

Innovative Retirement Income and Old-Age Insurance Products: Risks and Barriers

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Risks older Americans face in old age

Risks transferable, poolable

- Longevity: individual and spouse
- Cost of disability and long-term care
- Cost of acute health care
- Economic loss on death of spouse
- Investment risk and interest rate risk

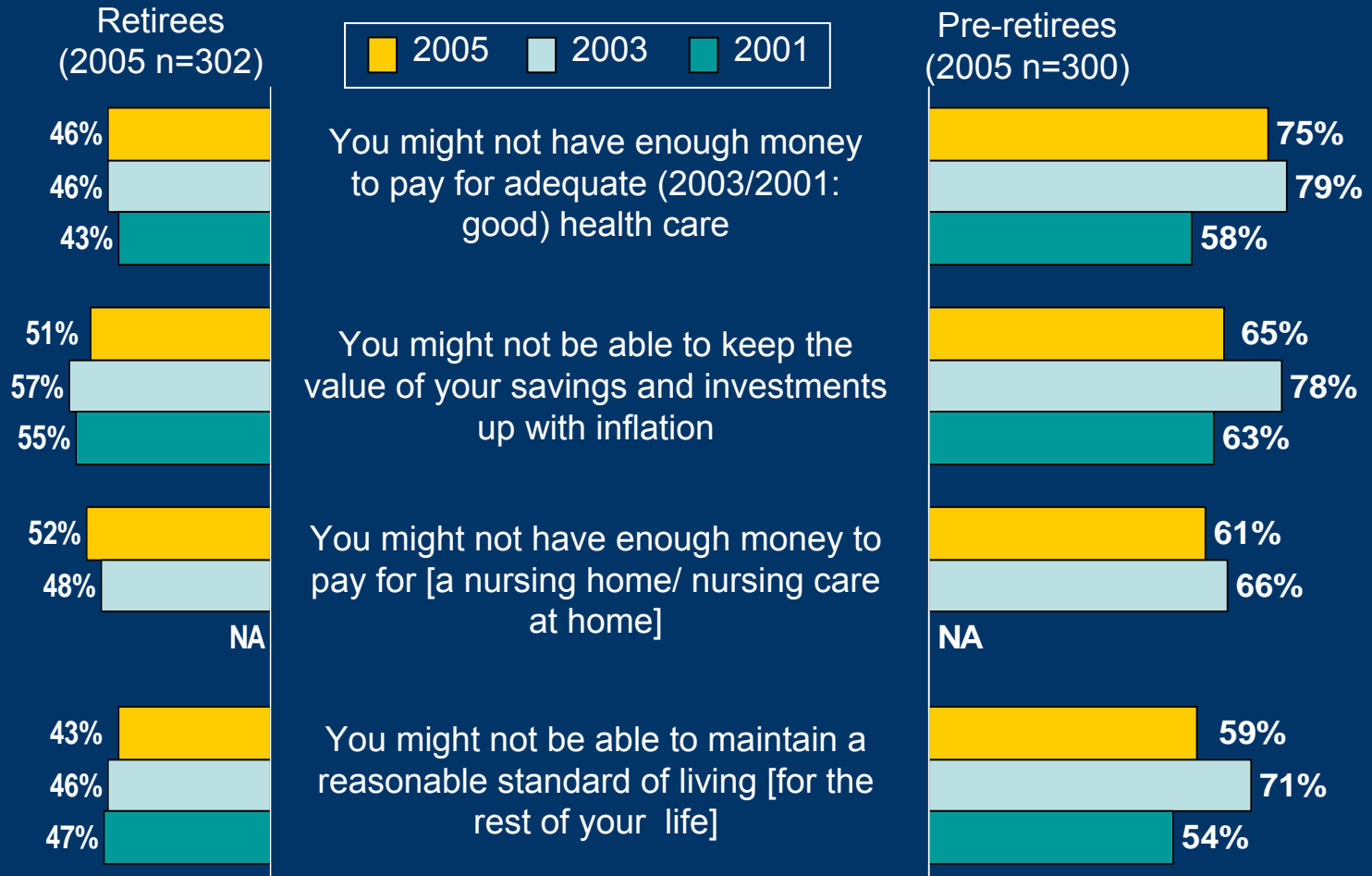
Examples of other risks

- Inability to find job, earn expected income
- Family members needing care
- Inflation risk (sometimes transferred)

Inadequate knowledge about risk

Concerns about risk fairly constant

How concerned are you that . . . ? (percentage very or somewhat concerned)



Source: Society of Actuaries, 2001, 2003 and 2005 Risks and Process of Retirement Surveys

Barriers to use of annuities

- Individuals (can experience multiple risks):
 - How they think about issue
 - Availability of resources/cost
 - Lock-in once decision is made
 - Overestimating how long self-managed money will last
- Employers:
 - Custom and structure in plans
 - Complex and interacting regulations
- Insurers:
 - Distribution system issues
 - Lack of adequate investments to fully hedge risks
 - Complex and interacting regulations

How individuals think about retirement

- Focus is on investments: not risk transfer
- Planning time horizon and focus
 - Relatively short/take things as they come
 - Many use intuitive approach
- Perceptions
 - Can do better on their own: overestimate safe withdrawals and don't focus on longevity
 - Annuity products have poor image (reinforced by advisors) (confusion between deferred/immediate annuities also)
- Inability to change mind later is big negative
- Main risk reduction strategy is reduce spending
- More likely to chose investment advisor than broad based planner

Custom and structure in employer sponsored plans

- DB plans typically pay monthly income, directly from plan –no annuity purchase is required
- DC plans typically pay lump sum
- Where DC plan offers annuities: low election rates and all or none decision
- Complexities in DC plans
 - Risky for employer if compliance not perfect
 - Safest annuity rule and fiduciary responsibility
- Innovation: IRA approach linked to employer DC plan
 - Automated shopping and gradual annuitization
- Terminations often before retirement
- Best for future: DB or in DC, new distribution options that focus on risk management/support phased retirement

Complex and interacting regulations: When DC plans offer income

- Subject to insurance regulations and ERISA
- ERISA joint and survivor requirements and spousal consent apply if income based program, not if only lump sum
- Desirable annuitization strategies conflict with Minimum Distribution Rules (MRDs)
- Insurance products rated by sex vs. benefit plan prohibition on sex based rates
- Fiduciary responsibility and safest annuity rule
- Some products subject to securities regulation
- Disclosure and election issues if options
- Phased retirement still does not fit well

Note: DB plans provide income directly from the plan, and regulatory issues are entirely different

Availability of resources/cost

- Focus needed on middle market solution
- Few people have enough money to adequately protect against long life, long term care, medical costs, and maintain living standard
- Products often seen as expensive
- Selection issues: Healthiest people tend to buy annuities – creating expensive risk pool
- Sale most often involves interaction with individual agent: creating expensive sales process
- Cost driven by underlying risks, risk pool, expenses, etc.

Design of income products

- Few inflation protected annuities available in U.S.
- People want to maintain control
- Products generally are separate by area of risk
- How to get good risk pool
- Need to cover costs and make economically attractive
- Guarantees are expensive and valuable, but their value is often not appreciated
- Dollar cost averaging is a good idea, but implies timed purchases – age 75 good time to buy

Distribution system issues

- Middle market not seen as attractive to skilled advisor, but biggest need
- Level of sale does not support adequate compensation for agent
- Long term care and immediate annuities tend to be sold by specialists – different people
- Investment advisors are often not risk protection focused, and not middle market focused
- Working through employer plans offers potential for reaching many more middle level people

Investment and insurer risk management issues

- Lack of adequate investments to fully hedge risks
- Uncertainty about future mortality
 - Wide range of predictions
- Long time frame over which benefits paid
- Product realities help drive price
 - Risk pool reflects likely mortality/anti-selection
 - Need to cover distribution cost/often personal sale
 - Very long term promises/guarantees

Overcoming the barriers: Focus on solutions

- “Dream 401(k) Distribution Options including distribution defaults”
- Longevity insurance — deferred annuity to age 85 or a similar age (no cash value)
- Coping with anti-selection
 - Combination products
 - Getting a good risk pool
- Balancing cost with need for service and guarantees
- Working in dollar cost averaging without requiring multiple purchase decisions

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