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The Need to Insure Retirement with Fixed Deferred and Immediate Annuities

Fixed annuities are an important tool for retirement planning. The need to be exposed to and understand the value of fixed annuities and their insured guarantees is important to individuals who participate in employer-sponsored retirement plans, as well as the 78 million working Americans who lack access to a workplace retirement plan.

A fixed annuity is the ***only product*** that allows individuals to **accumulate retirement savings, protect those savings from declining markets and receive guaranteed income for life.**

NAFA
National Association for Fixed Annuities
Securing the Future!

Contents

RIN 1210-AB33 For information contact ***Kim O'Brien***, Executive Director, NAFA at 414-332-9306 or kimobrien@nafa.com

I. About NAFA

NAFA, the National Association for Fixed Annuities, is a national trade association exclusively dedicated to promoting the awareness and understanding of fixed annuities – including income, declared rate, market value adjusted and indexed. NAFA is the only association whose sole purpose is advocating for the fixed annuity product and educating regulators, legislators, consumers, members of the media, industry personnel, and distributors about fixed annuities and their benefits to retirees and those planning retirement. NAFA's membership of fixed annuity carriers and independent marketing organizations (or field organizations) represents over 200,000 agents and registered representatives selling fixed annuities. NAFA is grateful to its membership for their efforts and contributions to these comments. NAFA was founded in 1998 and is located in Milwaukee, Wisconsin.

A fixed annuity is the ***only product*** that allows individuals to **accumulate retirement savings, protect those savings from market losses and guarantee income for life.** Other financial products and financial strategies don't offer such guarantees and in fact, consumers who rely on those strategies are subject to market risk that may seriously erode their ability to have sufficient retirement income. Unfortunately, outside of the fixed insurance marketplace, there is little understanding of or exposure to the variety of income planning choices available utilizing both immediate and deferred fixed annuities.

NAFA commends the Employee Benefits Security Administration, Department of Labor, and the Internal Revenue Service, Department of the Treasury (Agencies), for their interest in securing the retirement interests of American citizens. In the wake of the worst economic crisis since the Great Depression, at a time when the largest population is beginning retirement or about to retire, now more than ever, consumers must be encouraged to plan for retirement. As the Agencies note, unlike previous generations who enjoyed access to defined benefit pension plans, most members of the baby boom generation—and those younger—are unable to rely on an employer-provided DB pension as a means to secure retirement income. This means that individuals must be prepared to manage their savings to last throughout retirement. Consequently, Americans are being faced with the difficult task of managing market, inflation and longevity risks.

Unfortunately, there has been a lack of understanding and knowledge about the variety of guaranteed income insurance solutions offered by fixed annuities and frankly, consumers nearing retirement or in retirement have not been given the information or tools to consider fixed annuities in making retirement planning decisions.

The need to be exposed to and understand the value of fixed annuities and their insured guarantees is important to individuals who participate in employer-sponsored retirement plans, as well as the 78 million working Americans who lack access to a workplace retirement plan. Accordingly, NAFA hopes that any action taken by the Agencies will not only encourage the use of fixed annuities in 401(k) and other defined contribution plans, but they will also encourage their use generally for retirement planning.

NAFA's submission will address the importance of enhancing retirement security for consumers and discuss existing consumer trends and rationale. We discuss the need to change the retirement discussion from one of asset allocation and wealth accumulation to one of protecting savings and the managed distribution of income. Past psychological tendencies for investment professionals and consumers to frame the retirement planning discussion in purely investment (asset growth and returns) strategies will no longer suffice to meet the challenges of retirement shortfalls and longevity that face today's and tomorrow's retirees. Recent studies demonstrating that a discussion framed around consumption and income to ensure funds will be available throughout retirement and insure retirement security strongly suggest that will lead consumers to more diversified product and retirement strategies. With that end in mind, NAFA's comments will expose the variety of income options with fixed annuities, the advantages and tradeoffs to those choices, and how to better educate and expose the consumer so that they may consider them.

II. Factors Impacting Retirement Savings

From the many publications on retirement planning published in the past five years, there is little dispute that a variety of distinct forces are converging to create a retirement income revolution. This convergence has been called "A Perfect Storm" and a "Time Bomb."[1] Some have called it a "Gray Tsunami," [2] but whatever the title, experts agree the following factors combined could create retirement ruin for millions of retirees if they are not addressed.

1. The decreasing levels of Social Security benefits
2. The increase in the payroll tax and decrease in workers
3. The death of defined benefit plans
4. The aging of baby boomers
5. The increase in life expectancy rates.

<u>The decreasing levels of Social Security benefits</u> over time can best be described as the "cliff effect." According to the Social Security Administration, individuals born in 1880 might have enjoyed an "implicit" rate of return of nearly 25%. From there it dropped to almost 12% percent for individuals born in the early 1900's, to just an inflation-adjusted rate of slightly over 1% for today's baby boomers and their children.

<u>The increase in the payroll tax and decrease in workers</u> contributing to Social Security has a negative impact on retirement savings. As the payroll tax increases to address the continued solvency issues of Social Security, individuals have less after-tax savings to contribute to alternative financial products with a likely higher return. That means today's workers nearing retirement face significant retirement funding issues.

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[1] Philip J. Scrofani, "Perfect Storms and Ticking Time Bombs." *Sage Advice,* October 2005.

[2] Linda M. Springer, director of the U.S. Office of Personnel Management (OPM), January 31, 2006, *The Public Manager,* Spring 2006.

The death of defined benefit plans. The Agencies' Request for Information did an excellent job of outlining the current climate of defined benefit and contribution plans in today's workplace. Not only has the number of active participants in defined benefit plans fallen dramatically, but a number of other factors have impacted Americans.

A recent report by Babbel and Merrill[3] states that the last fifteen years has seen ***only one new*** pension program initiated. The number of pension plans in the U.S. peaked at 175,000 in 1983 and has since declined to less than 25,000. Meanwhile, 30% of the remaining programs will close within the next two years. At the same time, defined contribution plans (401(k), 403(b), etc.) have increased from 17,000 to over 650,000 plans in place today. With more and more retirement savings accumulating in these defined contribution plans, the demand for a pre-planned, guaranteed income stream will continue to grow. However, as a result of the recent economic crisis, the amount of money invested in these plans and available for retirement has taken a significant hit. Not only did the crisis severely reduce the amount of money in defined contribution plans, but many employers cut off their matching programs to curtail company expenses and improve profit and loss forecasts.

The aging of boomers means that more and more Americans enter retirement each year. Beginning in 2006, the first members of the largest generation in American history turned 60 and will be leaving jobs and entering retirement. According to the Babbel and Merrill[4] report, this group represents 27% of the U.S. population and 47% of all households.

The increase in life expectancy rates is seriously contributing to Americans' retirement vulnerability. The probability that an individual retiring at age 65 will reach age 80 is over 70% for females, and over 62% for males. Married individuals have increased probabilities, as the chance that at least one

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[3] David F. Babbel and Craig B. Merrill, Policy Brief: Personal Finance, *Investing your Lump Sum at Retirement,* (Wharton Financial Institutions Center, August 14, 2007) 2.

[4] David F. Babbel and Craig B. Merrill, Page 3.

spouse will reach age 80 is nearly 90% and the chance that one spouse will live to age 85 is more than 85%. (Ibbotson Associates, Inc., January 2003).

Ernst & Young's 2009 report[5] produced for ***Americans for a Secure Retirement*** showed that the economic crisis of 2008 and 2009 significantly increased the retirement vulnerability of both near and recent retirees. Without making serious reductions to expenses, three-fifths of new retirees could expect to outlive their financial resources. A startling 95% of middle-income married couples without defined benefit plans would outlive their income [6] and those without a guaranteed source of income beyond Social Security would have to reduce their standard of living by an average of 32 percent to avoid outliving their financial assets. Near retirees, those seven years out from retirement, without a guaranteed source of income would have to reduce their standard of living by 45 percent to minimize the likelihood of outliving their financial assets.

[5] Ernst & Young LLP, Updated Retirement Vulnerability Analysis: The Likelihood of Outliving their Financial Assets (June 2009) 2.

[6] Ernst & Young LLP 2.

III. Understanding Retirement Income Needs

The Agencies requested input on how to best educate the consumer to help them understand retirement income options and opportunities. However, before we can address consumer education (which is equally essential and addressed later) we must first address the importance for professional retirement planners to understand retirement income needs and planning for those needs. Americans face three fundamental risks in planning for their retirement income:

1. **Market Risk** – the risk that you will make money and lose money based on the performance of your portfolio and you won't have time to recover those losses;
2. **Inflation Risk -** the risk that your pre-determined retirement income will be eroded by inflation and you will not be able to sustain your retirement lifestyle; and,
3. **Longevity Risk** – the risk that unexpected health or financial needs will deplete your savings or, even without those budget strains, you will simply outlive your savings.

Unfortunately part of the primary focus of the investment community has been in managing client assets with the goal of maximizing wealth accumulation and asset growth NOT income sustainability. Most investment advisors are biased toward a standard balanced (diversified) investment portfolio with a systematic withdrawal of a fixed income stream during the retirement period. Individuals relying on these types of retirement plans are headed toward retirement ruin because of the high likelihood they will exhaust savings while they are still alive.

The Retirement Income Insurance Association[7] (RIIA) outlines in its "How to Benefit from the View Across the Silos"[8] the need to build a portfolio for retirement income and not simply one for asset accumulation. But to do so, advisor must understand the need to "build a floor" (also called in the

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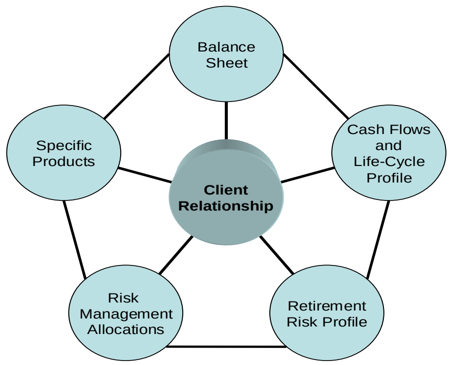
[7] NAFA and RIIA share affiliate memberships in each association.

[8] Francois Gadenne and Michael Zwecher, How to Benefit from "The View Across the Silos": *From Investment Management to Retirement Income and Retirement Management,* (RIIA's Advisory Process, June 2009).

insurance industry "the guaranteed level of income") for the retiree that will sustain a lifecycle plan even though the end date is unknown.

RIIA's Retirement Management and Retirement Income Advisory Process



Graphic: Francois Gadenne and Michael Zwecher, Page 19

To build the floor and manage the growth, the paper proposes a "Hub and Spoke Model" with the client at the center of the planning process or hub. The Spokes consist of five analytical processes that are connected to and interact continuously with the client.

Spoke 1 consists of an analysis of the household finances which starts the planning process and is used to analyze current income and expenses, assets versus liabilities and a snapshot of the cash inflows and outflows. Spoke 2 uses the cash flow analysis to match the client's anticipated "social capital" (essentially Social Security and pension income), their human capital (income from any jobs held during retirement), and their financial capital (investments and other cash assets). This information along with the information from Spoke 1 is used to determine the client's **minimum income** which will come from the social and human capital and how much will be needed from financial capital to establish their **desired income floor**.

Spokes 3 and 4 take the results of the three sources of capital from the life cycle plan, matching it to the potential cost associated with retirement risks (e.g., inflation, longevity and market) and creates a risk management allocation model that creates the income floor with growth potential in line with the client's risk profile (modest or medium growth potential and preservation for the moderate and low risk tolerance and higher growth potential for the high risk individual or some combination). Spoke 5 proceeds to identify specific products and providers to implement the plan and meet the plan's objectives.

This Hub and Spoke process is extremely relevant to the discussion of retirement income planning because to fully understand a client's needs, advisors must have the tools to help them anticipate how much will be needed for a guaranteed income stream. Once that income need is solved, the appropriate product or products to provide for the guaranteed income can be selected. The process is product neutral because it does not assume the use of a particular income product or products. As a result of process, neutrality the planner will look into a variety of products and perhaps multiple product solutions that will ultimately benefit the retiree.

VI. The Advantages of Fixed Annuities in Retirement Planning

About Fixed Annuities

All fixed annuity insurance products provide the *insurance* coverage of traditional insurance products, including death benefits, withdrawal options, payout options and benefits triggered by disability or incapacitation. These insurance guarantees mean that only life insurance companies can issue fixed deferred insurance products. Life insurance companies are subject to strict regulation by the states. State regulation is designed to assure that life insurance companies will have sufficient assets to make good on their guarantees, even if the general economy and the business fortunes of an individual life insurance company fall. Moreover, ***only*** fixed insurance products are backed by their state guaranty fund.

> *For almost 40 years, America's life, annuity and health insurance guaranty associations have protected policyholders. State guaranty associations are located in every state as well as the District of Columbia and Puerto Rico. Guaranty associations provide a financial safety net for consumers if their insurance company fails. America's insurance safety net is time-tested, experienced—and little known, despite its proud history of helping millions of policyholders. Guaranty associations help keep the promises of the insurance industry and provide additional security to policyholders in troubled times. These funds provide the money to compensate owners if a life insurance company defaults.*
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> (*Source:* The Life and Health Guaranty Association System consumer brochure.)

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Outside this basic insurance contract, fixed annuities differ in three specific ways[9];

1. How many payments are made into the annuity - Single and Flexible Annuities
2. When the company makes income payments - Deferred or Immediate Annuities
3. How and when interest is credited - Declared and guaranteed for a stated period, multiple interest rates or indexed rate annuities

How many payments you make

When only one payment is made to fund an annuity it is called a single premium annuity. When a series of payments are made it is called a flexible premium annuity. How many payments you may make and how often you make them will be prescribed by the annuity purchased.

When the company makes income payments

An owner of an *immediate (also called a lifetime income or payout)* annuity can begin receiving income payments from the insurance company right after purchase or at some point during the first year. Generally, immediate annuities are purchased with sizeable initial or single premium payments, and frequently as a rollover from another source or retirement product.

An owner of a *deferred* annuity does not begin receiving income payments right away. Instead, the owner of a deferred annuity accumulates monies for a period of time and postpones or “defers” choosing whether to begin receiving income payments from the insurance company.

Deferred annuities offer accumulation benefits during a pay-in period and retirement income benefits during a pay-out period.

[9] The National Association of Insurance Commissioners Disclosure Working Group, The NAIC Consumer’s Buyers Guide to Fixed Annuities (draft March 2009).

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During the *pay-in* period, owners make purchase payments to an insurance company. Owners generally have the option of making purchase payments when and in amounts they choose. Owners earn a rate of interest on their purchase payments and do not pay taxes on the interests until the owner withdraws money.

At retirement, the owner can take the accumulated money in either a lump-sum or a system of periodic payments for life or some other period of time.

During the *pay-out* period, the owner receives income payments from the insurance company. As under other fixed annuities, the dollar amount of the payments are specified and, unlike variable annuities, do not vary up and down in dollar amount. As under other annuities, owners have the flexibility of receiving these income payments for various periods, such as life, life of the owner and spouse and a specified number of years.

How interest is credited

You may be familiar with *variable* annuities, in which the owner earns a rate of return that the insurance company derives from the investment performance of a pool of assets invested by the company and managed by an investment adviser. The dollar amount of annuity payments also varies up and down with the performance of a pool of assets. The owner bears all of the investment risk that the pool will earn less than the owner could earn elsewhere and that the owner's accumulated value or dollar amount of annuity payments will drop.

By contrast, under all forms of fixed annuities – income, declared rate, market value adjusted and indexed – the owner bears no investment risk whatsoever. This protection from investment risk is a major reason that fixed annuities should and do appeal to those consumers saving for retirement.

Under fixed annuities with *declared* rates of interest, the insurance company credits the owner with a rate of interest that the company declares in advance and guarantees the rate for a specified period. The owner bears no investment risk that the insurance company will fail to credit the declared interest rate. The dollar amount of annuity payments (annuitization) that may be selected in the future is set in advance and remains the same during the pay-out period. The owner bears no investment risk that the insurance company will fail to continue making annuity payments in that dollar amount.

Rates that are guaranteed in advance and the period of time for which they are guaranteed is the same period as the period over which surrender charges apply (e.g., three or five years) are called Multi-Year Guaranteed Annuities (MYGAs).

Other declared rate (often referred to as "traditional" annuities) guarantee the interest for the first year and subsequent declared rates may be reduced or increased depending on the insurance company's investment returns, but never below the minimum guaranteed rate.

Some annuity contracts apply different interest rates to each premium you pay or to premiums you pay during different time periods. Other annuity contracts may have two or more accumulated values that fund different benefit options. These accumulated values may use different interest rates. You get only one of the accumulated values depending on which benefit you choose.

Under fixed annuities with *indexed* rates of interest, the insurance company credits the owners a rate of interest that the company calculates by reference to a formula that includes a factor for changes in an independent index specified by the company. As under other fixed annuities, the owner bears no investment risk that the life insurance company will fail to pay the interest rate calculated with reference to the index. Subsequent indexed calculation formulas may be reduced, but never below the minimum guaranteed formula, and the annuity owner will always be credited with the minimum guaranteed interest rate if that is higher than the interest rate calculated with reference to the index. Also, as under other fixed annuities, the dollar amount of annuity payments purchased by each dollar of contract value is set in advance and remains the same during the pay-out period. The owner bears no investment risk that the insurance company will fail to continue making annuity payments in that dollar amount.

Fixed indexed insurance products are increasingly popular with the public. As with all cash value insurance products, fixed indexed insurance products offer a combination of insurance and interest-rate features.

Fixed indexed insurance products are a natural evolution of the traditional fixed insurance product which offers one method of crediting interest. Fixed indexed insurance products are nothing more than a traditional fixed insurance product that offers owners an opportunity to receive interest based on positive changes in a financial markets index coupled with *insurance* guarantees of purchase payments and minimum rates of interest. All fixed indexed annuities offer multiple indices from which to choose for additional interest calculation during the calculation period as well as the ability to forego the indexed calculation and earn a declared guaranteed interest rate over the same period. Most fixed indexed annuities allow you to allocate your annuity value over various indices or between indices and the declared rate. In other words, fixed indexed insurance products offer guaranteed preservation of premiums coupled with guaranteed growth in value, even when indexed-based interest is small or non-existent.

The added benefits under fixed indexed insurance products can increase in amount depending on the changes in financial market indexes. At the same time, benefits have guaranteed floors that protect against loss of principal if the performance of financial market indexes is not favorable. The result is that an owner has limited downside risk while *potentially* realizing a greater (or lesser) amount of credited interest than a life insurance company could declare and guarantee in advance as a fixed rate.

These insurance guarantees mean that only life insurance companies can issue fixed indexed insurance products. Life insurance companies are subject to strict regulation by the states. State regulation is designed to assure that life insurance companies will have sufficient assets to make good on their guarantees, even if the general economy and the business fortunes of an individual life insurance company fall. Moreover, fixed indexed insurance products are backed by state guaranty association funds. These funds provide the money to compensate owners if a life insurance company defaults.

Income Provided by Fixed Annuities

Annuity product innovations include a wide variety of ways to provide guaranteed income through annuitization choices, income riders called guaranteed lifetime withdrawal benefits (GLWB) or guaranteed lifetime income benefits (GLIB) and withdrawal benefits. These provide retirees options as to the amount of guaranteed income and flexibility and control over retirement savings.

Annuitization

Traditional income options from annuities include guaranteed income for life, for a specified period, or a combination of a lifetime payout with a guaranteed period. These options are typically referred to by the industry as "annuitization." Annuitization is available in both immediate (also called payout or income annuities) and deferred annuities. The selected income stream is guaranteed. Also, many products offer inflation adjustment features and more innovation is currently underway that will provide guaranteed inflation protection using the consumer price index and other inflation measurement index. Here is a typical list of annuitization options available on fixed deferred and lifetime income (immediate) annuities:

Life Option

The life option typically provides an income stream for life, which is an effective hedge against outliving retirement income.

Joint-Life Option

This common option allows the spouse to continue to receive payments when the annuity recipient dies. The monthly payment is lower than that of the life option because the calculation is based on the life expectancy of both the husband and wife.

Period Certain

With this option the value of the annuity is paid out over a defined period of time that the owner chooses such as 10, 15 or 20 years. If a 15-year period certain payout is selected and the annuitant dies within the first 10 years, the contract is guaranteed to pay your beneficiary for the remaining five years.

Life with Guaranteed Term

Many people like the idea of guaranteed income for life (which they get with the life option), but they are afraid to choose that option in case they die in the near future. The life-with-guaranteed-term option provides an income stream for life (like the life option), so it pays you for as long as you live. But this option also allows the payout recipient to select a guaranteed period, such as a 10-year guaranteed term, for which the annuity must pay to the estate or beneficiaries even if death occurs before that guaranteed period is over.

Systematic Withdrawal Schedule

This method allows the recipient to select the ***amount of payment*** that is desired each month and how many payments are needed. However, the insurance company will not guarantee that the recipient will not outlive income payments. How much is received and how many months payments are received depends on the annuity cash value at payout. The risk of outliving the income is born by the recipient.

Lump-Sum Payment

Taking out all of the cash value is the least efficient payout method from a tax minimization perspective. Ordinary income taxes are due on the entire portion of the annuity (for IRAs and annuities in employer-sponsored plans) rather than spread out over time when the tax bracket may be lower in retirement.

Electing Not to Take Payments

With deferred fixed annuities you are not required to take the payments unless you choose to. This is beneficial in that the retiree doesn't need to make any payout decision until and if income is needed.

Income Riders

Income riders which have become one of the most popular benefits ever added to fixed deferred annuities. NAFA members are reporting that over 50 percent of people who purchase fixed deferred annuities also elect to add an income rider. These income riders are called by names such as guaranteed lifetime withdrawal benefits (GLWB) or guaranteed lifetime income benefits (GLIB).

The first income riders were introduced on variable annuity products in 2003, and they became available on fixed and fixed indexed annuity products a few years later. Income riders provide consumers with a guaranteed income for life (similar to what can annuitization provide), but without giving up access to remaining principal – a feature that caused many consumers to shy away from annuitization. By purchasing an income rider on a fixed rather than a variable annuity, a consumer get the benefits of the income rider while also being protected from investment risk.

An income rider on a fixed or fixed indexed annuity allows a retiree to build a secure retirement income. The payout provided by the income rider is guaranteed by the issuing insurance carrier for the life of the annuity owner. The issuing insurance carrier bears all of the investment and longevity risk on the guaranteed payout, which means that the consumer is completely protected from these risks. Some annuity carriers even provide for the income to substantially increase in the event that the annuity owner becomes confined to a nursing home, further sheltering the annuity owner from risk. In addition, the annuity owner retains access to the annuity's remaining value and also continues to reap the benefits of interest credits to the annuity's value.

How Income Riders Work

As previously noted, a guaranteed lifetime income or withdrawal benefit is typically optional on a fixed annuity, and it is added to the annuity by a rider. Whereas the annuity has an accumulation value to determine the death benefit or annuitization, the rider adds a second value, the income value.

The accumulation value works just as it always does on a fixed annuity. The annuity owner's premium earns additional interest that is declared and guaranteed in advance or guaranteed through a calculation of an index (or indices) performance while at all times promising a minimum guaranteed interest. The unique benefit of a fixed indexed annuity (FIA) is that it has a built-in inflation hedge because additional interest is calculated based on a formula tied to the designated index (e.g., S&P 500).

With income riders, the income value is completely separate from the accumulation value. It typically grows at a fixed rate of interest and when the retiree elects to start taking lifetime withdrawals, a payout factor is applied to the income value to determine the guaranteed annual withdrawal. If the accumulation value is higher than the income value when the income is desired, then the accumulation value is used in the payout calculation instead. Once the amount of guaranteed withdrawal is calculated, the retiree may withdraw that amount from the annuity every year for life. While taking these withdrawals, the retiree is provided with two very valuable guarantees. First, although the annual withdrawals are deducted from the accumulation value, the additional interest (declared or indexed) continues to be credited to the accumulation value, and the retiree retains access to the remaining accumulation value at all times. Second, even if the annual withdrawals ultimately deplete the accumulation value, the issuing carrier must continue making the annual payments as long as the retiree lives.

How Income Riders Work – At a Glance		
Value	Accumulation Value	Income Value
How it is used	It is the basis for most benefit calculations, including the value to be paid upon death, surrender, or maturity	It has one purpose – it is the value that is used to determine the lifetime payments that can be taken from the annuity
How it grows	Interest is credited to this value using a choice of fixed and/or index-based methods	A separate fixed, guaranteed interest rate (usually in the 5% - 8% range) is credited to this value

Withdrawal Benefits

Most fixed annuities contain a provision to withdraw a portion of the annuity value without any surrender charge, usually after the first policy year. Many fixed annuities which are qualified contracts (IRAs) allow the stated withdrawal amount or the required minimum distribution (RMD), whichever is greater. However, this benefit is not guaranteed and if you withdraw more than the amount specified by the benefit you may incur a withdrawal charge. The withdrawal benefit allows access to funds in an emergency or planned withdrawal for income or required distribution under qualified retirement fund rules. The amount usually allowed is 10% of the annuity's account once per year. Some policies let you accumulate the percentage allowed if you do not take a withdrawal in a given year with a maximum total accumulated percentage that is typically 50% of the account value. A few products limit penalty-free withdrawals to the interest earned during a year.

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Liquidity Available under an Annuity

Nursing Care Rider

This feature is a special form of penalty-free withdrawal. To qualify, you usually must be admitted to a qualified care facility (or receive home health care) after the first policy year, for a specified period of time (often 90 days). When you qualify you may usually elect a penalty free withdrawal of up to 75% or 100% of your account value.

Terminal Illness Rider

This feature is a special form of penalty-free partial withdrawal. To qualify you must be diagnosed by a doctor as terminally ill (death expected within one year) after the first policy year. When you qualify you may usually elect a penalty free withdrawal of up to 75% or 100% of your account value.

Tradeoffs of Income Choices

Annuitization or Lifetime Income Annuities

As we have discussed, the fixed immediate or lifetime annuity's most significant (and understood) benefit is that the customer is guaranteed a steady stream of income for the rest of their lives, a specific period or a combination of lifetime and period guarantees. Economists have suggested that individuals can achieve substantial gains to their welfare if they eliminate the uncertainty related to their lifespan by purchasing annuities.[10]

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[10] Julie R. Agnew, Lisa R. Anderson, Jeffrey R. Gerlach, and Lisa R. Szykman, The Annuity Puzzle And Negative Framing, (Center for Retirement Research at Boston College, July 2008), Page 1.

The first tradeoff for the guarantee that you cannot outlive your savings is that the customer may not change their election. Therefore, if the customer needs more money for unexpected expenses, they may not access the money they have chosen to annuitize. *But note: the insurance industry has recognized and solved for this need with GLWB income riders mentioned previously.*

In addition, many annuities do not owe the beneficiary any remaining value when the customer dies. Retires who would like a payout of the remaining value need only select from the products that offer this benefit and, in exchange for the benefit, accept a lower income stream than he or she would have received otherwise.

Charges for Income Riders

Income riders attached to a deferred annuity provide consumers with more flexibility to access their remaining annuity value if the consumer needs money for unexpected expenses. However, that flexibility comes at a cost. While the income riders guarantee lifetime income or withdrawal amounts that add a valuable benefit to the fixed annuity for retirees interested in a reliable retirement income, the riders are not free. Some carriers build the rider into the annuity product, so the cost is reflected in a lower interest rate on the accumulation value, the income value, or both. Other carriers charge directly by deducting a fee from the accumulation value of the annuity, usually based on the income benefit base. This charge may cause the accumulation value to fall in years in which no indexed interest is credited. Rider charges normally continue until the accumulation value of the annuity is depleted or the rider is removed from the contract.

V. Consumer Education & Disclosure

We have discussed how the fixed annuity – deferred or lifetime payout - offers individuals insurance guarantees of minimum interest and the elimination of the risk of outliving income. Yet despite these benefits the actual size of the fixed annuity marketplace is actually quite small compared to the amount of money in mutual funds, stocks, bonds and other financial products (e.g., certificates of deposit). Over the years, there have been many studies by industry professionals, academics and economists to understand why the fixed lifetime annuity market is so much smaller than would be expected given the product's benefits and the demographics of the last five years. The recent stream of new research has focused on possible psychological reasons and the Center for Retirement Research recently addressed how a marketing technique called negative framing[11] can influence people away from fixed lifetime annuities.

The report not surprisingly concluded that people who are financially conservative or risk intolerant are more likely to choose annuities and that financial literacy affects choice. Individuals scoring above average on a financial literacy quiz chose the investment option more often than the annuity. However, a significant finding of the report was that ***negative framing matters***. The study concluded that individuals were influenced by the investment-biased presentation and women were 16 percent less likely to choose the annuity option if they saw the presentation that negatively framed the annuity choice while men were 14 percent less likely to choose an annuity after the investment-biased presentation.

The study concluded that, "the sizeable and significant influence of the biased presentations demonstrates that, even with factual statements, consumers can be swayed to purchase one financial product over another."[12] Whether the presentation bias is unintentional or is intentionally used as a sales

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[11] Julie R. Agnew, et. al., Page 2.

[12] Julie R. Agnew, et. al., Page 4.

technique to lead the customer to the product preference of the salesperson is really secondary to the most significant problem. The most significant problem is not matching consumers' needs and financial requirements to the product or products best able to meet those needs following a complete retirement needs analysis. Consumers need to be made aware of and cautious about the potential influence of negative framing when making important financial decisions and need to be provided unbiased and product neutral information about all their options.

Another study titled "Why Don't People Insure Late Life Consumption?"[13] described the importance of framing in economic decisions to shed light on the "under-annuitization puzzle." Put simply, the paper explains, experimental findings suggest that choices are not based solely on material consequences, but are filtered through the particular frame that individuals use to view and interpret the choices. The study describes them as either an investment frame - how to invest to maximize return and minimize risk - or a consumption frame which places the focus on the end result of what can be spent (consumed) over time. Stated another way, consumers effectively isolate one choice (how to invest) and focus on the specific features of that choice (e.g., risk, return) while ignoring other choices (how to consume) so that they miss the broader, integrated set of choices which can be utilized together and leveraged for the best possible outcome to meet all outcomes. The study concludes that "framing matters in annuitization decisions: in a consumption frame annuities are viewed as valuable insurance, whereas in an investment frame the annuity is a risky asset because the payout depends on an uncertain date of death."

The need for insured, guaranteed retirement choices which can only be provided through fixed annuities could not have been any more viscerally demonstrated than in the fall of 2008 and through 2009. Both a fixed and a fixed indexed annuity guarantee (insure) the purchaser's initial premium payment and prior credited interest. Fixed annuities with interest declared in advance never fall in value

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[13] Jeffrey R. Brown, Jeffrey R. Kling, Sendhil Mullainathan, Marian V. Wrobel, Why Don't People Insure Late Life Consumption? A Framing Explantion of the Under-Annuitization Puzzle, (TIAA-CREF Institute, January 2008)

despite the underlying investment portfolio performance of the insurer and always the required minimum interest must be paid.

Fixed annuities with indexed interest also never fall in value even if the market index drops. So if, for example, the indexing formula used the S&P Index and it fell 20% (like it did in 2008), the only negative consequence is that no new additional interest would be credited that year above the required minimum interest the contract must provide. With all fixed annuities there is never a reduction of the account value unless the customer surrenders the annuity prior to the end of the contract period.

The benefit of including fixed annuities in a retirement income strategy was emphasized in a recent article in the Journal of Financial Planning. The article compared wealth management strategies for retirees and focused on the trade-offs of wealth accumulation and longevity risk comparing a number of distribution strategies that utilized three financial products: mutual funds, fixed lifetime income annuities, or variable annuities alongside strategies that utilized various combinations of the three. The authors concluded that since none of the strategies dominated, the consumer is best advised to "segment wealth to minimize necessary consumption and hedge against longevity risk" rather than focusing on growth opportunities. The fact that it did not utilize any of the income opportunities mentioned earlier in fixed deferred annuities (such as the very attractive income riders) demonstrates the product bias of the securities industry.

Fortunately for those with a thorough understanding of the guaranteed floor and income elements of the fixed deferred annuities, an even stronger conclusion may be made about the potential for both:

- Insured retirement protection and guaranteed lifetime income for a designated portion of retirement funds in the event of investment losses in other areas of the retirement portfolio;
- Income shortfalls from unexpected health or lifestyle events; or,
- Significant and unplanned increase in inflationary pressures on income.

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VI. Product Neutrality and Accessibility

Today's American retiree has a disparate assortment of needs, lifestyle choices, lifetime expectations and consequences as well as a varied understanding of economic, financial and insurance considerations and solutions. The American retiree doesn't fit into any one category, financial industry, product solution or portfolio no matter how "diversified" or "fluid" any of these are.

There is no magic bullet to meet every retiree's need but there is a smoking gun that will kill the sustainability of retirement income and enjoyment – putting limitations on retirement planning and the makeup of a retirement portfolio by mandating product or plan options, or developing rules and regulation that will limit plan options to save costs or compliance.

CHOICE

An open and competitive plan that provides choice of product (both retail and institutional), professional planners, and product providers will benefit all involved but most importantly the retiree. It is also important that plan participation is voluntary and not mandated by converting 401(k) funds or through enrollment in new government programs. NAFA also recommends the integration of Individual Retirement Accounts (IRAs) along-side employer-sponsored plans to provide more opportunity for retirement fund growth and security. IRAs can be a strong complement to a 401 (k) or other employer-sponsored plans. They provide the opportunity to diversity product by selecting investment-oriented IRA product or a savings protector and insured fixed annuity. In addition, they offer the flexibility to move retirement funds among various product alternatives to meet changing goals and market conditions.

EDUCATION

But choice is nothing if you don't understand the choices or haven't had enough information to help you make decisions or ask the right questions. To ensure that consumers have all the tools at their disposal, NAFA encourages education about the retirement planning process, how to find a planning professional, product considerations, common planning mistakes and retirement pitfalls etc. The information should be available through internet-based, interactive financial planning calculators, public

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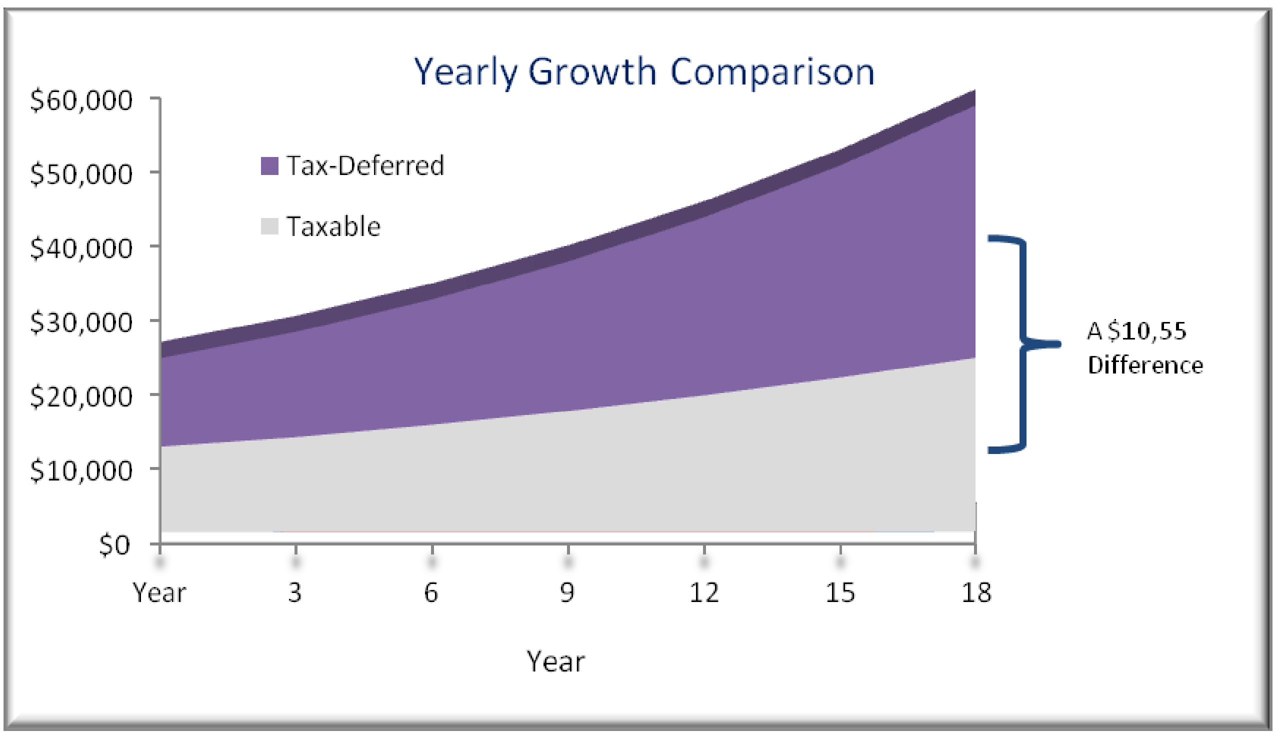
forums and Wikipedia information as well as through written brochures and literature. In addition both online and telephone chat capabilities should be available for informal discussion and research.

To ensure that participants are informed and knowledgeable about their retirement needs and requirement, the Agencies must require that Plan Administrators or Sponsors ensure participant education about retirement planning and planning options with educational tools and calculators and that all product providers and advisors develop product-neutral information through all available and accessible media – the internet, print and physical or web classroom offering a retirement curriculum.

EARLY INTRODUCTION

Early education and starting the retirement planning process could have the most significant influence on a successful retirement. The power of tax deferral and time makes a huge difference in the amount available for retirement. And, the sooner the planning and savings begin, the more time that consumers have to learn more about the process, potential pitfalls, and retirement possibilities.



Yearly Income Comparison							
Year	3	6	9	12	15	18	21
Taxable	$678	$765	$864	$976	$1,103	$1,245	$1,406
Tax-Deferred	$715	$851	$1,014	$1,207	$1,438	$1,713	$2,040
Additional Income due to tax deferral	**5%**	**11%**	**17%**	**24%**	**30%**	**38%**	**45%**

FIXED ANNUITIES GUARANTEE THAT RETIREES WILL NOT RUN OUT OF MONEY!

The fundamental challenge facing retirees is how to ensure that they can use their retirement savings to sustain their desired lifestyle given that they do not know what future investment returns they will generate, nor what future inflation rates will be, nor how long they will live.

An article in the Journal of the Financial Planning Association[14] explored this issue in depth. The authors explored the sustainability of a 4.5% withdrawal rate using various asset allocations. (Obtain a copy by clicking here).

Let's start with an explanation of a 4.5% withdrawal rate. The authors assumed that the retiree has, say, $1 million in retirement savings. If the retiree withdraws $45,000 in the first year (4.5% of the $1 million), and takes out a higher amount each subsequent year equal to the $45,000 plus inflation, what is the chance of the retiree running out of retirement savings before death?

Investment-based Asset Allocations

The answer depends upon the asset allocation used by the retiree. Let's suppose that the retiree uses a balanced asset allocation of 40% stock, 40% bonds, and 20% cash equivalents. The article showed (in its Table 6) that using a set of historical returns, there was nearly a 65% chance of the retiree running out of money by 30 years later. Even the most optimistic scenario – which assumed use of 85% stock and 15% bonds – showed over a 33% chance of the retiree running out of money by 30 years later.

[14] John Ameriks, Ph.D., Robert Veres and Mark J. Warshawsky, Ph.D., "Making Retirement Income Last a Lifetime", Journal of Financial Planning (December 2001).

Obviously, results like that demand a better solution. A key conclusion of this article was that annuitization – the use of immediate annuities for a portion of the asset allocation – improved the results by decreasing the chance of running out of money. But to be fair, at the time of the article, fixed annuities had not sufficiently evolved to provide an inflation hedge and to fully eliminate the risk of ruin. Now they have.

Inflation-Indexed Lifetime Income Annuity

Some companies offer an inflation-indexed lifetime income annuity. It rates change from time-to-time, but using the rates in effect on May 1, 2010 a 65-year-old single male could pay the carrier $1,000,000 and receive in return a monthly payment of $4,593, adding up to $55,116 annually, increase every year with the Consumer Price Index (the CPI-U).

Notice that this immediate lifetime income annuity supports a 5.5% withdrawal rate and completely eliminates the chance of financial ruin. Payments are guaranteed to keep pace with inflation. Payments are guaranteed to continue for the rest of the purchaser's life, no matter how long he lives. And the purchaser is completely protected from investment risk.

Suppose that our 65-year-old is married, so he desires payments to continue as long as either he or his spouse is alive. The same style of annuity provides a 4.4% withdrawal rate, again with no risk of financial ruin whatsoever.

Deferred Annuity with an Income Rider

Purchase of an immediate lifetime income annuity requires the consumer to turn over management of the purchase price to the insurance carrier. Some clients would rather retain access to their retirement savings. The fixed annuity industry created income riders to satisfy this consumer desire and provide guaranteed income for life.

As previously described above, by selecting an income rider, the consumer is provided an income that is guaranteed to continue for the rest of his, her, or their lives. Additionally, the amount of the payment is guaranteed never to decrease, and for fixed indexed annuities, it increases from time-to-time based in part on the growth of a stock market index so long as the withdrawals do not exceed the specified amount. Thus, these riders held consumers keep pace with inflation.

At the same time that the consumer has full access to the annuity's value, the income rider pays a withdrawal rate of generally of 4% for a single life or 3.5% for joint lives. These payments are guaranteed to continue for the rest of the purchaser's life, no matter how long he lives. And the purchaser is completely protected from investment risk.

The conclusion is obvious. Fixed annuity products provide an unparalleled level of safety for consumers by providing for a reliable retirement income and a transfer of investment and longevity risks to issuing insurers.

NAFA is grateful for the opportunity to participate in this very important and impacting process, and the association looks forward to continual dialogue and discussion. We are available at your convenience and upon your request.

Respectfully submitted,

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