# FIXED ANNUITY SOLUTIONS

## A foundation for innovative retirement and future planning

Financial advisors and insurance agents have historically used fixed annuities as an alternative to cash and fixed income as the foundation of an integrated investment or retirement plan. In recent years, fixed annuity innovations have expanded the role of these products, allowing them to provide new opportunities for annuity professionals to reduce portfolio and retirement risks and complement individual retirement plans with guarantees and insurance. These innovations uniquely address the needs of retiree income, security, and quality of life concerns with long-term care and chronic illness benefits.

### The Challenge of Retirement Planning

To understand how advisors can use these annuities to help consumers meet their specific financial needs, it is helpful to examine the core challenges facing retirees and individuals planning for retirement. To retire with confidence, most retirees need:

- Certainty that they cannot outlive their income;
- Sufficient income to cover their fundamental expenses;
- A plan to pay for long-term care or assisted living services should they be necessary;
- Income that can increase over time to help bridge any gap between Social Security and other supplemental income sources; and
- Discretionary income for travel, vacations and leisure activities.

An investment portfolio might help create a desired income over the course of a typical retirement. However, without the foundation of an insurance element to offset key risks before and during retirement, the investment-only portfolio is exposed to uncertainty and variability that can be well beyond the risk tolerance of many clients. Further, when retirees don't prepare in advance, the cost or lack of availability of potential solutions to help reduce these risks can be troubling.

#### *Addressing Longevity Risk*

Diversified asset allocation, even with professional management, is an imperfect tool to combat longevity risk — the risk of outliving one's assets. According to Aegon's Retirement Readiness Survey 2019, the number one retirement concern (cited as a concern by nearly half of Americans!) is outliving their income in retirement[1]. Among all financial products, only annuities can provide a guaranteed lifetime income.

[1] "The New Social Contract: Empowering individuals in a transitioning world." Aegon Retirement Readiness Survey 2019, released May 20, 2019.

Today's annuities offer both security and flexibility. Current product designs allow the annuity professional to craft tailor-made solutions to ensure supporting strategies are in the best interest of the consumer. As a starting point, the agent can look at a few broad types of fixed annuity products:

### Immediate Income Annuities

Immediate annuities begin making payments within one year of purchase. These annuities provide consumers with various options, including payment frequency (monthly, quarterly or annually), payment length (a specified period certain or for life) or the lifetime of the last to die (if purchasing joint coverage). Additionally, some immediate annuities offer an inflation adjustment, which may increase future payments at a predetermined rate or based on an inflation index.

### Deferred Annuities

Deferred annuities do not begin making payments until a future date to be determined by the owner. In the meantime, funds in the policy accumulate with interest much like a bank savings account or certificate of deposit. In most deferred annuities, annuitization (payout) is either never required or only at very old ages, e.g., 90 to 100. As a result, many deferred annuities never enter payout status but instead are surrendered, exchanged for other annuities or distributed in a lump sum after death. In other instances, deferred annuities are paired with an income rider, which may be included in the contract or available for a fee, to address income needs and asset flexibility.

### Deferred Income Annuities

Deferred income annuities, on the other hand, allow a consumer to purchase a stream of guaranteed income starting at an age well in the future. The deferred payout can be based on the life of one person or a couple. Because the income is delayed until a later date and because (in some cases) it is only paid if the individual is still alive, it can be funded more cost efficiently. If clients prefer a return of premium (ROP) guarantee, that can be structured into reduced payouts as well.

When the longevity risk "tail" — living into advanced old age — is covered by an insured solution, clients can optimize other goals, such as maximizing growth potential or creating a legacy. As part of an optimally structured investment portfolio, clients may have more confidence to fully enjoy the early years of retirement knowing income is guaranteed when they need it later.

### *Addressing Age-Related Health Risks*

The second most cited retirement concern among Americans in Aegon's Retirement Readiness Survey 2019 is declining physical health[2]. According to research posted by the Department of Health and Human Services, about half of all Americans are expected to need substantial long-term services and supports (LTSS), averaging $138,000 in paid services (not including unpaid support)[3]. Medicare typically does not cover such LTSS beyond a short period following a hospital stay, and Medicaid will typically not pay for long-term care until after a client's assets are depleted. Thus, this is a burden that often falls on family members to manage, and it can be costly. For example, the median annual cost of a private room in a nursing home is $102,204[4].

---

[2] "The New Social Contract: Empowering individuals in a transitioning world." Aegon Retirement Readiness Survey 2019, released May 20, 2019.

[3] Department of Health and Human Services, ASPE Issue Brief, "Long-Term Services and Supports for Older Americans: Risks and financing," revised February 2016.

[4] Genworth Cost of Care Survey, 2019.

As Americans age, the demand for services will increase, which will subsequently increase the cost of care services. Unfortunately, most clients have not created a plan to pay for these costs, and less than 10% have purchased any form of long-term care insurance.

## Annuity Innovation: Long-Term Care and Chronic Illness Benefits

Annuities offer a solution that addresses concerns about the cost of chronic illness, as well as any expenses related to such care. Some annuities offer benefits included in the policy that automatically increase income payments if long-term care is needed or the policyholder has qualifying medical conditions.

Within these annuity designs, clients do not pay out-of-pocket for the long-term care benefit; rather, the insurance carrier deducts charges from the interest that is credited to the annuity to pay for such coverage. These charges are designed to be less than the amount of interest being credited to the annuity, so the annuity balance can continue to grow. Moreover, these monthly charges are not included in the owner's income, but instead reduce the income-tax cost basis of the annuity.

The benefits for clients are clear: Through setting aside a portion of their assets in a new annuity contract, or executing a 1035 exchange of their existing non-qualified annuity, they can add protection if chronic care is needed or related expenses occur. If they are fortunate and care is not needed, they have retained control of their annuity asset as part of their legacy. Depending on the benefits offered, some underwriting may be required to qualify for these riders.

Finally, almost all deferred fixed annuities provide some form of surrender-free liquidity option. Some offer or include a rider providing liquidity if the owner cannot perform certain activities of daily living (ADLs) due to age, chronic or terminal illness. Thus, even if clients opt not to purchase insurance specifically to cover long-term care services, many fixed annuities can, in addition to protecting assets with guaranteed principal protection, also offer liquidity for unforeseen events as part of their plan for funding necessary care. As a financial professional, you can encourage your clients to take the time to create a written plan to address potential LTSS to help reduce the burden on family members who may be unable or unwilling to care for a sibling, parent or spouse if the need arises.

## Summary

Longevity and long-term care are frequently cited as the leading two retirement risks clients face in planning for a more confident future. Asset allocation strategies alone cannot fully mitigate these risks for most clients. As fixed annuity innovation continues, these tools can be extremely beneficial to clients seeking better protection and more certainty that their long-term financial plan can withstand future threats. Insured solutions can create efficient ways to reduce clients' concerns of outliving their money or seeing their hard-earned nest egg decimated by the costs of medical care. Consider these annuity innovations to help enhance their retirement outlook.