

Building the Income Pillar

As a vice president in MetLife's retirement strategies unit, Garth Bernard knows a lot about income annuities. Find out why he thinks advisors should consider them a necessity in every well-balanced retirement income portfolio.

Research: How should advisors approach the distribution phase?

Bernard: Financial security approaching retirement has historically been built on the pillar of accumulation, which is all about maximizing someone's bag of cash for a given risk tolerance. It's about building wealth and managing risk around that. Advisors are totally familiar with this pillar; it's based on familiar principles, tools and products like modern portfolio theory, asset allocation and

rebalancing, mutual funds, annuities and so on.

But when you start looking at financial security in retirement, you need a second pillar. You're no longer exclusively building wealth, but are starting to draw on that wealth for income. And a new category of risk



is introduced: longevity risk. This is the lens that focuses all the other risks you're faced with in retirement: inflation, market risk, the catastrophic effect of acute or chronic care. In accumulation, time is your friend. But the issue with longevity is that as you age, your exposure to these risks increases. In other words, time is your enemy here.

So it's not just about risk-adjusted returns any more?

Another profound difference is that the longevity pillar turns all the principles, the tools and the materials used to build that first pillar on their head. They either do not apply at all or are no longer as effective in solving the financial problems or needs people have in retirement. Modern portfolio theory never contemplated that you would take regular withdrawals from your portfolio. You can't just use asset allocation and apply it as you would in the accumulation phase, because you're not just thinking about risk in terms of the volatility of returns any more. Your goal is the reliability of income to support a desired lifestyle. What's needed are new tools, different risk measures.

What role should annuities play here?

Because of these multiple risks, it's no longer about a single product meeting all of someone's needs. This is where income annuities find their legs. It's not "all about" income annuities, but it's about how these vehicles facilitate a holistic retirement financial solution. They're the most efficient way to generate after-tax income for life, by definition. Why? Because they involve the insurance element of risk pooling. In other words, if you had to do the same thing yourself, or "self-insure," you would have to use a lot more assets to generate the same amount of

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income while protecting against all the risks.

Where do they fit into the lifecycle of a modern retirement portfolio?

It's a necessity. The average consum-

er — the average boomer, not just the ultra-high-net-worth type — has limited resources. As government and employer safety nets erode, those resources have to serve multiple needs, including generating income, protecting it from inflation, leaving a legacy and protecting other assets from the devastating consequences of long-term care events or acute medical conditions. It can appear daunting, but here's the beauty of income annuities: Because income annuities are so efficient, inserting them as one component of a retirement solution leaves more assets left over to address other needs while protecting the income and the remaining assets from risk.

Aren't retirees paying for that efficiency in other ways?

This holistic model addresses a lot of the misconceptions that some advisors have about income annuities. There is indeed a trade-off around liquidity; if you use income annuities, you have to give up some liquidity. But how much of a legacy do you need, and how much liquidity do you really need? When you look at a client's total needs, you'll find different components that help you meet the key needs. It's absolutely correct to say that if you put an entire portfolio into income annuities, that's not going to work. But if a client needs to leave a significant bequest, something like life insurance should be included as a component. It's like putting a team together. Each product component has certain types of skills or strengths, and if you put them together, they'll work together coherently and powerfully. A superstar can't always win the game by himself. At MetLife, we call this the power of integrated solutions — they are both efficient and effective at the same time.

Moving back into the accumulation phase, how and when should advisors deploy annuities?

Deferred annuities are essentially an accumulation vehicle with additional features that help protect more conservative investors concerned about protecting their future wealth and their future income. Within the accumulation annuities, we provide these future guarantees for a price to help protect against this downside risk in the accumulation phase. That's essentially how annuities should be used. In addition, annuities are tax-deferred and so portfolios can get some benefits by keeping earnings that would otherwise have gone to taxes during the accumulation phase. So those are the basics.

Beyond that, things are changing as the industry comes to greater awareness in thinking beyond just targeting a basic level of wealth. Is a client going to use that wealth for something? If it's income, consider buying some income protection in the future. Advisors can suggest that their clients buy "longevity insurance" in the form of an income annuity that you purchase in the accumulation phase. You can allocate part of your accumulation to a desired level of guaranteed future income. That's another tool in the toolkit.

How else do you see these products evolving?

We'll continue to see enhancements in risk management guarantees provided for a fee, such as guaranteed minimum income benefits, and guaranteed minimum withdrawal benefits. I think you may see long-term care benefits and even acute-care benefits provided for a fee.

In terms of the way they're sold, I think we'll also see some evolution. We'll probably start seeing the tools that have been used in the accumula-

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tion phase evolve to align with the principles of distribution — thus coating the first pillar with a bit of the second pillar. And annuity products tend to be very complex, especially when we put all the additional fea-

tures on them to help customize them to an individual client's needs and situation. That'll mean even more of a focus on compliance and communication to ensure that only products that are suitable to a client are being delivered, and that the benefits are clearly understood.

What do advisors think they know, but don't?

Some advisors espouse beliefs that are actually fallacies or myths based on the accumulation mindset. For example: Income annuities cannot provide liquidity or can't keep up with inflation. Guess what? There is innovation taking place right here at MetLife where we're building annuities that provide significant liquidity as well as inflation protection. Another simple one: Some advisors believe income annuities don't provide much income or that they're expensive and so on. Perhaps they haven't taken a look at the quotes. The return on investment may be perceived to be low, but remember, that's not actually the goal here. The goal is how much income is being produced.

How can they make annuities a more effective part of their practice?

It's about establishing a process that speaks to the client's needs as opposed to trying to sell product. What problem are they trying to solve? The value proposition of income annuities is that, when used as part of a portfolio, that portfolio can produce more income right now, effectively giving a client a raise. The fact that a portion of the income is guaranteed for life is the icing on the cake. This means that you can meet more client needs with fewer assets, enabling the client to achieve more dignity and happiness in retirement. **B**