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Your Retirement Nest Egg: A Goose Egg or a Golden Goose

By Lawrence Stein

Glen and Susan did everything right. They saved the prescribed percentage of income each year for their retirement—Glen contributing to his school district's 403(b) plan and Susan saving through her employer's 401(k).

They resisted making many impulse purchases along the way and did not borrow or invade their retirement nest egg. They both planned to retire at age 60 and enjoy the many splendors that retirement life offers.

Glen and Susan began their retirement savings journey when fixed annuity accounts were in favor, paying 8% plus interest rates, peaking at rates exceeding 10%. They subsequently rode the wave of diversified stock funds, attracted by their inflation-beating claims.

Unfortunately, Glen and Susan just didn't plan on the market free-falling the year before their retirement, eradicating years of their hard-earned savings. They lost a staggering 40% in value in one year.

Like so many others, their plans were crushed. Their dream turned nightmare and forced them to remain in the workforce for five years or more instead of enjoying their golden years.

What could Glen and Susan have done differently to protect their retirement savings?

Hindsight, of course, would have had them reposition their investment allocations into safer accounts as their planned retirement date approached. While reallocating may have protected them somewhat, they also may have missed some of the market growth by being too conservative. Is there a way they could have protected their retirement funds from future devastation without sacrificing favorable returns?

Leverage Your Liquidity

For years, we have been taught that maintaining liquidity of assets, particularly at retirement, is beneficial. After all, don't we need that special reserve to supplement our State Teachers Retirement System benefits, Social Security, and other monthly retirement checks? Isn't that the "retirement gap" we were told to prepare for?

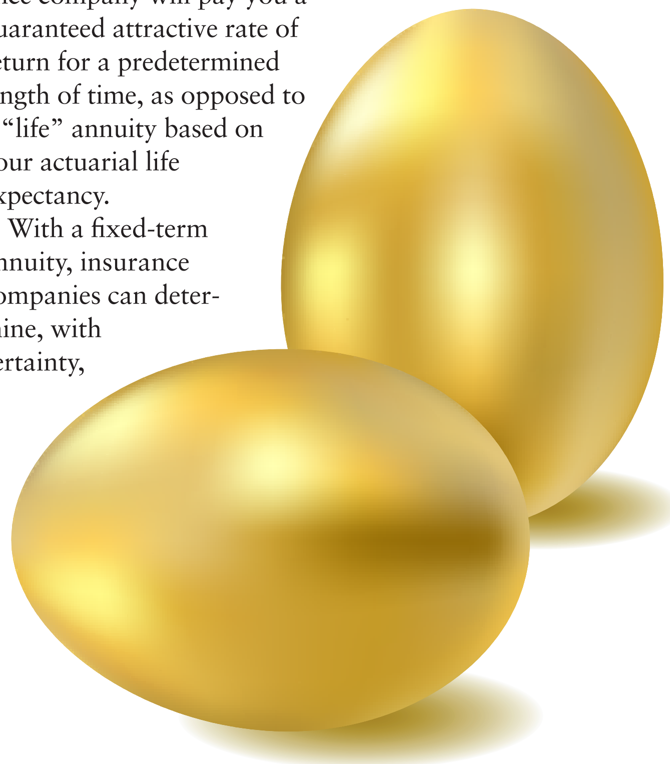
Your liquidity, that is, monies you control and have ready access to for discretionary withdrawals, translates into uncertainty to the company holding those assets because they can be withdrawn at any time. If you can increase a depository's certainty, for example, by assuring it that monies won't be withdrawn for five years, it will pay you a bonus.

That is precisely why the $400 airplane seat from New York to Atlanta purchased the day before the flight would have cost only $128 if purchased two weeks before. That two-week advance purchase gave the airline certainty. Even though you sacrificed your liquidity by buying a nonrefundable ticket and committing yourself to that flight, you benefited with a 68% savings. Insurance companies likewise will pay you for certainty.

A Revelation

Historically, consumer aversion to annuitization has been based on a limited awareness of the concept of "fixed-term" annuitization as opposed to "life" annuitization. With fixed-term annuities, the insurance company will pay you a guaranteed attractive rate of return for a predetermined length of time, as opposed to a "life" annuity based on your actuarial life expectancy.

With a fixed-term annuity, insurance companies can determine, with certainty,



the length of time to which they are committed to pay you, as opposed to the uncertainty of paying you across your actual life expectancy. Consequently, they can guarantee you a built-in return on your money.

In addition, should you not reach that projected lifetime, your beneficiaries would receive the unpaid balance of your contracts, not necessarily true for "life" annuities. You, as a consumer, will know exactly what your retirement income will be throughout your retirement years, and when it will increase at stated and guaranteed points of time.

In fact, earlier this year, one insurance company offered rates up to 7%, the actual internal rate of return, guaranteed for 30 years, for its designated-period annuities. This was no gimmick: guaranteed payments, guaranteed rates, with a full refund of unpaid principal and interest to any and all beneficiaries.

An expert financial adviser can then "ladder" or structure a series of "fixed-term" annuity contracts with highly rated companies that will increase your income at predetermined periods up to age 80, 85, 90, or whatever age you select.

"This type of annuity purchase completely changes the character of the insurance vehicle from a traditional annuity, with all its complex pricing and choices, to a simple investment payout arrangement: present value, term, and rate," says Curtis Cloke, president and founder of the Thrive® Income Distribution System.

Cloke, a Burlington, Iowa, financial adviser, admits that he stumbled onto the concept quite by accident: "While typing in the information for an annuity quote for my client, I accidentally typed in the wrong retirement date. To my surprise, a quote was made with a delayed payout commencement date. The payout was much higher than expected, and I called Prudential to see if I had made any error. They verified that there was no error, and that I could indeed delay the commencement date far into the future, thus taking advantage of the higher fixed rates of return."

That discovery sent the insurance industry into overdrive. Solidly rated carriers such as Prudential, the Hartford, and Symetra reviewed their annuity payout products and began to offer what Cloke has termed the delayed income annuity (DIA). But he will tell you that a single DIA cannot fulfill the entirety of needs and objectives of a complete retirement plan. The key is to combine multiple DIAs with other products to provide a comprehensive income plan that meets the retiree's need throughout retirement, in the most efficient manner possible.

Cloke took the knowledge of DIA products and completely retooled his retirement-planning strategy for his clients. Developing what he calls the Thrive® Income Distribution System, he reinvented how retirement plan payouts are structured.

Working with actuary Garth Bernard, Cloke integrated the little-known insurance retirement vehicle (DIA) with the more traditional single-premium immediate income annuities and deferred annuities. Each component is timed and layered for optimum tax efficiencies, including required minimum distributions for qualified plans, and provides for annual payout increases to help combat inflation. The resulting package provides a guaranteed monthly income that matches the retiree's needs through retirement.

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Mike St. Clair, a former insurance executive who is now on the faculty of Rutgers University, sees the issue from both sides of the desk: "What got my attention was that the Thrive income model not only takes into account the optimal payout series to meet Internal Revenue Service mandates, but calculates the minimum amount of assets needed to fulfill the retirement needs objective. I haven't seen too many financial services firms looking to attract fewer assets; perhaps we found a true consumer advocate."

Rethinking Your Annuity Options

An annuity has two distinct phases: the accumulation phase and the distribution phase. Up to retirement, we typically accumulate via payroll reduction (pretax) using our 403(b) and 457 plans. Sometimes, we move assets from one underwriter to another, but we're still in the accumulation phase.

For an insurance company, accumulation is a far more costly business than distribution. This circumstance is due primarily to the significant costs associated with enrolling and servicing active 403(b) plans: product approval for payroll reduction, 403(b) compliance support, marketing, sales, and so forth.

During the distribution phase, the insurance company pays you back the money you've accumulated during your working years. Distributions can be single sum, monthly, or periodic as requested. With qualified plan distributions, such as a 403(b), monies are taxable when received. In addition, the IRS mandates that a minimum amount must be distributed each year after age 70½;

these minimums are commonly known as required minimum distributions.

"The retirees realize a secondary value to their retirement account balances, a trade-in value, if you will, that significantly reduces their cost of purchasing a guaranteed monthly income that spans the length of retirement," says St. Clair.

The revelation for the financial adviser community is the high interest rates insurance companies are willing to pay out to annuitants in exchange for their liquidity. More and more advisers are beginning to understand the value of liquidity. This may account, in part, for the recent increase in deferred fixed annuity sales, which grew by 60% in 2008, as reported by LIMRA International, an insurance industry association.

Be "Bias Aware"

If you are approaching retirement, you need to find the optimal payout product (or combination of products) that meets your family's needs. Most of us blindly sign off on an option offered by our accumulation provider. In many cases, this tendency is tantamount to having no option, as many retirees leave their money on deposit and take surrenders when needed, receiving required minimum distributions automatically.

Just because you have accumulated your 403(b)/457 with a particular company doesn't mean you must select one of their distribution options.

Many retirees are unaware that they have options beyond those provided by their accumulation company. Just because you have accumulated your 403(b)/457 with a particular company doesn't mean you must select one of their distribution options. They may not provide the best payout program for your needs.

Your 403(b)/457 balances at retirement are assets you can use to attract the best payout program for you. Just as you would for your home or auto insurance, shop around for the best options and prices. The IRS allows you to "roll" your balance (transfer to an account at another insurance company) with no penalty or tax, providing you complete your rollover to the appropriate type of account or product and complete your rollover in accordance with applicable tax rules and in a timely fashion. Be aware that some accumulation companies have surrender charges on your funds. However, most surrender charges, if any, should have disappeared by the time you reach retirement.

Don't be intimidated into taking no action because of "complex tax restrictions" or IRS penalties. After age 59½, you can freely roll your 403(b) accounts into an IRA with any company you want—tax free and IRS penalty free.

Self-Advocate: Whose Life Is It Anyway?

Even though your family doctor is capable and licensed to treat your sudden coronary arrhythmia, he or she would most likely refer you to a cardiac specialist. Why shouldn't you receive the same specialized, expert care for your retirement plan? Shouldn't you work with a retirement distribution expert for your retirement options? That may not necessarily be your accumulation provider, who, not surprisingly, is in business to retain assets.

The term "cradle to grave" was coined by the insurance industry; it describes their goal of wanting to keep managing your money for a lifetime. Never forget that it is your money, not theirs.

Back to Glen and Susan

Although there is no way to erase what happened to their nest egg in the 2008 market collapse, Glen and Susan can ensure that their new account balances, when rebuilt over the course of the next 5 to 10 years, will not be exposed to those same market risks. With the understanding that in addition to building account balances, they are creating a secondary asset called liquidity, they can leverage that combination into a guaranteed monthly income well into their 80s or 90s. Should they not live to those golden years, all unpaid balances will be paid to their children or any beneficiary they name.

Using innovative and creative approaches to retirement planning, they can allocate their retirement account values to a series of fixed-term annuities that are layered to maximize their monthly payouts, maximize tax efficiencies, and eliminate any risk of another market collapse. Glen and Susan can regain the confidence that their nest egg may once again be golden.

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