Annuities in Retirement Income Planning

For much of the recent past, individuals entering retirement could look to a number of potential sources for the steady income needed to maintain a decent standard of living:

- **Defined benefit (DB) employer pensions:** In these plans the employer promises to pay a specified monthly amount for the life of the retiree and/or spouse.
- **Social Security:** Designed to replace only a part of an individual's working income, Social Security provides a known benefit for the life of a retiree and his or her spouse.
- **Defined contribution (DC) plans:** Such as 401(k), 403(b), or 457[1] plans, which allow for contributions from the employee (in some cases from the employer as well) to a retirement account. The funds in the account, whatever they amount to at retirement, provide retirement income.
- **Individual retirement plans:** Such as Traditional IRAs or Roth IRAs. These are "individual" versions of employer-sponsored DC plans. The funds in the IRA at retirement, whatever the amount, are used to provide retirement income.

The Changing Face of Retirement

The saying that "life is what happens when you're making other plans" is particularly true when it comes to retirement income planning, for several key reasons:

- **Fewer employer pensions:** Over the past several decades, many employers have changed from defined benefit to defined contribution plans. From 1985 to 2000, for example, the rate of participation in defined benefit plans by full-time employees of medium and large private firms dropped from 80% to 36%.[2] A survey by the Bureau of Labor Statistics, published in 2018, found that only 22% of civilian workers in the U.S. participated in defined benefit pension plans.[3]

[1] These refer to the sections of the Internal Revenue Code which authorize these different types of retirement plans.

[2] See, "Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000." U.S. Bureau of Labor Statistics, updated June 16, 2004.

[3] National Compensation Survey: Employee Benefits in the United States, March 2018, Table 2.

- **Social Security:** Social Security is a "pay-as-you-go" system, with current workers supporting those already receiving benefits. As the baby boom generation retires, the number of individuals remaining in the workforce to support them grows smaller. Although politically unpleasant, fiscal reality may force higher payroll taxes, reductions in benefits, or both.

- **We're living longer:** A child born in 1900 had an average life expectancy of 47.3 years. For a child born in 2014, however, average life expectancy had increased to 78.9 years.[1]

With the stable, lifetime income stream from employer pensions and Social Security playing an ever shrinking role, retirement income planning demands that each individual accept a higher degree of personal responsibility for both accumulating and managing the assets needed to pay for retirement. And managing these assets has to be done in a world where constant inflation, fluctuating interest rates, and sometimes volatile financial markets are a fact of life.

Longer lives mean the money has to last longer, although exactly how long is unknown.

One Possible Answer – Immediate Annuities

Life insurance is designed to help solve the problems created when someone dies prematurely. An annuity, on the other hand, is designed to protect against the possibility of living too long. An "immediate" annuity is a contract between an individual and an insurance company. In exchange for a single, lump-sum premium, the insurance company agrees to begin paying a regular income to the purchaser for a period of years or for life. The periodic payment amount depends on a number of factors:

- **Premium paid:** Generally the larger the payment, the larger the income stream.

- **Age:** Older individuals typically receive larger periodic payments.

- **Payout period selected:** A shorter payout period usually results in a larger payment.

- **Underlying investment medium:** Generally, either a fixed or a variable annuity.

[1] Source: National Vital Statistics Reports, Volume 66, Number 4. United States Life Tables, 2014, Table 19. August 14, 2017.

FIXED ANNUITY	VARIABLE ANNUITY
A fixed annuity pays a fixed rate of return. The insurance company invests in a portfolio of debt securities such as mortgages or bonds and pays out a fixed rate of return. Generally, this rate of return is guaranteed for a certain period of time after which a new rate is calculated. Most insurance companies offer a guaranteed minimum rate throughout the life of the contract. Such guarantees are based upon the claims-paying ability of the issuing insurance company.	A variable annuity offers the potential for higher returns in exchange for assuming a higher level of risk. You can choose from among several types of investment portfolios, such as stocks or bonds. The amount of each annuity payment will fluctuate depending on the performance of the underlying investments. Variable annuities are long-term investments designed for retirement purposes. They have certain limitations, exclusions, charges, termination provisions, and terms for keeping them in force, and are sold by prospectus only.[1]

Annuities are not insured by the FDIC or any government agency. Since an annuity may be payable far into the future, dealing with a financially solid insurer is essential. Credit rating companies such as A.M. Best, Standard and Poor's, or Moody's can provide an objective measure of a firm's financial stability.

Seek Professional Guidance

For many individuals, an immediate annuity can form an important part of their retirement income planning. Because an immediate annuity is a complex product, the advice and guidance of a trained financial professional is highly recommended.

[1] The prospectus for a variable annuity contains complete information including investment objectives, risk factors, fees, surrender charges, and any other applicable costs.