Retirement Researcher

Workshop: Annuities and Risk Pooling

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What We're Going to Cover

- Overview of Annuity Types
- Income Annuities: SPIAs and DIAs
- Fixed Index Annuities
- Registered Index-Linked Annuities
- Annuities as Accumulation Tools
- Guaranteed Lifetime Withdrawal Benefits
- Fitting Annuities into a Retirement Plan
- Action Plan for Annuities

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Caveat

Assuming "Good" Annuities

i.e., Competitively Priced

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Annuity Vocabulary

Fixed vs. Variable

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Fixed Annuities

Principal protection
Insurance company general account
Growth can be variable, but not negative

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Variable Annuities

Subject to losses
Either investment-styled subaccounts
Or RILAs

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Annuity Vocabulary

Immediate vs. Deferred

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Immediate vs. Deferred

When is contract annuitized?

When do lifetime payments begin?

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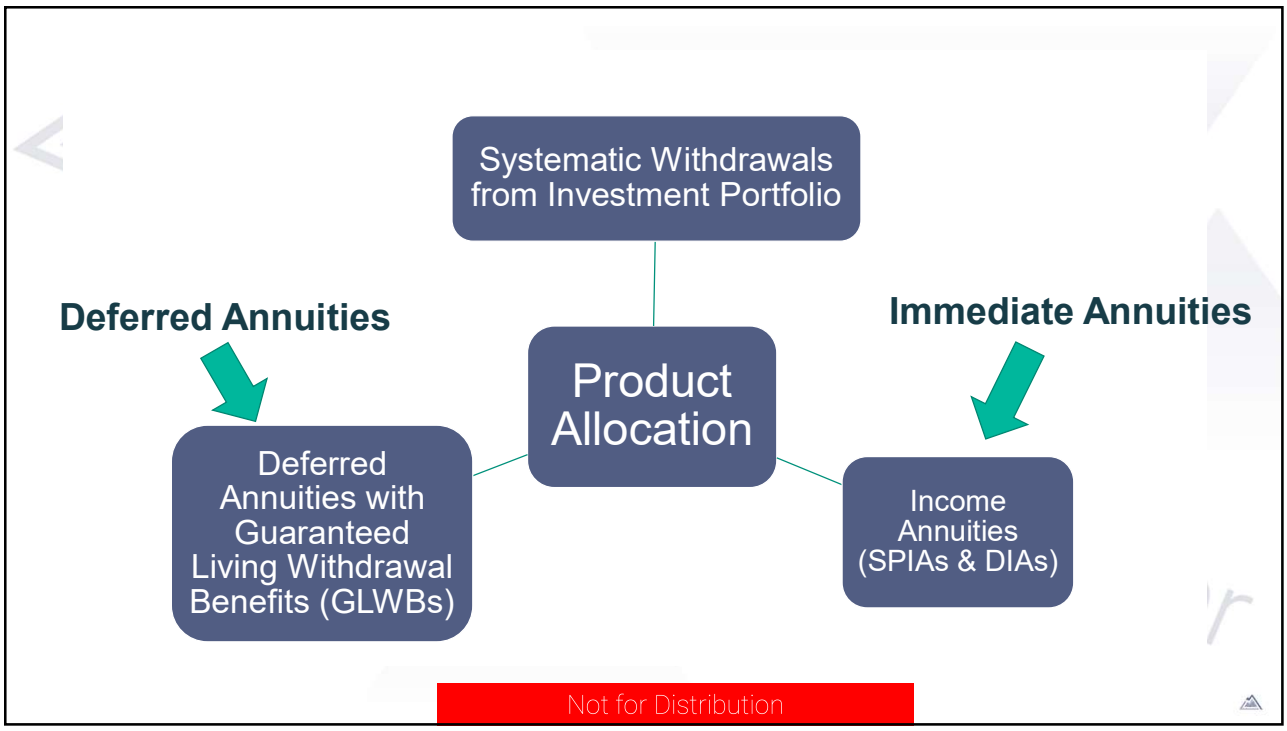

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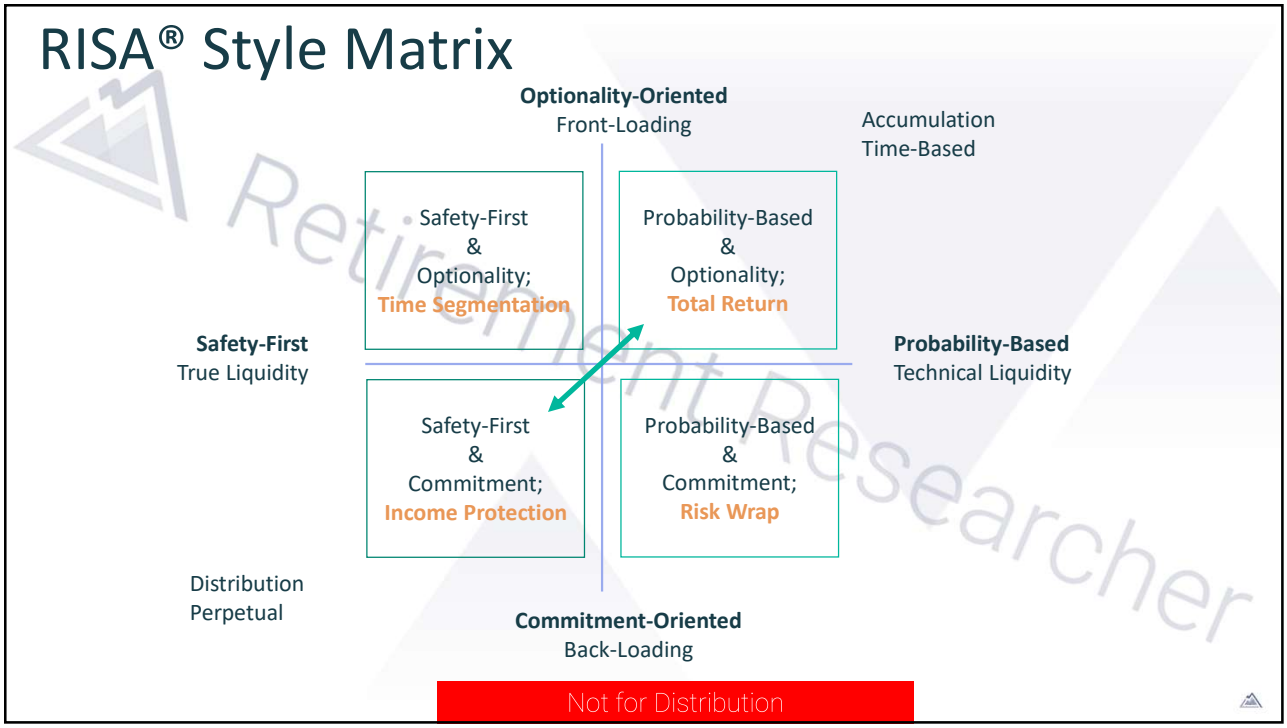

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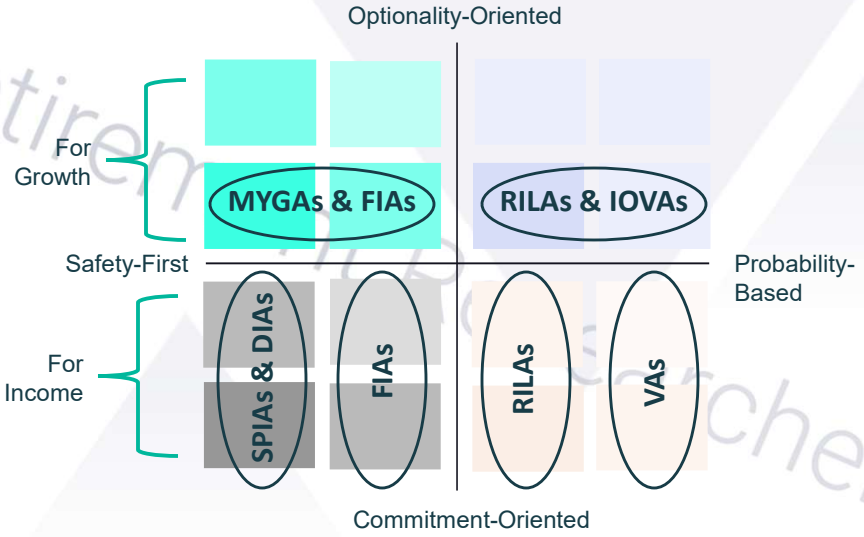
RISA® Style Matrix – Role for Annuities



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Income Annuities (SPIAs and DIAs)

- *Who is covered by an annuity?*
  owner, annuitant, beneficiary
- *When do income payments start?*
  immediate or deferred
- *Do income annuities cover one life or two?*
- *What are the different flavors of payouts?*
  Life only, life with period certain, life with cash refund, life with installment refund, period certain (not linked to mortality)
- *Are payments fixed or do they grow over time?*
  Level payments, cost-of-living adjustments, inflation-indexed (CPI)

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Pricing an Income Annuity

1) Mortality rates (which vary by age and gender) impact how long payments will be made.

2) Interest rates impact the returns the annuity provider can earn on the underlying annuitized assets.

3) Overhead costs relate to extra charges an annuity provider seeks to cover business expenses and to manage risks related to the accuracy of their future mortality and interest rate predictions.

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Pricing an Income Annuity – Life Only for 65-Year Old Female

Discount Rate:		4.81%			
Age	Income	Discount Factor	Discounted Value of Income	Survival Probabilities	Survival-Weighted Discounted Value
65	$10,000	100.0%	$10,000	100.0%	$10,000
66	$10,000	95.4%	$9,541	99.4%	$9,484
67	$10,000	91.0%	$9,103	98.8%	$8,992
68	$10,000	86.9%	$8,685	98.1%	$8,522
69	$10,000	82.9%	$8,287	97.4%	$8,073
70	$10,000	79.1%	$7,907	96.7%	$7,643
71	$10,000	75.4%	$7,544	95.9%	$7,231
72	$10,000	72.0%	$7,197	95.0%	$6,837
73	$10,000	68.7%	$6,867	94.1%	$6,460
74	$10,000	65.5%	$6,552	93.1%	$6,099
75	$10,000	62.5%	$6,251	92.0%	$5,753
…	…	…	…	…	…
95	$10,000	24.4%	$2,443	32.0%	$781
96	$10,000	23.3%	$2,331	27.3%	$637
97	$10,000	22.2%	$2,224	23.0%	$510
98	$10,000	21.2%	$2,122	18.8%	$398
99	$10,000	20.2%	$2,024	15.0%	$305
100	$10,000	19.3%	$1,932	11.7%	$225
101	$10,000	18.4%	$1,843	8.8%	$162
102	$10,000	17.6%	$1,758	6.5%	$114
103	$10,000	16.8%	$1,678	4.5%	$76
104	$10,000	16.0%	$1,601	3.1%	$49
Cost of the Bond Ladder Through Age 100 (Sum of Discounted Values):					**$177,743**
Cost of Annuity (Sum of Survival-Weighted Discounted Values):					**$145,129**
Annuity Payout Rate:					**6.89%**

*Survival Probabilities are calculated from the Society of Actuaries 2012 Individual Annuitant Mortality Tables with improvements through 2025.

For illustration purposes only. Does not represent any specific annuity.

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Other Income Annuity Pricing Dynamics

Reduced payment for:

1) Increased certainty of payments (period certain, cash refund)
2) Joint life instead of single life
3) Cost-of-living adjustments on payments

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Income Annuities & Investment Returns

Payout rate ≠ Rate of return

Includes return of principal
Comparable to "4% rule" style withdrawal rates

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Income Annuities & Investment Returns

Payout rate includes an underlying return assumption linked to performance of insurance company's general account

- Primarily fixed income
- Asset-liability matching
- Higher fixed income yields than households might earn – longer maturity, more diversified credit risk, less need for liquidity, institutional pricing on trades

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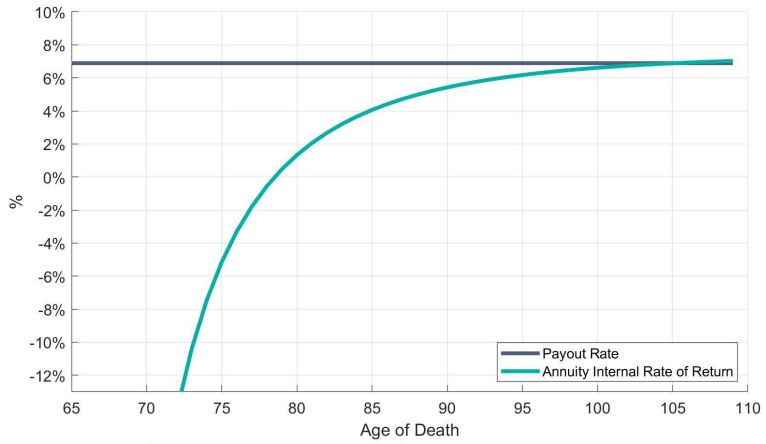
Mechanics of a Single-Premium Immediate Annuity Payout Rate and Internal Rate of Return by Age of Death for Purchase by a Female at Age 65



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How Much do Income Annuities Cost?

Spread products – like checking accounts
Fees not observable

Reverse engineer: Money's Worth measure

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Deferred Income Annuities

Including a deferral period for an income annuity increases the payout rate for two reasons:

1) Reduced probability of survival for receiving payments

2) Opportunity for investment growth on premiums in insurance company's general account

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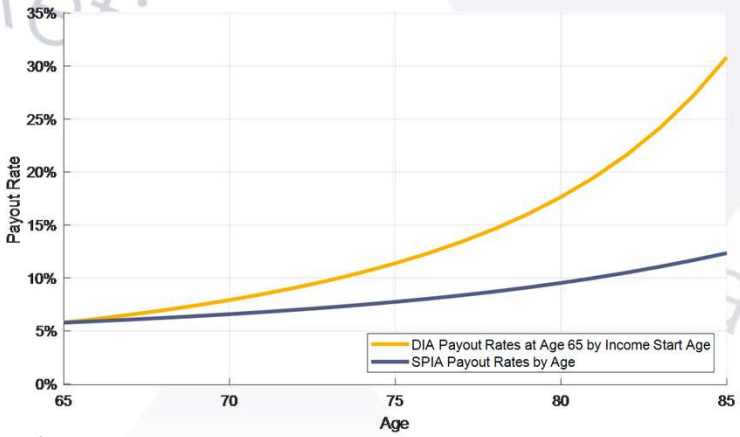
Deferred Income Annuities – Payout Rates



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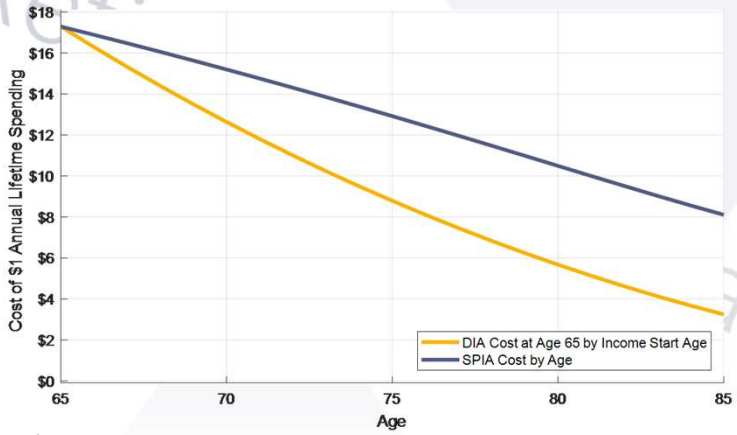
Deferred Income Annuities & The Cost of Hedging Longevity Tail Risk



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What Age to Buy an Annuity?

Moshe Milevsky's Implied Longevity Yield:

Buy SPIA today vs.
Take distributions for 5 years then buy

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What Age to Buy an Annuity? Implied Longevity Yield

Current Age	$1,000 of Lifetime Income with SPIA today	$1,000 of Lifetime Income with SPIA in 5 Years	Implied Longevity Yield
65	$17,291	$15,197	3.75%
70	$15,197	$12,920	4.09%
75	$12,920	$10,493	4.68%
80	$10,493	$8,105	6.08%
85	$8,105	$6,045	9.25%

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Income Annuities

Income guaranteed amount	What is the minimum guaranteed amount of lifetime income?
Guaranteed withdrawal rates	What is the guaranteed payout rate? How does it vary by age and length of deferral period?
Other withdrawal features	Does the contract provide liquidity to take nonguaranteed withdrawals? (Answering yes is uncommon)
Death benefit	What are the death benefit provisions, such as cash refund, installment refund, or period certain payments?
Insurance company credit rating	What credit ratings has the insurance company earned from the major credit rating agencies?

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Fixed Index Annuity – General Features

- Principal protection for contract value
- *Some* degree of upside potential
- Liquidity – contract is not annuitized
- Tax deferral
- Lifetime spending protection through optional guaranteed lifetime withdrawal benefit (GLWB)

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Fixed Index Annuity – Behavioral Aspects

- Obtain risk pooling without "sacrificing" asset
- Can still see assets on the balance sheet
- Principal protection – not at risk of loss
  -> more investing comfort elsewhere

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Crediting Method

FIA "returns" = **interest crediting**

Fixed interest or
linked to external index performance

Ex. S&P 500, MSCI EAFE, Low-Volatility Index

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Linked Index

FIAs **do not** invest in the index

Interest is based index performance through **financial derivatives**

This means price returns **without** dividends!

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Principal Protection

FIAs are fixed annuities

Contract value does **not** decrease when index experiences losses

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Fixed Index Annuity Fees

1. ~~Underlying fund expenses~~
2. ~~Mortality and expense charges~~

} "no fees"

3. Surrender charges (for excess distributions in early contract years)
4. Charges for optional living benefits (i.e. the GLWB) or death benefits
5. Unobserved internal spread
   (like a single-premium immediate annuity)

New fee-only annuities:
do not pay commissions, which can reduce (3) and (5)

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One-year Term Point-to-Point Crediting Method with Annual Reset

- Most common method (more competition on pricing)
- One-year: length of term; could be longer
- Point-to-point: compare value of market index at the start and end of year/term
- Credit interest for the year based on index price return (excluding dividends)
- Annual reset: Comparisons start fresh for each term – no need for cumulative gains to make up for previous losses

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Basic idea – FIA Interest Crediting

1. Buy enough bonds to protect principal after interest is received
2. From remainder, keep enough to cover company expenses (i.e. internal fees)
3. Use remaining funds to purchase financial derivatives (call options) providing upside exposure to linked index

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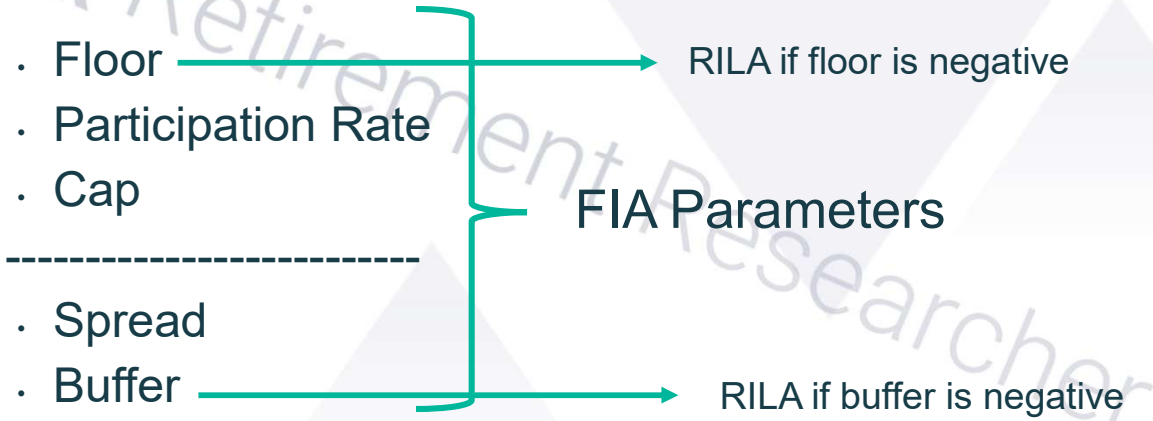
Crediting Interest -- Translating Price Return into FIA "Return"



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FIA Parameters Depend on…

Level of **interest rates**

How much is needed for principal protection?
What is the options budget?

Cost of **financial derivatives**

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Factors for Options Pricing

Factor	Impact of Increase on Call Option Price
Implied Volatility	Increased volatility = more expensive option; most important factor
Current Index Price & Option Strike Price	Increased Strike Price = less payoff potential = cheaper option
Risk-Free Interest Rate	Increased interest rate = slight increase in price (though offset by larger options budget)
Term to Maturity	Increased term = more expensive option (but not linear)

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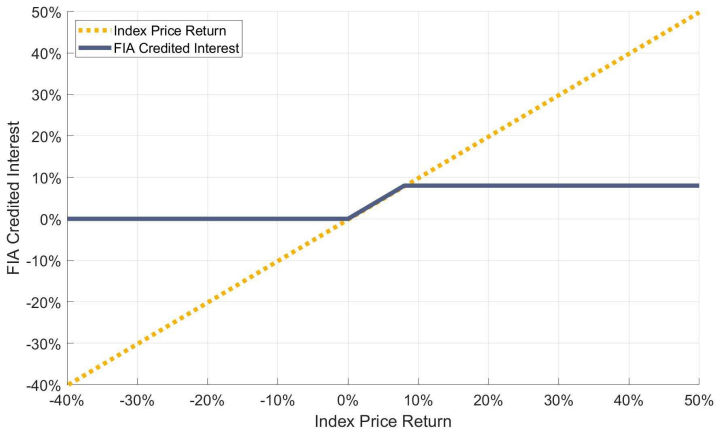
Fixed Index Annuity Credited Interest, based on Index Price Return and 8% Cap



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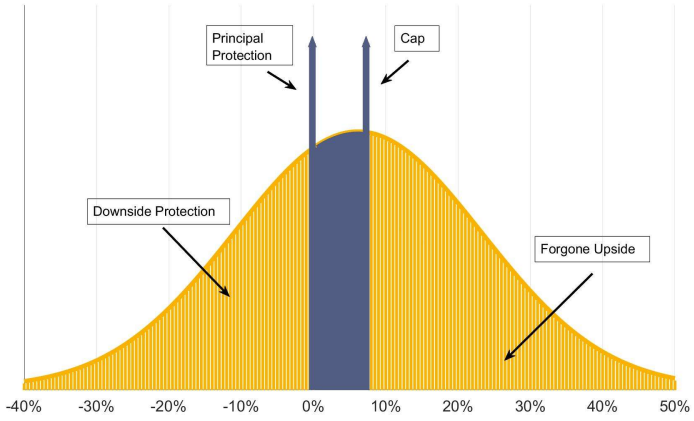
Annual Return Distribution for a Fixed Index Annuity with a 1-Year Term & 8% Cap



Price Returns (Excluding Dividends)

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Parameter Renewals for Each Term

Same process each term for insurance company

Buy bonds to protect principal
and buy derivatives for upside

Degree of upside depends on interest rates and option pricing factors – conditions change

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Parameter Renewals for Each Term

Insurance companies must maintain the right to change parameters each term

Good companies will not take advantage of this (recommendation: examine renewal history)

Especially during the surrender charge period

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What is the best crediting method?

Once index returns are known, one method will perform best

But with competitive pricing,
the choice of crediting method should not matter
(can't predict market returns)

Most important: how has the company treated its customers?

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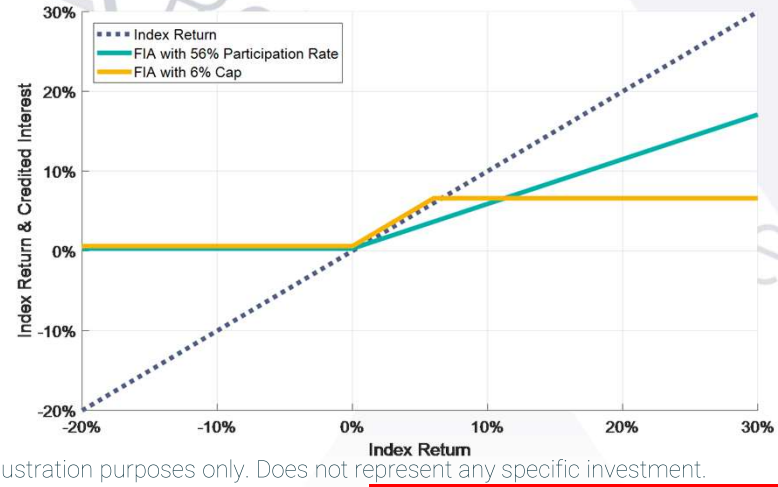
Comparing Crediting Methods: Cap Rate vs. Participation Rate



Participation Rate: 56%

Cap Rate: 6%

Cap rate is better for index price return between 0% and 10.7%. Participation rate is better if price return > 10.7%

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Longer Term Length

(+) Current parameters locked in for longer
(+) More upside from financial derivatives

(-) No interest credited until term end

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RILAs work the same way as FIAs, except their parameters allow for **principal loss,** classifying them variable annuities

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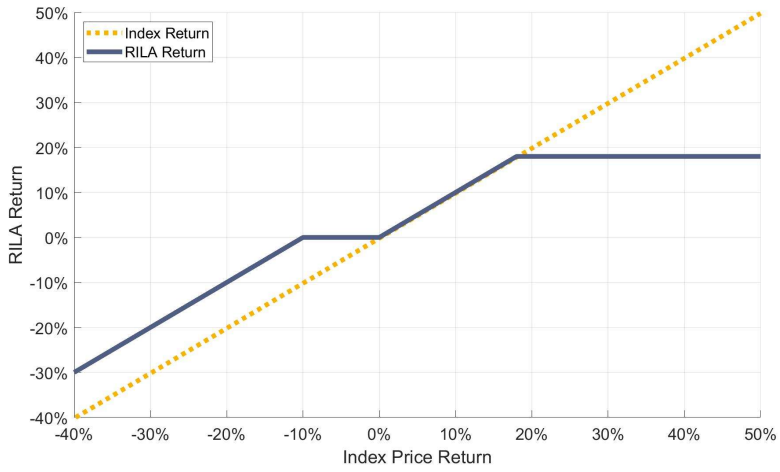
Return for RILA with 10% Buffer & 18% Cap, based on Index Price Return



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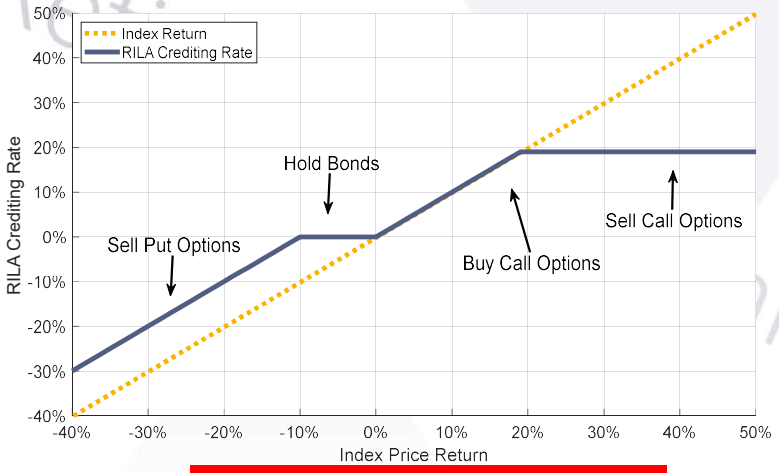
Return for RILA with 10% Buffer & 18% Cap, based on Index Price Return



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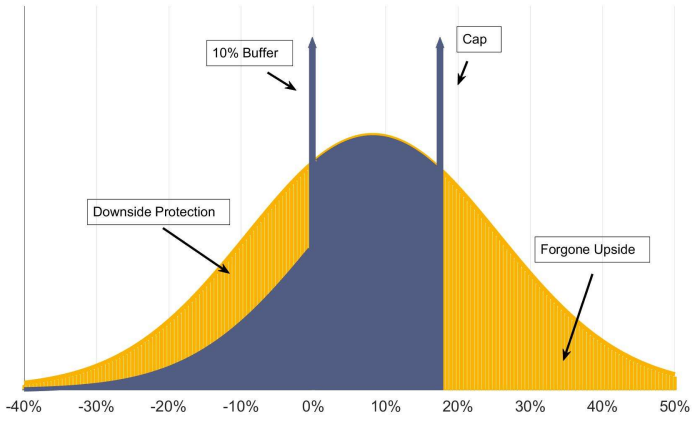
Annual Return Distribution for a RILA with 10% Buffer, 18% Cap, & 1-Year Term



Price Returns (Excluding Dividends)

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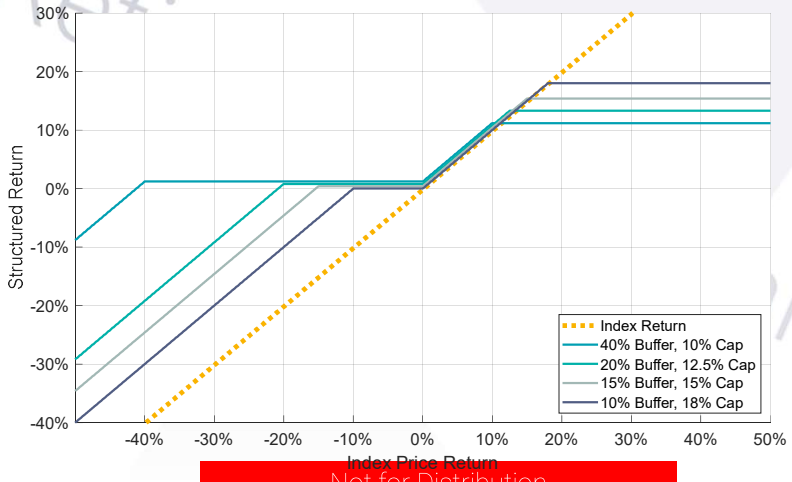
Relationship between RILA Buffer & Cap
Standard RILA Design



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Relationship between RILA Buffer & Cap
"Dual Direction" RILA Design

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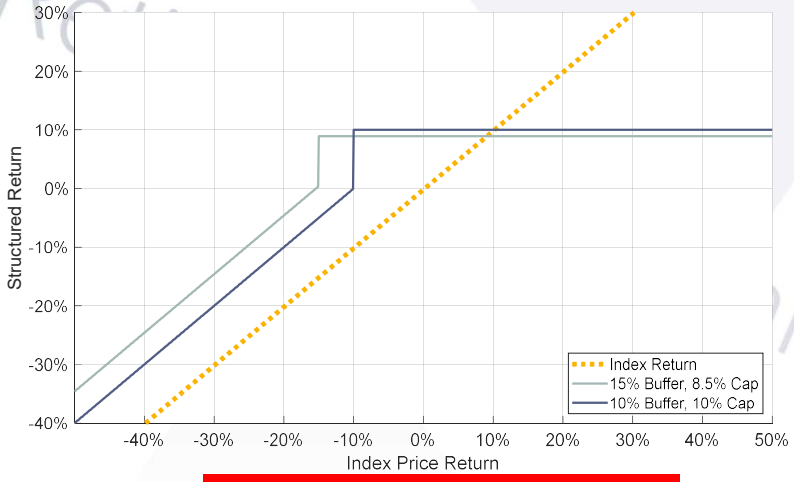
Relationship between RILA Buffer & Cap
"Dual Step-Up" RILA Design



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Accumulation without income protections

- Multi-year Guaranteed Annuities (MYGAs) / Deferred Fixed Annuities (DFAs)
- Fixed Index Annuities (FIAs)
- Registered Index-Linked Annuities (RILAs)
- Variable Annuity with guaranteed minimum accumulation benefit
- Investment-only Variable Annuities (IOVAs)

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MYGAs or DFAs as an "Asset Class"

- Principal is protected from investment volatility
- Assets grow at a higher yield than Treasuries
- Diversified asset base with less credit risk
- Tax deferral
- Potential early withdrawal penalties

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FIA as an "Asset Class"

FIA for accumulation without living benefits:

Principal protection

Competitive with bonds net of taxes

Not a stock replacement

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RILA as an "Asset Class"

RILA for accumulation without living benefits:

Limits on upside potential
More upside exposure than FIAs
May draw from stocks & bonds

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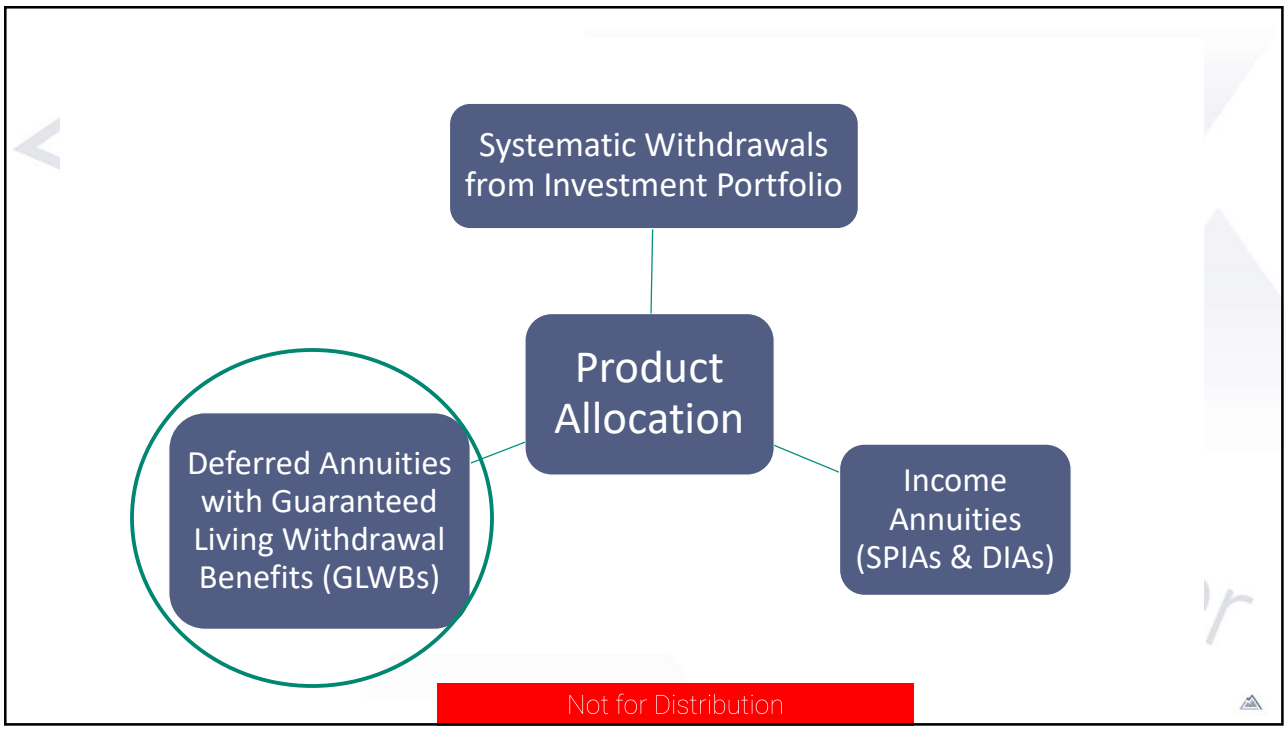

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Living Benefits

Contract Value
Benefit Base
Rollup Rate
Deferral Credits (vs Benefit Base & Rollup Rate)
Step-up opportunities
Guaranteed Withdrawal Rate

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Benefit Base & Roll-Up Rate
Annuity with $100,000 premium, 10-year deferral

Roll-up Type	Benefit Base
5% Simple	$150,000 -- $100,000 x (1+0.05 x 10)
5% Compounded	$162,890 -- $100,000 x (1.05 ^ 10)
6% Simple	$160,000
6% Compounded	$179,080

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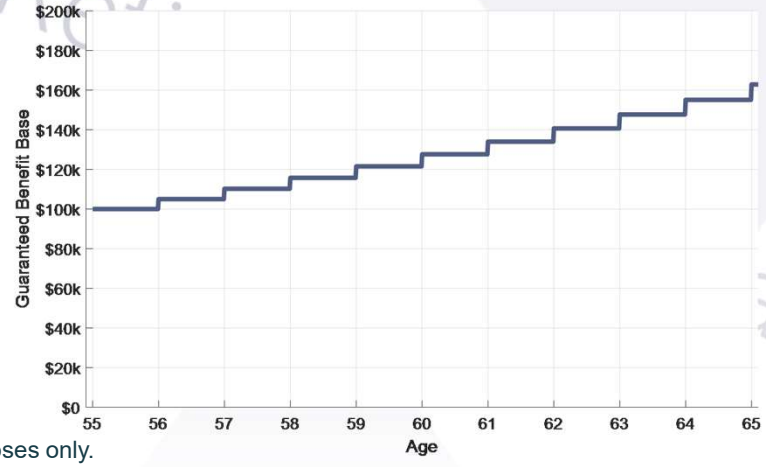
Guaranteed Benefit Base for $100k with 5% Annually Compounded Rollup Rate



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Rollup Rate

NOT a guaranteed rate of return!!!

Other compounding frequencies

When are rollups vested?

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Step-up Opportunities

New high watermarks

Frequency (daily, monthly, quarterly, annual)

Vesting

Do rollups stack on step-ups?

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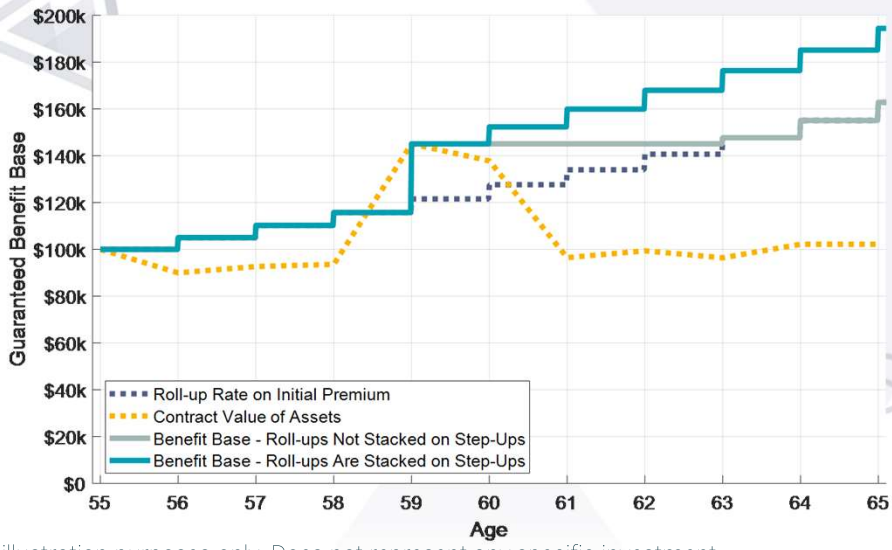
Benefit Base: Stacking vs. No-Stacking for Step-ups



19% More
With Stacking
(in this example)

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Types of Living Benefits

- **GLWB: supports lifetime income without annuitization**
- Guaranteed Minimum Income Benefit: requires annuitization, providing age-based guaranteed payout rates applied to benefit base. Lifetime income with annuitization.
- Guaranteed Minimum Accumulation Benefit: Protects contract value growth to a minimum value. No link to income.
- Guaranteed Minimum Withdrawal Benefit: Guarantees certain amount (such as return of premium or value of benefit base). No lifetime income.

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Guaranteed Withdrawal Amount

GLWB

Age-based Withdrawal Rate **x** Benefit Base

No more rollups

Step-ups are still possible

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Guaranteed Income for a $100,000 Premium

After 10-Year Deferral Period

		Withdrawal Rate				
	Rollup Rate	4.0%	4.5%	5.0%	5.5%	6.0%
Compounded	4.0%	$5,921	$6,661	$7,401	$8,141	$8,881
	4.5%	$6,212	$6,988	$7,765	$8,541	$9,318
	5.0%	$6,516	$7,330	$8,144	$8,959	$9,773
	5.5%	$6,833	$7,687	$8,541	$9,395	$10,249
	6.0%	$7,163	$8,059	$8,954	$9,850	$10,745
	6.5%	$7,509	$8,447	$9,386	$10,324	$11,263
	7.0%	$7,869	$8,852	$9,836	$10,819	$11,803
Simple	5%	$6,000	$6,750	$7,500	$8,250	$9,000
	6%	$6,400	$7,200	$8,000	$8,800	$9,600
	7%	$6,800	$7,650	$8,500	$9,350	$10,200
	10%	$8,000	$9,000	$10,000	$11,000	$12,000

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Guaranteed Income for a $100,000 Premium

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Simple	5%	$6,000	$6,750	$7,500	$8,250	$9,000
	6%	$6,400	$7,200	$8,000	$8,800	$9,600
	7%	$6,800	$7,650	$8,500	$9,350	$10,200
	10%	$8,000	$9,000	$10,000	$11,000	$12,000

For illustration purposes only. Does not represent any specific investment.

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“In the Money”

Contract value
is less than benefit base

Increases the value of the GLWB

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Step-up Opportunities

New high watermarks

Could be less common for FIAs
(Especially if cap rate is less than rollup or distribution rate)

Thus, focus on guaranteed income

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Guaranteed Withdrawal Amount
(Deferral Credits instead of Roll-Up Rate)

Withdrawal Rate **x** Benefit Base

Age at contract issue + deferral credit x length of deferral

Ex. 4.5% payout at issue; increases by 0.3% for each deferral year (i.e. 7.5% after 10 years)

Provides an alternative to using rollup rate
Step-ups are still possible (they may not be likely)

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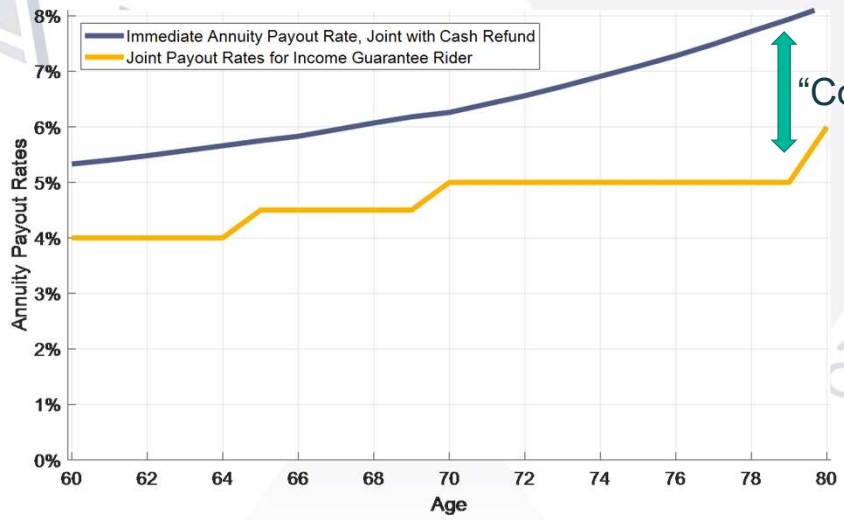
Guaranteed Withdrawal Rates: GLWB vs. SPIA



"Cost" of Liquidity & Upside

For illustration purposes only. Does not represent any specific investment

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Guaranteed Withdrawal Amount

FIAs with GLWBs
can be **competitive** with SPIAs

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GLWB and Deferred Annuitization

Annuity owner is spending own money until contract value depletes

Insurance company is only on the hook for the guarantee after account depletion

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Framing Annuity Fees

Ongoing fee drag
vs. required assets to meet goal

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Framing Annuity Fees

Ongoing fee drag
vs. asset allocation choice

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Death Benefits

Basic death benefit provisions

Optional death benefit riders may be incompatible with living benefit riders

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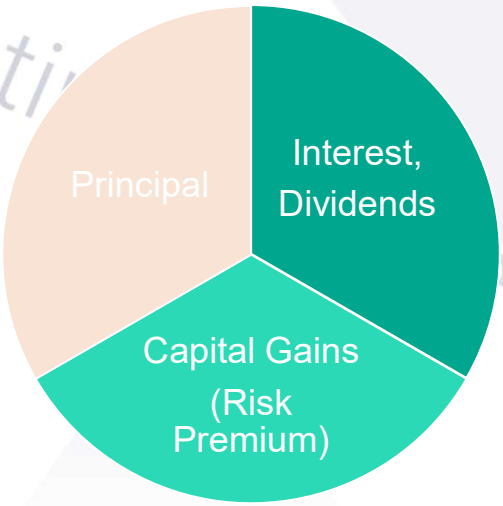
Sources of Investment Spending



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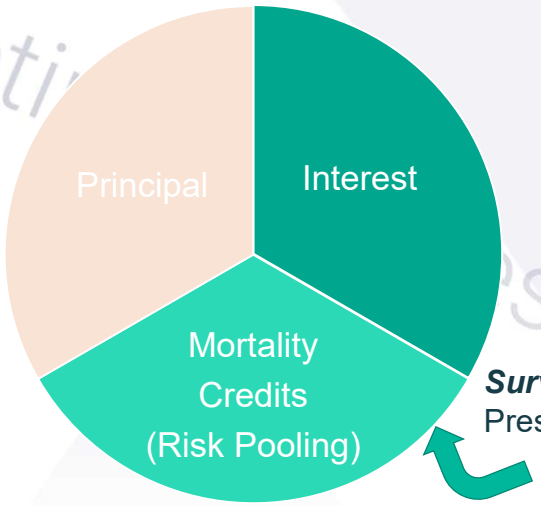
Sources of Annuity Payments



Survival-Weighted
Present Value of Cash Flows

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Case Study: Adding an FIA for Lifetime Income

- Capital Market Expectations:

	Arithmetic Means	Compounded Returns	Standard Deviations
U.S. Equities	8.2%	6.5%	18.7%
U.S. Aggregate Bonds	4.1%	4.0%	4.8%

Source: BlackRock Investment Institute, November 2025. Data as of September 30, 2025. Return expectations over twenty years for gross total nominal returns.

- Assumed dividend yield: 1.1%
- Fixed Index Annuity: 0% Floor, 8% Cap, 1-Year Terms, Credited Interest Linked to U.S. Equity Price Returns
- Optional GLWB for FIA: 5.5% Payout Rate; Rider fee: annual 1.1% of benefit base

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The Efficient Frontier for Retirement Income

- 65-year old positions $100,000 to fund $3,000 spending goal with 2% annual COLAs through age 100
- Product Allocation Choices: Stocks, Bonds, & FIA with GLWB
- Risk Measure: Unable to meet spending goal with high success rate [percentage of lifetime spending goal through age 100 not met in 10th percentile of distribution – bad market outcome]
- Reward Measure: Preserve financial assets for liquidity and legacy [average value of remaining financial assets at age 100]

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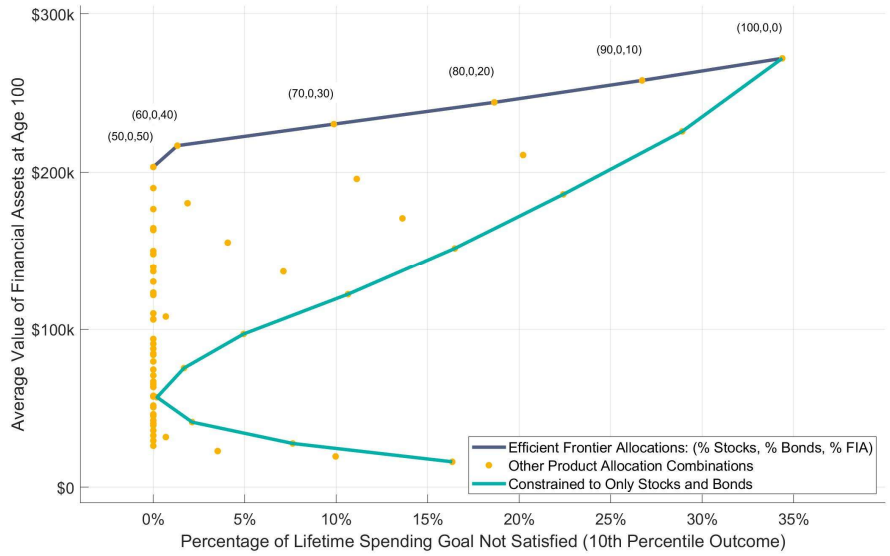
The Efficient Frontier for Retirement Income



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Retirement CARE Analysis – Annuities & Asset Allocation

CAPACITIES (Resiliencies)	Impact of Partial Annuity Use
Reliable Income	Annuity Increases Reliable Income
Spending Flexibility	
Funded Ratio	Annuity Increases Funded Ratio
Availability of Reserves	Annuity Increases Availability of Reserves
ASPIRATIONS (Goals)	
Lifestyle	
Legacy	
RETURNS (Assumptions)	
Capital market expectations	
EMOTIONAL COMFORT (Constraints)	
Traditional risk aversion	Still important: Can Individual Frame Annuity as Bond Replacement?
Longevity risk aversion	
Financial tool aversion	
Susceptibility to behavioral mistakes	
Financial plan complexity	
Financial savvy of all household members	

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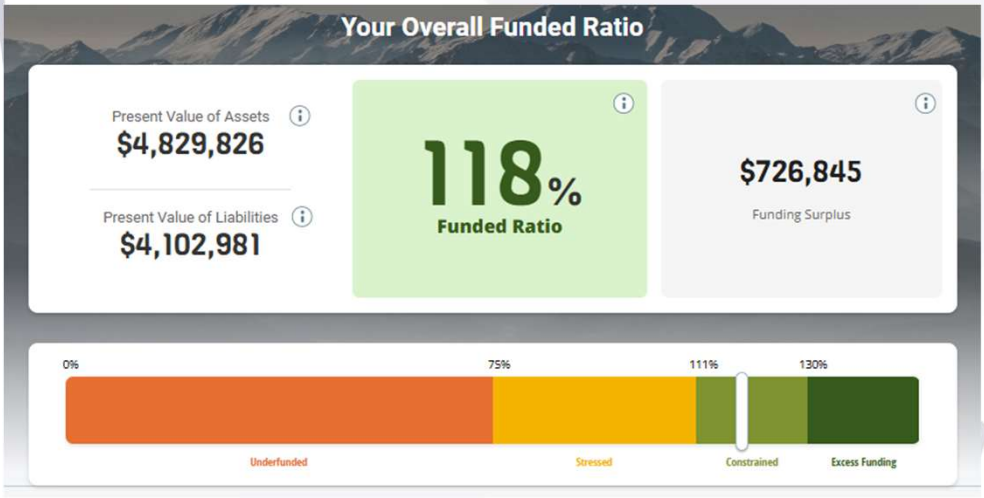
Bill & Susie Funded Ratio



Note: This is a purely hypothetical example.

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The Funded Ratio & RIO Map Subcomponents

- We can consider the funded status both from the perspective of the overall RIO-Map and for different subcomponents.
- Even when the full plan is funded, there may be gaps in some categories.

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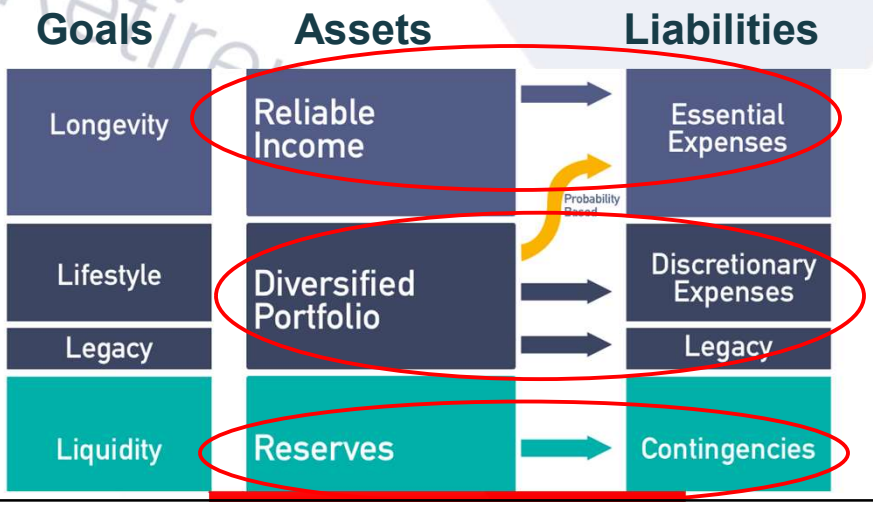
Category Scores



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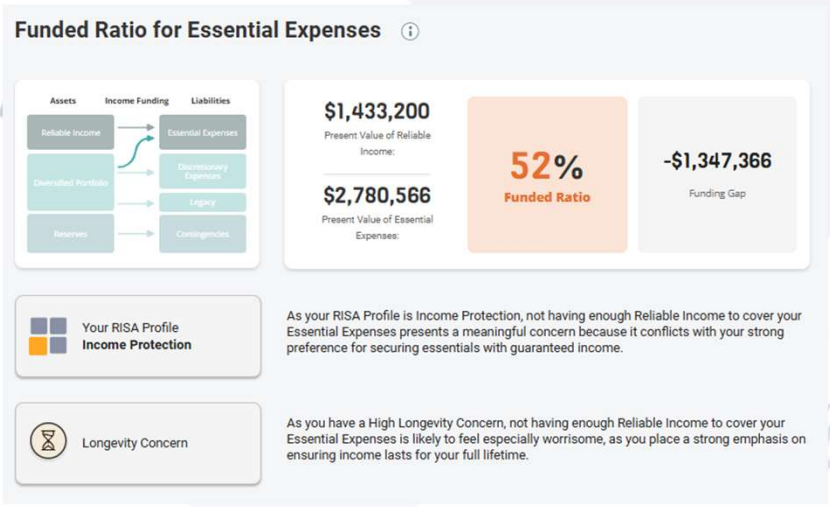
Funded Ratio & RIO-Map Components



Note: This is a purely hypothetical example.

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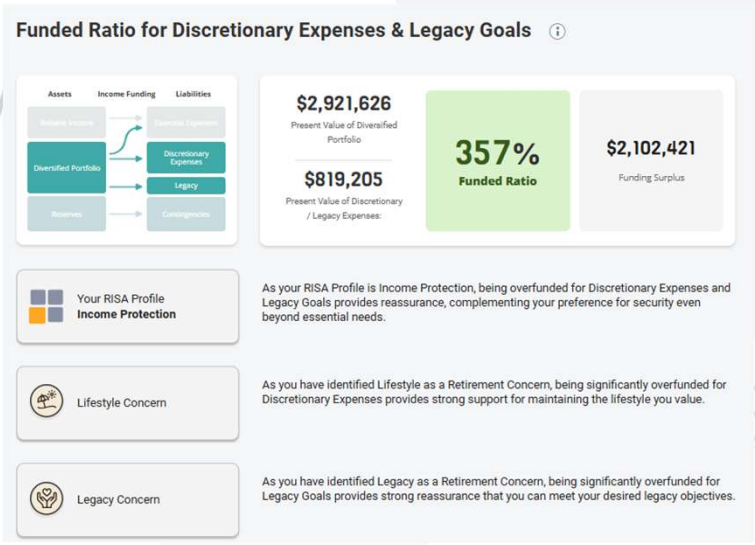
Funded Ratio & RIO-Map Components



Note: This is a purely hypothetical example.

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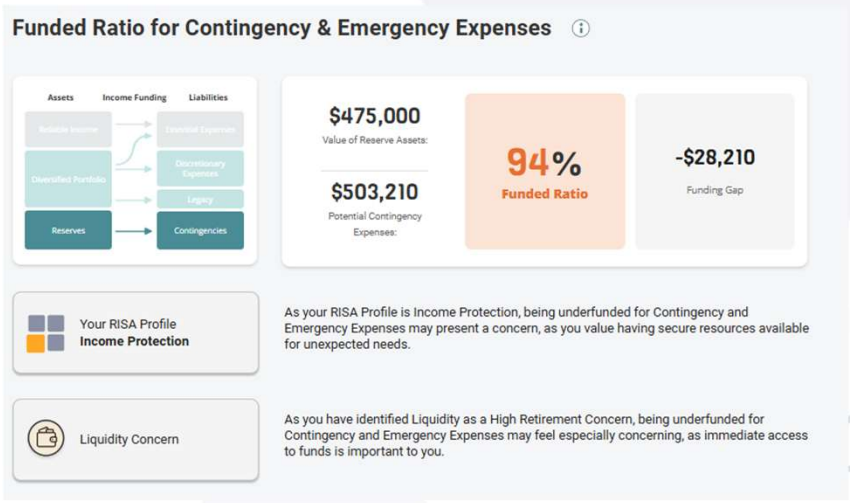
Funded Ratio & RIO-Map Components



Note: This is a purely hypothetical example.

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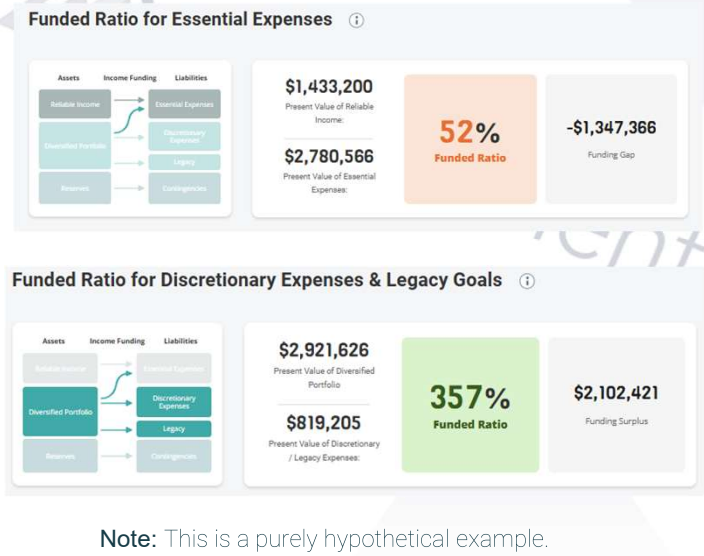
Funded Ratio & RIO-Map Components



- Safety-first style: allocate some of diversified portfolio surplus to reliable income to better fund essential expenses (~ $1.35 mil)
- Probability-based style: combining these provides 121% funded status. There are sufficient assets here for essential, discretionary, & legacy. No change needed
- Some diversified portfolio can be reclassified as reserves

Note: This is a purely hypothetical example.

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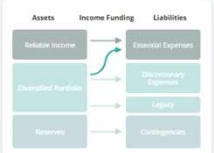
Funded Ratio & RIO-Map Components

Funded Ratio for Essential Expenses



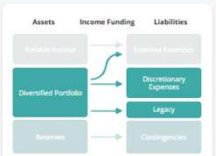
$1,433,200
Present Value of Reliable Income:

$2,780,566
Present Value of Essential Expenses:

52%
Funded Ratio

-$1,347,366
Funding Gap

Funded Ratio for Discretionary Expenses & Legacy Goals



$2,921,626
Present Value of Diversified Portfolio

$819,205
Present Value of Discretionary / Legacy Expenses:

357%
Funded Ratio

$2,102,421
Funding Surplus

?

Note: This is a purely hypothetical example.

Not for Distribution

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RISA Action Steps

- **Total Return**: Just enjoy the 121% combined funded ratio for reliable income and diversified portfolio over essential and discretionary
- **Time Segmentation**: Reallocate some diversified portfolio to a short-term fixed income bucket to fill reliable income gap for upcoming expenses
- **Income Protection:** Reallocate from diversified portfolio to a fixed annuity with lifetime income for a stronger floor of reliable income
- **Risk Wrap:** Reallocate from diversified portfolio to a variable annuity with lifetime income for a stronger floor of reliable income

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A Summary of Annuities

- For retirees who view annuities as a bond replacement and whose overall spending goal implies a lower withdrawal rate than the annuity payout rate, partial annuity strategies can:
  - Increase success rates
  - Protect more of lifetime spending goals
  - Improve legacy outcomes especially beyond life expectancy
- The longevity credits provided through risk pooling provide relief for the distribution needs from non-annuity assets, giving them more potential to grow.
- But not everyone will need or want an annuity.
  - Some retirees may already have plenty of lifetime annuity income through Social Security and traditional pensions.
  - Others will prefer the optionality and growth potential of investments.

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Assess whether your characteristics and preferences are aligned with annuities

- Your RISA Profile suggests that your preferences align with income protection and risk wrap strategies.
- You have an income gap in which there is not enough reliable income to cover your longevity expenses.
- Your risk tolerance limits your comfort with stocks in retirement. The case for annuities is stronger for those with a lower stock allocation.
- You have greater longevity risk aversion. Concerns about outliving retirement assets lead to more relative benefits from annuities as the alternative is to spend even less from investments.
- You view annuities as a replacement for bonds and are comfortable using a higher stock allocation with remaining investment assets.
- You seek protection from making behavioral mistakes with your investment portfolio, you lack self-control for spending, or you find investments intimidating. Annuities may also protect less financially savvy family members.

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Learn about the features and mechanics of different annuities

- When comparing annuities for lifetime income, first focus on the minimum guaranteed withdrawals for your purchase age and anticipated income starting age.
- Consider your preferences for tradeoffs between upside and downside, the desire for liquidity, and the types of asset allocations you would use both with and without income protections.
- Determine whether there may be an annuity option with other attractive features that make it worth accepting even if it does not have the strongest downside guarantees.

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Learn about the features and mechanics of different annuities

- Determine the income gap you are seeking to fill and decide whether the amount of assets needed to fill that gap with annuities is reasonable. Decide on a premium amount.

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Take your time with the purchase decision

- Discuss the decision with family members to coordinate both with the spouse/partner and with any potential heirs.
- Work with someone who is familiar with the vast array of available annuities and understands which work better for different purposes, ages, and deferral periods.
- Make sure you understand how the annuity works with respect to its various features and fees.
- Only add living or death benefits that you intend to use.
- Consider diversifying purchases between different companies and even different types of annuities.

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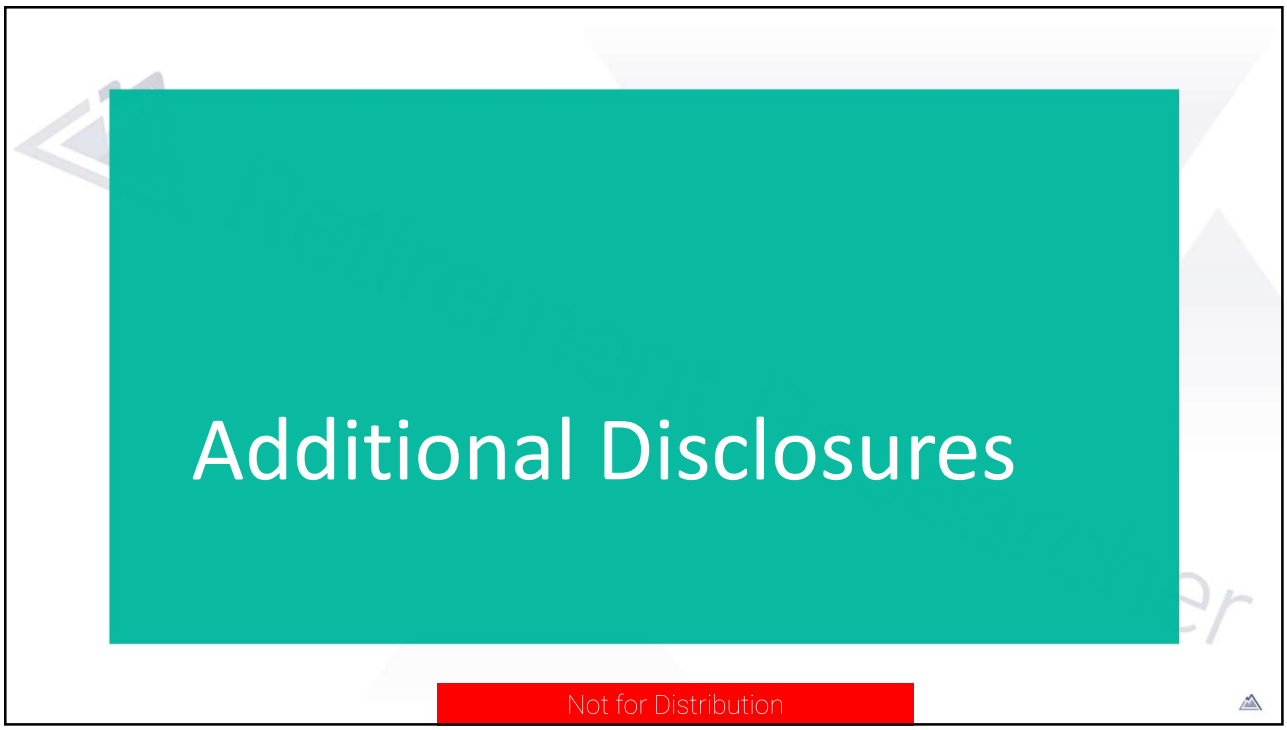

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