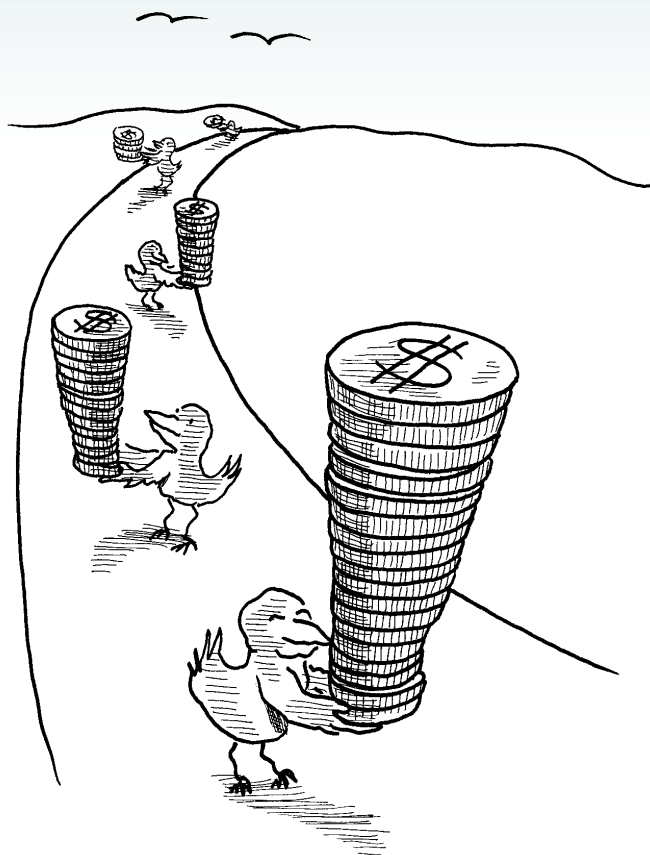


Making ^{Your} Money Last ^{For A} Lifetime

Why You Need to Know About Annuities



A Joint Project of
The Actuarial Foundation and
WISER, the Women's Institute for a Secure Retirement

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The Actuarial Foundation and WISER,
the Women's Institute for a Secure Retirement**

The Actuarial Foundation, a 501(c)(3) organization, was established in 1994 to help facilitate and broaden the profession's contribution to society. The Foundation explores innovative ways to apply actuarial skills in the public interest and brings together broad partnerships of individuals and organizations to address social problems in creative ways.

WISER is a 501(c)(3) organization, established in 1996 by the Teresa and H. John Heinz III Foundation to improve the opportunities for women to secure retirement income.

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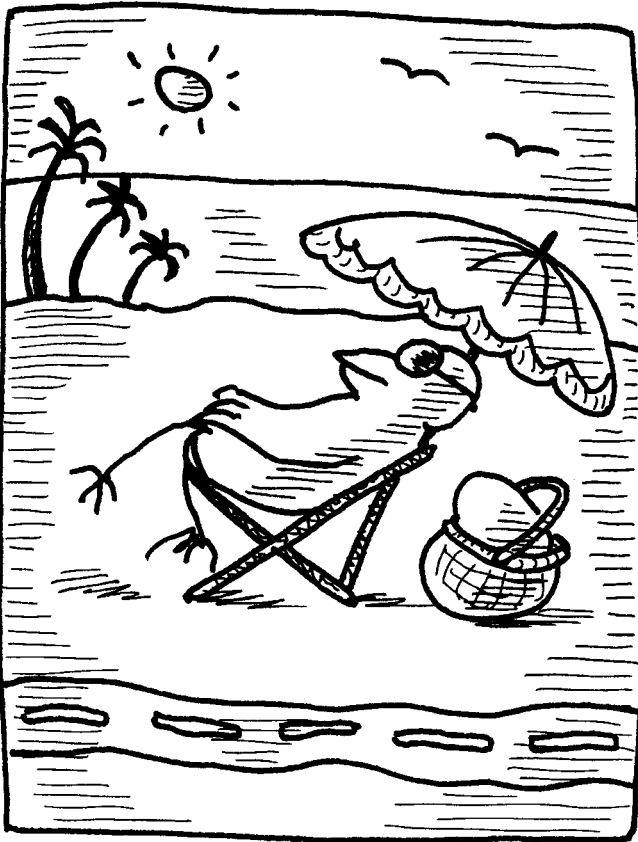
This booklet is intended to provide general information. It should not be used as a substitute for legal or other professional advice.

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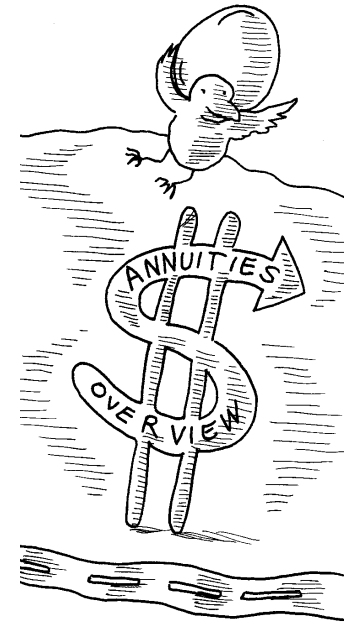
Why You Need to Know About Annuities

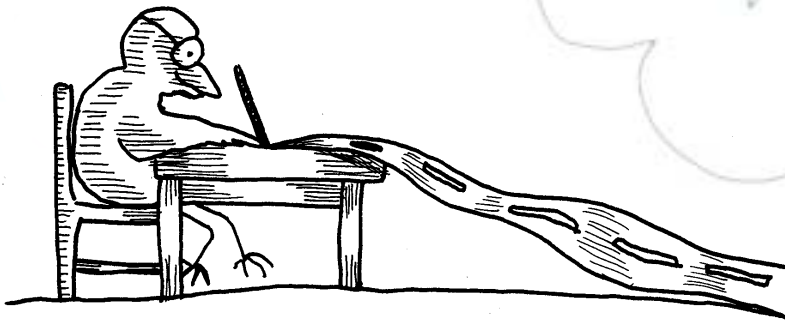
Introduction

Most of us have seen ads and heard commercials telling us to get ready and start saving for our retirement years. But, what we do not hear much about is the next stage, the time when we reach our retirement age and have to figure out how to make our savings last as long as we need it.

Of course, in order to make our money last it would be helpful to be certain about how long our retirement will last. But none of us knows the answer to that larger question. Not only do we not know how long our retirement will last but there is no magic formula to help us come up with the answers. Each individual and couple enters retirement in a different situation, and their futures will unfold differently. The more you know about what you have and how to manage it, the better off you will be.

This booklet provides information and guidelines for people on how to make their savings last. It helps explain the important role that immediate annuities can play by stretching out your money to make sure it will last no matter how long you will live.





Planning Your Retirement Income

Many Americans use their retirement assets too quickly and later find out they have to cut back on necessities because they cannot afford a decent standard of living. This outcome can be particularly difficult for women because they often live longer than men. In fact, married couples sometimes fail to adequately plan for the time when one of them is living alone and their income from pensions and Social Security may be less.

Meanwhile, others may be too conservative about spending their retirement savings, and later find they could have lived more comfortably. Somehow, retirees need to steer a safe path between these two major pitfalls: running out of money or, perhaps a lesser evil, living below the standard and depriving themselves of the things they wanted and could have afforded.

Annuities in a Nutshell

There are many different annuities on the market today. This is a quick reference, and much more information follows.

This booklet focuses on:

Immediate Annuities, which you can buy at or after retirement. The payments begin right away and will continue for as long as you live.

Fixed Immediate Annuity —

the insurance company invests the money that you give it and pays you a fixed amount each month.

Variable Immediate Annuity —

the insurance company will pay you income as long as you live, but amount will vary based on what you choose to invest it in, for example, the stock market.

Deferred Annuities, not discussed in this booklet, are investment products that accumulate money over the years before retirement until future payment.

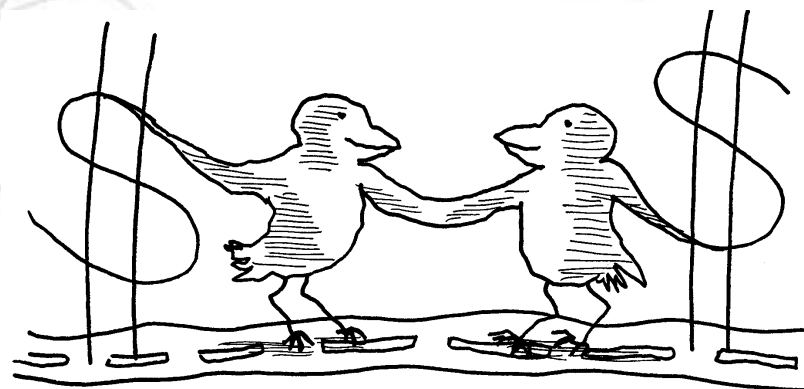
The road to a Secure Retirement – Planning for the journey Ahead

As you start down the path to retirement, you will need to answer several questions. Some questions you can answer with certainty, while others are dependent on circumstances that you cannot predict in the future.

1. Retirement Needs

Any initial planning for retirees must include an assessment of their needs for retirement income. A commonly accepted benchmark is that retirees will need roughly 75 - 80% of the income they had while working. Depending on your circumstances, however, you may decide that you need closer to 90%.

When you estimate your own expenses in retirement, remember that some of your expenses will decrease. For example, you won't have to pay Social Security taxes, or work-related expenses. However, other expenses – prescription drugs, long-term care insurance, and others – may go up considerably.



2. Survivor Issues

When planning for retirement, it is very important that couples understand what income would be available to a surviving widow or widower. Nearly 85 percent of older married women outlive their husbands.

Many women face poverty for the first time when their husbands die before them and one or more sources of income stop or are reduced. A husband's pension is often reduced by half after he dies, and if the couple receives two Social Security benefits, the lower benefit is eliminated.

Couples should consider what their current costs are, what their sources of income are, and how those factors will change in the event of the death of one spouse. An individual needs about 75% of the income of a couple to cover basic needs.

3. Life Expectancy

No one knows how long his or her retirement income must last. Life expectancy figures, though meaningful for a large group of people, mean very little for one or two individuals. As a general rule, women live longer than men and therefore need more retirement income. Once you have reached age 65, the table shows the percentage expected to survive to each of the ages listed. For example, about half of women (51%) who reach age 65 can expect to live past 85.

Survivors To Age	Men	Women
65	100%	100%
70	88	92
75	74	82
80	56	69
85	36	51
90	17	31
95	6	13
100	1	4

If inflation is	\$10,000 will be worth:			
	At Retirement	After 10 years	After 20 years	After 30 years
3%	\$10,000	\$7,441	\$5,537	\$4,120
5%	\$10,000	\$6,139	\$3,769	\$2,314
7%	\$10,000	\$5,083	\$2,584	\$1,314

4. Inflation

Inflation is very difficult to predict. Retirees in the 1970s faced 7% inflation, in the 1980s 5% inflation, and in the 1990s 3% inflation. Over time, these rates make a big difference in what you'll be able to buy with a fixed income (see table above).

Conservative investments such as CDs or money market funds cannot always keep up with inflation. Over the long term, investments in the stock market offer the greatest chance for higher returns, and therefore keeping up with inflation, but they also carry higher risk of loss.





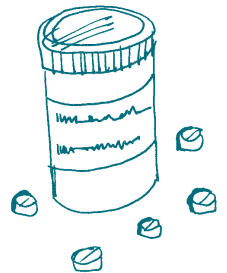
Some benefits and investments provide inflation protection:

- ❑ Social Security benefits automatically increase each year.
- ❑ Some traditional pension benefits are also increased each year but most are not.
- ❑ Stock investments historically have stayed ahead of inflation but often lose money in the short run, so they need to be used carefully.
- ❑ Inflation-indexed Treasury bonds or inflation-indexed annuities are new but are not widely used.
- ❑ Variable annuities invested in a stock market portfolio, require careful shopping — some carry high costs/fees.

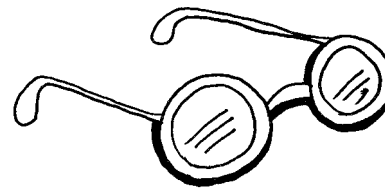
5. Health Care Costs

Health care costs in retirement should not be overlooked. Health care costs, and prescription drug costs in particular, have risen much faster than other costs. Here are some points to consider:

- ❑ You usually can continue your employer's health insurance for 18 months by paying a group rate for "COBRA" coverage.
- ❑ Medicare coverage starts at 65. If you are eligible, it will pay part of your bills for hospital care (under Part A) and doctor's services (under Part B). You still must take care of any deductibles, coinsurance, or costs that are beyond Medicare limits.



- ❑ At age 65, you can buy a Medicare supplemental policy, Medigap, to help pay covered and non-covered expenses, including prescription drugs. Before reaching age 65, you may want to start getting information on rates for Medigap policies.



- ❑ Some medical expenses fall outside of Medicare and Medigap, such as for dental care, eyeglasses, and hearing aids.
- ❑ Long-term care insurance can cover a range of services for individuals who can no longer live independently. Medicare and health insurance plans don't cover these costs.
- ❑ Medicaid is available only if you have a very low income.

6. How to Manage Your Retirement Savings

Once you have some retirement savings, you need to consider how to make your money last through your retirement. Few of us have really thought about how to make that money last for perhaps 20 or 30 years after we stop working.

Think of yourself at a fork in the road. You can choose to go in one of two directions.

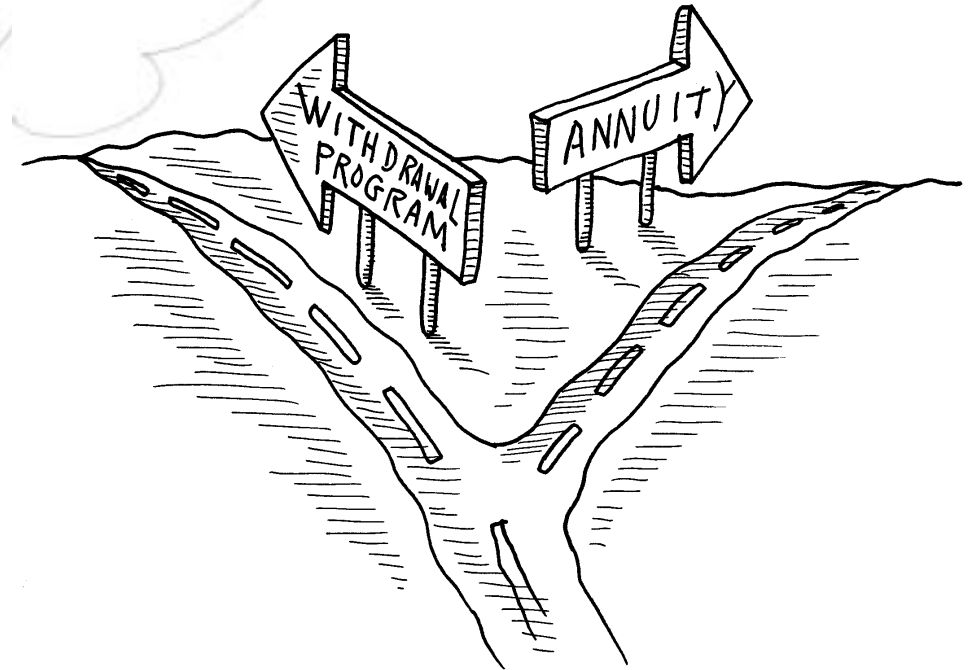
One road you can take will require you to establish a withdrawal program for your retirement savings:

- Estimate how much you can withdraw and spend from your savings so that it will last the rest of your life.
- Invest the balance of your savings until you need it.

The advantage of this method is that it gives you the freedom to invest your money as you wish and the flexibility to respond to needs or opportunities that may arise. Life is full of surprises (and surprise expenses), so you will need to re-evaluate your plan at least every few years.

Estimated Amount You Can Withdraw	
Age	Percent of Assets
50s	3-5%
60s	4-6%
70s	5-7%
80s	6-8%
90s	8-10%

The table gives you an idea of how much of your assets you can withdraw and spend each year so that your money will last your entire lifetime. The figures are only an estimate because every individual's circumstances will vary.



Or you can take the other road, and use some of your money to buy an immediate annuity:

This will provide you with payments for the rest of your life.

- If you choose a fixed immediate annuity, you will receive a guaranteed amount of money each month. Some suggest that you wait to buy an annuity until you're at least age 70. If you retire earlier, you get the flexibility of managing your money for a few years.

Immediate Annuities

An annuity lets you convert all or part of your retirement savings to a guaranteed stream of lifetime income. This gives you the security of knowing that you will continue to receive money each month for the rest of your life – even if you live to be 100 or older. The insurance company takes on the risk of figuring out how to make the money last as long you will live, so that you don't have to worry about it.

How they work

You can buy an immediate annuity with funds available from a 401(k) plan, IRA, savings account, life insurance policy, inheritance, or the sale of a home.

An insurance company that you select invests the money and makes regular payments, either by check to you or by automatic deposit to your bank or financial institution. You can choose how often you receive a payment: every month, quarter, half-year, or year.

The amount of income is based on the amount of money that you have to buy it, plus a number of factors including your age, sex, income option selected, and interest rates at the time of purchase. With a variable immediate annuity, the payments also are based on the performance of investments you choose.

Immediate Annuities – They may be right for you if:

- ❑ **You have retirement expenses not covered by monthly pension and Social Security benefits.**

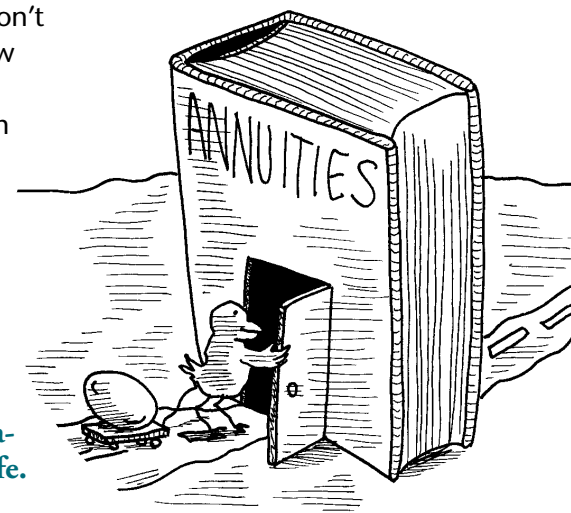
An annuity can guarantee a regular monthly payment for the rest of your life, and it transfers the job of managing your assets to the insurance company so you don't have to worry about how much money you can withdraw each year from your savings.

However, if you have a large income to pay all your expenses, you may not need an annuity.

- ❑ **You have every expectation of living a long life.**

Most of us don't know and can only make our plans based on reasonable expectations. An immediate annuity can be a good choice for individuals who are in good health.

However, if you know (not think) that you won't live for many years, you may want to manage the lump sum yourself.



☒ You want the certainty of knowing you won't outlive your means.

An annuity is the best way to be certain you will get payments for the rest of your life, no matter how long you live. Some people worry they will die early and lose almost all that they paid for an annuity. An alternative is to get an annuity that is guaranteed to pay benefits for at least 5 or 10 years, which is explained in the next section.

You may or may not be able to make more money in the stock market – if you can live with the uncertainty, you can withdraw a certain amount of your money each year from your investments.

☒ The money you would use to buy an annuity is for retirement, not for your heirs.

The more money you leave in the pension plan, or use to buy an annuity, the less you have to pass on to your children. Annuities generally don't pay death benefits. However, if you kept your money in a lump sum and made periodic withdrawals, and then lived for a very long time, your heirs wouldn't get anything anyhow and might end up supporting you.

☒ You have money set aside or figured in your annual expenses for other items.

You should not put all of your retirement savings into an annuity. Keep some money set aside for expenses such as long-term care insurance, Medigap insurance, prescription drugs or other unexpected costs. Also, make sure you understand the terms of the annuity contract before you sign.

However, some people worry about having a lot of money tied up in an annuity because they have less flexibility to deal with emergencies or special needs or interests.

☒ As you get older, you want to take fewer risks with your money.

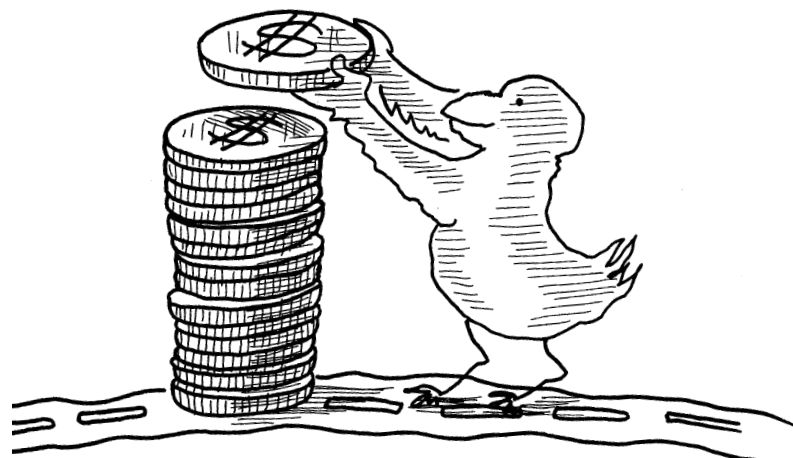
Some financial advisors and insurance agents may say they can do better for you than an immediate annuity. Make sure you understand the risks involved, because you may have to take greater risks with your money in order to do better than an annuity.

A financial advisor should provide you with a plan, and you should be comfortable with the risks and with the fees that you will pay the planner, either directly or from your investments.

Remember, the financial advisor cannot guarantee results and you are the one taking the risk.

☒ If you have your retirement money in an Individual Retirement Account (IRA) and are approaching (or over) age 70½, you may be concerned about the IRS rules that require you to take out some of your money.

An annuity meets the Internal Revenue Service's (IRS) requirement that you start taking out a certain amount of money each year. This requirement is called the "minimum required distribution."



What forms of annuities are available?

An optional form of pension or annuity can include lifetime benefits for a survivor, or can guarantee payments for at least a minimum period such as 10 years if you die soon after payments begin.

The table below outlines several annuity options that are commonly offered, and gives an idea of the amount of the benefit for each option. These examples use a \$100,000 payment for a 65 year old couple.

Payment Choices

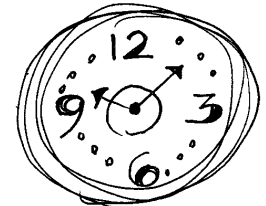
Income Option	Monthly Income*
Lifetime Income , also called Life Income or Life Only – pays you income for the rest of your life, and then the payments cease.	\$794 per month for life.
Life With Period Certain – pays you income for the rest of your life. If you die before the “period certain,” often 10 years, your beneficiary will receive the balance.	\$754 per month for life, 120 month minimum.
Life With Refund Certain – pays you income for the rest of your life. If you die before you receive the amount you paid in, your beneficiary will receive the balance of the amount paid in.	\$743 per month for life, 135 month minimum.
Joint and Survivor – lifetime income for two people. At the death of one person, the survivor will receive a percentage of the original amount, for example, 50% or 100%.	\$646 per month, as long as one person is alive, under the 100% option.

These figures are based on 6% interest and representative mortality. Your actual income may be different.

Other kinds of annuity options, sometimes used to protect against inflation, provide automatic annual benefit increases that are indexed to inflation. The design, cost, and availability of such annuity forms vary widely.

When should I buy an annuity?

Some people suggest that you wait until you are between ages 70 and 80 to buy your annuity, because you get a better deal from the insurance company.



Just make sure you don't spend too much money before then.

How much annuity do I need?

Estimate your annual expenses in retirement. Remember that some of your expenses will go down. You won't have to pay Social Security taxes, you won't need to pay work-related expenses, and you probably won't need to save. However, be prepared for some expenses to go up.

- ☒ Review the sources and amounts of retirement income that you listed on page 26.
- ☒ Subtract your monthly Social Security benefit from your estimated monthly expenses.
- ☒ If you have an employer pension that will pay a monthly income, also subtract that amount from your monthly expenses.
- ☒ Subtract any other sources of income that will provide a monthly benefit.

If you decide to buy an annuity, it should cover the remaining monthly expenses that will not be covered by Social Security and pension benefits.

What if your total income falls short of your needs?

While you may not like these solutions, if you find that your income will not cover your expenses, there are several ways to fill the gap:

- ☒ Staying on your job a little longer can mean an increase in your pension and more time to build savings.
- ☒ Taking on either a part-time or full-time job will increase income.
- ☒ Consider ways to spend less, such as moving to a smaller house or to a lower-cost area.
- ☒ Consider a reverse mortgage that can produce income without forcing you to move out of your home.

How do I shop for an annuity?

The two main criteria for comparing companies when shopping for an annuity are price and safety. You will want to choose the annuity with the best price offered by the safest companies.

Start shopping before you're ready to buy, and get a sense of what the stronger companies are offering. Don't worry if you find that prices are changing a bit — they may change for the better as you get older.

Here's a checklist you can follow in shopping for an annuity.

☒ Use a strong insurer

Use a life insurance company that has a strong financial rating. The annuity business is a long-term arrangement, and you want a company that will always be around. Several insurance company rating services measure financial strength and your public library can help you check rating information.

☒ Find good rates

For fixed annuities, comparing rates among different insurers requires little paperwork and no physical exam. For variable annuities, cost comparisons are much more complex but are important, so make sure you understand all of the fees and expenses, and look for products with low loads (commissions) and low expense charges.

☒ Check with your State Guaranty Association

If an insurance company goes under, State insurance guarantee funds may continue to pay your annuity up to the state's maximum amount. You may want to find out how this fund would cover your annuity contract, including any dollar limits that apply; some of these state funds do not guarantee an insured annuity value that exceeds \$100,000.



Where to get more information on buying an immediate annuity

You may be able to find these sources in your public library or on the Internet. In addition, you can purchase the Annuity Shopper for \$14 an issue by calling 800-872-6684.

Rating agencies: The following private firms rate the financial strength of life insurers.

- ☒ A.M. Best Company (ambest.com)
- ☒ Duff & Phelps Credit Rating Co. (dcrco.com)
- ☒ Moody's Investors Service (moody's.com)
- ☒ Standard & Poors Insurance Ratings Services (standardpoor.com)
- ☒ Weiss Ratings Inc. (weissratings.com)

Annuity rates and planning information:

These Web sites are operated by organizations who sell annuities, and have information on rates that insurers have charged for immediate annuities, dollar limits of state guaranty funds, and IRS rules:

- ☒ Annuityshopper.com
- ☒ Annuitynet.com
- ☒ Annuity.com

Tax issues

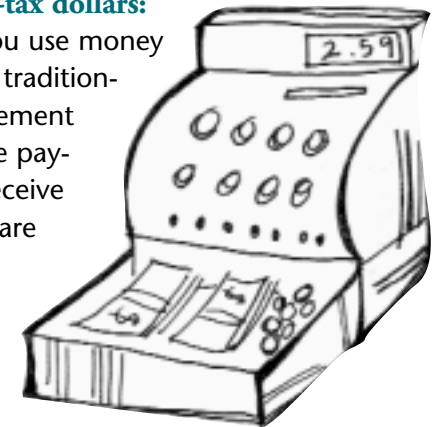
This discussion covers highlights of certain tax rules for general guidance. Individual taxpayers, especially those with high income, should consult a qualified tax advisor.

☒ If you bought your immediate annuity with pre-tax dollars:

For example, if you use money that you had in a traditional Individual Retirement Account (IRA), the payments that you receive from the annuity are fully taxable.

☒ If you bought your immediate annuity with post-tax dollars:

However, if you use money from personal savings on which you have already paid income tax, the IRS treats part of each benefit as a tax-free return of principal (or the amount you paid in for the annuity), and part as taxable earnings. Once the entire principal has been paid back to you, your annuity payments are fully taxable.



Depending on the state where you live after retirement, you may also owe state income taxes.

“Early distributions” before age 59½

Benefits paid from a qualified plan or IRA to an individual who has not reached age 59½, except certain early distributions permitted by IRS rules, are subject to a 10% excise tax (in addition to income tax). However, annuity payments (and other “series of substantially equal periodic payments”) are not subject to the 10% penalty.

Age 70½ “minimum required distributions”

IRS rules require individuals who are age 70½ or older to start receiving payments from certain pension plans and retirement accounts. Amounts paid under a single-life or joint-life immediate annuity usually will satisfy these IRS rules in a simple way that does not expose the annuitant to the 50% excise tax.

“Mom, take care of *yourself*, don’t leave me any money.”

by Ron Gebhardtsbauer, Senior Pension Fellow of the American Academy of Actuaries



My mom is 77 and she had money in an Individual Retirement Account at the Savings & Loan. Once she turned 70½, she had to start taking a minimum monthly amount required by law. Basically, she has to take out enough so that she would empty the account over her lifetime. This amount changes each year as her life expectancy changes, and the amount of money is less.

I told her she could get an annuity from an insurance company, which will always pay more.

She asked, “How can an insurance company beat the Savings & Loan? Insurers generally have high expenses.”



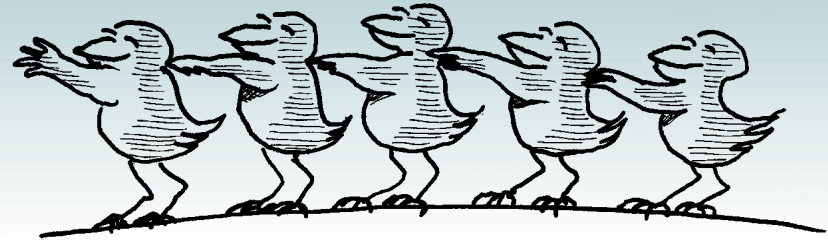
I agreed with her, but said that the insurance company can still win – it focuses all of mom’s money on her, not on me as her heir, because, fortunately, I don’t need it.

Under her current payment system, taking out the minimum required amount each year, she was taking out close to \$3,000 a year, and this annual amount would soon begin to decrease. If she lived to 95, she would get only about \$1,500 a year, and about \$500 a year at 100.

However, if the insurance company had the money, about \$33,000, they would pay her about \$4,000 each year. They would pay her that amount each year, even if she lived to 100 or beyond. It took a while, but my mom finally bought the annuity, and she’s glad she did. Her income is higher now, and she doesn’t have to worry about it running out, even if she lives a long time.

Getting Your Ducks in a Row

Taking Your Money Out: Comparing Two Strategies



Systematic Withdrawals

Immediate Annuity

How does this method spread income over your life?	You estimate how much money you can take out based on how you predict your investments will do and how long you will live. You may outlive your money.	An immediate annuity provides income that's spread over your future lifetime, no matter how long you live or what the economy does.
Does it protect you against inflation?	It depends on what you invest in, and how well it does.	Fixed annuity payments will lose purchasing power with inflation. Variable annuity payments will vary depending on how well the investments do.
Is it flexible enough to meet your individual needs?	You have control over the investment and withdrawal of funds as your circumstances and the economy change. Also, you can buy an annuity at a later time.	The terms of an annuity contract are not subject to change once it's issued, so consider your options before you buy.
Who may not be happy with this method?	Don't use this method if you're uncomfortable about being responsible for the risks and rewards of managing your assets.	Younger retirees and people in poor health probably won't get their money's worth from an annuity.
Who will be happy?	People who like to manage their own finances and people with plenty of money for all of their expenses.	Buying an annuity makes the most sense for someone who's older, in good health, and ready to transfer to an insurer the job of managing assets.

Add Up Your Sources of Retirement Income

The table below will help you identify all your sources of retirement income. It also will help you estimate what benefits will be available for as long as you

live, for your spouse as a widow or widower, and whether it will keep up with inflation.

Source of income	Monthly	Can you count on getting the income amount for life?	Will the income keep up with inflation?	Can some or all of the income continue to your surviving spouse?
A. Social Security	\$ _____	Yes	Yes	Yes, offset by other Social Security benefits payable to the survivor
B. Employer pension – if paid as monthly income	\$ _____	Yes	Private plans usually do not. Public employee plans often will. What is your plan's track record?	Yes, if you use a joint and survivor form
C. Employer savings plan account (401-k) – if paid as guaranteed monthly income	\$ _____* * Enter the estimated annuity income these funds could buy.	Yes	Not usually. Amount is fixed unless you use a variable or indexed annuity.	Yes, if you use a joint and survivor form
D. Employer pension or savings plan account – if paid in a lump sum that's rolled over to an IRA and invested	\$ _____* * Enter the estimated annuity income these funds could buy.	Some risk of running out of money, depending on how well you manage investments and spending	Depends on performance of your investments and the economy while you're retired	Depends on how well you manage investments and spending during your lifetime
E. Part-time work	\$ _____	No. In later years you're unlikely to find a suitable job that you can perform.	Probably, as long as you keep working	No



Total from all sources	Amount	How to Calculate Total Amount
Initial income	\$ _____	Add A, B, C, D, and E
Income you can count on for life	\$ _____	Add A, B, and C
Income that can keep up with inflation	\$ _____	Add A and E, maybe B, C, D





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