Rethinking Retirement Income

Revisiting an established rule

Charlie Gipple, CLU, ChFC
National Director of Index Products

Revisiting a rule

When it comes to uncertain things like retirement, rules can be appealing. Following an established rule can provide a sense of confidence and security.

The only problem with rules is that they can change when the environment does. That's why we published *Rethinking Retirement Income: New Strategies in an Uncertain World* in 2013. This white paper examined the validity of one of retirement's most accepted rules: The 4% safe withdrawal rate.

We pointed out that adding a fixed index annuity (FIA) with Guaranteed Lifetime Withdrawal Benefits (GLWBs) to a client's portfolio can help reduce their dependence on withdrawals from savings, providing guaranteed lifetime income no matter what happens with markets.

In effect, FIAs with GLWBs can make the idea of "safe withdrawal rates" seem a bit outdated, particularly in environments characterized by market volatility and record-low interest rates.

Since we released *Rethinking Retirement Income,* you and your clients have witnessed continued market volatility, as well as pressure on interest rates. That means those clients relying on regular "safe" withdrawals from retirement savings could face a heightened risk of outliving those savings, or of being dependent upon income that simply isn't keeping up with inflation.

In other words, it's a good time to update our analysis of two fundamentally different retirement strategies: relying on a presumed-safe amount of income from a retirement account versus putting a portion of retirement savings in an FIA that can provide guaranteed lifetime income.

Although the vast majority (84%) of Americans think it's important to have a guaranteed monthly paycheck in retirement, only a small percentage (14%) have purchased an annuity that will ensure it.

Source: TIAA-CREF 2015 Lifetime Income Survey

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Setting a standard

For many people, the traditional retirement income strategy is simply "spending down" their portfolio using a predetermined withdrawal rate.

It sounds simple, but requires some fairly sophisticated thinking. Your clients will need to determine a withdrawal rate that will not drain their savings too quickly, yet will provide enough income to support the lifestyle they want for as long as they live. And their withdrawal rate will need to be revisited if the markets decline and their savings are unexpectedly reduced. That's also the case if interest rates drop and your clients don't enjoy the kind of savings growth they had hoped for.

As we discussed in *Rethinking Retirement Income*, much thought has been put into the optimal safe withdrawal rate for a comfortable retirement. In particular, we examined a 1994 study by William Bengen, as well as the updated study coauthored by Morningstar, Inc. The purpose of the Bengen and Morningstar studies was to identify the proper withdrawal rate that a consumer could take from a 50% stock/50% bond portfolio once they retired based on back-testing the stock market and the bond market.[1]

Bengen defined "success" as a 50% stock/50% bond portfolio with $1 in it after 30 years of distributions. Bengen's optimal safe withdrawal rate would have to deliver a 100% success rate over multiple periods of time.

62% of Americans have not even done an analysis of how to translate their savings into monthly income. [2]

2.8%

In 1994 Bengen calculated the safe withdrawal rate as 4% of the original portfolio value. Morningstar revisited Bengen's work in 2013, resulting in a revised safe withdrawal rate of 2.8%.[3]

The right rate?

After much work Bengen calculated the safe withdrawal rate as 4% of the original portfolio value, adjusted each year for inflation or deflation. So, a $1 million portfolio at retirement should have no more than $40,000 taken out in that first year of retirement, adjusted thereafter for inflation or deflation, and should last for thirty years.

The **4% rule** quickly became the standard for financial professionals on how a client should spend down their retirement portfolio. In 2013 Morningstar revisited Bengen's work, resulting in a revised safe withdrawal rate of 2.8%. What caused this shift in thinking?

The key factors were volatile stock markets, and, equally as important, low interest rates.

Clearly, the prudent thing to do in such an environment is for clients to drain their savings more slowly—yet a drop of 1.2 percentage points could have a significant impact on their income and lifestyle. This revision to the 4% rule also raises a troubling question: How low could the safe withdrawal rate drop if the economy struggles?

[1]Note: The Morningstar study actually modeled a 40%/60% (Stocks/Bonds) portfolio, a slight difference to the Bengen study. Additionally, Morningstar also took into consideration advisory fees of 1% where the Bengen study did not.

[2]TIAA-CREF 2015 Lifetime Income Survey

[3]Blanchett, David; Finke, Michael; Pfau, Wade, Low bond yields and safe portfolio withdrawal rates, January 21, 2013

The guaranteed alternative.

Those concerns lead naturally to a comparison between the safe withdrawal rate approach and an index annuity with a guaranteed lifetime withdrawal benefit. For the sake of simplicity, we will use the standard safe withdrawal rate of 4% and compare it with a SecureLiving® Growth+ annuity with Income Choice rider.

Let's start by looking at what a $1 million SecureLiving Growth+ with Income Choice contract could deliver in terms of income. Table 1 shows what the minimum lifetime income dollar amounts would be for a range of issue ages and deferral periods. Note that this example shows what would happen if the market returned 0% between now and the time the client elects to take withdrawals. Their income could be even higher in a growth market.

Table 1: SecureLiving Growth+ with Income Choice rider delivers significant income in a flat market

Minimum Level Income

Deferral Period	Issue Age 50	Issue Age 55	Issue Age 60	Issue Age 65	Issue Age 70
5 Years	$50,500	$58,000	$65,500	$73,000	$80,500
10 Years	$63,000	$75,500	$88,000	$100,500	$113,000
15 Years	$75,500	$93,000	$110,500	$128,000	$145,500
20 Years	$88,000	$110,500	$133,000	$155,500	$178,000

Hypothetical assumptions: $1,000,000 contract purchase; 100% allocation to Annual Point to Point crediting strategy; Assumes no index interest credit. Assuming client selected level income. If the client had selected the increasing income option that the withdrawal factor would be 1% less and would result in an initial guaranteed withdrawal of $55,500 per year.

How does that compare with the traditional safe withdrawal rule? Consider a hypothetical 60-year-old with $1 million in a 50% stock/50% bond portfolio. He wants to retire at age 65 (5 years from now). Let's assume he is contemplating two choices:

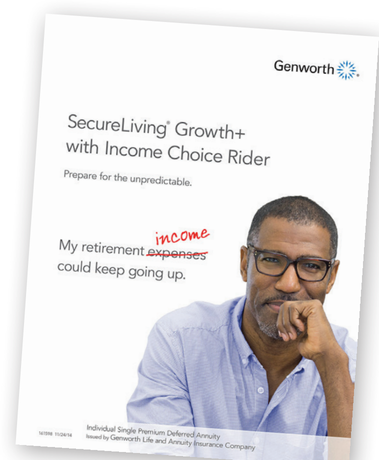
1. Stick with the 50/50 portfolio he currently has and use the 4% rule when he retires, or
2. Purchases a SecureLiving Growth+ with Income Choice Rider fixed index annuity

As shown in Table 1, for an issue age of 60 years old the minimum lifetime withdrawal amount after a five-year deferral period is $65,500. Again, this is assuming no index interest was credited to the contract value.

If your client stays with his 50/50 portfolio, how much money would he need in this portfolio to generate the same level of income ($65,500)? Using a 4% annual withdrawal rate, the balance required in that portfolio to generate $65,500 would be $1,637,500 ($65,500/.04).

A simplified approach

SecureLiving® Growth+ with Income Choice takes a simplified approach to providing guaranteed retirement income. There are no "benefit base" numbers or calculations to worry about. Your client's withdrawal factors will be based on either their single premium or their contract value, whichever is greater. Plus, the withdrawal factors increase every year the client is in deferral, as opposed to every five years, which is common with other riders. The income rider is included for an annual charge of 1.10%.



A guarantee versus a goal

To amass that portfolio balance of $1,637,500 over five years, your client would need to achieve a compounded average growth rate (CAGR) of 10.37%. Considering that 50% of this hypothetical portfolio is in low-interest bonds, fulfilling that goal would be tough to say the least. In contrast, the index annuity will deliver that predictable annual income for your client's lifetime.

Table 2 shows the CAGRs required from a 50/50 portfolio for each of the income cells in the table above in order to generate the same income as the guaranteed amount of income from the Income Choice rider. Keep in mind that these CAGR numbers are net return numbers. Therefore, any advisory or other fees that are taken from the 50/50 portfolio would make the required returns listed below even higher.

The index annuity will deliver that predictable annual income for your client's lifetime.

Table 2: Required growth for 50% bond/50% stock funds to replicate FIA income

CAGR Required using 4% Rule for Same Income

Deferral Period	Issue Age 50	Issue Age 55	Issue Age 60	Issue Age 65	Issue Age 70
5 Years	4.77%	7.71%	10.37%	12.79%	15.01%
10 Years	4.65%	6.56%	8.20%	9.65%	10.94%
15 Years	4.33%	5.79%	7.01%	8.06%	8.99%
20 Years	4.02%	5.21%	6.19%	7.02%	7.75%

Inflation addressed

SecureLiving® Growth+ annuity with Income Choice rider has the ability to help keep pace with inflation by having two options for lifetime income withdrawals. The first is the level payout option, as was just illustrated in Table 1.

Option two provides the potential for increasing income withdrawals. With this option, your client's initial income withdrawal factor begins 1% lower than it would under the level option. However, from that point on their income would increase by the same percentage rate the contract is credited. Even if the contract value is reduced to zero, the withdrawal limit can still increase based on the same rate of interest the contract value would have earned with the crediting strategy allocations.

The increasing income withdrawal option gives your client's income the opportunity to help keep pace with inflation. Table 3 shows a range of income levels for different issue ages and deferral periods using this option.

Let's return to the hypothetical 60-year-old client deferring income for five years. He would now be able to take a minimum of $55,500 in the first year, which has the ability to increase thereafter by the percentage rate credited to the contract.

Table 3: Increasing income option helps clients keep up with inflation

Minimum Increasing Income

Deferral Period	Issue Age 50	Issue Age 55	Issue Age 60	Issue Age 65	Issue Age 70
5 Years	$40,500	$48,000	$55,500	$63,000	$70,500
10 Years	$53,000	$65,500	$78,000	$90,500	$103,000
15 Years	$65,500	$83,000	$100,500	$118,000	$135,500
20 Years	$78,000	$100,500	$123,000	$145,500	$168,000

Table 4 shows the respective CAGR required by the 50/50 portfolio to generate the same level of initial income at retirement. As you can see, our 60-year-old would need a CAGR of at least 6.77% in the 50/50 portfolio to generate the same level of income. If he had advisory or management fees in that 50/50 portfolio of say, 1%, than the portfolio would have to return 7.77%.

Table 4: Required growth for 50% bond/50% stock funds to replicate FIA income

CAGR Required using 4% Rule for Same Income

Deferral Period	Issue Age 50	Issue Age 55	Issue Age 60	Issue Age 65	Issue Age 70
5 Years	0.25%	3.71%	6.77%	9.51%	12.00%
10 Years	2.85%	5.06%	6.91%	8.51%	9.92%
15 Years	3.34%	4.99%	6.33%	7.48%	8.47%
20 Years	3.40%	4.71%	5.78%	6.67%	7.44%

Even if the 50/50 portfolio in Table 4 achieves a high enough CAGR to match the initial income provided by an FIA, it would struggle to provide the same income on an ongoing basis. Over the 68 years of data that William Bengen incorporated into his model, the S&P 500 averaged 10.3%, the bond component averaged 5.1%, and the inflation average (which affects withdrawal size) was 3%. What if bonds perform even worse than they did during the worst period of time that Bengen utilized? What if inflation was higher? The 50/50 investor could face a risk of portfolio failure.

A benefit when your client needs it most

So far we've shown that a SecureLiving Growth+ annuity with Income Choice rider can do a good job providing your clients with guaranteed lifetime income, even in an inflationary environment. We've also shown that this annuity compares well with the traditional 4% safe withdrawal approach.

Yet there's one benefit SecureLiving Growth+ offers that the safe withdrawal approach simply cannot replicate. It's called an Enhanced Withdrawal Limit provision. It means that the withdrawal limit of your client's contract can be doubled for up to five consecutive years under qualifying circumstances.

Those circumstances:

- Your client must be in a state-licensed facility providing medically necessary in-patient care as prescribed by a physician
- Their contract must have been inforce for at least two years

In other words, SecureLiving Growth+ with Income Choice rider can double your client's income when they need it the most—when they are facing an illness or injury that requires long-term medical care confinement. In contrast, if your client was relying on withdrawals from their portfolio, they'd simply be draining their savings that much faster in such a situation.

2x

The Enhanced Withdrawal Limit provision means that the withdrawal limit of your client's contract can be doubled for up to five consecutive years under qualifying circumstances.

This feature is much more than just a "bonus." It addresses a top retirement-related fear. In fact, a recent survey by Legg Mason[1] reveals the top three challenges consumers fear could affect their lifestyle in retirement are:

"1. Having a catastrophic event (i.e. illness, injury) that uses up retirement funds

2. Living longer than my retirement funds last

3. My income won't keep up with inflation"

As we've shown, SecureLiving Growth+ with Income Choice rider addresses all three, with greater certainty and stronger guarantees than a safe withdrawal rate approach can provide.

[1]Legg Mason Global Investment Survey, November 2014 – January 2015, As accessed in US Investors Need $2.5 Million for Retirement, Published March 9, 2015

Rules can change

The safe withdrawal rate approach to retirement funding has provided countless retirees with a simple way to think about savings and income. Yet in today's volatile, low-interest market environment, it may not be the best approach anymore.

Your clients can add significant strength and certainty to their retirement plans by adding a SecureLiving Growth+ with Income Choice rider fixed index annuity. By putting a portion of their money into one of these contracts, they can establish a guaranteed source of lifetime income that many portfolios simply cannot replicate. Clients can benefit from built-in inflation protection, potential for growth, and access to twice their income when they need it most.

For all these reasons, choosing a SecureLiving Growth+ with Income Choice rider fixed index annuity could be the best rule for your clients to follow today.

Annuities Issued by

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