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Reaching Guaranteed Lifetime Income: Tackling Nine Misconceptions
Fact Sheet

As more companies move from defined benefit to defined contribution plans, individuals are forced to claim ownership of the risks they face in retirement. Members from the Society of Actuaries (SOA) are helping clarify key misconceptions in retirement planning. These actuaries emphasize the importance of leveraging guaranteed lifetime income products as part of a larger financial plan for retirement.

A recent study by the SOA found more than one-third of Americans ages 45-70 are worried about running out of money during retirement, but only 20% plan to purchase an annuity or other form of guaranteed lifetime income. Annuities and other forms of guaranteed lifetime income are often overlooked by individuals. While widely misunderstood, these products can provide a valuable function as insurance against outliving your assets. The same SOA survey found nearly half (48%) of respondents have no financial plans in place to protect themselves against outliving their assets should they live longer than expected. So why is it that people are willing to insure against unplanned events happening for just about everything – from car accidents to home disasters to premature death – except outliving their assets in retirement?

Just like Social Security, other financial instruments are available to help fill the void left by lack of a regular paycheck in retirement and can help individuals balance maintaining their lifestyle in old age with the need to retain assets early in retirement. In looking at the larger picture around retirement savings, securing lifetime income plays an important role within a well-diversified portfolio. In some cases, the amount of assets and their diversification can assure a lifetime income; in others, a lifetime income guarantee may be the best way to assure lifetime income. Below, several actuarial experts have debunked nine misconceptions surrounding guaranteed lifetime income and explain how these financial instruments can play an important role in retirement planning.

Misconception #1: I am OK if I have assets to cover my life expectancy; I don't need an annuity
One of the biggest risks individuals face in retirement is living beyond their life expectancy. It is the uncertainty of one's future lifespan that creates the need to secure guaranteed lifetime income. None of us truly know how long we are going to live and only can make plans based on reasonable expectations. According to a 2006 SOA retirement risk report, at least six in 10 people underestimate average life expectancy (67% retirees, 61% pre-retirees). In fact, only one retiree in five (21%) and one-third of pre-retirees (35%) provide an estimate of life expectancy that is on target or higher. Approximately half of all individuals will exceed average life expectancy, so they should not be planning their finances based on these averages. It is essential that individuals understand their full expected lifespan in order to have a long enough planning horizon. This concept, coupled with the fact that population life-spans are increasing and each person's life expectancy is constantly moving further into the future, strengthens the rationale for individuals to consider annuities or other guaranteed lifetime income options.

Misconception #2: I am already covered by Social Security and/or a 401(k) account
401(k) accounts do not hedge against longevity risk, but rather require expertise to manage the use of the money over a lifetime. Turning at least a portion of a 401(k) account into guaranteed lifetime income can be an important strategy in providing sufficient retirement income. In some cases, individuals may have a lifetime income option in their defined benefit plan and this should be considered versus taking a lump sum. Social Security provides a stable source of retirement income for many individuals, but it was never intended to be the sole source of income, particularly for middle income individuals. Additionally, a recent survey by the SOA found that nearly three quarters (71 %) of respondents plan to claim Social Security before the age of 70. However, actuaries emphasize the importance of understanding the impact of claiming Social Security

later. Monthly income started at age 70 is 75% higher than at age 62, and the monthly income increases gradually between those ages. Claiming Social Security as late in life as possible helps secure more guaranteed lifetime income in retirement and helps hedge against the risk of outliving assets. While a good way to get more guaranteed lifetime income is to claim Social Security later, for many people Social Security does not provide enough income to cover even basic needs in retirement.

Misconception #3: My spouse will have plenty of money if I pass away first
For many women, the death of a spouse is accompanied by a decline in standard of living. Women are much more likely to be alone in old age, and periods of widowhood of 15 years or more are not uncommon. Retirees face an increased risk of poverty when their spouse dies before them, as one or more sources of income stop or are reduced. A spouse's pension is often reduced by half after their spouse dies, and if the couple receives Social Security benefits based on each of their own work histories, the survivor gets the higher benefit. Couples need to consider what their current expenses are, what their sources of income are, and how those factors will change when a spouse dies. Typically an individual needs about 75% of the income of a couple to cover basic needs, and an annuity can be instrumental in providing this income stream in retirement.

Misconception #4: You'll be fine if you don't draw down assets more than four percent a year plus inflation
A popular guideline for structuring income in a self-funded retirement is to withdraw four percent of assets in the first year and increase that dollar amount by the inflation rate in subsequent years ("four percent rule"). A recent study by Christopher O'Flinn and Felix Schirripa, *Revisiting Retirement Withdrawal Plans and Their Historical Rates of Return*, examined the four percent rule, and found a possible risk of depleting assets before the end of life. This depletion of assets is driven mostly by high inflation and timing of equity market drops. Lifetime income guarantees can be wrapped around a mutual fund withdrawal program to fill this gap.

Misconception #5: Fixed income annuities are a bad deal, you are better off investing the money yourself
Individuals should consider a mix of products to balance liquidity needs with the need for guaranteed life income. Fixed income annuities may appear "expensive," particularly in low-interest rate economic conditions, but they trade investment risk and longevity risk for lifetime income certainty. They protect against the risk of investments declining in value and the risk of outliving assets, and can protect against inflation depending on the options chosen. For example, an individual can protect against inflation risk with an inflation adjusted annuity, although this requires a larger premium for the same starting income. Individuals also should keep in mind that a standard annuity is not necessarily a good investment for someone in poor health. Alternatively, impaired life or substandard annuities can provide value for retirees in poor health.

Misconception #6: Guaranteed lifetime income is an all or nothing decision
Guaranteed lifetime income can be provided through income annuities or other guarantees added to deferred annuities or mutual funds. In any case, not all retirement assets should be invested in guaranteed income. Annuities or similar financial instruments can be one asset in your retirement plan, and there are several combination strategies that can be used in a diversified portfolio. Developing a strategy that covers basic needs with assured lifetime retirement income is important. In addition, income annuities can be purchased with refund options that allow for some return of assets in cases of "premature" death. Lifetime income guarantees on deferred annuities or mutual funds can provide a flexible approach that provides access to assets. Individuals can make the decision to buy an annuity or similar financial instrument at anytime, including before, at, or during retirement. For example, purchasing smaller annuities over a period of time can help alleviate concerns that annuities are "too expensive" at any particular time due to the economic environment.

Misconception #7: All guaranteed lifetime income products are created equal
There are several different factors to consider when choosing the right financial product to secure lifetime income in retirement. These factors include time limits, cost of living adjustments, and the desire to pass money down to children and/or charities. Additionally, costs vary among providers. It should be kept in mind that the annuity market is a competitive market, and some annuities are a better deal than others. Embedded expense charges vary significantly between different purchase options. Also, annuities include many different features with different products offering different features. It is important to match the product with the need, and the guarantees are probably a good deal for those who need them but may not be for others. Individuals should work with a financial advisor to pick the financial vehicle that best fits their needs.

Misconception #8: It is never a good idea to take an annuity from a defined benefit plan
Depending upon circumstances, taking a lump sum from employers' defined benefit plan may not be the better option. There are several advantages to taking an annuity from a defined benefit plan. First, and most importantly, the individual may very likely get the same income for fewer dollars than if they went to the marketplace. Second, the pension plan may have several options for providing income to an individual or a couple. Third, the rates that companies use to determine lump sums have become less favorable due to recent legislative changes. Finally, the income (up to certain limits) will be protected by the Pension Benefit Guaranty Corporation should your employer ever become bankrupt.

Misconception #9: It requires a great deal of investment knowledge to maintain guaranteed lifetime income
Annuities and other forms of guaranteed lifetime income are in fact very low maintenance, once it is purchased. Investing on one's own takes continued review and attention, a task that gets more difficult as an individual gets older and possibly impaired. Guaranteed lifetime income is good protection against fraud and other financial mistakes as you get into your 80s and 90s, but should be balanced against the need to plan for long-term care needs and emergencies.

For more information about leveraging guaranteed lifetime income products in retirement planning, please visit www.soa.org.

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