Still require knowledgeable and unbiased advisors



# Academy Lifetime Income Resources

- Academy Lifetime Income Initiative Webpage
  - <http://actuary.org/content/lifetime-income-initiative>
- Risky Business Discussion Paper
  - [http://www.actuary.org/files/Risky-Business\\_Discussion-Paper\\_June\\_2013.pdf](http://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf)
- Risky Business Capitol Hill Presentation
  - [http://www.actuary.org/files/Risky-Business\\_Hill-Briefing\\_June-27-2013.pdf](http://www.actuary.org/files/Risky-Business_Hill-Briefing_June-27-2013.pdf)
- Pension Committee Letter on Proposed Lifetime Income Benefit Statements
  - [http://www.actuary.org/files/PC\\_Comments\\_DOL\\_lifetime-income-statements-ANPR\\_Aug-7-2013.pdf](http://www.actuary.org/files/PC_Comments_DOL_lifetime-income-statements-ANPR_Aug-7-2013.pdf)





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