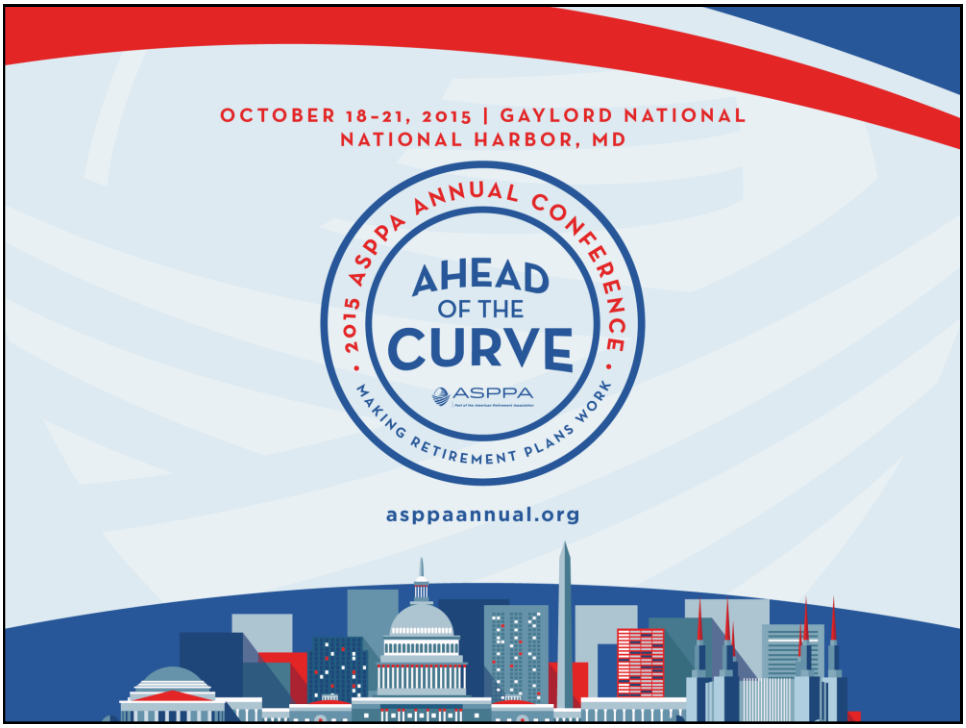

Workshop 2: Extend Your Nest Egg: Planning a Stream of Income in DC Plans

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- Some of these concepts were put forth by Michael Zwecher and Francois Gadenne in their publication *Body of Knowledge for RIIA's Retirement Management Analyst (RMA) Designation, How to Benefit from "The View Across the Silos"*, copyright 2009-2010. Additionally, some of the information regarding the annuitization concepts were put forth by Moshe A. Milevsky, Ph.D. and Alexandra C. MacQueen, CFP in the Second Edition of *"Pensionize your Nest Egg",* published by John Wiley & Sons, Inc.
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Separating Out the Planning

The issues are simple:

- How much do I need for retirement?
- How disruptive will my medical costs be?
- How much do I want to leave as a legacy?
- When am I going to die?

This program focuses on "at" retirement. The issues become more "emotionally driven", so the solutions should be more "advisor driven".

Retirement Risks vs. Retirement Tools

- Market Risk
  - Risk Tolerant
  - Risk Adverse
- Psychological Risk
- Longevity Risk
- Sequential Risk
  - Investment
  - Spending
- Issuer Risk
- Health Risk
- Inflation Risk
- Interest Rate Risk
- Credit Risk
- Legacy Risk
- Dependent Care Risk
- Unexpected Risks

Retirement Tools

- Chicken Dinners
- Replacement Ratio Tools
- Financial Planning Reports
- Asset Allocation Models
- Annuity Solutions
- Seat of the Pants

Agenda

- No Free Pensions
- Cost of Self-Insuring
  - Pay upfront
  - Pay at the end
- Example
- Coordinating with LTCi and Legacy Planning
- Financial Considerations
- Four Methods
- Considerations
- Spending Rates
- Complex Hybrid Products
- Using the Existing Plan
- Recommendation

There Are No Free Pensions

- The "high costs" of annuities are often shown
  - Low interest environments cause concerns that the annuities are too expensive
  - The forfeiture of money in life annuities to the insurance company on early deaths cause individuals to feel a loss of control
  - Commissions, insurance company profits and anticipated expenses are all built in
  - The press and regulators focus on the fees but not on the benefits

Cost of Self-Insuring

- Systematic Withdrawal Plan (SWP) has it's own costs for self-insuring
  - Establishing the segmenting approach to have bands of assets
    - Withdraw from cash portion
      - Out of market, so a cost
    - Securing the base amount with low risk investments
      - Low interest and yields (Govt Bonds) so a cost of greater reserves
    - Not protecting the assets can cause the survivor to have a significantly diminished life style
    - Cost of long term care
      - 70% chance of any individual needing care
      - 99.5% chance of at least one of a healthy couple at age 65 needing some form of long term care in their lifetime

Robert and Roberta Retiree

- Robert is 81 years old, and Roberta 14 years younger; age 67
- Has a pension of $60k per year 50% J&S
- Has $400,000 in cash
- Has SS benefits of $25,000 for him $12,500 for Roberta.
- Has a degenerative disease causing him to lose mobility

Who thinks Robert and Roberta are in a good place?

- What are we missing?
- What is the exposure?
- What happens to Roberta when Robert passes?

Cost of Long Term Care

- Robert is going to need long term care shortly
  - In Connecticut the cost is approximately $110,000 per year
  - He is in good health otherwise, so it may last a while
  - If it lasts approximately 4 years, they have no cash
  - The house needs to be fitted for Robert
- If Robert continues to live his income will go towards the cost of care
- Once Robert dies, Roberta has no cash, has his social security survivor benefit of $25,000, loses her spousal benefit of $12,500 and has the pension cut by 50% or $30,000
- Her income drops from $97,500 to $55,000
- She has no cushion if she needs care

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Financial Considerations

- Financial Risks in Retirement
- Mitigating the Risks
- The Asset Portion of the Equation
- The Expense Portion of the Equation
- The Income Portion of the Equation
- The Spending Rate: Making it Work
- Solid Foundation with an Upside Opportunity
- Insured vs. Self-Insured Models
- Capital Market Tools.

Risk Management Techniques

- Risk Avoidance or Transference
- Risk Pooling
- Self Insuring or Reserving
- Diversifying

Four Methods of Asset Planning

- Asset Allocation Using Modern Portfolio Theory
    - Risk adjusted for age
        - Example: 100 less age for fixed allocation
  - Segmentation
    - Isolating specific costs/events
    - Banding by frequency and timing
        - 5 yrs bands
        - Asset allocation based upon band
  - Annuitization
    - Series of immediate and deferred annuities
    - Fixed and variable
  - Flooring with Upside Opportunity

Asset Allocation Method

- Differences between risk tolerance vs. risk adverse
- Age dependent asset allocation
    - Similar to Modern Portfolio Theory with adjustments
        - Keeps the equity component prominent
        - Keeps risk tolerance as the core of the method
  - Example
    - 100 less age into fixed
  - Using similar market tools that are used for pre-retirement allocations
    - Stocks, bonds, mutual funds, ETF's

Segmentation

- Blocks of money for time segments
  - First 5 years of expenses in very secure investments
    - Cash, short term bonds, Certificate of Deposits, 5 year certain annuity
  - Second 5 years
    - Mid-term bonds 5- 10 yrs.
    - Allocation of inflation adjusted expenses for the period
  - Third 5 years
    - Longer term bonds, dividend paying stocks, some growth
  - Select and Ultimate
    - Long term bonds, equities, modern portfolio theory for asset allocation

Annuity Banding-Pensionize™

- Variation of Segmentation
  - Separate out the known expenses
  - Determine the present value of the fixed expenses
    - Inflation adjusted
  - Purchase a series of immediate and deferred term annuities
    - Segments that are guaranteed by insurance carriers
    - Use of term certain annuities for first two segments
      - » Immediate first 5 years
      - » Deferred fixed for second 5 years
    - Deferred fixed annuities
    - Life Annuities with variations
      - » Equity Indexed annuities
      - » Variable Annuities
      - » Provides market exposure with potential floor
  - Longevity annuity for extended insurance

Retirement Sustainability Quotient

- Pensionize Your Nest Egg
  - Calculation that provides you some certainty of not outliving your money
  - Pensionizeyournestegg.com

  - How much money can I spend each year?
  - How many years can I spend it?
  - 100% - good to go, should never outlive your assets
  - 0%- keep working

  - It calculates a Spending rate, a Wealth to Needs calculation is compute. It gives us the probability of ruin.

Retirement Sustainability Quotient

- The greater the percentage of spending needs that is guaranteed (Social Security, pensions, annuities) the higher the RSQ.
- RSQ = (fraction of income that is Pensionized™) x 100% +
- Fraction of Income that is not Pensionized ™) x 1-Portfolio's Probability of Ruin)%
- Probability of Ruin computed using Stochasitic forecasting
  - Think of it as the probability of running out of money while living

Solid Foundation With an Upside Opportunity

- Building a solid foundation
  - Risk Adverse
- Determine lifestyle needs for the family unit
- Determine sources of income
  - Continued work
  - Hobbies
  - Inheritances
- Determine outside retirement income
  - Social Insurances and pensions
- Determine retirement savings
- Determine your spending rate
- Develop the solid foundation with capital market instruments

Lifestyle Needs of the Family Unit

- Not just the individual.
- What are the overall costs and when do we expect them to occur?
- Have we included an emergency fund?
- Are there dependents that we are assuming will no longer need our support?
- Are there people that we are assuming that will never be our dependent but could be?

Determine the Sources of Income

- Will you continue to work at some level?
- What income can you make?
- Are there Veteran's benefits available?
- Are there any long forgotten pension benefits?
- Do you have a hobby that makes some income?
- Do any other family members have an income opportunity?
- Are you expecting any inheritances?

Social Insurances

- When do you expect to receive Social Security?
- How much do you expect to receive?
- What will your spouse receive from Social Security and when and how should those benefits be received?
- When should you elect Medicare?
- Will there be any employer coordinated benefits?

Retirement Savings

- What are the sources from which you can draw?
  - IRA's
  - 403-b's
  - 401-k's
  - Pensions
  - Annuities
  - Life insurance policies
  - Collectibles
  - House (reverse mortgage)

Determining the Spending Rate

Lifestyle needs of the family unit

Minus

Income from working, pensions and Social Ins

Equals

Amount required from Retirement Savings

Divide

Amount required from Retirement Savings by total Retirement Savings

Equals

Spending Rate

Spending Rate

- Using age 65 as our target
  - If our spending rate is less than 3.5% then we are fully funded
  - If our spending rate is in excess of 7% we are underfunded
  - If our spending rate is in between, we are limited

Solid Foundation

- The higher our spending rate the more conservative we need to be
  - Can not take a loss
  - Must immunize against the retirement risks
  - Don’t bet against the house!
  - Need to carefully chose the retirement funding vehicles

Upside Opportunity

- The amount that is left over once we subtract out the present value of the future retirement spending that we will need (inflation adjusted)
- This amount can be invested for the longer duration and can be put into the more volatile markets like the stock market

Insured vs. Self-insured? That is the Question!

- The balance needs to be understood
- Control and knowledge are the keys
  - Would you go without health insurance, car insurance, home-owners or renters insurance?
- Longevity risk and pooled annuity premiums
- Long Term Care Insurance – Disability Income for Retirees
- Legal expenses to mitigate and loss of control

Capital Market Tools for Securing the Foundation

- Certificates of Deposit
- Government and Agency Bonds
- Corporate Bonds
- Municipal Bonds
- Treasury Inflation Protected Securities
- Fixed Annuities
- Bonus Annuities
- Life Insurance
- Savings Accounts
- Stable Value Funds
- Longevity Risk Premiums

Complex Hybrid Products

- Equity Index Annuities
- Variable Annuities
- Interest Index Annuities
- Multi-Year Guaranteed Annuities

- These products may offer longevity risk protection along with a solid foundation. Each one has particular features associated with the products. Please see your investment professional for information regarding each one.

Using the Existing Plan

- Check vendor services for distributions
- Can pay out of some fixed/guaranteed accounts
- Liquidity is maintained
- Lower costs for assets under management
- Check annuity features

Examples of In-Plan Options

- Managed Account selected with a cost for converting to a longevity guaranty
  - Target Date fund that goes to fixed at or close to retirement
  - A distribution amount normally 3% to 5% is available for life with the option to withdraw
  - Participant selects and pays the cost of the insurance
- Additional Fee for providing the protection
  - Borne by the participant at the participant's election
- May have portability issues when plan sponsor changes vendors and there are no distributable events
- Some have mitigated the issuer risk by having the annuitization split by a few carriers
- Three illustrations: There may be others and information is general, please see prospectuses before investing or recommending

In Plan Options

- Voya Lifetime Income Protection Program
  - Guaranteed Income for Life diversified by guarantees from multiple insurers
  - Income growth potential from market gains
  - Downside income protection from market losses
- Use of target date funds that allocate between a multi-manager approach and annuity contracts
- Glide path to age 65 based upon a pre-determined approach
  - A lifetime income stream diversified by guarantees from multiple insurers (Voya, Axa Equitable and Nationwide)
  - Begins 17 years prior to portfolio's target date
  - 5 years prior 100% is allocated to the contracts and factored into the Minimum Guaranteed Withdrawal Base (MGWB)
  - Withdrawal flexibility available but will directly affect MGWB
  - Withdrawal amount not pre-determined
- Please see a Voya representative for fees and availability

In Plan Options

- John Hancock Guaranteed Income for Life
  - Provides for 5% withdrawal option at 65 for single
  - Provides for 4.5% withdrawal option for J&S
  - Establishes a benefit base with additional withdrawal privileges
  - Provides a benefit base that will not decline if the market does.
  - Provides a solution to the longevity risk
  - Has a holding period for five years prior to determining benefit base
  - Non-spousal death benefit
    - Remaining account balance if any (not benefit base)
  - Managed accounts
  - Please see a John Hancock representative for fees and availability

In Plan Options

- Prudential Income Flex Target with Target Date Funds
  - Guaranteed Income for Life
  - Downside Protection for Retirement Income
  - Complete access to market value
- Market Value becomes Income Base on first day and Income Base is the greater of new Market Value or old Income Base determined on the participant's birthday each year
- Lock-in date is the last measurement date
- Age 65 distribution rates: 5% life only, 4.5% J&S
- Money invested in target date funds
- Please discuss fees and availability with a Prudential representative

Active Management vs. Passive Management

- Broad Market Tools
  - Index Funds
  - Exchange Traded Funds
  - Balanced Funds
  - Asset Allocation/Target Date Funds
  - Asset Managers with Dividend Paying Stocks
  - Asset Managers with Specific Bond Holdings

Exchange Traded Funds

- Passive Management
- Broad Market Approach
- "Black Pool" Trading and "Algorithmic" Trading
- Stop Loss Orders
- Instant Trading vs. Close of Market Trading

Life Insurance as a Tool

- LTCi may be considered a waste of precious money
  - Why pay for something you may not use?
- Life Insurance
  - Guaranteed premium amount
  - Underwriting is normally the same for LI
  - Can pay out cash value tax free up to the Capital costs
  - If not used, death benefit paid out

Recommendation

- It depends!
  - Health
  - Legacy planning
  - Spending habits vs. assets
  - Long term care protection
  - Number of dependents
- Emotional

A Complete Retirement

When you wake up in the morning:

- You have someone to love
- You have someone who loves you
- You have something to do, and
- You have something to look forward to.

Questions