Retirement Alpha

How Mortality Credits Improve Retirement Outcomes

By Tom Hegna
CLU, ChFC, CASL

RETIRE HAPPY NOW

www.RetireHappyNow.com

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1

IT'S ALL ABOUT ALPHA — RETIREMENT ALPHA, THAT IS!

In writing my book *Paychecks and Playchecks*, I spent months devoting myself to reading hundreds of academic and research white papers on Retirement. Nearly every single document stressed the importance of Guaranteed Lifetime Income in Retirement. It became crystal clear to me that any Retirement solution that did not include some form of Guaranteed Lifetime Income would be suboptimal — that is, less than what it could or should be.

> *"If you get nothing else out of this paper, get that you MUST take longevity risk off the table."*

So this white paper is really nothing more than a compilation of many of these research papers, along with my notes and experience in this field. For me, writing the book *Paychecks and Playchecks* was really an evolutionary process. I have been in this field for 25 years and specifically focused on the Retirement Income Market for over a decade. I was a Senior Executive Officer of a Fortune 100 company and was a popular seminar and client appreciation speaker for many years. Whenever I finished a seminar, someone would inevitably say to me, "You should write a book." Within a few years, I became a Main Platform speaker for some of the biggest venues of the Financial Services Industry. When I would finish my talk, people would rush up to me and ask, "Where is your book? I want to learn more!" Well, at that point I didn't have a book.

In 2011, I finally decided to write that book. The purpose of this white paper is not to summarize or replace it. You would miss so many unique ideas and specialized solutions to specific problems if you didn't read the book. This paper is really to dig deep into the bottom line of why you have to have some Guaranteed Lifetime Income in your Retirement Portfolio.

See, many people think the success of your Retirement is based on some "number." Now, obviously, the bigger your number, the more opportunities you will have in Retirement. However, what is really important is what you do with that number. The success of your Retirement will really depend on two simple factors:

(1) How much Guaranteed Lifetime Income you have.

(2) If you have taken the key Retirement Risks off the table, such as inflation, long–term care, market risk and longevity risk.

While researching the book, I discovered absolute nuggets of gold. Retirement gold! For example, I discovered that ONLY the life insurance industry can solve the retirement crisis that the Baby Boomers face. See, there are many risks in retirement — market risk, order of return risk, withdrawal — rate risk, inflation, deflation, risk of death, risk of long–term care. There are a lot of risks! But the number-one risk — by far — is longevity risk. Now, living a long time is NOT a bad thing. It is a wonderful thing. And medical technology is developing so rapidly that many of the people reading this paper will live MUCH longer than planned.

But living a long life multiplies the other risks. See, if you retire at age 65 but then die at age 68, it doesn't matter if the stock market falls 3,000 points. It doesn't matter if you were withdrawing 10% per year or that you forgot to buy a long–term care policy — you didn't live long enough for it to matter. However, if you live to be 85, 90 or 95 — it is all of those other risks that could wipe you out. So what math and science say is that you have to take longevity risk off the table. If you get nothing else out of this paper, get that — you must take longevity risk off the table.

1. IT'S ALL ABOUT ALPHA — RETIREMENT ALPHA, THAT IS!

Only an Insurance Company can do that. Stocks can't do it, bonds can't do it, CDs can't do it. Only some form of an Annuity can do it — a Lifetime Income Annuity, a Deferred Lifetime Income Annuity, or a living benefit rider on a Fixed or Variable Annuity. That is it! But here is WHY only an insurance company can do it. See, the Life Insurance Industry is on both sides of the Longevity Risk scale. Therefore, they have a natural hedge that protects them in a way no other industry is protected.

This has everything to do with mortality credits. All of you already own Mortality Credits —you just don't know it. You call it life insurance. See, you experience Mortality Credits with life insurance through low premiums when you're young. For example, a 20–year–old could write a check for $25 to an insurance company, later that afternoon accidentally step in front of a bus, and the insurance company would pay a $1 million death claim. How can they afford to pay $1 million if they only got one check for $25? Because they know that not a lot of 20–year–olds are going to accidentally step in front of a bus. It is those same Mortality Credits that can guarantee a 90–year–old man nearly 20% per year for the rest of his life with a Lifetime Income Annuity.

The risk when an insurance company sells a Life Insurance Policy is that someone will die too soon. The risk when they sell a Lifetime Income Annuity is that someone will live too long. Because they are on both sides of that risk, they can neutralize Longevity Risk to themselves and to the client. Let me explain it a different way. Many people believe that medical technology will continue to increase at a rapid pace. If people start living to 120 or 150 years of age, you may think that the insurance companies would go broke since they are guaranteeing income for life. However, they won't be paying death claims on their Life Insurance Policies. Similarly, if an epidemic wiped out a portion of the population, they would be paying an increased number of death claims, but wouldn't be paying Lifetime Income on those people. All of this has everything to do with Mortality Credits and Risk Pooling. For more detail on Mortality Credits, read my book *Paychecks and Playchecks*.

Now, one of the turning points in my research happened when I went through the Financial Research Corporation (FRC) white paper that they did for New York Life Insurance Company in 2010.[1] This quote really struck me: "***Income Annuities offer features others can't — high cash flow, uncorrelated-to-market returns; retirement alpha in the form of mortality credits, which only life insurance companies can manufacture; longevity hedging and liquidity features."*** If you think about it, ALPHA is the extra return that a portfolio manager brings to the performance of a portfolio. But "Retirement Alpha" was something I had never heard of before! The Mortality Credits of a Lifetime Income Annuity were a form of ALPHA! That was an "a–ha" moment for me.

In this low–interest rate environment, CDs and Bonds are not going to give the "alpha" necessary to provide adequate income to retirees. Stocks have been so volatile that most retirees do not want to put their money at risk, and the order of returns will lock in losses for the seniors who are withdrawing money from stock portfolios. The stock market just isn't providing adequate "alpha" — at least not on a consistent basis. So what is a Retired person supposed to do? Utilize "Retirement Alpha" by using Life Insurance and Guaranteed Lifetime Income from a life insurance company! Let me now prove that to you…

1. IT'S ALL ABOUT ALPHA – RETIREMENT ALPHA, THAT IS!

When you ask most people how much money they want to leave their children or grandchildren, many of them say, "Well, I guess whatever is left over when we die…" Okay, but is this the most efficient way to transfer assets? I don't think so. Additionally, many Seniors live a diminished Retirement because, in the back of their minds, they want to "leave something for the kids." I discuss this further in my book. I ask people if they have done all the things that they said they were going to do in Retirement. They said they were going to buy a boat, join the country club, and take a cruise around the world. I ask them, "Have you done that yet?" The answer: "No, we need to keep this money — just in case. Just in case. Just in case." See, these people are living what I call a "just–in–case retirement!" So they don't spend their money; they don't spend their money; they don't spend their money — then what happens? They die. What happens to the money? It goes to their kids. What do they do with it? THEY buy the new boat, THEY join the country club, THEY take a cruise around the world!

See, why not decide UP FRONT how much to leave the kids? Then, for PENNIES on the dollar, use Life Insurance to go to the kids income- and estate-tax-free! You get the leverage of MORTALITY CREDITS offered by the Life Insurance Policy. Then you can buy Guaranteed Lifetime Income — receiving DOLLARS for pennies from the leverage of MORTALITY CREDITS offered by the Annuity! Do you see how Life Insurance and Guaranteed Lifetime Income are tied together?! This is the new "Retirement Alpha" that is the key to success in Retirement.

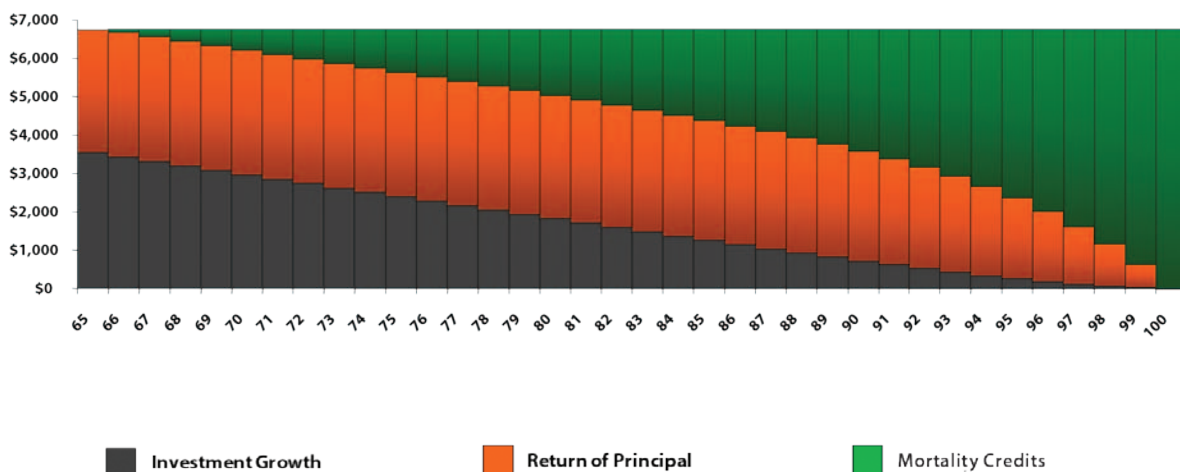
2

OTHER PEOPLE'S MONEY

Here is another way to think of mortality credits: a financial advisor told me that many of his clients had not saved enough money for retirement. There was no way that they could use stocks, bonds, or cds to withdraw enough money without a high probability of running out of money. He told his clients the best chance they had was to pool their money with a group of other people who also had not saved enough. If they all selected "life-only" payouts, the payout rates would be high enough for them to have a decent chance at a successful retirement. As people died, some of their money, in effect, went to those who were still alive. The financial advisor called the mortality credits "other people's money." These people had decided it would be better to "leave some money on the table" if they died early, rather than running out of money while alive. I believe, unfortunately, that many Baby Boomers will find themselves in a similar situation.

Components of Lifetime Income Payout

Male age 65, $100,000 investment



New York Life Insurance Company, 2009.

There are three parts to a lifetime income annuity paycheck. The first part is principal — the orange in the middle of the chart above. The second part is interest, or investment growth, which is the lower dark portion. The extra income is indicated in the green area. Investment advisors using stock or bond funds can give you both principal and interest. But what they cannot do without an insurance company is pay mortality credits, the extra income indicated in the green at the top.

2. OTHER PEOPLE'S MONEY

If you have ever heard me speak, then you have no doubt heard me talk about the "math and science" of a proper Retirement. The person I quote most often is Dr. Menahem Yaari. If you do some research on Dr. Yaari, you will find that he had really set the economic world on fire with his analysis of consumer behavior and Lifetime Income Annuities. In a 1965 article,[2] he put forth the theory that a retiree who wanted to maximize his income would put all of his money into a Lifetime Income Annuity. According to Dr. Yaari, there was no alternative that could guarantee a more "optimal" solution. The reason has everything to do with Mortality Credits. The Risk Pool can pay more than a person trying to maximize income on their own. Now, I am not recommending full annuitization because Dr. Yaari assumed that the retiree would not consider passing on money to his or her heirs.

The benefits of an Annuity–heavy portfolio are reiterated, 40 years later, in a study called "Annuities and Individual Welfare."[3] While the authors give possible reasons for not fully annuitizing a portfolio, they prove that, in most cases, significant investments in Annuities were optimal. The low utilization rate of Annuities by U.S. retirees was not rational and was "plausibly due to psychological or behavioral biases."

3

A SHIFT IN TIME

"For those over age 70 or 75, the evidence is really overwhelming on the side of annuities."

One of the modern–day heroes of Retirement Income is a gentleman by the name of Moshe A. Milevsky. He has written many pieces on the importance of using Annuities in Retirement. In one of his articles,[4] he said that the way most people have taken money in retirement historically was by using a well–diversified portfolio of stocks, bonds, real estate, and the normal investment classes, then withdrawing a fixed amount from principal, dividends, and interest. However, this "do–it–yourself" strategy will likely fail if you live too long or continue to withdraw money during an extended bear market.

Milevsky went on to state in his paper, as many revered analysts have before and since, that very few people actually annuitize their wealth even though countless studies have shown that this is exactly what they should do. Where Milevsky's study really differs from others is in its attempt to determine when and how much a person should invest in annuities. For those over age 70 or 75, the evidence is overwhelming on the side of Annuities. However, for those younger than age 70, Milevsky makes a case for delaying annuitization, that the internal "load" or cost of the contract may not outweigh the benefits of the Mortality Credits. I will also say that this paper was written prior to the lost decade of the stock market from 2000–2010, and the increased volatility of recent years.

Milevsky also wrote a paper with Virginia R. Young,[5] which built on his earlier paper, but made some amendments. First, it highlighted that the more risk tolerant someone is, the more they may want to delay shifting to annuities. Conversely, the more conservative an investor is, the earlier they would want to annuitize. This paper also talks about Variable Immediate Annuities, which I mention in my book. They are quite rare, but you should keep your eye on these. Because Variable Immediate Annuities entitle you to market participation, it may not pay to delay investing in them. I will say, again, that this paper was written prior to all of the market volatility that we have experienced in recent years.

4

THE EMERGING CONSENSUS

George Bernard Shaw once said, "If you laid all the economists end to end, they still wouldn't reach a conclusion." David Babbel, professor of the Insurance and Risk Management Department and Finance Department at the University of Pennsylvania, proved that Shaw's time–honored quote no longer holds true when it comes to using Annuities for a "substantial portion of retirement wealth." Economists from coast to coast now agree that Annuities are the best way to go. "The list of economists who have discovered this includes some of the most prominent in the world, among whom are Nobel Prize winners," Babbel and Craig Merrill wrote in 2007.[6] The tremendous value that Annuities provide in Retirement seems to be an area where most economists agree.

Babbel and Merrill go on to say that you should start by covering 100% of your "minimum acceptable level of retirement income" with Annuities. This approach provides the most cost–effective and practical way to provide security in Retirement. Even after covering these basic expenses, you will still need to put a significant amount of your remaining portfolio in Annuities, while still investing some in stocks, bonds, and money market funds. I would add to this slightly, because I believe extra attention needs to be paid in the optimization phase to inflation–protected investments like gold, silver, oil, and real estate. Like Milevsky, Babbel says that while they can certainly complement the portfolio, stocks and bonds are no substitutes for Annuities.

> ***"Economists from coast to coast now agree that annuities are the best way to go."***

5

A SMALL PRICE TO PAY

For those of you who believe that Annuities cost too much, Professors Babbel and Merrill have some food for thought. The market for Annuities has become so competitive that the fees, called "loadings", are extremely low. When you compare the one–time 0%–5% internal loading with the 1%–2% annual fees charged by mutual funds and managed money or back–end charges, which can be as high as 8%, the Lifetime Income Annuities compare very well. They also remind readers that Lifetime Income Annuities offer guaranteed income for life — something that mutual funds or managed money cannot do.

When asked if it would not be cheaper to cut out the insurer and create a "homemade" strategy, Babbel and Merrill reply that it would be great if something like that existed, but at this point, it is a fantasy. They could not find people saying the same thing about life insurance. And why not? Because it takes an insurance company to be able to group a large enough risk pool of thousands of people all paying premiums. These premiums fund the death benefits that go to the people who die prematurely. The exact concept, in reverse, is what insurance companies do with Lifetime Income Annuities.

As far as giving up control of some of the funds, Babbel and Merrill argue that far from being a disadvantage, giving up some control for Guaranteed Income is actually a smart move. Many people get frail as they age; their judgment becomes impaired. Think of how many older people have been taken advantage of not only by strangers, but by their own families. They become vulnerable to pressure to help their children and others with their retirement funds. Many people have lost everything in cases like this. Annuities also reduce the risk that people will withdraw too much and overspend. Babbel and Merrill conclude, "Sometimes we pay a very high price for maintaining what we think is control."

"Sometimes we pay a very high price for maintaining what we think is control."

6

A CLASS BY THEMSELVES

As far as optimizing Retirement Income and Retirement Security are concerned, DeMonte and Petrone emphasized that their analysis found that there was no other investment vehicle — none — that could match the Income Annuity for providing Retirement security. No other investment vehicle was as efficient in creating Retirement Income from assets. They went on to say that no other investment could generate more income per dollar of capital than the Income Annuity, and that they "perfectly hedge Longevity Risk." Now, think about what they are saying — there is no other vehicle that rivals the Income Annuity for providing income and peace of mind in Retirement!

Many financial planners and brokers use age 90 as the maximum age for Retirement Income Plan illustrations. I believe that they do this because their plans will not hold up much beyond that. Even though most people do not think that they will live to age 90, the facts are very different. Keep in mind that 33% of men, 44% of women, and 63% of married couples will have at least one of them live beyond age 90. Therefore, if you are married and you set up a financial plan that will last until age 90, that plan will fail 63% of the time.

DeMonte and Petrone also looked at using other sources of income instead of Income Annuities. Their focus was on successful outcomes. They found that because of the mortality credits paid from a Lifetime Income Annuity and the guarantee of lifetime checks, Longevity Risk is taken off the table. This, more often than not, ensures a successful outcome using a Lifetime Income Annuity.

> ***"There is no other vehicle — none — in the market today that rivals the income annuity for providing income and peace of mind in retirement!"***

“We have proven that even a well–constructed moderate portfolio is likely to fail over the long term if investors get aggressive with withdrawal rates, as many will.”

7

DON’T RETIRE WITHOUT ONE

Few financial advisors have made the transition from accumulation to distribution. They still use systematic withdrawals from diversified portfolios or bond ladders to provide income. These investment vehicles subject their clients to Market Risk, Interest–rate Risk, Withdrawal Risk, Order of Return Risk, and, most significantly, Longevity Risk. To those advisors, the FRC report says, “We have proven that even a well–constructed moderate portfolio is likely to fail over the long term if investors get aggressive with withdrawal rates, as many will.” What is aggressive? Today, a 4% or higher withdrawal rate is considered aggressive.

DeMonte and Petrone go on to say that financial advisors have the obligation of ensuring that their clients have successful financial outcomes, no matter the economic storms we face. High inflation, market downturns, and medical advances in longevity are all examples of these storms. My question is a simple one: If a financial advisor does not use a Lifetime Income Annuity, then optimizes the rest of the portfolio with an eye on inflation, how can they do that? The answer is, they can’t.

The FRC report adds that most investors do not understand the secret sauce of income annuities — namely, the mortality credits: Think of it as a new form of alpha or investment return. Only life insurance companies can manufacture mortality credits. It is these mortality credits that allow a lifetime income annuity to have such high guaranteed payouts. No other investment can do this. That simply means that you cannot use futures, options, hedge funds, or any other vehicle to do what the lifetime income annuities can do!

Here is something interesting: did you know that the life insurance industry has a limited amount of mortality credits and therefore has a limited number of lifetime income annuities it can sell? This was news to me! I did not realize that the supply of Income Annuities is limited. Therefore, in 10 or 15 years, these products may be priced very differently than they are today.

As a demonstration of the significant income possibilities using a Lifetime Income Annuity, the FRC report said, “Currently, income payout rates from AAA insurers for a 75–yr–old male are at 8.9%, a 770 bps spread over the 1.2% 5–year Treasury.”

7. DON'T RETIRE WITHOUT ONE

DeMonte and Petrone also noted that this product is perfect for the Baby Boomers who will be retiring in record numbers. They are coming into Retirement with damaged portfolios. The credit crisis, dot–com dot–bomb, housing bubble, and euro crisis have really done a number on them. They will be seeking guarantees and less risk, and will be drawn to the high guaranteed income offered by Lifetime Income Annuities.

For people who tend to shop for the highest payout rate, the FRC report cautions that ratings for Lifetime Income Annuities are even more important than ratings on bonds, since you are tied to a Life Insurance company for the rest of your life. It would be a big mistake to go with a lower–rated insurance company to try to squeeze out an extra $15 a month. The financial strength of the insurance company should be paramount in the buying decision. As Babbel has noted in his studies, the financial strength of the insurer is very important. The website SeekingAlpha.com puts it this way, "There are no more guarantees, only guarantors."

I do not want this to be a technical, geeky paper. But I have to provide enough evidence for you to feel comfortable with my research. For those who want to do more research, there are many websites you can go to for more technical information.

"There are no more guarantees, only guarantors."

The FRC report found the following about adding a Lifetime Income Annuity to a diversified portfolio: The portfolios that did not contain an Income Annuity significantly underperformed the portfolios that had a Lifetime Income Annuity. Look, there is a simple test that you can do to try to prove all of this research wrong. Take any diversified portfolio with both stocks and bonds, remove some of the bonds, and replace them with a Lifetime Income Annuity. You know what it will do to that portfolio? It will reduce the risk and increase the returns! Here is why: When you add a lifetime income annuity to a portfolio, it functions like an AAA bond with a CCC yield and zero standard deviation or volatility. Try it. See if you can prove me wrong.

"The financial strength of the insurance company should be paramount in the buying decision."

8

INSURE YOUR INCOME

In November 2012, Matthew Drinkwater, Ph.D., FLMI, AFSI, PCS, and Jafor Iqbal, both Associate Managing Directors, wrote a paper for LIMRA in Retirement Research titled "The Case for Income Annuities in Retiree Portfolios." In their paper, they specifically looked at the results of using an Annuity in Retirement versus the old "do it yourself" strategy of a systematic withdrawal from a diversified portfolio. In fact, they said, "the SWP at 4.0 percent withdrawal strategy has come under serious doubt by many financial experts as a sustainable income approach for the future." They went on to quote *InvestmentNews* on January 22, 2012 saying, "Some planners have moved to a 3.5 percent or 3.0 percent rule for their clients."

With the uncertainty that retirees face on how long they will live, what type of returns they will receive, and the impacts of future taxes and inflation, the mortality credits offered by a Guaranteed Lifetime Income Annuity become even more powerful. See, when people try to compare an Income Annuity to an investment, they always struggle. They ask, "What is my internal rate of return?" I smile and answer, "What do you want it to be?" I then explain that the insurance company does NOT set the internal rate of return of a Lifetime Income Annuity — the client does — by how long they live! If you want a higher internal rate of return, just live longer.

But that gets me to another point. You shouldn't really think of the Income Annuity as an investment — it is really income INSURANCE. It guarantees that you will never run out of money. What is that peace of mind worth? No other investment can give you that. Read the section on being HAPPY in Retirement: The happiest people in Retirement are those who are receiving Guaranteed Paychecks for life! But this section really tries to show that while systematic withdrawal plans from a portfolio are fine for covering discretionary expenses, they are suboptimal for covering basic expenses in Retirement.

History shows us that a retiree starting their Retirement in 1969 with $500,000 invested in a balanced portfolio ran out of money in 22 years with a beginning withdrawal rate of 4.5%. Yet a retiree starting in 1970 — just ONE year later — ended up with nearly $1,000,000 after 22 years of using the same withdrawal method![7] How can this be? It is due to the order (or sequence) of returns. This is a key concept to understand. Dr. Babbel of Wharton referred to it in one of his white papers as "reverse dollar cost averaging." See, the money you withdraw in a down market is gone. It can never earn back what it lost. Not only that, you have to withdraw more shares since the market is down to take out the same amount of money. It only takes a few consecutive down years to put your portfolio into a tailspin. LIMRA did a study in 2009 titled "Liquidity and the Value of Annuitization," where they showed how adding an Income Annuity to a portfolio increased the longevity of the portfolio in a down market.

To investigate whether Lifetime Income Annuities do have a comparative advantage over systematic withdrawal plans, LIMRA looked at a number of scenarios. The following charts assume a male annuitant, life-only payout, with rates from https://www.newretirement.com/services/annuity_calculator.aspx, (effective as of February 14, 2012). For simplicity, they assumed that the annual rate of return would be constant across the years. Unfortunately, this is the same assumption that many investors make since it completely removes one of the key risks — the order of returns.

The first chart simply compares an Income Annuity to a systematic withdrawal plan. It shows the rate of return necessary each year to match the guaranteed payout of the income annuity. Now two things to note — the order of returns is not present and the payout stops at age 95. Remember that 25% of married 65-year-old couples will have one spouse live to age 97!

Fixed Income Annuity vs. Systematic Withdrawal Plan Method

Male	Payout Ratio from a Fixed Income Annuity	Minimum Annual Return Required from SWP Portfolio to Match Annuity Income			
		Investment Horizon	SWP Method Net of Fees	SWP Method with 100 bps Fee	SWP Method with 200 bps Fee
Age 60	5.82%	35 years, up to age 95	5.005%	6.066%	7.148%
Age 65	6.31%	30 years, up to age 95	5.180%	6.242%	7.326%
Age 70	7.31%	25 years, up to age 95	5.905%	6.975%	8.066%

LIMRA 2012 [8]

Then they looked at an Income Annuity that provided an annual payout that increased 3% every year to hedge against inflation. They compared that to the required annual rate of return from a portfolio needed to match the exact amount of income provided by the Income Annuity for 25, 30, and 35 years for ages 60, 65, and 70.

3.0 Percent COLA Income Annuity vs. Systematic Withdrawal Plan Methodn

Male	Payout Ratio from a 3.0% COLA Annuity	Minimum Annual Return Required from SWP Portfolio to Match Annuity Income			
		Investment Horizon	SWP Method Net of Fees	SWP Method with 100 bps Fee	SWP Method with 200 bps Fee
Age 60	4.56%	35 years, up to age 95	6.159%	7.232%	8.326%
Age 65	4.94%	30 years, up to age 95	6.074%	7.145%	8.154%
Age 70	5.60%	25 years, up to age 95	6.142%	7.214%	8.308%

LIMRA 2012 [9]

LIMRA also did a similar analysis using a Monte Carlo simulation instead of static returns. They again found that by adding a Lifetime Income Annuity to the portfolio, the odds of the portfolio lasting through Retirement increased. They concluded, "We believe the time has come to integrate income annuities into most households' portfolios. The concept of safe withdrawal or drawdown rates practiced is based on historical rates of return, and there is no assurance that future investment returns will match historical returns. The drawing down from a portfolio also means assets invested in stocks and bonds need to be managed prudently over an unknown number of retirement years. Income and assets invested, therefore, remain exposed to the uncertainty in financial markets. Income annuities can relieve retirees of the effort and anxiety of managing their investments at older ages when their mental and physical capacity to do so may diminish."

This finding matches what the FRC white paper concluded as well: "The income annuity-enhanced portfolios significantly outperformed the conventional portfolios. Conventional portfolios are not likely to deliver the desired income to the investor at inflation-adjusted withdrawal rates in excess of 4%." They finished by saying that income annuities allow "retirees to generate more income with the same amount of assets."

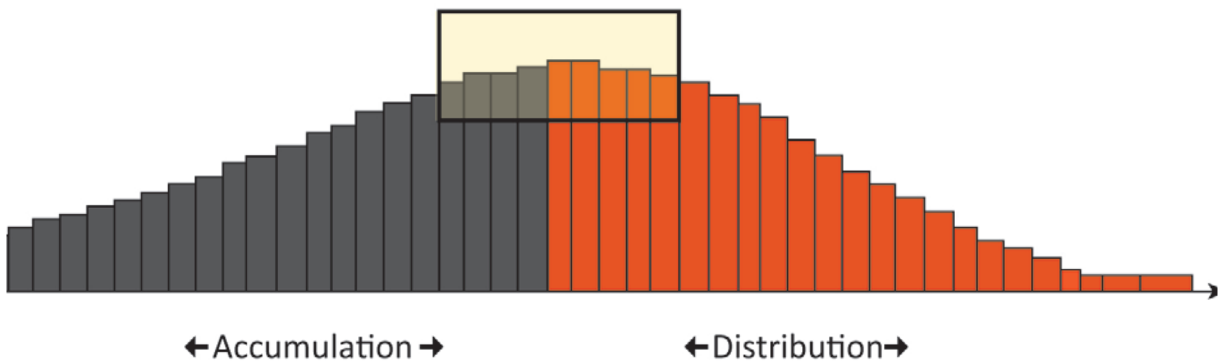
9

A "MUST READ" FOR WOMEN

In July 2008, Dr. David Babbel wrote a piece titled "Lifetime Income for Women: A Financial Economist's Perspective."[10] He starts with a story about a couple attending a sporting event. He found out that the husband had been educated at a top American university. He enjoyed a very successful career. Shortly before retirement, his company changed from a Defined Benefit Pension Plan to a Defined Contribution Plan. When he retired, he took a generous lump–sum settlement. His nephew convinced him to invest almost all of it into a promising new opportunity that the nephew would personally manage. Well, as you might expect, things went south quickly and they basically lost his entire retirement savings. To make things worse, his health began to fail. Now, the wife, at age 66, had to get her first job! They had to remortgage the house. She now hopes to be able to retire at age 81 — not quite the retirement of their dreams.

Many people think that the older you are the riskier the market is. That is not true. In reality, the riskiest time to invest your money is the five or six years BEFORE retirement and the five or six years AFTER retirement. Losing money in this time frame can devastate your retirement, as Dr. Babbel so eloquently explained.

Market Risk is Greatest in the Years Just Before and After Retirement



New York Life Insurance Company, 2011.

9. A "MUST READ" FOR WOMEN

Babbel goes on to highlight FIVE overwhelming forces bearing down on women.

"Currently American women face:

(1) Decreasing rates of return on their Social Security contributions (averaging 1.8% per year for single women – *Source:* Social Security Administration)

(2) The accelerating demise of defined benefit pensions (150,000 pension plans, which would have provided lifetime income security, have been discontinued since 1983, leaving less than 25,000 plans today, many of which plan to close within two years – *Sources:* Pension Benefit Guaranty Corporation, Employee Benefits Research Institute, Mercer)

(3) The transition of the Baby Boom generation into retirement (the first Boomers reached retirement eligibility in 2006 and will continue to enter the retirement ranks over the next 20 years, creating a huge cash drain on our Social Security system – *Source:* Social Security Administration)

(4) Longer expected lifetimes (65–year–old women have added another four years to their life expectancy since the 1960's – *Source:* US Census Bureau; over the past 160 years, women in the most developed countries have steadily added another year to their life expectancy for each four years that pass – *Source:* Dr. James Vaupel, Director of the Max Planck Institute for Demographic Research)

(5) The much smaller post–Baby Boom generations who are being asked to support Boomers' unfunded benefits along with their own health care and retirement needs (and, owing to their greater life expectancy, women's benefits will be much costlier to fund than men's, all other things equal – *Source:* U.S. Census Bureau)."

9. A "MUST READ" FOR WOMEN

OK, so we know the problems… What are the solutions? Babble goes on to say there are really only three basic ways to invest your retirement money. First, you can annuitize a significant portion of your Retirement savings, thus ensuring you will have income guaranteed for life. You must then invest the rest of it in a diversified portfolio to help provide some inflation protection. You may give up some upside potential but, more importantly, you protect yourself from the downside of the market right at the time that people can least handle downside risk.

Secondly, you could invest in conservative Fixed–Interest investments — things like CDs or Government Bonds. The problem here is that we are at 45–year lows in interest rates. Since these products do not offer any retirement alpha (Mortality Credits), it will take a much larger portion of your funds to generate the same amount of income. You also INCREASE (not decrease) the odds that you will eventually run out of money since, if things don't go as planned, as many times they don't, people start tapping their principal, which can then quickly be depleted.

The third way is to just "roll the dice" and invest the entire amount in the market. However, the distribution phase is VERY different than the accumulation phase and you are subjected to what Babbel refers to as "Reverse Dollar Cost Averaging." This is really Order of Returns risk, which most people don't understand. I cover it in depth in *Paychecks and Playchecks*. I would also strongly recommend that every woman read Dr. Babbel's entire report. It is concise, clear, and extremely well written, and is only 17 pages long.

The paper can be found online, at: http://fic.wharton.upenn.edu/fic/policy%20page/retirementincome-women.pdf

He concludes by reiterating that economists the world over agree that a significant portion of a person's retirement savings should be invested in annuities. He laments all of the bad press that annuities have received, but clarifies that almost all of the press attacks have been focused on deferred annuities, not lifetime income annuities. In fact, the press has been highly supportive of lifetime income annuities.

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WHAT DOES THE MEDIA SAY ABOUT LIFETIME INCOME ANNUITIES?

"Annuities' ability to generate superior retirement income is conjured by pooling risk. The annuities transfer savings from people who don't need it (because they are dead) to those who do. This ability to match assets to future liabilities sends academic hearts aflutter. Economists who study the retirement market have long been sold on the merits of annuities and frustrated by consumers' aversion to them. U.S. vendors sold a piddling $6 billion worth of immediate fixed annuities last year. The 2008 figure will likely be around $10 billion. This in a country with $2.7 trillion tucked away in 401(k)s."

Scott Woolley
"Guaranteeing Lifetime Income," *Forbes*
(May 25, 2009)

The link for this article is: http://www.forbes.com/forbes/2009/0525/098-investment-guide-09-guaranteed-income.html

"Retirees in their mid–to–late sixties should consider replacing some or all of their bond funds with immediate fixed annuities that pay guaranteed monthly checks for the rest of the policyholder's life… Knowing you have this money coming in [from an immediate annuity] can also give you the confidence to invest the rest of your retirement savings more aggressively."

Steven T. Goldberg
"The 25 Best Mutual Funds" *Kiplinger's Personal Finance*
(May 2005)

"A better bet if you're … worried about running out of savings might be to invest some of it in … [an] immediate annuity and invest the rest more boldly."

Ira Carnahan
"Do It Yourself Retirement," *Forbes*
(June 6, 2005)

Use the annuity for basic expenses and other investments to guard against inflation.

Annuities are "part of a diversified overall retirement plan. You can always use the other half or three quarters of your money to invest in a mix of bonds and stocks."

Paul J. Lim
"Finding Income in Retirement," *U.S. News & World Report*
(June 5, 2005)

This quote suggests that one–quarter to one–half of your retirement portfolio should be used to purchase a Lifetime Income Annuity.

"… income annuities can assure retirees of an income stream for life at a cost as much as 40% less than a traditional stock, bond and cash mix. What it means is that retirees who need a nest egg of, say, $1 million, can live the same lifestyle with as little as $600,000 in an income annuity."

Jeff Opdyke
"The Case for Income Annuities," *The Wall Street Journal*
(August 8, 2007)

10. WHAT DOES THE MEDIA SAY ABOUT LIFETIME INCOME ANNUITIES?

Why is that? Because of the mortality credits and principal that is included in each check. (This article discussed the report done by Professor David Babbel of the University of Pennsylvania's Wharton Financial Institutions Center.)

"Many investors approaching retirement think they have no need for annuities. But the lifetime income guarantees offered by these insurance–company products can add security to portfolios that are mostly composed of stock and bond mutual funds…"

Lavonne Kuykendall
"Making the Case to Buy an Annuity," ***The Wall Street Journal***
(March 8, 2011)

"Annuities sold through big insurance companies… have soared in popularity as retirees have come to understand that guaranteed lifetime income makes them more financially confident — and happier, too."

Dan Kadlec, Time.com

"The happiest people in retirement were those who had a stream of guaranteed paychecks for life. Some had pensions. The others purchased lifetime income annuities."

Jonathan Clements
"The Secret to Happier Retirement," WSJ.com
(July 25, 2005)

Jonathan Clements looked at what the happiest people in retirement had in common. He listed seven common traits, including surrounding yourself with friends and neighbors who you get along with, thinking ahead, and getting a guaranteed stream of income.

[Retirees would likely have to] work longer, save more and delay their Social Security benefits until at least full retirement age."

"RETIREMENT INCOME, Ensuring Income Throughout Retirement Requires Difficult Choices,"
Report to the Chairman, Special Committee on Aging, United States Senate, GAO-11-400, (June 2011)

This report concluded that Social Security is not enough to retire on. It went on to say that seniors should "convert some of their savings into an income annuity to cover necessary expenses."

Curtis Cloke, another friend of mine, runs the Thrive Income Distribution System. He has compiled a very impressive library of other articles on his website:

www.thriveincome.com/related_articles.shtml

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ABOUT TOM HEGNA

> “In my 20 years speaking and coaching across 50 countries, I have never encountered a speaker as powerful and practical as Tom. Simply incredible! His message resonates with all of us who need to emotionally connect with our clients and craft a prosperous retirement for them. He will BLOW your audience away with passion, practicality and power.”
>
> **Anthony Morris CEO, Top Advisor Program Inc.**

TOM HEGNA CLU®, ChFC®, CASL®

Tom Hegna is the President of TomHegna.com. He is a former First Vice President of New York Life. Originally from Glenwood, Minnesota, he attended North Dakota State University on an Army ROTC scholarship and graduated with honors with degrees in Economics, Business Administration and German. He was commissioned in the U.S. Army and spent six years on active duty and another 16½ years in the U.S. Army Reserve and retired as a Lieutenant Colonel in 2006.

In 1988, Tom started his career in the insurance industry with MetLife. He qualified for membership into the Million Dollar Round Table (MDRT) in each of his first three years. (MDRT is recognized throughout the industry as the standard of sales excellence in the life insurance and financial services business.) In July 1996, he joined New York Life. He was promoted to Vice President in March 2006 and First Vice President in March 2010. In August 2011, he started TomHegna.com and now speaks for numerous companies all over the world. He is the author of the book *Paychecks and Playchecks*. He resides in Fountain Hills, Arizona.

He is a popular industry speaker, having spoken at the MDRT Boomertirement® Roadshows, the National NAIFA Convention and the Society of Financial Service Professionals National Forum meetings, as well as numerous state and local association meetings. In October 2009, he spoke main platform at the Top of the Table meeting for the Million Dollar Roundtable. He spoke at the 2010 and 2012 AALU National Meeting, the main platform at the 2010 NAIFA Annual Meeting in Seattle and on the main platform at the Million Dollar Round Table meeting in Vancouver in June 2010. In 2011, he spoke in Singapore at the MDRT Experience, as well as at the Growth Summit at the 2011 MDRT Annual Meeting. He will be speaking for Taiwan MDRT in 2013. He has been featured in articles in the American College Wealth Channel Magazine, Round the Table (an MDRT publication), the National Underwriter and NAIFA’s Advisor Magazine, Investment News Net, Life/Health Pro, and FoxBusiness.com.

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