FPA ANAHEIM 2009

The Annual Conference of the Financial Planning Community

TRACK:	***RISK MANAGEMENT & INSURANCE***
SESSION: ***979056***	**ANNUITIES: WAGING WAR ON THE RISKS**
	TUESDAY, OCTOBER 13, 2009
	8:45 AM - 10:15 AM
PRESENTER:	Michael J. Zmistowski, RFC
	First Gulf Advisors
	Suite 125
	204 South Hoover Boulevard
	Tampa, FL 33609-3582

Michael J. Zmistowski, president of First Gulf Advisors, specializes in retirement income planning. Michael has been in private practice for 27 years designing and implementing financial plans for his clients of which more than 70% are senior investors. Known for his energetic speaking style, he has spoken for the Financial Planning AssociationTM, Financial Advisor Symposium, Franklin Templeton, Ameritas Advisor Services, National Financial Partners, National Association of Variable Annuities, International Association of Registered Financial Consultants and MoneyShow.com. As a retirement income consultant, Michael is an authorized presenter for the International Foundation for Retirement Education. He has written for or been quoted in the NAPFA Advisor, Journal of Financial Planning, AICPA Journal, Financial Advisor, Senior Market Advisor, The IARFC Register, The Wall Street Journal, Washington Post, Dow Jones Investment Advisor and USA Today.

ANNUITIES:
WAGING WAR ON RISK

Michael J. Zmistowski

FPA Anaheim 2009

Annual Conference

Annuities: Waging War on Risk

"The essence of investment management is the management of risk, not the management of returns."

Benjamin Graham
Father of Value Investing
Mentor to Warren Buffett

Annuities: Waging War on Risk

"CFP requires risk management … insurance … to be a part of the client engagement."

Rick Adkins, III, CFP, CLU, ChFC
Chair of FPA Best Practices
Task Force on CFP Board of Standards of Conduct

History of Annuities

- 10 A.D. Roman “annua,” “annual stipends”
- 1698 UK: first group annuity
- 1759 USA: Presbyterian ministers
- 1930 Catch on. Depression favors ins.
- 1952 First variable

History of Mutual Funds

- 1849 Scotland: first mutual fund
- 1893 USA: first closed-end fund
- 1924 USA: first modern (MIT-MFS)
- 1929 19 open-ended funds
- 1954 100
- 2008 Over 10,000

History of Annuities

Annuities +/- 2000 years older than Mutual funds.

Annuities are here to stay.

Understand provisions of the contract, internal charges & proper application to the clients’ goals, needs and objectives.

“As advisors are forced by law to move from a suitability to a fiduciary standard, the proper use of annuities will become even more important.”

Richard P. Austin, President (Retired)
Templeton Funds Annuity Co.

History of Annuities

Annuities are not to be compared to other investments.

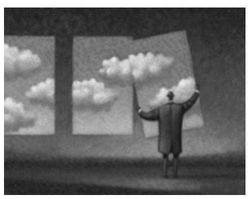
Codified into Federal tax law giving tax benefits encouraging use for retirement income.

Insurance protection that securities and bank products are not allowed to provide.

Not purchased to provide the “best” investment performance.

Waging War on Risk

A recent Cerulli & Associates survey showed that while 70% of financial planners said they did financial planning, only 9% did so according to criteria from the CFP® Board of Standards.



Managing Retirement Income

Ask Yourself:

Why Would Financial Advisors NOT use Variable Annuities?

Reasons Advisors Do NOT Use VAs

- Transaction at Ordinary Rates 7%
- Suitability Concerns for Client 17%
- Product is Too Complex 12%
- Level of Annual Contract Fees 4%
- Fear of Possible Sales Practices Allegations 13%
- Alternative Products Achieve Same Results 47%

Source: Financial Research Corp.

Reasons Advisors Do NOT Use VAs

- Alternative Products Achieve Same Results 47%

Source: Financial Research Corp.

Alternative Products Cannot Achieve Same Results

- **20% more expensive to privately insure income.**
- **Insurance companies have scale.**
- **Transfer risk to insurance company.**
- **Tax deferral.**

Dr. Moshe Milevsky
Professor of Finance at York University Canada

Alternative Products Cannot
Achieve Same Results

Research Studies from Ibbotson

"We found that all combined portfolios have higher median income levels and lower shortfall income risk than stand-alone traditional mutual fund portfolios."

Ibbotson, VA+GMWB
Oct 5, 2007

Suitability, Complexity & Expense = 34%

"(Financial Planners) are afraid of the 'media drama.' And don't know how to differentiate annuities that have been painted with negativity over high costs and low returns."

Mark Snodgrass, President
Money Tree Software

Personal Finance Media Going Positive On Annuities

Jonathon Clements, WSJ
Humberto Cruz, Syndicated
Jean Chatzky, Columnist

Jean Chatzky, Talking Money:

Recommends that retirees use good immediate annuities …it provides a guaranteed stream of income for life.

(No mention of mortality credits.)

"Safety net main attraction to lifetime-income riders on annuities."

"In June, I wrote that my wife, Georgina, had bought a variable annuity offering a guarantee of lifetime income without having to annuitize, that is, without giving up access to her principal."

Humberto Cruz
Syndicated Columnist

Convert Modest Savings Into Steady Income for Retirement

"Many baby boomers could salvage their retirement dreams by buying immediate-fixed annuities, which would convert their modest savings into a healthy stream of lifetime income."

Jonathon Clements, Columnist
Wall Street Journal, 2006

Sheryl Garrett
Garrett Planning Network

Recommend: that retirees use annuity payments along with Social Security and pension income to cover their required basic monthly living expenses.

Annuities and Fiduciary Standard of Care

"Fiduciary standard of care says it is your duty to present all appropriate alternatives. Even if it is beyond your scope of service. If you fail to disclose a legitimate alternative, you are not fulfilling your fiduciary duty."

David Lawrence,
Accredited Investment Fiduciary
dLawrence@EfficientPractice.com

Annuities and Fiduciary Standard of Care

Comprehend the Contractual provisions.
Learn the proper applications.
Apply the applications to suit the client.
Honor the clients' risk aversion.

Have a trustworthy source of expertise.

Contract Law & Tax Benefits

- Annuity = Legal contract with varying provisions.
- Defined by Internal Revenue Code.
- Deferred: any increase is not taxed until gains are withdrawn.
- IRC Publication 575

Annuity. An annuity is a series of payments under a contract made at regular intervals over a period of more than one full year. They can be either fixed (under which you receive a definite amount) or variable (not fixed).

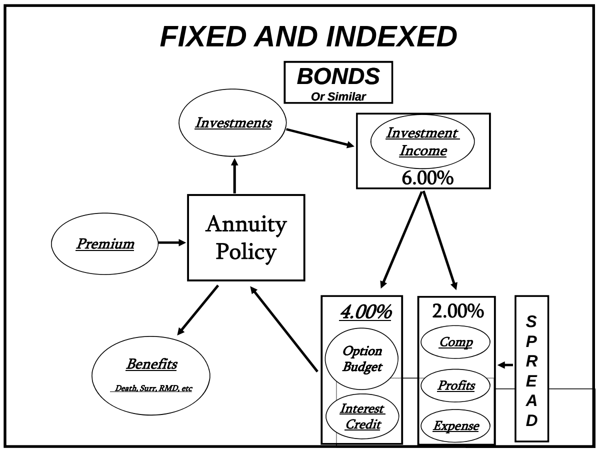
Retirement Income Solutions: Types of payout (immediate) annuities

- ***Fixed:***
  Provides steady, reliable stream of lifetime income.
- ***Variable:***
  - **Similar in many respects to mutual funds.**
  - **Combines the assurance of regular income with ability to invest in the equity markets for growth potential.**
  - **Typical variable annuity offers three basic features not commonly found in mutual funds:**
    - **favorable income tax treatment of distributions**
    - **various death benefits e.g. guaranteed**
    - **annuity payout options that can provide guaranteed income for life.**

Guaranteed Living Income Benefit Annuities (GLIB)

Guaranteed lifetime income with <u>NO ANNUITIZATION.</u>

- **Investment management.**
- **Step-ups without risk of subsequent decreases. E.g. Income GTD @ 6%**
- **Withdraw Rate 4% to 7%.**
- **Spousal continuation.**
- **Cost varies: 45 to 85 bps/year**



BUFFETT ON ANNUITIES

"Like GEICO…, BHLN maintains a low cost structure and, thus, can offer savings to many customers. By visiting the web-site, you can evaluate the specific products, get quotes and actually make a purchase. Check to see whether one or more of the products meet your financial planning needs."

Sincerely,

Warren E. Buffett

<u>Retirement Risks</u>
International Foundation for Retirement Education

- LONGEVITY
- INFLATION
- INVESTMENT
- HEALTH: ACUTE AND LONG-TERM

InFRE.org = Managing Retirement Income

Retirement Risks
Ken Ziesenheim: Las Vegas
Financial Advisors Symposium

- Health related risks
  - Prescription Drug Costs
  - Supplemental plans
  - Long-term care needs
- Financial Risks
  - Tax Increases
  - Inflation
  - Prolonged Stock Market downturn
  - Decline in interest rates
- Mortality Risks
  - Dying too soon – Family Security
  - Living too long – Running out of money

Retirement Lifestyle Goals

- Defined by Income needs.
- Essential Expenses
  - Compare to Lifetime Income Sources.
  - Identify the “Gap.”
- Discretionary Expenses
  - Compare to Managed Assets.
  - Identify the “Gap.”

Waging War on Risk

NEW Comforting research on withdrawal strategies that satisfactorily answers

"Will I Outlive My Income?"

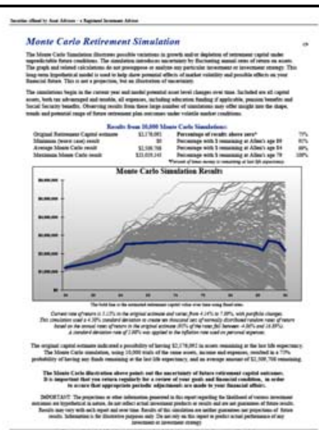
Let's Prioritize for Our Clients

Sustaining Income
vs.
Accumulation

Waging War on Risk

What is the problem with a Monte Carlo simulation probability of 91%?

How do annuities help?

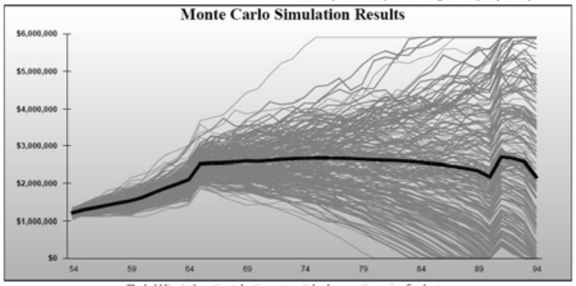

Monte Carlo Retirement Simulation

Monte Carlo Simulation Results

Results from 10,000 Monte Carlo Simulations:

Original Retirement Capital estimate	$2,176,092	**Percentage of results above zero***	75%
Minimum (worst case) result	$0	Percentage with $ remaining at Allen's age 89	91%
Average Monte Carlo result	$2,509,708	Percentage with $ remaining at Allen's age 84	99%
Maximum Monte Carlo result	$23,019,143	Percentage with $ remaining at Allen's age 79	100%

**Percent of times money is remaining at last life expectancy.*



The bold line is the estimated retirement capital value over time using fixed rates.

Current rate of return is 5.15% in the original estimate and varies from 4.14% to 7.89%, with portfolio changes. This simulation used a 4.50% standard deviation to create ten thousand sets of normally distributed random rates of return based on the annual rates of return in the original estimate (95% of the rates fall between -4.86% and 16.89%). A standard deviation rate of 2.00% was applied to the inflation rate used on personal expenses.

Managing Retirement Income

"Adding the Income Dimension"

By Peng Chen and James X. Xiong

IBBOTSON AND ASSOCIATES,

Morningstar Advisor, Spring 2008

The Role of Annuities in Retirement Income Planning

- Meet essential spending needs.
- Decrease Risk Aversion of client.
- Diversify Investment Portfolio.
- Improve Simulation Probability of success.
- **Increase feelings of safety in clients.**

Variable Annuity

Guaranteed Minimum Withdrawal Benefit

NO ANNUITIZATION.

- **Typically guarantees <u>at least</u> 100% of contributions in form of 5% annual withdrawals <u>for lifetime.</u>**
- **Step-up feature creates increase in withdrawal guarantee when investments perform well <u>without risk of subsequent decreases.</u>**
- ***New*: GMWB with 5% floor; inflation protection, Liquid, Age rated, spousal continuation.**

Insurance – Variable Annuity plus Guaranteed Minimum Withdrawal Benefit

<u>VA +GMWB</u>

1.Idea:Good or Bad

2.Simplicity

3.Fair Price

VA + GMWB: Idea: Good or Bad

1.Never running out of income

2.Account value to heirs

3.Potential increase

VA + GMWB: Simplicity

No.

Drawn by attorneys.

Need Informed advisors.

VA + GMWB: Fair Price to Insure Income

1. No Commission.
2. 115 Basis Points.
3. 100 bps for home.
4. 250 bps for car.

Research Studies from Ibbotson

Empirical Results and Monte Carlo simulations of Incorporating VA +GMWB in Portfolio

Combining Mutual Funds and VA +GMWB

- Lower average negative income return
- Lower semi-deviation
- Higher average INCOME return
- Higher total INCOME withdrawals

Research Studies

"Calculating A Sustainable Withdrawal Rate: A Comprehensive Literature Review"

John R. Salter, PhD, CFP, AIF

Assistant Professor, Texas Tech University

Harold Evensky, CFP, AIF

Research Faculty, Texas Tech University

JOURNAL OF PERSONAL FINANCE

Managing Retirement Income

"Retirement Portfolio and Variable Annuity with Guaranteed Minimum Withdrawal Benefit (VA+GMWB)."

Published in October 2007

Managing Retirement Income

"Adding the Income Dimension"

By Peng Chen and James X. Xiong

IBBOTSON AND ASSOCIATES,

Morningstar Advisor, Spring 2008

Sustaining Income vs. Accumulation

Systematic Withdrawal Plan
plus Variable Annuity+GMWB

Allows Greater Allocation to Equity
(Maintain Appropriate Risk Tolerance)

Annuities: Waging War on Risk

"Comparing Strategies for Retirement Wealth Management: Mutual Funds and Annuities"

Gaobo Pang, Ph.D and Mark J. Warshawsky, Ph.D (2009)

Journal of Financial Planning. August 36-47.

Morningstar/Ibbotson Associates

"Adding the Income Dimension"

Increase Sustainable Income Levels

Reduce Risk of Coming Up Short

Annuities: Waging War on Risk

One Primary Benefit

PEACE OF MIND

THANK YOU !

Annuities: Waging War on Risk

Michael J. Zmistowski

FPA Anaheim 2009

Annual Conference