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NAIC Center for Insurance Policy and Research Symposium

Lifetime Income Insurance Products and Emerging Issues

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Agenda

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

Background

Insured Solutions History

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

Insured Versus Invested

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

Insured Lifetime Income Product Advantages

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

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Resistance to Using Insured Lifetime Income Products

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

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Whether or Not To Use Insured Products

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

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Products

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Single Premium Insured Annuities (SPIA)

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

Deferred Income Annuities (DIA)

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

Other Annuities

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

Guaranteed Lifetime Withdrawal Benefit (GLWB) Rider

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

Challenges With GLWB Riders

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

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Guaranteed Minimum Income Benefit (GMIB) Rider

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

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Contingent Deferred Annuities (CDA)

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

Implementation

Advisors

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

FIA Incorporation With an Investment Strategy

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

DIA Incorporation With an Investment Strategy

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

Recent Regulations

Qualified Longevity Annuity Contracts (QLAC)

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

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

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

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

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

Challenges to DOL Proposed Regulations

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

DOL Proposed Regulation on Advisor Conflict of Interest

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

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Initiatives To Consider

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Improvement in Retiree Financial Literacy

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

Lifetime-income Friendly DC Plan Changes

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

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Secret Sauce Research

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

Academy Lifetime Income Resources

- Academy Lifetime Income Initiative Webpage
  - http://actuary.org/content/lifetime-income-initiative
- Risky Business Discussion Paper
  - http://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf
- Risky Business Capitol Hill Presentation
  - http://www.actuary.org/files/Risky-Business_Hill-Briefing_June-27-2013.pdf
- Pension Committee Letter on Proposed Lifetime Income Benefit Statements
  - http://www.actuary.org/files/PC_Comments_DOL_lifetime-income-statements-ANPR_Aug-7-2013.pdf

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