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2017 Edition

Annuity Decision Guide

by Lauren Minches, *Actuary*

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Hi -

If you're thinking about retirement and feeling insecure about the permanence of your finances, I wrote this guide for you. In the post-pension era, creating a secure retirement is certainly more complicated. Instead of retiring with a continuation of your salary, you're forced to figure out how to invest, manage, and withdraw from your savings to meet your spending needs. It's a challenge, but you have options.

One of those options is to buy an annuity – specifically, an income annuity – to do what a pension would have done for you. The purpose of this guide is to introduce you to annuities, the good and the bad, and provide you with the education you need so that you can decide what makes the most sense for your retirement.

The knowledge reflected in this guide is that of an actuary. When I learned these products, it wasn't so I could sell them. Everything I know about annuities came from years of experience working at New York Life and years of studying for actuarial exams. I know how annuities are priced, how insurers manage risk and make a profit, and when the consumer wins (or loses).

I wrote this guide to help you get it right. Even if you don't read it cover-to-cover, I hope you heed my advice in three important areas:

1. **Buy an annuity for its guarantee.** If you can't figure exactly how much an annuity will pay you in the future, you shouldn't buy it. Period.
2. **If you have multiple goals for retirement, segment your portfolio and address each need separately.** Products that promise to do everything do nothing well.
3. **Be diligent about seeing the whole market and getting the best price at the credit rating you prefer.** Since you're buying an annuity for its guarantee, the rating matters.

I hope you find this guide helpful. I've included my contact information below and throughout the guide. Please feel free to call or email me with any feedback or questions.

Regards,

Lauren Minches

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Lauren Minches

Abaris Financial, Inc.

Lauren is the Director of Insurance and Chief Actuary for Abaris, a digital platform and marketplace for income annuities. In that role, Lauren is responsible for choosing the annuity products available on Abaris' website, partnering and innovating with insurance companies, developing analytical retirement tools, and writing annuity educational content.

New York Life Insurance Company

Prior to joining Abaris, Lauren spent most of her professional career at New York Life. She worked on both life insurance and annuity products, performing numerous functions including product development and pricing, financial projections, financial reporting, data analytics, and risk management. While at New York Life, Lauren completed all of her actuarial educational requirements and became a Fellow of the Society of Actuaries.

Columbia University

Lauren studied at Columbia University's School of Engineering and Applied Science. She graduated Magna Cum Laude with a B.S. in Financial Engineering. While at Columbia, Lauren served as treasurer of the Engineering Student Council and head of the Undergraduate Recruitment Committee. Lauren is also a member of the Tau Beta Pi Engineering Honor Society.

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What An Annuity Does Well

1. Converts your retirement savings into a pension-like steady stream of guaranteed income you can't outlive...

   a. starting right away → SPIA *page 7*

   b. starting in the future → DIA *page 25*

   c. starting far in the future and also deferring your RMDs → QLAC *page 49*

2. Offers a safe, guaranteed, and tax-deferred way to grow your retirement savings → MYGA *page 71*

What An Annuity Doesn't Do Well

3. Provides an all-in-one solution with a stream of income, liquidity, and upside potential → FIA *page 91*

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SPIAs

Single Premium Immediate Annuities

Convert your retirement savings into a guaranteed lifetime income stream

Introduction

You've been saving for years, and years, and years, and are finally ready to retire! It's exciting, and overwhelming. On the one hand, you're proud of how much you've saved and feel pretty sure it's sufficient for a comfortable retirement. But, you're definitely going to miss the guarantee of a steady paycheck.

The situation you're finding yourself in is an unfortunate reality for today's retiree as pensions have been replaced by IRAs and 401(k)s. These defined contribution retirement plans are great for accumulation but don't offer a clear path for turning those assets into income. Without a pension, you're forced to manage the decumulation of your 401(k) or IRA alone, which is particularly challenging when you don't know how long you'll live.

Contents

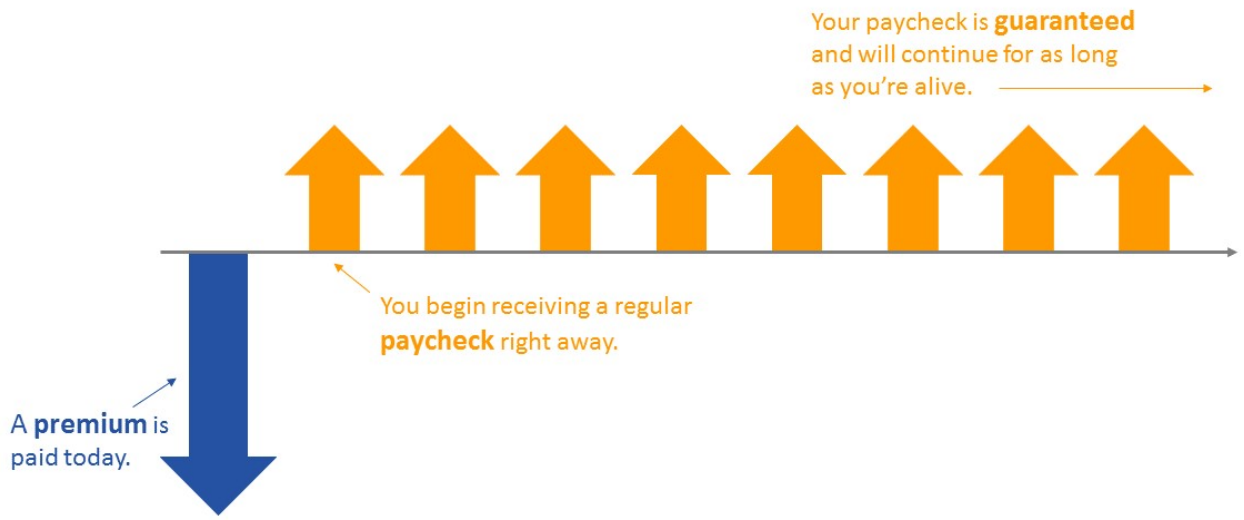
There is good news, though, and it's called a Single Premium Immediate Annuity, or SPIA. A SPIA is essentially a pension that you can buy for yourself once you're ready to retire. The wealth you've accumulated – whether in your IRA, 401(k), or personal savings accounts – can be converted into a guaranteed lifetime paycheck you can't outlive. This means more certainty and comfort for you during the golden years that lie ahead.

Whether it's called an immediate annuity, single premium immediate annuity, SPIA, or immediate income annuity, it all means the same thing.

In this guide, we'll tell you everything you need to know about SPIAs – how they work, how they're customized, and how to evaluate whether converting a portion of your assets into income makes sense for you.

What is a SPIA?

A Single Premium Immediate Annuity (SPIA) is guaranteed retirement income you can purchase to protect your longevity and minimize the risk of outliving your savings. When you buy a SPIA, you convert a portion of your savings into a monthly paycheck that starts within one year and continues for as long as you're alive. Whether purchased with your retirement or personal savings, a SPIA turns your assets into guaranteed income for life. You can think of it like a pension you buy for yourself.



A SPIA is… an **income annuity**.

> An income annuity is a contractual agreement between you and an insurance company. In exchange for a lump-sum premium, the insurance company promises to give you a steady, guaranteed paycheck for life (or a certain period of time, a less-common version of the product). The size of the paycheck is specified upfront and depends on factors such as your premium, age, and gender.

More specifically, a SPIA is… an **immediate** income annuity.

> An immediate income annuity begins annuity payments within one year of the premium payment. (In contrast, deferred income annuities don't begin payments right away, deferring their start to as late as 40 years from now.) As a result, SPIAs can only be funded with a single premium, leaving no room for future contributions.

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And finally, a SPIA can be… **qualified** or **non-qualified**.

Qualified SPIAs are purchased with pre-tax money from your 401(k), Traditional IRA, or other qualified plan. The money is transferred penalty and tax-free, but all income payments will be fully taxable at ordinary income tax rates.

Non-qualified SPIAs differ in that they are purchased with post-tax savings. In this case, only a portion of the income payments will be taxable to avoid taxing the money used to purchase the SPIA twice.

In summary, a SPIA is a pension you can buy for yourself using your pre- or post-tax retirement savings. Your hard-earned savings will be converted into a retirement paycheck which will keep you financially secure no matter how long you live.

Benefits

Figuring out how long your retirement savings need to last is difficult. Guaranteed lifetime income can provide you with peace of mind through a paycheck that you won't outlive. Buying a SPIA with your retirement savings offers a number of benefits:

✓ Longevity Protection

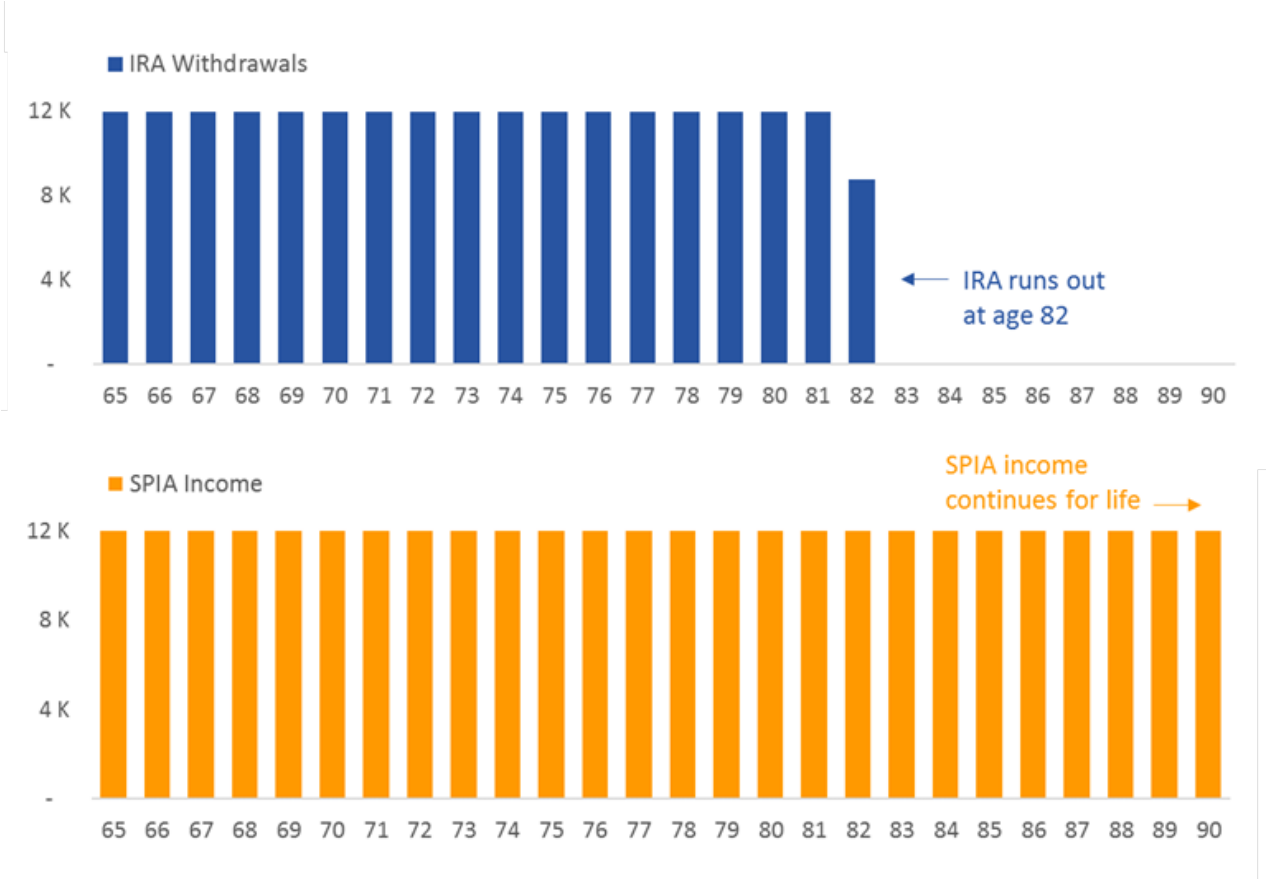
Insurance is typically thought of as something you buy to protect you and your family from unfortunate events. By turning your assets into income you can't outlive, the SPIA offers a more pleasant kind of protection: longevity insurance. The longer you live, the more financial value the SPIA provides.

✓ Alternative Fixed Income Investment

While SPIAs are primarily insurance products, the value they offer can be compared to low-risk fixed income investments, such as an investment grade bond fund. As you approach retirement and no longer want to take equity market sized risks, you'll likely move your assets into safe but low returning bond funds. Moving some of those assets instead into a high-rated SPIA will make your money last longer.

Let's take a look at an example. Matthew is 65-years-old and about to retire. A big portion of his IRA is invested in an investment grade bond fund which is only earning 2%. Taking a look at his sources of retirement income (such as Social Security and a rental income property), Matthew has a spending gap of $1,000 per month, i.e. his projected monthly expenses are $1,000 higher than his income. Matthew decides to fill that spending gap with a SPIA.

Matthew will take $178,000 of his IRA that's currently earning only 2% and use it to purchase a SPIA. Starting in one month, the SPIA will provide him with a $1,000 paycheck that will continue for as long as he's alive. In comparison, simply leaving the money invested in his IRA bond fund and withdrawing $1,000 per month would deplete his IRA by age 82.



SPIA rates based on a $177,651 Integrity life-only policy for a male aged-65 with income starting immediately. Rates as of 2/2/2017.

✓ Simplified Asset Management

Adding a SPIA to your portfolio can dramatically simplify your retirement planning. Knowing that you'll be receiving a steady paycheck, which could cover all or a portion of your expenses, makes it easier to manage your remaining assets. Guaranteed income means that you can take more risk with how your remaining assets are invested and be more comfortable deciding whether to take that extra vacation.

✓ Spousal Benefits

SPIAs can be set up as joint annuities, which means that payments continue as long as either you or your spouse are alive. Structuring the contract like this is a great way to preserve financial stability and quality of life for the surviving spouse.

Let's continue to use Matthew as our example. Matthew expects that he will pass away before his 63-year-old wife, Lindsay. He wants to know that that she'll be okay (at least financially) once he's gone, so he's considering adding her to his SPIA. Matthew can purchase a joint life policy that's contingent on her life as well, such that income payments continue until both of them have passed away. The income payments will be lower, but they're expected to be paid over a longer period of time. Since their expenses will decrease when it's just Lindsay, they've opted for a 25% income reduction, which increases their income while they're both alive.

SPIA rates based on $177,651 Integrity single and joint life-only policies for a male aged-65 and a female aged-62 with income starting immediately. Rates as of 2/2/2017.

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✓ **Principal Protection**

The savings that you allocate to a SPIA are protected from swings in the stock or bond markets. And, by selecting the death benefit option (more on this later), you can guarantee that all of your savings will be passed onto your beneficiaries if you pass away prematurely.

✓ **Some Liquidity**

While SPIAs are generally illiquid products functioning like a paycheck and not a savings account, many carriers offer some level of liquidity. Most commonly, this is in the form of commutation, or withdrawal benefit which permits accelerating upcoming monthly benefits. A limited number of monthly payments can be accelerated at once, and guidelines exist around when and how often the policyholder can take advantage of this liquidity.

✓ **Clear Product Structure**

The SPIA has a simple structure. For any amount of premium you would like to put into the contract, the insurance company will tell you how much monthly income they can offer. There are some decisions you'll have to make (more on this later) that affect the level of income, but that's it. The income is net of the insurance company's expenses and the commission collected by the distributor.

Drawbacks

Despite these benefits, SPIAs are not good for everyone or for all situations. Here are some of the drawbacks:

✗ **Limited Liquidity & No Cash Value**

SPIAs don't offer much liquidity or have a cash value that can be withdrawn or borrowed from. SPIAs should be thought of as a paycheck, like a pension.

✗ **No Market Exposure**

The income you'll receive is determined upfront, fixed, and isolated from any market volatility. While this is a positive attribute for those focused on insurance coverage, it isn't right for those seeking an investment-style product.

Typical Buyers

A SPIA is a powerful way to ensure you have a guaranteed source of income in retirement. That doesn't mean it's right for everyone, and it never makes sense to purchase an annuity with your entire portfolio. Here's the methodology we've developed at Abaris to help you think about whether a SPIA may (or may not) be a fit for you:

Consider buying a SPIA if...

✓ Social Security and/or pension benefits won't cover your regular expenses
✓ You're about to retire or are already in retirement
✓ You've accumulated between $250,000 and $5 million in retirement savings
✓ You have average or above-average health
✓ You're seeking greater certainty in retirement and more of an insurance product

A SPIA is probably not the right product for you if...

✗ Social Security and/or pension benefits cover your regular expenses
✗ You're years away from retirement
✗ You've accumulated less than $250,000 or more than $5 million in retirement savings
✗ You have below-average health
✗ You're seeking higher risk and more of an investment product

A common objection to SPIAs is that they don't build or provide access to cash value unlike other insurance products used for retirement planning. This is true, but the trade off is access to higher guaranteed income than these more liquid products will offer. Using only a portion of your portfolio to purchase a SPIA leaves the rest of your assets to provide liquidity and market upside.

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SPIA Rates

The income offered on SPIAs will vary over time as market conditions change, being driven most notably by longer-term Treasury and investment grade corporate bond yields. In addition, your personal attributes (age, gender) and the policy options you select will impact the quote. As of February 2017, highly-rated carriers are offering the following SPIA annual income payments for a $100,000 purchase:

Age	Male	Female	Joint
55	$5,700	$5,600	$5,600
60	$6,100	$5,800	$6,000
65	$6,800	$6,400	$6,700
70	$7,900	$7,300	$7,700
75	$9,500	$8,700	$9,200

SPIA quotes shown as annual income for a $100,000 premium as of 2/2/2017. All quotes are life only. Joint quotes are for a male and female with the same age and 50% continuation.

On our website you can compare quotes across top-rated carriers.

Understanding how your personal attributes and the options you select drive quotes enables you to structure the policy to best suit your needs. Expect to have to think about the following when evaluating a SPIA:

Age: Income will increase as you age. The older you are when you buy, the fewer remaining years you're expected to live. Holding all else equal, spending the same amount when you're older will generate more income.

Gender: Income will be higher for males than females. Because women have longer life expectancies than men, the income women receive each year will be smaller.

Premium: Income will increase with higher premiums. A portion of the insurance company's expenses incurred are fixed per contract such that incremental premium can go entirely towards buying income. Said another way, there is usually a discount for larger premium deposits.

Single vs. Joint Life: Income will be higher for single life than joint life policies. A joint life policy will provide income as long as either person is alive, which is almost certainly longer than if contingent on one person.

Payout Option: Income will be lower for richer guarantees. Guaranteeing a minimum cumulative income (cash refund / installment refund) or a minimum number of payments (period certain) increases the amount the insurer expects to pay you. To compensate for the extra guarantee, they will need to lower the recurring payments.

Riders: Income will be lower for each rider added. In general, any extra options or riders added to a policy will require compensating the insurer for additional risk they've assumed. Typically these options increase your guarantee or provide you with extra protection, both of which will result in lower base income amounts. Some examples of the riders available for SPIAs are:

- **Inflation Protection**: Your income benefit can be increased annually by a certain percentage (typically 1-5%) or based on changes to the CPI-U.
- **Changing Needs / Future Adjustment**: Allows for a one-time future adjustment (increase or decrease) to your income benefit but must be decided at issue.
- **Income Enhancement**: Your income benefit is tied to a benchmark interest rate index that can potentially increase your benefits on a specific future date.

Finally, you'll usually notice an inverse relationship between the creditworthiness of an insurer and the income they offer. Insurers with higher credit ratings have earned them by maintaining higher capital reserves and more conservative investment portfolios limiting their profitability and thus the income they can offer you. Only highly-rated insurers (A.M. Best rating of at least A) make the cut for inclusion on the Abaris platform. And, even among the insurers we've decided to work with, it's worth distinguishing among the levels of financial strength. The guaranteed income you're promised is only as good as the financial strength and longevity of the insurer backing it.

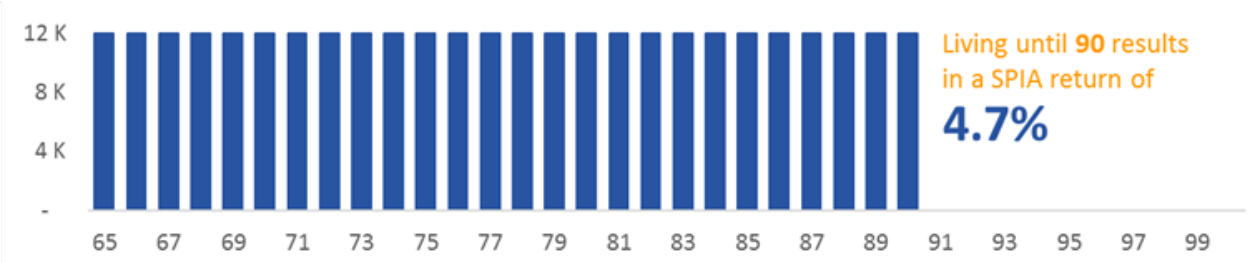
Financial Value

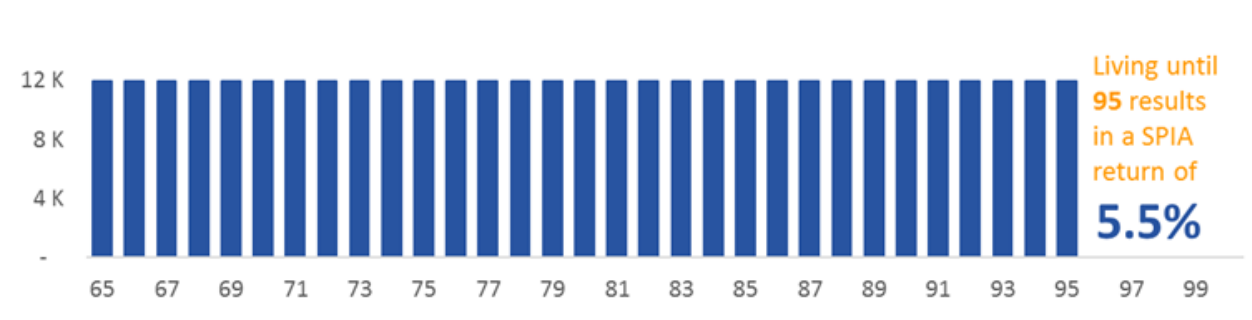
A common question asked when considering moving some of your retirement assets into a SPIA is: what value will I get from this purchase? Typically, people look for a quantitative answer, such as an IRR or ROI, that they can compare to returns generated in their fixed income portfolio.

Unfortunately, the value of a SPIA cannot be understood quite so simply or compared to the return of a traditional financial product on an apples-to-apples basis. Why not? Because calculating an IRR or ROI requires knowing the upfront investment and all future income amounts and dates. As a longevity insurance product, the SPIA will provide you with income for as long as you're alive, i.e. end date to be determined!

Instead, we can calculate a range of IRRs based on your potential lifespan. The longer you live, the higher the IRR over the life of the product will be. While thinking about your quantitative return should be a part of your analysis, don't forget about the more qualitative risk reduction and peace of mind the product is providing as well.

Continuing with 65-year-old Matthew, his SPIA could wind up generating a 4.7% return if he lives until 90, which increases to 5.5% at age 95 and 5.9% at age 100.





SPIA rates based on a $177,651 Integrity life-only policy for a male aged-65 with income starting immediately. Rates as of 2/2/2017.

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Taxation

The taxation of annuities depends first and foremost on whether the annuity was purchased with pre-tax or post-tax money. If the premium was paid with post-tax money, as with a non-qualified annuity, the portion of any income payments that constitutes a return of that premium will not be taxable. On the other hand, qualified annuities are purchased with pre-tax retirement savings. Because the money used to fund the annuity has never been taxed, all distributions from the annuity will be fully taxable. In either case, ordinary income tax rates will apply.

For SPIAs with death benefit riders, a benefit would be due to a beneficiary if the cumulative income payments made are less than the initial premium paid. Any death benefit owed will be paid directly to the beneficiary, thereby avoiding the probate process. The beneficiary can elect to annuitize the death benefit over his/her life expectancy instead of taking it as a lump sum in some instances. Either way, the annuity contract will typically be included in the deceased's estate, and the beneficiary will be taxed on any proceeds they receive at ordinary income tax rates. Note that designating your spouse as your beneficiary will typically result in the annuity being excluded from your estate.

Taxation of Non-Qualified SPIAs

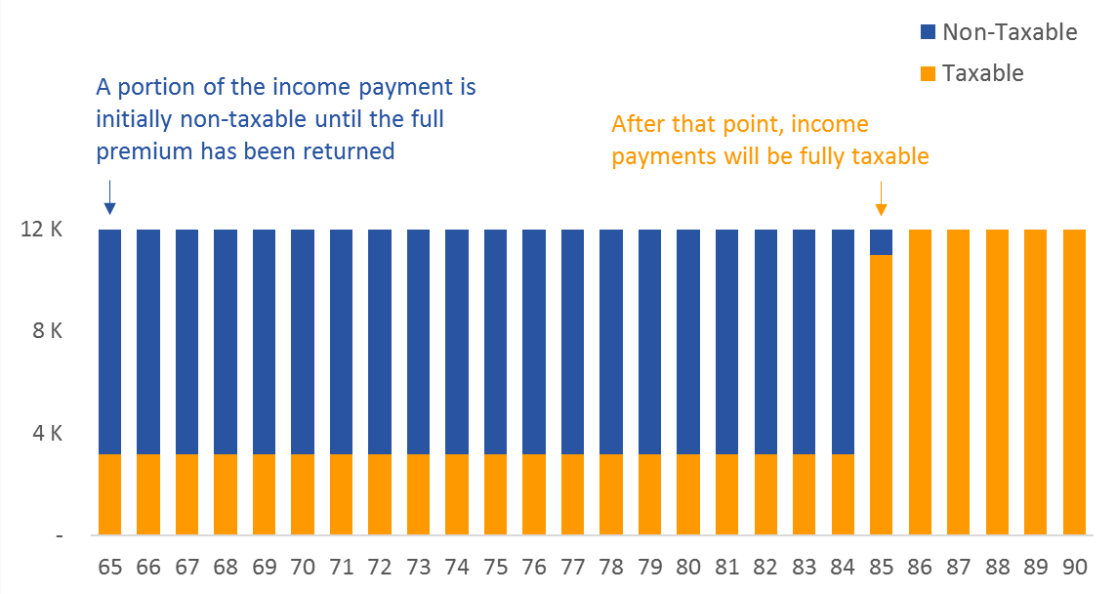
Because a non-qualified SPIA is purchased with after-tax money, your income payments will not be 100% taxable. Each income payment can be split into two pieces: a part that's returning your initial investment, and a part that's your gain or interest earned. Taxes will only be owed on the gain, as the premium you invested in the contract has already been taxed. This non-taxable portion of the income payment is determined using an exclusion ratio, which is provided by the insurance company at purchase.

Exclusion Ratio = Investment in the Contract ÷ Expected Return

The exclusion ratio will be applied to each income payment, indicating how much is not taxable, until the full investment in the contract has paid out. Once the investment has been fully returned, subsequent income payments will be fully taxable.

To see how this works, let's continue analyzing Matthew's SPIA. If Matthew does not wind up using pre-tax retirement savings to buy the SPIA, it'll be classified as non-qualified.

The exclusion ratio for Matthew's policy is 74%. The insurance company calculated this as the ratio between his investment in the contract ($178,000) and the total amount of income they expect to pay him ($241,000 in this case). Thus 74% of his income payments will be excluded from his taxable income until a total of $178,000 has been excluded. For Matthew, this will be the case once he's received 21 years worth of payments, after which the SPIA income will be fully taxable at ordinary income rates.



SPIA rates based on a $177,651 Integrity life-only policy for a male aged-65 with income starting immediately. Rates as of 2/2/2017.

Finally, if a death benefit is due to your beneficiaries, taxes owed will be calculated in a similar manner. Any portion of the death benefit that constitutes a return of premium will be received tax-free, whereas benefits in excess of the initial investment will be taxed at ordinary income levels. Either way, the benefit will be passed directly to beneficiaries, thus avoiding the probate process. And, unless your spouse is designated as your beneficiary, the annuity will typically be included in your estate.

Tax treatment of these payments can be tricky, so be sure to reach out to a tax advisor for a complete explanation.

Diversification

It is widely accepted that a diversified portfolio is superior to one with singular or uniform market exposure. For nearly every target rate of return, a diversified portfolio of minimally-correlated investments can be constructed that will be lower risk than one investment with equal expected return. When diversifying your retirement portfolio, you will likely select a combination of equity and bond market investments that are appropriate for both your risk-appetite and your investment horizon. In general, your portfolio should tend towards equity investments in the early years and then gravitate more towards fixed income investments as you near retirement.

The fixed income assets in your portfolio serve to provide steady, reliable income that is uncorrelated, or inversely correlated, with the equity markets. Sound familiar? This is exactly the purpose that a SPIA or any income annuity serves, with one major added benefit: the annuity will continue to make payments until you die. Allocating a portion of your fixed income portfolio to a SPIA can generate comparable returns (see the Financial Value section) and reduce your longevity risk.

In fact, adding the security of a SPIA to your portfolio can enable you to earn a higher rate of return with the rest of your portfolio. If your SPIA or other annuities generate enough income to cover your retirement expenses, you have even more flexibility to invest the equity portion of your portfolio without putting your livelihood at risk.

Features & Riders

It's best to think of the base SPIA product as that which provides the most income based on your premium, age, and gender. But, there's room to customize the product or add additional guarantees to meet your needs. In some cases, the insurance company will refer to these options as product features. Other times they'll be listed as riders.

Below are the various ways you can customize your policy, noting that these options can vary from insurer to insurer:

Single vs. Joint Life

SPIA income can be tied to a single or joint life:

- **Single**: income paid over the lifetime of the insured
- **Joint**: income paid over the 'joint life' of two insureds, i.e. as long as one or both are alive

The income level following the loss of the first life can be designed to remain level or decrease. Opting to reduce the income upon the passing of the first spouse (typically to 40-99% of the starting income level) allows for a greater income level while both are alive.

An alternative to buying a joint life annuity is to purchase a single life annuity with a death benefit (a.k.a. cash refund) and designate your spouse as the beneficiary. Upon your passing, he/she will have the option to continue the contract in his/her name until the benefit has been paid out.

Payout Options

Income can be based purely on lifespan or can have a guaranteed component:

- **Life Only**: payments stop at death (or later of two deaths for joint)
- **Life with Cash Refund**: additional guarantee over life only that pays beneficiaries the difference between the premium and sum of all payments already received upon insured's death
- **Life with Period Certain**: additional guarantee over life only that guarantees payments for at least a certain number of years. Payments will continue to beneficiaries if insured passes away during this period of time

Payout Frequency

Income payments can be made monthly, quarterly, semi-annually, or annually.

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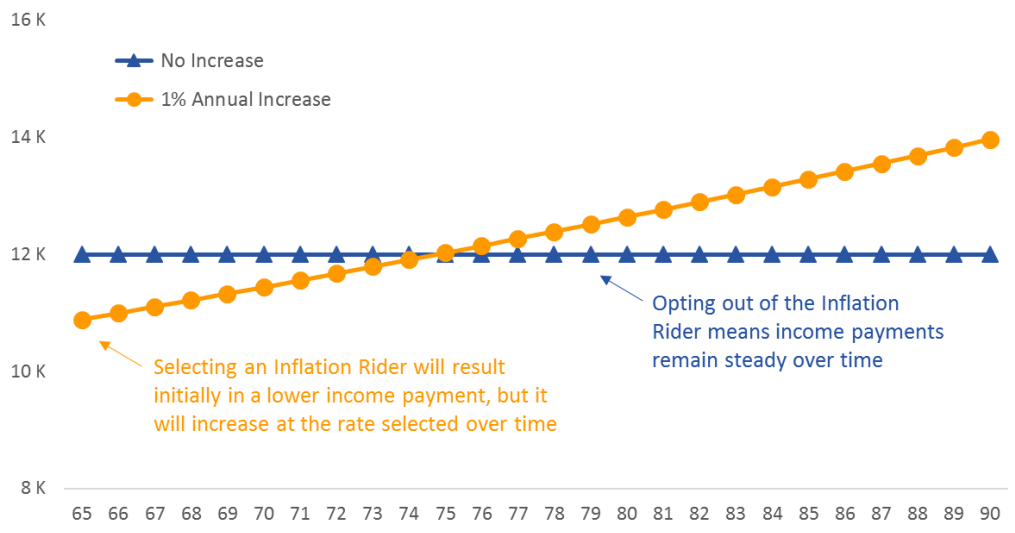
Inflation Protection

Most insurance carriers offer an inflation adjustment or annual increase rider that will adjust the SPIA income payments annually for inflation. The adjustment made could be predetermined (between 1-5%) or in some cases be based on a Consumer Price Index. Providing these increases will require a lower starting income.

To illustrate, let's continue with Matthew, our 65-year-old who is purchasing a $178,000 SPIA. His initial quote excluded inflation protection and got him $1,000 per month ($12,000 per year). If he'd like his income payments to keep pace with inflation, estimating it to be 1% per year, he'll have to accept a lower initial income of $910 per month ($10,900 per year) which will increase over time.



SPIA rates based on $177,651 Integrity life-only policies with and without a 1% increase rider for a male aged-65 with income starting immediately. Rates as of 2/2/2017.

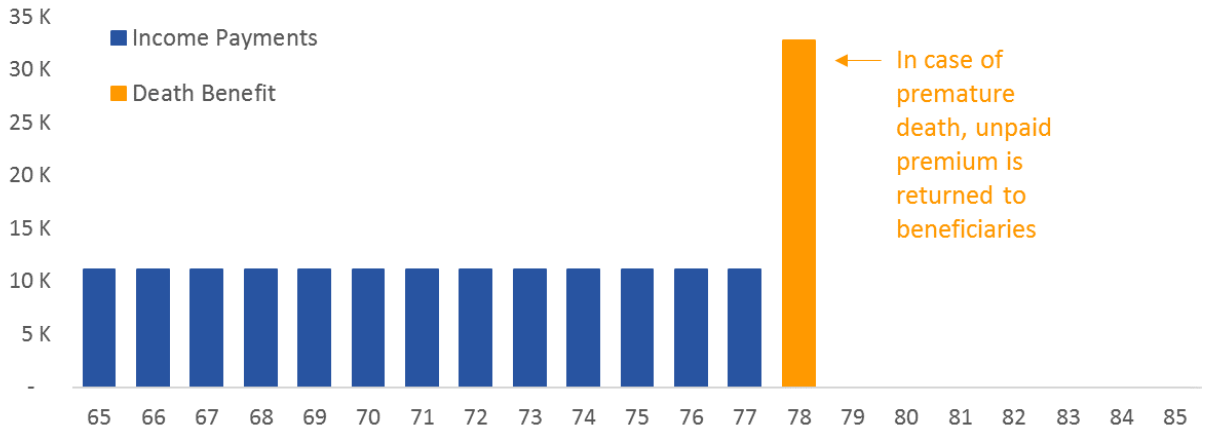
Because inflation affects the purchasing power of money, it presents a challenge for retirement, which could last 40 years. While we're currently experiencing a period of low inflation, it's averaged 3.2% over the past century, meaning that prices have almost doubled every 20 years.

Adding an inflation rider to your SPIA is one way to mitigate the risk of declining purchase power, but it's probably not the most efficient way as the extra protection will come at a cost. Consider instead more direct ways to earn inflation-adjusted dollars. Your Social Security benefit, for one, will be indexed for inflation through a Cost of Living Adjustment. And, for the rest of your assets, maintaining exposure to equity markets and investing in inflation-linked bonds, such as TIPS or I-Bonds, can provide an effective hedge.

Principal Protection

With the cash refund payout option (also known as the death benefit), you are guaranteed that any principal (premium paid into the contract) not yet returned through income payments will be returned to your beneficiary upon your passing.

For example, if our 65-year-old Matthew is worried about losing money in the event of prematurely passing away, he can elect the cash refund payout option (as opposed to life only). His SPIA policy will offer a lower monthly income to cover the cost of the richer guarantee, but any unrecognized value in the contract will be passed onto his heirs. Should Matthew pass away before he's received $178,000 in cumulative income payments, his beneficiaries will receive $178,000 less the total income payments made.



SPIA rates based on $177,651 Integrity life-only policies with and without a death benefit rider for a male aged-65 with income starting immediately. Rates as of 2/2/2017.

Payment Acceleration

While SPIAs are generally illiquid products, functioning like a paycheck and not a savings account, many carriers offer some level of liquidity. Most commonly, this is in the form of commutation, or withdrawal benefit which permits accelerating upcoming monthly benefits. A limited number of monthly payments can be accelerated at once, and guidelines exist around when and how often the policyholder can take advantage of this liquidity.

Buying Tips

Buying a SPIA is a long-term commitment, so dedicate enough time and attention to doing it right! In addition to being available to help walk you through the process, Abaris has compiled a list of things to keep in mind:

Available Carriers

Immediate income annuities are offered by leading insurance companies, including Guardian Life, Lincoln Financial, MassMutual, MetLife, Mutual of Omaha, New York Life, Pacific Life, and Principal. Before you buy, you'll want to compare quotes and product features – and remember, not all companies sell all products in all states.

Where To Buy A SPIA

SPIAs are sold via insurance agents, brokers, and financial advisors. It's also possible to shop for a SPIA online via our website. We limit our product offerings to only those sold by top-rated insurers (A.M. Best rating of at least A), and our Quote Tool allows you to easily compare quotes side-by-side.

Consider Your Agent/Broker's Incentives

The Department of Labor has been working for nearly a decade to reform the requirements for giving financial retirement advice. The goal is to ensure that advisors, agents, and brokers put their clients' best interests before their own. Regardless of whether the reforms are implemented, make sure you consider your agent or broker's incentives. How are they compensated on the sale? How do they select the products they're showing you? Do they work with only one or a handful of insurance companies? Are they acting in your best interest?

Compare Quotes Apples-to-Apples

Some financial products are too unique to be compared to one another, but this isn't the case with SPIAs. You should be able to see quotes from different carriers that are exactly the same in all major respects except two: price and credit rating.

Credit Ratings Matter

It can be enticing to just go with the company that offers the highest payout, but be careful. The value of a SPIA is undeniably linked to the claims-paying ability of the insurance company. The insurer needs to be around at least as long as you are! Buying from only highly-rated insurers is the way to go.

DIAs

Deferred Income Annuities

Convert your retirement savings into a future guaranteed lifetime income stream

Introduction

The decline of pension plans is an unfortunate reality for today's American worker. More than just an effective way to pool money for retirement, the pension enabled the "golden years" of financial security, world travels, and new hobbies. This ideal is harder to achieve with Traditional IRAs and 401(k)s which help you save but don't provide a good way to automatically turn those savings into dependable income, especially when you don't know how long you'll live.

There is a solution: a Deferred Income Annuity, or DIA. A DIA, known more casually as longevity insurance or a longevity annuity, is essentially a pension that you can buy for yourself. With a DIA, the wealth you've been accumulating – whether in your IRA, 401(k), or after-tax savings accounts – can be converted into a guaranteed lifetime paycheck starting at some point in the future.

Contents

Deferred Income Annuities (DIAs) are also known as longevity insurance and longevity annuities.

In this guide, we'll tell you everything you need to know about DIAs – how they work, how they're customized, and how to evaluate whether converting a portion of your assets into income makes sense for you.

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What is a DIA?

A Deferred Income Annuity (DIA) is guaranteed retirement income you can purchase to insure your longevity, or the risk of outliving your savings. When you buy a DIA, you commit money now in exchange for a future monthly paycheck continuing for as long as you're alive. Whether purchased with your qualified or non-qualified savings, a DIA turns your assets into guaranteed income for life. You can think of it like a pension you buy for yourself.

A DIA is… an **income annuity**.

> An income annuity is a contractual agreement between you and an insurance company. In exchange for a lump-sum premium, the insurance company promises to give you a steady, guaranteed paycheck for life (or a certain period of time, a less-common version of the product). The size of the paycheck is specified upfront and depends on factors such as your premium, age, and gender.

More specifically, a DIA is… a **deferred** income annuity.

> A Deferred Income Annuity begins annuity payments at a future date, typically 2-40 years after the premium is paid. (In contrast, immediate income annuities begin payments within 1 year.) During the deferral period, the insurance company invests your money on your behalf. The longer you delay starting to receive payments, the greater the size of the payments they'll be able to offer you.

And finally, a DIA can be… **qualified**, **non-qualified**, or a **QLAC**.

> Qualified DIAs are purchased with pre-tax money from your 401(k), Traditional IRA, or other qualified plan. The money is transferred penalty-free and will not incur any taxes during the deferral period. DIAs are subject to Required Minimum Distributions (RMDs), meaning that income must begin by age 70½.
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> Non-qualified DIAs differ in that they are purchased with post-tax savings, are not subject to RMDs, and thus can be annuitized after age 70½. In addition, the taxes incurred once distributions begin will be lower to avoid taxing the money used to purchase the DIA twice.
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> QLACs fill the void left by qualified and non-qualified DIAs: the ability to use pre-tax qualified savings but begin distributions after age 70½. This type of DIA has the added benefit of deferring a portion of your RMDs until as late as age 85.

In summary, a DIA is a pension you can buy for yourself using your pre- or post-tax retirement savings. In purchasing a DIA, you insure your financial security no matter how long you live.

History & Importance

The concept behind a Deferred Income Annuity, an exchange of a premium today for a stream of payments in the future, is not new. This is exactly the model upon which Social Security was built and exists today: the taxes you pay while working fund the Social Security income you'll collect in retirement. Pensions are another example of DIAs where the employer pays the premiums on your behalf.

A DIA is the only way for an individual to purchase a future stream of guaranteed income – like that offered by pensions and Social Security – by him or herself. The product was introduced more recently in response to employers' shift from defined benefit (pension) to defined contribution (401(k)) plans. This shift has meant that individuals are forced to do more retirement planning on their own. A 401(k) does a great job of helping you accumulate assets, but then what happens when you need to turn that pool of money you've accumulated into a steady stream of income you won't outlive?

That's where DIAs come in. In exchange for a premium paid today, an insurance company will provide a guaranteed lifetime paycheck that continues for as long as you're alive. Like the other types of insurance they offer, a DIA is a transfer of risk and a form of protection. Just like you insure your home, you can insure your longevity by passing on the risk that you outlive your savings to an insurance company.

Qualified Plans

- ✓ Tax-deferred savings growth
- ✓ Ability to diversify investments through mutual funds and ETFs
- ✓ Matched 401(k) contributions
- ✗ No easy way to turn your savings into income that won't run out

It's important to note that employers didn't stop offering pensions because they're not useful or financially responsible. It was simply too large of a liability for a company not specializing in insurance to manage. But today numerous insurance companies – and typically those with the highest credit ratings – offer DIAs.

Benefits

Figuring out how long your retirement savings needs to last is difficult. Guaranteed lifetime income can provide you with peace of mind through a paycheck that you won't outlive. Buying a DIA with your retirement savings offers a number of benefits:

✓ Longevity Protection

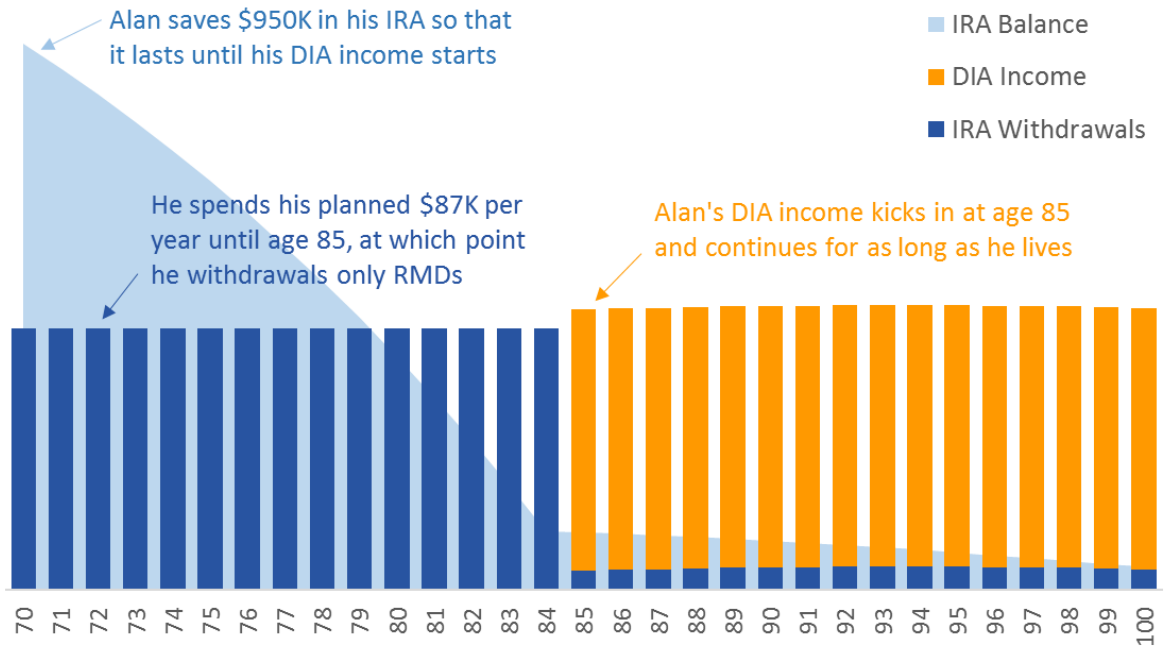
Insurance is typically thought of as something you buy to protect you and your family from unfortunate events. By turning your assets into income you can't outlive, the DIA offers a more pleasant kind of protection: longevity insurance. The longer you live, the more financial value the DIA provides.

✓ Finite Planning Horizon

Adding a longevity annuity to your portfolio can dramatically simplify your retirement planning. Knowing that at a future date you'll have a paycheck that sustains your lifestyle allows you to manage your remaining assets to a fixed instead of unknown investment horizon. The certainty of guaranteed future income can completely change your approach to investing, withdrawing, and spending.

To illustrate how a DIA offers longevity protection and fixes your investment horizon, let's use Alan as an example. Alan is 50 years old and plans to retire at 70, at which point he'd like to have $87,000 to spend each year. But, without knowing how long he'll live, Alan doesn't know how much more he needs to save. He's considering buying a DIA to simplify his retirement planning and to ensure his financial stability for as long as he's alive.

With $100,000 of his savings, Alan can buy a DIA that will cover his annual expenses starting at age 85 and continuing for the rest of his life. Knowing that he'll be set at age 85 regardless of his lifespan, Alan can more comfortably save for retirement. Assuming his IRA will earn a 5% return and ignoring inflation for simplicity, Alan needs to accumulate $950,000 by age 70. At that point, he'll be able to retire and withdrawal $87,000 from his IRA every year until age 85 when his DIA income will kick in. His retirement portfolio is much more predictable and secure with the longevity insurance offered by a DIA. Note that for ease of explanation, this example is on a pre-tax basis.

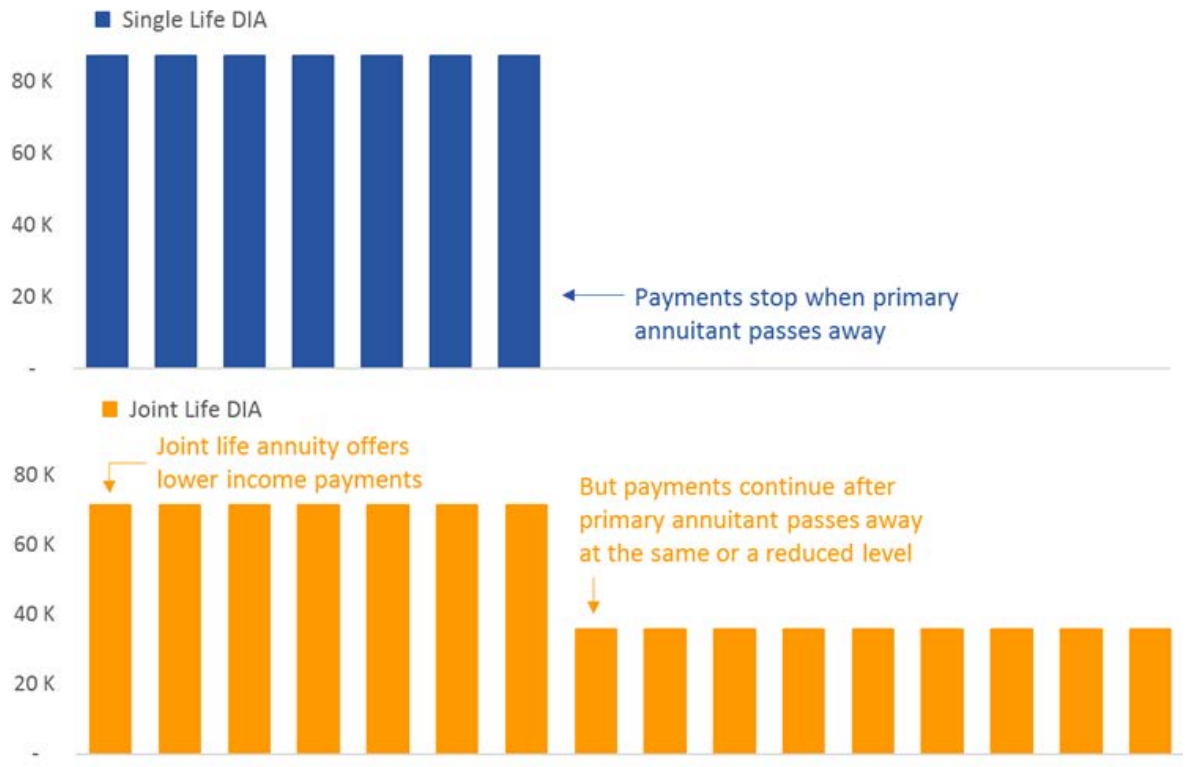


DIA rates based on a $100,000 Lincoln Financial life-only policy for a male aged-50 with income starting at age 85. Rates as of 2/2/2017.

✓ Spousal Benefits

DIAs can be set up as joint annuities, which means that payments continue as long as either you or your spouse are alive. Structuring the contract like this is a great way to preserve financial stability and quality of life for the surviving spouse.

Let's continue to use Alan as our example. Alan expects that he will pass away before his 48-year-old wife, Claire. He wants to know that that she'll be okay (at least financially) once he's gone, so he's considering adding her to his DIA. Alan can purchase a joint life policy that's contingent on her life as well, such that income payments continue until both of them have passed away. The income payments will be lower, but they're expected to be paid over a longer period of time. Since their expenses will decrease when it's just Claire, they've opted for a 50% income reduction, which increases their income while they're both alive.



DIA rates based on $100,000 Lincoln Financial single and joint life-only policies for a male aged-50 and a female aged-48 with income starting at age 85. Rates as of 2/2/2017.

✓ Tax Preferential Treatment

From the government's perspective, an annuity is a retirement savings vehicle. As such, it receives the same tax treatment as IRAs: no taxes are paid until distributions are made. For a DIA, this means that all the money you hand over to the insurance company can grow, albeit invisible to you, on a tax-deferred basis. The benefits are slightly different depending on whether the DIA is qualified or non-qualified:

- Qualified DIAs are purchased with pre-tax funds from your 401(k) or Traditional IRA, which are already accumulating on a tax-deferred basis. Retirement savings can be transferred to a DIA penalty-free, maintain their tax preferential treatment, and count towards your IRS-mandated required minimum distributions.
- Non-qualified DIAs are purchased with post-tax funds that, depending on how they're invested might incur income taxes annually. For your savings that are already earmarked for retirement but not sitting in a tax-deferred account, buying an annuity is a great way to postpone your taxes and allow your interest to compound.

✓ Principal Protection

The savings that you allocate to a DIA are protected from swings in the stock or bond markets. And, by selecting the return of premium & death benefit options (more on this later), you can guarantee that all of your savings will be passed onto your beneficiaries if you pass away prematurely.

✓ Some Liquidity

While DIAs are generally illiquid products functioning like a paycheck and not a savings account, many carriers offer some level of liquidity. Most commonly, this is in the form of commutation, or withdrawal benefit which permits accelerating upcoming monthly benefits. A limited number of monthly payments can be accelerated at once, and guidelines exist around when and how often the policyholder can take advantage of this liquidity.

✓ **Clear Product Structure**

The DIA has a simple structure. For any amount of premium you would like to put into the contract, the insurance company will tell you how much monthly income they can offer. There are some decisions you'll have to make (more on this later) that affect the level of income, but that's it. The income is net of the insurance company's expenses and the commission collected by the distributor.

Drawbacks

Despite these benefits, DIAs are not good for everyone or for all situations. Here are some of the drawbacks:

✗ **Limited Liquidity & No Cash Value**

DIAs don't offer much liquidity and don't have a cash value that can be withdrawn or borrowed from. DIAs should be thought of as a future paycheck, like a pension. While the value of your money will be growing during the deferral period, its growth will only be reflected in the income amount and will be otherwise invisible to you.

✗ **No Market Exposure**

The income you'll receive is determined upfront, fixed, and isolated from any market upside (or downside) potential. While this is a positive attribute for those focused on insurance coverage, it isn't the solution for those seeking a more investment-style product.

Typical Buyers

A DIA is a powerful way to ensure you have a guaranteed source of income in retirement. That doesn't mean it's right for everyone, and it never makes sense to purchase an annuity with your entire portfolio. Here's the methodology we've developed at Abaris to help you think about whether a DIA may (or may not) be a fit for you:

Consider buying a DIA if...

✓ Social Security and/or pension benefits won't cover your regular expenses
✓ You're a pre-retiree or early in retirement
✓ You've accumulated between $250,000 and $5 million in retirement savings
✓ You have average or above-average health
✓ You're seeking greater certainty in retirement and more of an insurance product
✓ You don't need access to the money immediately

A DIA is probably not the right product for you if...

✗ Social Security and/or pension benefits cover your regular expenses
✗ You're younger than 45 or over 75 years old
✗ You've accumulated less than $250,000 or more than $5 million in retirement savings
✗ You have below-average health
✗ You're seeking higher risk and more of an investment product
✗ You need access to the money immediately

A common objection to DIAs is that they don't build or provide access to cash value unlike other insurance products used for retirement planning. This is true, but the trade off is access to higher guaranteed income than these more liquid products will offer. Using only a portion of your portfolio to purchase a DIA leaves the rest of your assets to provide liquidity and market upside.

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DIA Rates

The income offered on DIAs will vary over time as market conditions change, being driven most notably by longer-term Treasury and investment grade corporate bond yields. In addition, your personal attributes (age, gender) and the policy options you select will impact the quote. As of February 2017, highly-rated carriers are offering the following DIA annual income payments for a $100,000 purchase:

Age	Income Start	Male	Female	Joint
55	65	$10,300	$9,700	$10,000
55	70	$15,000	$13,800	$14,400
55	65	$22,800	$20,600	$21,600
60	65	$8,300	$7,800	$8,100
60	70	$12,100	$11,300	$11,700
60	75	$18,800	$17,100	$17,900
65	70	$9,300	$8,800	$9,000
65	75	$14,700	$13,200	$13,900
65	80	$25,100	$21,500	$23,200

DIA quotes shown as annual income for a $100,000 premium as of 2/2/2017. All quotes are life only. Joint quotes are for a male and female with the same age and 50% continuation.

On our website you can compare quotes across top-rated carriers.

Understanding how your personal attributes and the options you select drive quotes enables you to structure the policy to best suit your needs. Expect to have to think about the following when evaluating a DIA:

Age: Income will decline as you age. The longer you wait to buy, the less time the insurance company will have to invest your premium before beginning income payments. Holding all else equal, buying income today will be cheaper than buying the same amount in the future.

Gender: Income will be higher for males than females. Because women have longer life expectancies than men, the income they can receive each year will be smaller.

Premium: Income will increase with higher premiums. A portion of the insurance company's expenses incurred are fixed per contract such that incremental premium can go entirely towards buying income. Said another way, there is a discount for larger premium deposits.

Income Start Date: Income will increase the longer you delay its start. Longer deferral periods mean (1) more time for the insurance company to invest your money before starting payments and (2) fewer years of expected income payments.

Single vs. Joint Life: Income will be higher for single life than joint life policies. A joint life policy will provide income as long as either person is alive, which is almost certainly longer than if contingent on one person.

Payout Option: Income will be lower for richer guarantees. Guaranteeing a minimum cumulative income (cash refund / installment refund) or a minimum number of payments (period certain) increases the amount the insurer expects to pay you. To compensate for the extra guarantee, they will need to lower the recurring payments.

Riders: Income will be lower for each rider added. In general, any extra options or riders added to a policy will require compensating the insurer for additional risk they've assumed. Typically these options increase your guarantee or provide you with extra protection, both of which will result in lower base income amounts.

Finally, you'll usually notice an inverse relationship between the creditworthiness of an insurer and the income they offer. Insurers with higher credit ratings have earned them by maintaining higher capital reserves and more conservative investment portfolios limiting their profitability and thus the income they can offer you. Only highly-rated insurers (A.M. Best rating of at least A) make the cut for inclusion on the Abaris platform. And, even among the insurers we've decided to work with, it's worth distinguishing among the levels of financial strength. The guaranteed income you're promised is only as good as the financial strength and longevity of the insurer backing it.

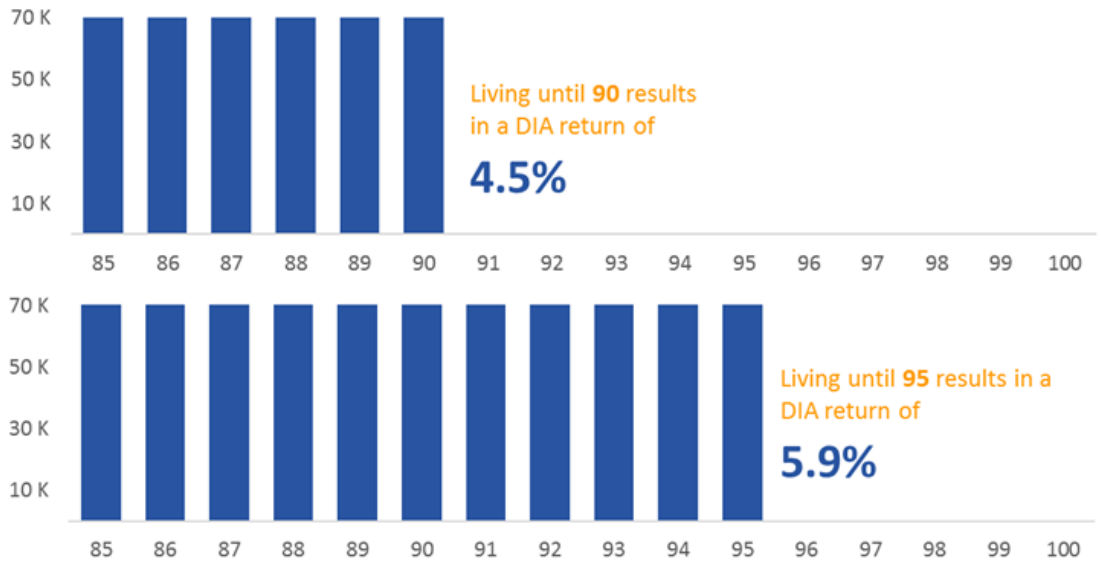
Financial Value

A common question asked when considering moving some of your retirement assets into a DIA is: what value will I get from this purchase? Typically, pre-retirees look for a quantitative answer, such as an IRR or ROI, that they can compare to returns generated in their fixed income portfolio.

Unfortunately, the value of a DIA cannot be understood quite so simply or compared to the return of a traditional financial product on an apples-to-apples basis. Why not? Because calculating an IRR or ROI requires knowing the upfront investment and all future income amounts and dates. As a longevity insurance product, the DIA will provide you with income for as long as you're alive, i.e. end date to be determined!

Instead, we can calculate a range of IRRs based on your potential lifespan. The longer you live, the higher the IRR over the life of the product will be. While thinking about your quantitative return should be a part of your analysis, don't forget about the more qualitative risk reduction and peace of mind the product is providing as well.

In one of our earlier examples, 50-year-old Alan bought a $100,000 DIA with income starting at age 85. The policy could wind up generating a 4.5% return if he lives until 90, which increases to 5.9% at age 95 and 6.5% at age 100.



DIA rates based on a $100,000 Lincoln Financial life-only policy for a male aged-50 with income starting at age 85. Rates as of 2/2/2017.

Taxation

The taxation of annuities depends first and foremost on whether the annuity was purchased with pre-tax or post-tax money. If the premium was paid with post-tax money, as with a non-qualified annuity, the portion of any income payments that constitutes a return of that premium will not be taxable. On the other hand, qualified annuities are purchased with pre-tax retirement savings. Because the money used to fund the annuity has never been taxed, all distributions from the annuity will be fully taxable. In either case, ordinary income tax rates will apply.

Taxation of Qualified DIAs

At purchase, pre-tax funds will be moved from one type of qualified retirement account to another. Traditional IRAs, 401(k)s, and qualified DIAs all have the same tax status, so moving money among them will not incur any taxes or penalties.

No taxes will be owed during the deferral period. DIAs do not have an account value that accumulates, so there isn't actually anything to tax. In fact, even if it had an account value that accrued interest (as with a fixed deferred annuity) or earned capital gains (as with a variable deferred annuity), no taxes would be due. As retirement savings vehicles, annuities can grow on a tax-deferred basis.

Once the DIA is annuitized, i.e. income payments begin, taxes will be owed. Because the money used to purchase a qualified DIA has never been taxed, all distributions will be 100% taxed as ordinary income. These taxable distributions will be reported to you and the IRS by your insurance company using tax form 1099-R.

For DIAs with return of premium and/or death benefit riders, beneficiaries will receive any remaining value in the contract in the case of the annuitant's premature death, amounting to the difference between the initial premium paid and the cumulative income payments received. Any death benefit owed will be paid directly to the beneficiary, thereby avoiding the probate process. The beneficiary can elect to annuitize the death benefit over his/her life expectancy instead of taking it as a lump sum. Either way, the annuity contract will typically be included in the deceased's estate, and the beneficiary will be taxed on any proceeds they receive at ordinary income tax rates. Note that designating your spouse as your beneficiary will typically result in the annuity being excluded from your estate.

Taxation of Non-Qualified DIAs

Non-qualified DIAs are purchased with savings that have already been taxed. If those savings are currently earning interest that is taxable annually, with a Certificate of Deposit for example, moving that money into a retirement savings vehicle can reduce your income taxes during the deferral period. Technically, even though annuities provide for tax-deferred accumulation, DIAs are not accumulation annuities, so there isn't actually anything to tax during the deferral period.

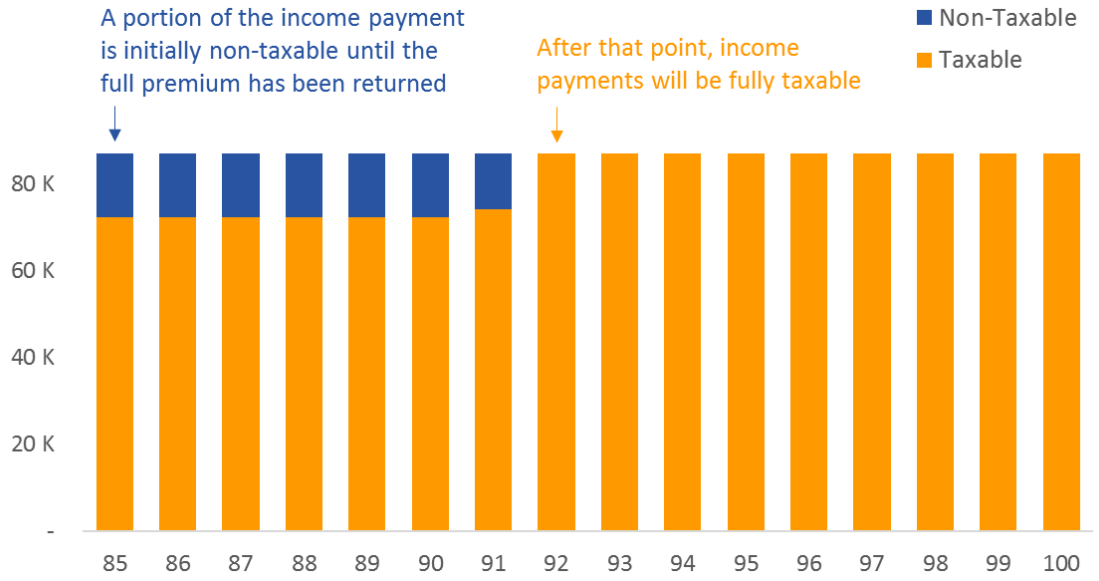
Once the DIA is annuitized, i.e. income payments begin, taxes will be owed. Each income payment can be split into two pieces: a part that's returning your initial investment, and a part that's your gain or interest earned. Taxes will only be owed on the gain, as the premium you invested in the contract has already been taxed. This non-taxable portion of the income payment is determined using an exclusion ratio, which is provided by the insurance company at purchase.

Exclusion Ratio = Investment in the Contract ÷ Expected Return

The exclusion ratio will be applied to each income payment, indicating how much is not taxable, until the full investment in the contract has paid out. Once the investment has been fully returned subsequent income payments will be fully taxable.

To see how this works, let's continue analyzing Alan's $100,000 DIA that he's buying at age 50 with income starting at age 85. Alan will not be using pre-tax retirement savings to buy the DIA, so it'll be classified as non-qualified. Once Alan starts receiving income at age 85, he'll have to pay taxes on a portion of the payments.

The exclusion ratio for Alan's policy is 17%. The insurance company calculated this as the ratio between his investment in the contract ($100,000) and the total amount of income they expect to pay him ($599,000 in this case). Thus 17% of his income payments will be excluded from his taxable income until a total of $100,000 has been excluded. For Alan, this will be the case once he's received 7 years worth of payments, after which the DIA income will be fully taxable at ordinary income rates.



DIA rates based on a $100,000 Lincoln Financial life-only policy for a male aged-50 with income starting at age 85. Rates as of 2/2/2017.

Finally, if a death benefit is due to your beneficiaries, taxes owed will be calculated in a similar manner. Any portion of the death benefit that constitutes a return of premium will be received tax-free, whereas benefits in excess of the initial investment will be taxed at ordinary income levels. Either way, the benefit will be passed directly to beneficiaries, thus avoiding the probate process. And, unless your spouse is designated as your beneficiary, the annuity will typically be included in your estate.

The tax treatment of qualified vs. non-qualified DIAs is summarized in the following table. However, you should consult a tax professional for complete information regarding annuity taxation as it applies to your personal situation.

Annuity Phase	Qualified	Non-Qualified
Purchase	No taxes or penalties incurred when moving pre-tax retirement savings to a qualified DIA.	No taxes or penalties incurred when moving post-tax savings to a non-qualified DIA.
Deferral	No taxes will be owed during deferral.	No taxes will be owed during deferral.
Annuitization	Income payments will be fully taxable at ordinary income tax rates.	The portion of income payments that are a return of premium, as determined by the exclusion ratio, are not taxable.
Death Benefit (if applicable)	The beneficiary will be taxed on any proceeds they receive at ordinary income tax rates.	The beneficiary will be taxed only on the portion of proceeds that exceeds a return of premium at ordinary income tax rates.

Diversification

It is widely accepted that a diversified portfolio is superior to one with singular or uniform market exposure. For nearly every target rate of return, a diversified portfolio of minimally-correlated investments can be constructed that will be lower risk than one investment with equal expected return. When diversifying your retirement portfolio, you will likely select a combination of equity and bond market investments that are appropriate for both your risk-appetite and your investment horizon. In general, your portfolio should tend towards equity investments in the early years and then gravitate more towards fixed income investments as you near retirement.

The fixed income assets in your portfolio serve to provide steady, reliable income that is uncorrelated, or inversely correlated, with the equity markets. Sound familiar? This is exactly the purpose that a DIA or any income annuity serves, with one major added benefit: the annuity will continue to make payments until you die. Allocating a portion of your fixed income portfolio to a DIA can generate comparable returns (see the Financial Value section) and reduce your longevity risk.

In fact, adding the security of a DIA to your portfolio can enable you to earn a higher rate of return with the rest of your portfolio. If your DIA or other annuities generate enough income to cover your retirement expenses, you have even more flexibility to invest the equity portion of your portfolio without putting your livelihood at risk.

One final benefit of owning a DIA is the ability to invest and manage the rest of your portfolio to a fixed time horizon. That is, you'll know exactly what type of income your portfolio needs to generate and for how long if the DIA will be covering your expenses starting at a known point in the future.

Features & Riders

It's best to think of the base DIA product as that which provides the most income based on your premium, age, gender, and income start date. But, there's room to customize the product or add additional guarantees to meet your needs. In some cases, the insurance company will refer to these options as product features. Other times they'll be listed as riders.

Below are the various ways you can customize your policy, noting that these options can vary from insurer to insurer:

Single vs. Joint Life

DIA income can be tied to a single or joint life:

- **Single**: income paid over the lifetime of the insured
- **Joint**: income paid over the 'joint life' of two insureds, i.e. as long as one or both are alive

The income level following the loss of the first life can be designed to remain level or decrease. Opting to reduce the income upon the passing of the first spouse (typically to 40-99% of the starting income level) allows for a greater income level while both are alive.

An alternative to buying a joint life annuity is to purchase a single life annuity with a death benefit (a.k.a. cash refund) and designate your spouse as the beneficiary. Upon your passing, he/she will have the option to continue the contract in his/her name until the benefit has been paid out.

Payout Options

Income can be based purely on lifespan or can have a guaranteed component:

- **Life Only**: payments stop at death (or later of two deaths for joint)
- **Life with Cash Refund**: additional guarantee over life only that pays beneficiaries the difference between the premium and sum of all payments already received upon insured's death
- **Life with Period Certain**: additional guarantee over life only that guarantees payments for at least a certain number of years. Payments will continue to beneficiaries if insured passes away during this period of time

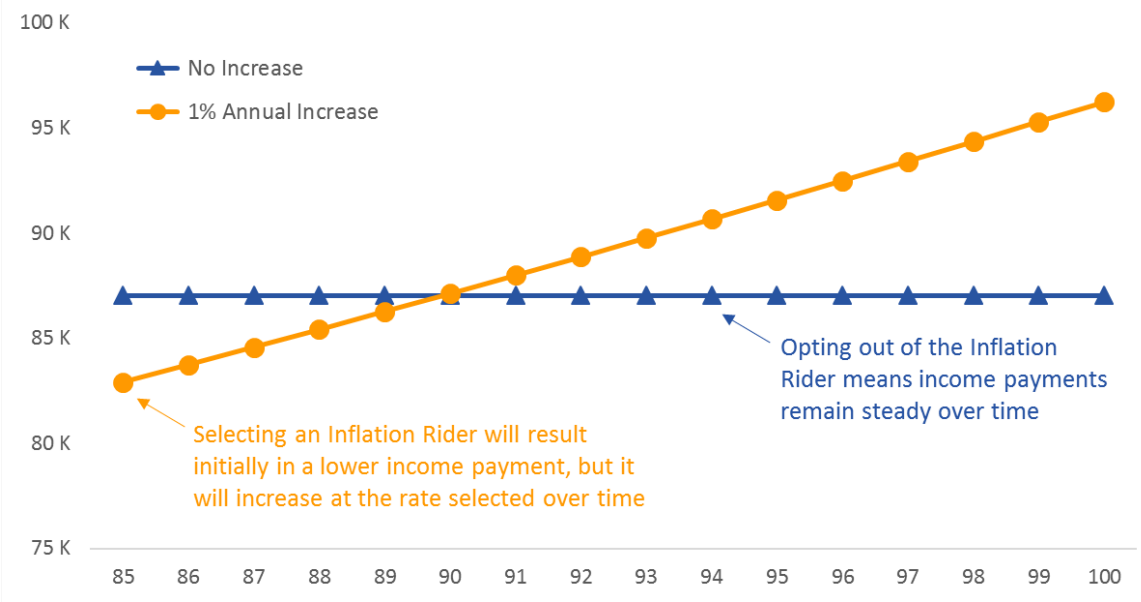
Payout Frequency

Income payments can be made monthly, quarterly, semi-annually, or annually.

Inflation Protection

Most insurance carriers offer an inflation adjustment or annual increase rider that will adjust the DIA income payments annually for inflation. The adjustment made could be predetermined (between 1-5%) or in some cases be based on a Consumer Price Index. Providing these increases will require a lower starting income. Note that the rider does not cover the deferral period, instead only going into effect once the income stream begins.

To illustrate, let's continue with Alan, our 50-year-old who wants to purchase a $100,000 DIA with income starting at age 85. His initial quote excluded inflation protection and got him $7,250 per month ($87,000 per year). If he'd like his income payments to keep pace with inflation, estimating it to be 1% per year, he'll have to accept a lower initial income of $6,910 per month ($82,900 per year) which will increase over time.



DIA rates based on $100,000 Lincoln Financial life-only policies with and without a 1% increase rider for a male aged-50 with income starting at age 85. Rates as of 2/2/2017.

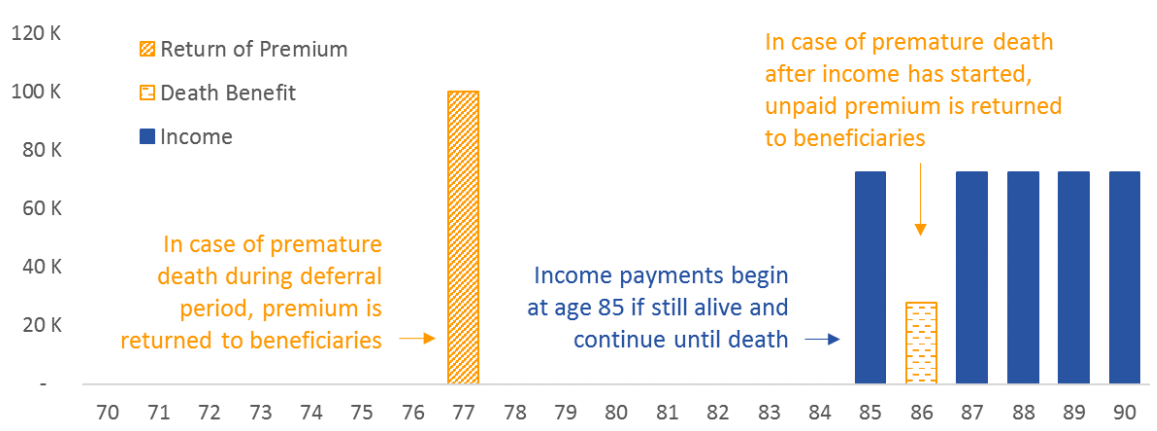
Because inflation affects the purchasing power of money, it presents a challenge for retirement, which could last 40 years. While we're currently experiencing a period of low inflation, it's averaged 3.2% over the past century, meaning that prices have almost doubled every 20 years.

Adding an inflation rider to your DIA is one way to mitigate the risk of declining purchase power, but it's probably not the most efficient way as the extra protection will come at a cost. Consider instead more direct ways to earn inflation-adjusted dollars. Your Social Security benefit, for one, will be indexed for inflation through a Cost of Living Adjustment. And, for the rest of your assets, maintaining exposure to equity markets and investing in inflation-linked bonds, such as TIPS or I-Bonds, can provide an effective hedge.

Principal Protection

Through return of premium and death benefit riders, you are guaranteed that your principal (premium paid into the contract) will be returned to your beneficiary should you pass away before getting it back through income payments. The return of premium option protects you before the income start date, and the death benefit rider protects you thereafter. Terminology varies from carrier to carrier, but we simplify it and always line up quotes apples-to-apples on our platform.

For example, if our 50-year-old pre-retiree Alan is worried about losing money in the event of prematurely passing away, he can add the return of premium and death benefit riders to his DIA. His $100,000 DIA policy will offer a lower monthly income to cover the cost of the richer guarantee, but any unrecognized value in the contract will be passed onto his heirs. Should Alan pass away before income payments begin, his $100,000 premium will be returned to his beneficiaries. If he passes away after income payments have begun but before those payments are cumulatively $100,000, his beneficiaries will receive $100,000 less the total income payments mad



DIA rates based on $100,000 Lincoln Financial life-only policies with and without return of premium and death benefit riders for a male aged-50 with income starting at age 85. Rates as of 2/2/2017.

Additional Premium Payments (Flexible or Subscription)

With some carriers you have the ability to fund your DIA over time, either through a flexible premium option or on a subscription basis. This is a good approach for those betting on pricing improvements or wanting to contribute a percentage of your income over time.

Income Start Date Flexibility

Some insurers' products allow you to change your income start date after purchasing the annuity, sometimes even more than once. Keep in mind that changing your income start date will affect your payments (increasing them if the start date is pushed back and vice versa).

Payment Acceleration

While DIAs are generally illiquid products, functioning like a paycheck and not a savings account, many carriers offer some level of liquidity. Most commonly, this is in the form of commutation, or withdrawal benefit which permits accelerating upcoming monthly benefits. A limited number of monthly payments can be accelerated at once, and guidelines exist around when and how often the policyholder can take advantage of this liquidity.

Buying Tips

Buying a DIA is a long-term commitment, so dedicate enough time and attention to doing it right! In addition to being available to help walk you through the process, Abaris has compiled a list of things to keep in mind:

Available Carriers

Longevity annuities are offered by leading insurance companies, including Guardian Life, Lincoln Financial, MassMutual, MetLife, Mutual of Omaha, New York Life, Pacific Life, and Principal. Before you buy, you'll want to compare quotes and product features – and remember, not all companies sell all products in all states.

Where To Buy A DIA

DIAs are sold via insurance agents, brokers, and financial advisors. It's also possible to shop for a DIA online via our website. We limit our product offerings to only those sold by top-rated insurers (A.M. Best rating of at least A), and our Quote Tool allows you to easily compare quotes side-by-side.

Consider Your Agent/Broker's Incentives

The Department of Labor has been working for nearly a decade to reform the requirements for giving financial retirement advice. The goal is to ensure that advisors, agents, and brokers put their clients' best interests before their own. Regardless of whether the reforms are implemented, make sure you consider your agent or broker's incentives. How are they compensated on the sale? How do they select the products they're showing you? Do they work with only one or a handful of insurance companies? Are they acting in your best interest?

Compare Quotes Apples-to-Apples

Some financial products are too unique to be compared to one another, but this isn't the case with DIAs. You should be able to see quotes from different carriers that are exactly the same in all major respects except two: price and credit rating.

Credit Ratings Matter

It can be enticing to just go with the company that offers the highest payout, but be careful. The value of a DIA is undeniably linked to the claims-paying ability of the insurance company. The insurer needs to be around at least as long as you are! Buying from only highly-rated insurers is the way to go.

Consider Buying In Chunks Or As A Subscription Over Time

If you're still years away from retirement, are optimistic about pricing improving, and/or would like to diversify across carriers, you can buy DIAs in pieces over time. Keep in mind that, all else being equal, waiting to buy will reduce the amount of income the insurance company can offer. In addition, the pricing usually isn't quite as good at smaller purchase sizes.

Understand The Difference Between Qualified & Non-Qualified

The decision to buy a qualified vs a non-qualified DIA is most likely driven by where your retirement savings are currently located: in a pre-tax IRA or 401(k), or in the form of after-tax savings. If you use pre-tax savings to purchase a DIA, it will be qualified. Otherwise, the DIA will be non-qualified. Like 401(k)s and IRAs, qualified DIAs are governed by Section 408 of the tax code and are subject to the same required minimum distributions beginning at age 70½. On the other hand, non-qualified DIAs are not subject to RMDs and thus can have an income start date later than 70½.

QLACs

Qualified Longevity Annuity Contracts

Defer RMDs and convert your retirement savings into guaranteed lifetime income

Introduction

As life expectancies lengthen and retirements grow to 30+ years, Americans are increasingly worried about outliving their savings. In response to these struggles and the decline of employer pension plans, the government has made significant advances to its retirement policy and tax code that allow for the purchase of annuities within qualified retirement plans.

With a Qualified Longevity Annuity Contract (QLAC) you can turn the savings in your 401(k) or IRA into a guaranteed lifetime paycheck that you can't outlive. It is the only qualified retirement product that allows you to defer those income payments to as late as age 85. In effect, a QLAC is a special type of Deferred Income Annuity that also defers Required Minimum Distributions (RMDs) applicable to 401(k)s and Traditional IRAs.

Contents

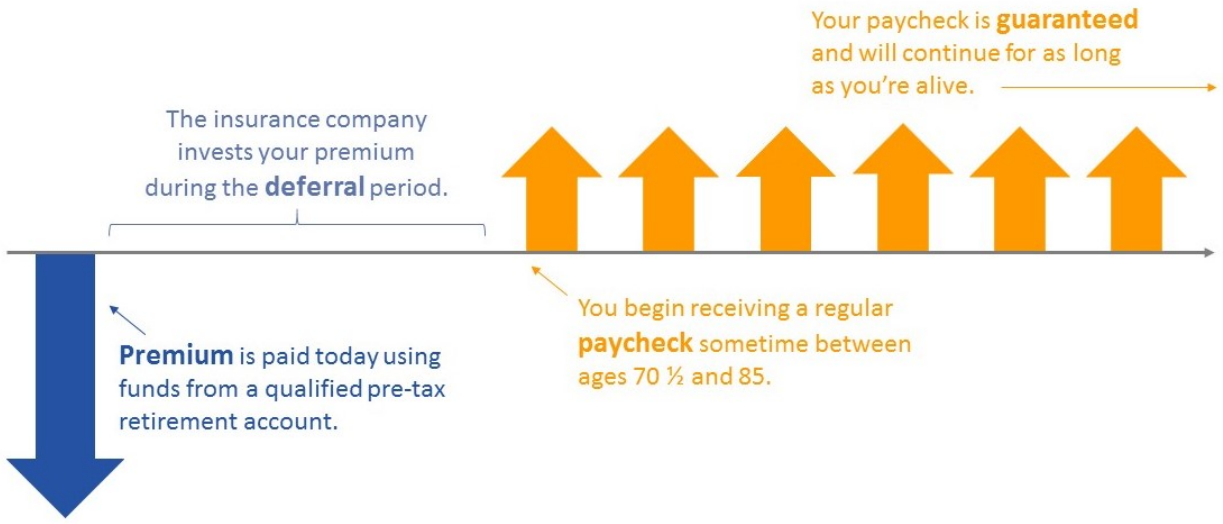
A Qualified Longevity Annuity Contract (QLAC) is a special type of Deferred Income Annuity that also defers RMDs.

Read on to learn more about this longevity annuity, how it works, the tax benefits, and whether allocating some of your savings towards a QLAC can improve your quality of life in retirement.

Abaris | www.myabaris.com | (888) 248-8995 lauren@myabaris.com

What is a QLAC?

A QLAC is a special type of Deferred Income Annuity (DIA) purchased with tax-deferred savings from your qualified retirement account. When you buy a QLAC, you commit money now in exchange for a monthly paycheck starting at some point in the future. Why? To reduce your risk in retirement. Turning your assets into guaranteed income for life means you can't outlive your savings. You can think of it like a pension you buy for yourself.



A QLAC is… an **income annuity**.

> An income annuity is a contractual agreement between you and an insurance company. In exchange for a lump-sum premium, the insurance company promises to give you a steady, guaranteed paycheck for life (or a certain period of time, a less-common version of the product). The size of the paycheck is specified upfront and depends on factors such as your premium, age, and gender.

More specifically, a QLAC is… a **deferred** income annuity.

> A Deferred Income Annuity begins annuity payments at a future date, typically 2-40 years after the premium is paid. (In contrast, immediate income annuities begin payments within 1 year.) During the deferral period, the insurance company invests your money on your behalf. The longer you delay starting to receive payments, the greater the size of the payments they'll be able to offer you.

A QLAC is… purchased with savings from your **qualified retirement account**.

> As a qualified annuity, the money used to make the purchase comes from your 401(k), Traditional IRA, or other qualified plan. The annuity maintains the special tax-deferred treatment meaning that you don't incur any penalties or pay any taxes until income payments begin.

And finally, a QLAC is… **exempt** from Required Minimum Distribution (RMD) rules.

> RMD rules force those older than 70½ to withdraw a specific amount of money from their tax-deferred retirement accounts each year. Using funds from these accounts to buy a QLAC reduces the balance subject to the RMD calculation. That means lower RMDs and lower taxable income during the QLAC deferral period.

In summary, a QLAC is a pension you can buy for yourself using your pre-tax retirement savings. Because of its special designation, QLAC income payments can start later than 70½, reducing your RMDs and associated taxes during that period of time.

History & Importance

As defined benefit plans are being replaced by defined contribution plans, individuals are forced to do more retirement planning on their own. A 401(k) does a great job of helping you accumulate assets, but then what happens when you need to turn that pool of money you've accumulated into a steady stream of income you won't outlive?

That's where the QLAC rulemaking from July 2014 comes into play. Not only does a QLAC allow you to convert savings in your 401(k) or Traditional IRA into guaranteed lifetime income, it allows you to delay the start of that income through an exemption to the Required Minimum Distribution rule. With Americans living longer and more concerned than ever about outliving their savings, this is an important enhancement to retirement policy and the tax code.

Qualified Plans

- ✓ Tax-deferred savings growth
- ✓ Ability to diversify investments through mutual funds and ETFs
- ✓ Matched 401(k) contributions
- ✗ No easy way to turn your savings into income that won't run out

Benefits

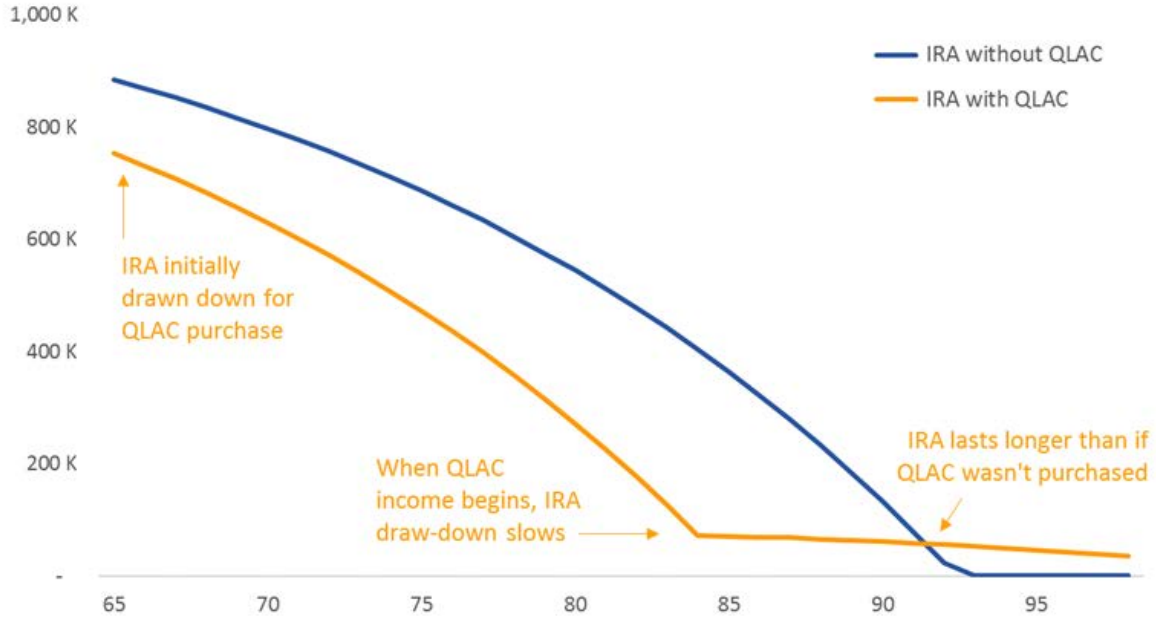
Figuring out how long your retirement savings needs to last is difficult. Guaranteed lifetime income can provide you with peace of mind through a paycheck that you won't outlive. Buying a QLAC with your qualified retirement savings offers longevity protection and a number of other benefits:

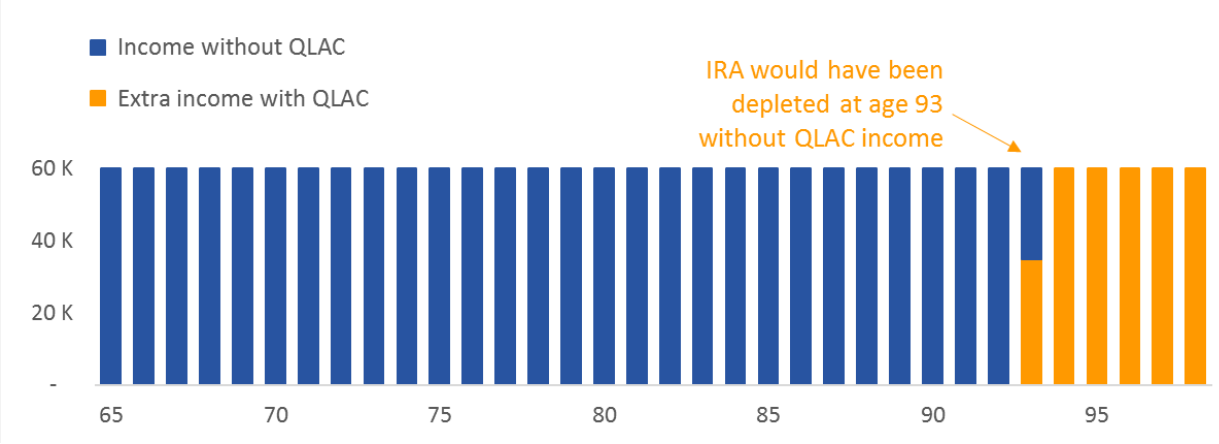
✓ Longevity Protection

Insurance is typically thought of as something you buy to protect you and your family from unfortunate events. By turning your assets into income you can't outlive, the QLAC offers a more pleasant kind of protection: longevity insurance. The longer you live, the more financial value the QLAC provides.

Let's take David, a 65-year-old about to retire, as an example. David has $900,000 in his IRA and he's worried about running out of money in the future. He would like to be able to spend $5,000 per month in retirement. Assuming his IRA will earn a 5% return and ignoring inflation for simplicity, he will deplete his IRA by age 93.

With $125,000 of his IRA balance, David can buy a QLAC that pays him a guaranteed $5,000 per month starting at age 85 and continuing for the rest of his life. With the QLAC he'll be able to maintain his lifestyle without depleting his IRA.





QLAC rates based on a $125,000 New York Life life-only policy for a male aged-65 with income starting at age 85. Rates as of 2/2/2017.

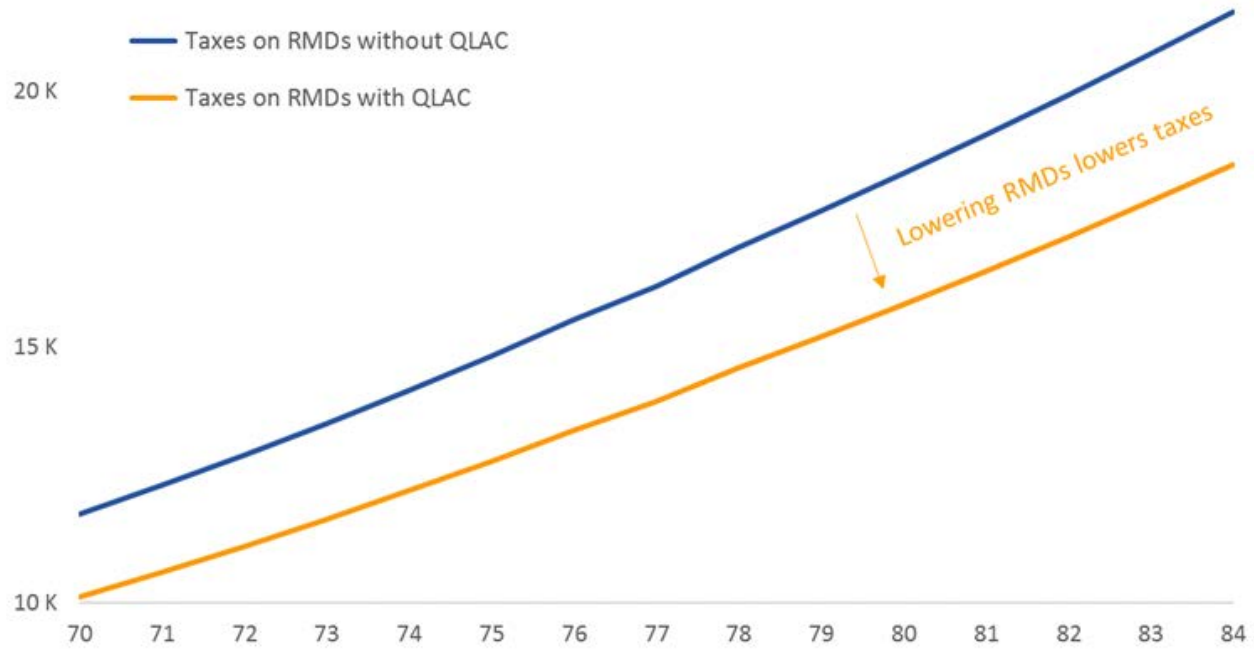
✓ Finite Planning Horizon

Adding a longevity annuity to your portfolio can dramatically simplify your retirement planning. Knowing that at a future date you'll have a paycheck that sustains your lifestyle allows you to manage your remaining assets to a fixed instead of unknown investment horizon. The certainty of guaranteed future income can completely change your approach to investing, withdrawing, and spending.

✓ Required Minimum Distribution (RMD) & Tax Deferral

The RMD is an IRS-mandated minimum amount you must withdraw from your tax-deferred retirement accounts every year starting at age 70½. However, QLACs are exempt from this rule, allowing you to delay distributions until as late as age 85. By moving money out of your 401(k) or IRA and into a QLAC, you can reduce the required withdrawals and associated taxes between ages 70½ and 85, allowing more of your money to work for you on tax-deferred basis.

Adjusting our example above, let's instead assume that David has another source of income that will cover most of his expenses in the near future. He'd like to leave his IRA alone to continue accumulating, but RMD requirements force him to start withdrawing at age 70½. By transferring $125,000 (maximum amount) from his IRA into a QLAC, he can reduce his required withdrawals. Assuming a 28% tax rate, David is able to defer over $34,000 of taxes between ages 70½ and 85.



QLAC rates based on a $125,000 New York Life life-only policy for a male aged-65 with income starting at age 85. Rates as of 2/2/2017.

✓ Principal Protection

The savings that you allocate to a QLAC are protected from swings in the stock or bond markets. And, by selecting the return of premium & death benefit options (more on this later), you can guarantee that all of your savings will be passed onto your beneficiaries if you pass away prematurely.

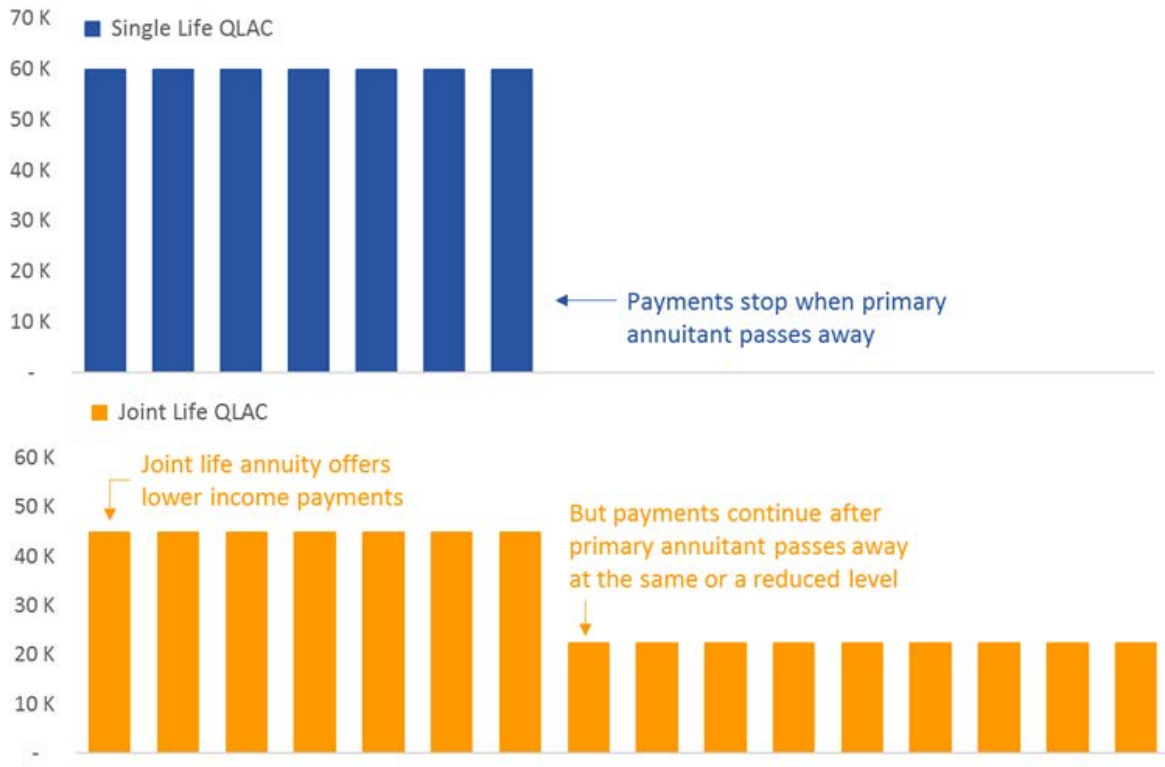
✓ Clear Product Structure

The QLAC has a simple structure. For any amount of premium you would like to put into the contract, the insurance company will tell you how much monthly income they can offer. There are some decisions you'll have to make (more on this later) that affect the level of income, but that's it. The income is net of the insurance company's expenses and the commission collected by the distributor.

✓ Spousal Benefits

QLACs can be set up as joint annuities, which means that payments continue as long as either you or your spouse are alive. Structuring the contract like this is a great way to preserve financial stability and quality of life for the surviving spouse.

Let's continue to use David as our example. David expects that he will pass away before his 62-year-old wife, Eve. He wants to know that that she'll be okay (at least financially) once he's gone, so he's considering adding her to his QLAC. David can purchase a joint life policy that's contingent on her life as well, such that income payments continue until both of them have passed away. The income payments will be lower, but they're expected to be paid over a longer period of time. Since their expenses will decrease when it's just Eve, they've opted for a 50% income reduction, which increases their income while they're both alive.



QLAC rates based on $125,000 New York Life single and joint life-only policies for a male aged-65 and a female aged-62 with income starting at age 85. Rates as of 2/2/2017.

Drawbacks

Despite these benefits, QLACs are not good for everyone or for all situations. Here are some of the drawbacks:

✗ No Liquidity or Cash Value

The QLAC is not liquid and does not have a cash value that can be withdrawn or borrowed from. Instead, the QLAC should be thought of as a future paycheck, like a pension. While the value of your money will be growing during the deferral period, its growth will only be reflected in the income amount and will be otherwise invisible to you.

✗ No Market Exposure

The income you'll receive is determined upfront and fixed for the life of the contract, a requirement for the QLAC designation. The funds you use to buy the QLAC will be isolated from the market and any upside (or downside) potential. While this is a positive attribute for those focused on insurance coverage, it isn't the solution for those seeking a more investment-style product.

Typical Buyers

A QLAC is a powerful way to ensure you have a guaranteed source of income in retirement. That doesn't mean it's right for everyone, and it never makes sense to purchase an annuity with your entire portfolio. Here's the methodology we've developed at Abaris to help you think about whether a QLAC may (or may not) be a fit for you:

Consider buying a QLAC if...

✓ Social Security and/or pension benefits won't cover your regular expenses
✓ You're over 45 but not too far into retirement
✓ You've accumulated between $250,000 and $5 million in retirement savings
✓ You have average or above-average health
✓ You're seeking greater certainty in retirement and more of an insurance product
✓ You'd like to reduce your Required Minimum Distributions and defer associated taxes

A QLAC is probably not the right product for you if...

✗ Social Security and/or pension benefits cover your regular expenses
✗ You're younger than 45 or over 75 years old
✗ You've accumulated less than $250,000 or more than $5 million in retirement savings
✗ You have below-average health
✗ You're seeking higher risk and more of an investment product
✗ You need access to the money immediately

A common objection to QLACs is that they don't build or provide access to cash value unlike other insurance products used for retirement planning. This is true, but the trade off is access to higher guaranteed income than these more liquid products will offer. Using only a portion (always less than 25%) of your portfolio to purchase a QLAC leaves the rest of your assets to provide liquidity and market upside.

QLAC Rates

The income offered on QLACs will vary over time as market conditions change, being driven most notably by longer-term Treasury and investment grade corporate bond yields. In addition, your personal attributes (age, gender) and the policy options you select will impact the quote. As of February 2017, highly-rated carriers are offering the following QLAC annual income payments for a $100,000 purchase:

Age	Income Start	Male	Female	Joint
60	75	$18,800	$17,100	$17,900
60	80	$31,800	$27,900	$29,800
60	85	$61,100	$51,000	$55,600
65	75	$14,700	$13,200	$13,900
65	80	$25,100	$21,500	$23,200
65	85	$48,900	$39,800	$43,800
70	75	$11,300	$10,400	$10,900
70	80	$20,000	$17,200	$18,500
70	85	$39,300	$31,800	$35,200

QLAC quotes shown as annual income for a $100,000 premium as of 2/2/2017. All quotes are life only. Joint quotes are for a male and female with the same age and 50% continuation.

On our website you can compare quotes across top-rated carriers.

Understanding how your personal attributes and the options you select drive quotes enables you to structure the policy to best suit your needs. Expect to have to think about the following when evaluating a QLAC:

Age: Income will decline as you age. The longer you wait to buy, the less time the insurance company will have to invest your premium before beginning income payments. Holding all else equal, buying income today will be cheaper than buying the same amount in the future.

Gender: Income will be higher for males than females. Because women have longer life expectancies than men, the income they can receive each year will be smaller.

Premium: Income will increase with higher premiums. A portion of the insurance company's expenses incurred are fixed per contract such that incremental premium can go entirely towards buying income. Said another way, there is a discount for larger premium deposits.

Income Start Date: Income will increase the longer you delay its start. Longer deferral periods mean (1) more time for the insurance company to invest your money before starting payments and (2) fewer years of expected income payments.

Single vs. Joint Life: Income will be higher for single life than joint life policies. A joint life policy will provide income as long as either person is alive, which is almost certainly longer than if contingent on one person.

Payout Option: Income will be lower for richer guarantees. Guaranteeing a minimum cumulative income (cash refund / installment refund) increases the amount the insurer expects to pay you. To compensate for the extra guarantee, they will need to lower the recurring payments.

Riders: Income will be lower for each rider added. In general, any extra options or riders added to a policy will require compensating the insurer for additional risk they've assumed. Typically these options increase your guarantee or provide you with extra protection, both of which will result in lower base income amounts.

Finally, you'll usually notice an inverse relationship between the creditworthiness of an insurer and the income they offer. Insurers with higher credit ratings have earned them by maintaining higher capital reserves and more conservative investment portfolios limiting their profitability and thus the income they can offer you. Only highly-rated insurers (A.M. Best rating of at least A) make the cut for inclusion on the Abaris platform. And, even among the insurers we've decided to work with, it's worth distinguishing among the levels of financial strength. The guaranteed income you're promised is only as good as the financial strength and longevity of the insurer backing it.

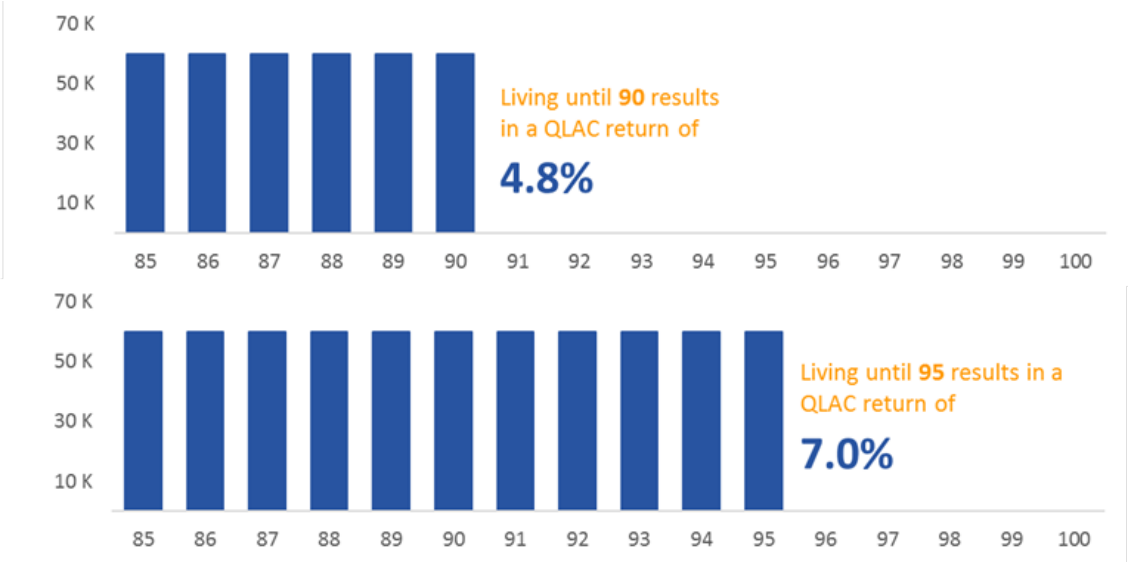
Financial Value

A common question asked when considering moving some of your retirement assets into a QLAC is: what value will I get from this purchase? Typically, pre-retirees look for a quantitative answer, such as an IRR or ROI, that they can compare to returns generated in their fixed income portfolio.

Unfortunately, the value of a QLAC cannot be understood quite so simply or compared to the return of a traditional financial product on an apples-to-apples basis. Why not? Because calculating an IRR or ROI requires knowing the upfront investment and all future income amounts and dates. As a longevity insurance product, the QLAC will provide you with income for as long as you're alive, i.e. end date to be determined!

Instead, we can calculate a range of IRRs based on your potential lifespan. The longer you live, the higher the IRR over the life of the product will be. While thinking about your quantitative return should be a part of your analysis, don't forget about the more qualitative risk reduction and peace of mind the product is providing as well.

In one of our earlier examples, 65-year-old David bought a $125,000 QLAC with income starting at age 85. The policy could wind up generating a 4.8% return if he lives until 90, which increases to 7.0% at age 95 and 7.9% at age 100.



QLAC rates based on a $125,000 New York Life life-only policy for a male aged-65 with income starting at age 85. Rates as of 2/2/2017.

Taxation

The taxation of annuities depends first and foremost on whether the annuity was purchased with pre-tax or post-tax money. If the premium was paid with post-tax money, as with a non-qualified annuity, the portion of any income payments that constitutes a return of that premium will not be taxable. This is not the case for QLACs, which are qualified annuities purchased with pre-tax retirement savings. Because the money used to fund the annuity has never been taxed, all distributions from the annuity will be fully taxable at ordinary income tax rates.

You should consult a tax professional for complete information regarding annuity taxation as it applies to your personal situation. At a high level, each phase of the QLAC contract and its corresponding tax treatment can be understood as follows:

Purchase: At purchase, pre-tax funds will be moved from one type of qualified retirement account to another. Traditional IRAs, 401(k)s, and QLACs all have the same tax status, so moving money among them will not incur any taxes or penalties.

Deferral: No taxes will be owed during the deferral period. QLACs do not have an account value that accumulates, so there isn't actually anything to tax. In fact, even if it had an account value that accrued interest (as with a fixed deferred annuity) or earned capital gains (as with a variable deferred annuity), no taxes would be due. As retirement savings vehicles, annuities can grow on a tax-deferred basis.

Annuitization: Once the QLAC is annuitized, i.e. income payments begin, taxes will be owed. Each distribution from the annuity will be taxed as ordinary income according to your applicable tax bracket. These taxable distributions will be reported to you and the IRS by your insurance company using tax form 1099-R.

Death Benefit: For QLACs with return of premium and/or death benefit riders, beneficiaries will receive any remaining value in the contract in the case of the annuitant's premature death, amounting to the difference between the initial premium paid and the cumulative income payments received. Any death benefit owed will be paid directly to the beneficiary, thereby avoiding the probate process. The beneficiary can elect to annuitize the death benefit over his/her life expectancy instead of taking it as a lump sum. Either way, the annuity contract will typically be included in the deceased's estate, and the beneficiary will be taxed on any proceeds they receive at ordinary income tax rates.

Spousal Exception/Continuation: When you designate your spouse as your beneficiary, the annuity is typically not included in your estate.

Tax treatment of these payments can be tricky, so be sure to reach out to a tax advisor for a complete explanation.

Diversification

It is widely accepted that a diversified portfolio is superior to one with singular or uniform market exposure. For nearly every target rate of return, a diversified portfolio of minimally-correlated investments can be constructed that will be lower risk than one investment with equal expected return. When diversifying your retirement portfolio, you will likely select a combination of equity and bond market investments that are appropriate for both your risk-appetite and your investment horizon. In general, your portfolio should tend towards equity investments in the early years and then gravitate towards fixed income investments as you near retirement.

The fixed income assets in your portfolio serve to provide steady, reliable income that is uncorrelated, or inversely correlated, with the equity markets. Sound familiar? This is exactly the purpose that a QLAC or any income annuity serves, with one major added benefit: the annuity will continue to make payments until you die. Allocating a portion of your fixed income portfolio to a QLAC can generate comparable returns (see the Financial Value section) and reduce your longevity risk.

In fact, adding the security of a QLAC to your portfolio can enable you to earn a higher rate of return with the rest of your portfolio. If your QLAC or other annuities generate enough income to cover your retirement expenses, you have even more flexibility to invest the equity portion of your portfolio without putting your livelihood at risk.

One final benefit of owning a QLAC is the ability to invest and manage the rest of your portfolio to a fixed time horizon. That is, you'll know exactly what type of income your portfolio needs to generate and for how long if the QLAC will be covering your expenses starting at a known point in the future.

Product Specifications

QLACs differ from other longevity annuities, and it's worth understanding the distinction. A QLAC is a type of Deferred Income Annuity that is purchased with funds from Traditional IRAs and 401(k)s. The QLAC designation, which came out of a 2014 U.S. Treasury ruling, exempts these DIAs from the standard RMD rules, which force those older than 70½ to withdraw a specific amount of money from their tax-deferred retirement accounts each year. As such, the QLAC has extra requirements and specifications as compared to a standard DIA. Here are some relevant details:

QLAC Designation

Annuities must be specifically designated as QLACs to qualify for RMD exemption. Any previously purchased annuities not labeled as a QLAC cannot be reclassified. To be a QLAC, the product cannot have any market-based features, with the exception of an inflation adjustment. There also cannot be any cash surrender value.

Premium Limits

QLAC premiums are limited to the lesser of $125,000 or 25% of your IRA holdings as of December 31st of the previous year.

- If you have $500,000 or more, this means $125,000.
- If you have less than $500,000, this translates to 25% of your IRA.

These limits apply to individuals, meaning that couples with separate IRA accounts could have up to $250,000 worth of QLACs.

Note that it's the insured's responsibility to make sure his/her QLAC purchase complies with the premium limitations. If the limits are exceeded, excess premium must be returned by the end of the calendar year following the purchase.

Sources of Funds

QLACs can be purchased with funds from all non-Roth IRAs, 401(k), 403(b), and 457(b) plans. QLACs can not be purchased with funds from Roth IRAs or Defined Benefit plans.

Deferral Period

Deferral of income is allowed until age 85, at which time income payments must begin. To benefit from the RMD exemption, you'd also want to start income after age 70½.

Features & Riders

It's best to think of the base QLAC product as that which provides the most income based on your premium, age, gender, and income start date. But, there's room to customize the product or add additional guarantees to meet your needs. In some cases, the insurance company will refer to these options as product features. Other times they'll be listed as riders.

Below are the various ways you can customize your policy, noting that these options can vary from insurer to insurer:

Single vs. Joint Life

QLAC income can be tied to a single or joint life:

- **Single**: income paid over the lifetime of the insured
- **Joint**: income paid over the 'joint life' of two insureds, i.e. as long as one or both are alive

The income level following the loss of the first life can be designed to remain level or decrease. Opting to reduce the income upon the passing of the first spouse (typically to 40-99% of the starting income level) allows for a greater income level while both are alive.

An alternative to buying a joint life annuity is to purchase a single life annuity with a death benefit (a.k.a. cash refund) and designate your spouse as the beneficiary. Upon your passing, he/she will have the option to continue the contract in his/her name until the benefit has been paid out.

Payout Options

Income can be based purely on lifespan or can have a guaranteed component:

- **Life Only**: payments stop at death (or later of two deaths for joint)
- **Life with Cash Refund**: additional guarantee over life only that pays beneficiaries the difference between the premium and sum of all payments already received upon insured's death

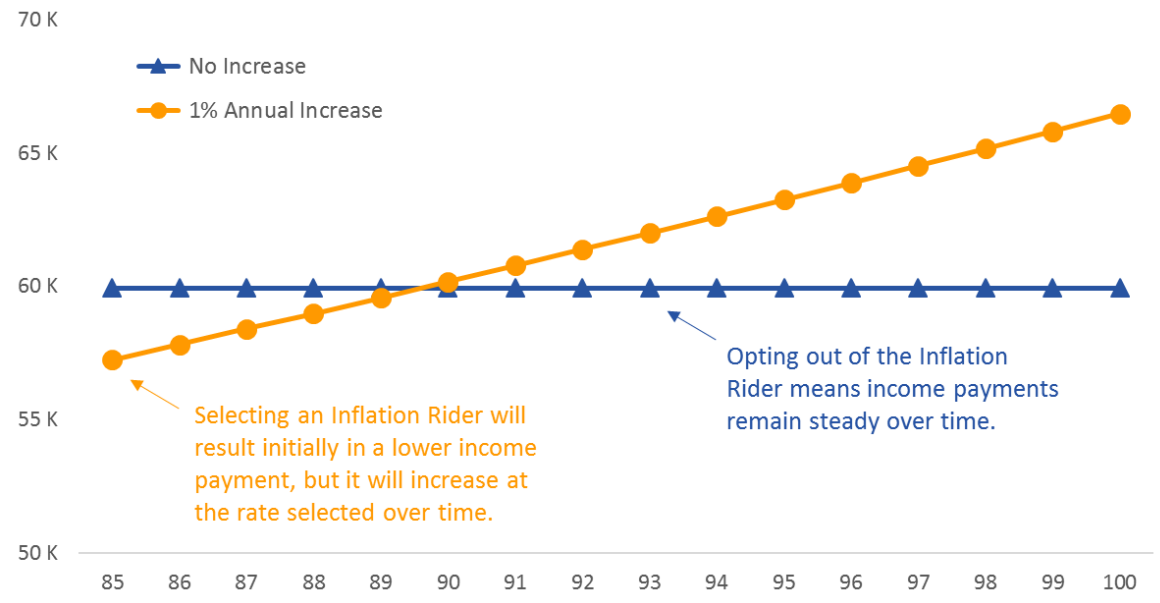
Payout Frequency

Income payments can be made monthly, quarterly, semi-annually, or annually.

Inflation Protection

Most insurance carriers offer an inflation adjustment or annual increase rider that will adjust the QLAC income payments annually for inflation. The adjustment made could be predetermined (between 1-5%) or in some cases be based on a Consumer Price Index. Providing these increases will require a lower starting income. Note that the rider does not cover the deferral period, instead only going into effect once the income stream begins.

To illustrate, let's continue with David, our 65-year-old who wants to purchase a $125,000 QLAC with income starting at age 85. His initial quote excluded inflation protection and got him $5,000 per month ($60,000 per year). If he'd like his income payments to keep pace with inflation, estimating it to be 1% per year, he'll have to accept a lower initial income of $4,800 per month ($57,600 per year) which will increase over time.



QLAC rates based on $125,000 New York Life life-only policies with and without a 1% increase rider for a male aged-65 with income starting at age 85. Rates as of 2/2/2017.

Because inflation affects the purchasing power of money, it presents a challenge for retirement, which could last 40 years. While we're currently experiencing a period of low inflation, it's averaged 3.2% over the past century, meaning that prices have almost doubled every 20 years.

Adding an inflation rider to your QLAC is one way to mitigate the risk of declining purchase power, but it's probably not the most efficient as the extra protection will come at a cost. Consider instead more direct ways to earn inflation-adjusted dollars. Your Social Security benefit, for one, will be indexed for inflation through a Cost of Living Adjustment. And, for the rest of your assets, maintaining exposure to equity markets and investing in inflation-linked bonds, such as TIPS or I-Bonds, can provide an effective hedge.

Additional Premium Payments (Flexible or Subscription)

With some carriers you have the ability to fund your QLAC over time, either through a flexible premium option or on a subscription basis. This is a good approach for those betting on pricing improvements or anticipating converting more of their IRA into income as it grows over time.

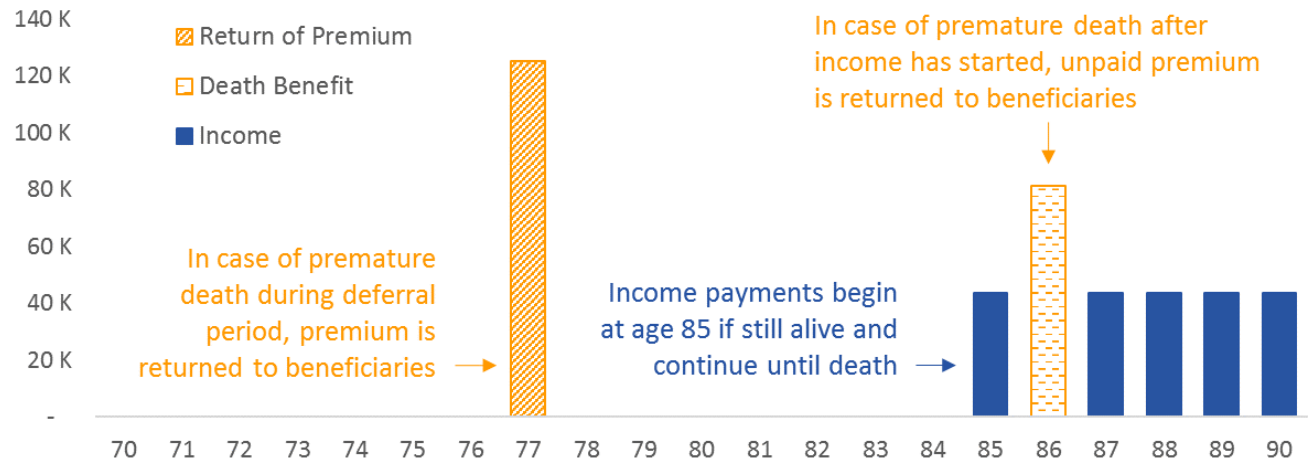
Income Start Date Flexibility

Some insurers' products allow you to change your income start date after purchasing the annuity, sometimes even more than once. Keep in mind that changing your income start date will affect your payments (increasing them if the start date is pushed back and vice versa).

Principal Protection

Through return of premium and death benefit riders, you are guaranteed that your principal (premium paid into the contract) will be returned to your beneficiary should you pass away before getting it back through income payments. The return of premium option protects you before the income start date, and the death benefit rider protects you thereafter. Terminology varies from carrier to carrier, but we simplify it and always line up quotes apples-to-apples on our platform.

For example, if our 65-year-old pre-retiree David is worried about losing money in the event of prematurely passing away, he can add the return of premium and death benefit riders to his QLAC. His $125,000 QLAC policy will offer a lower monthly income to cover the cost of the richer guarantee, but any unrecognized value in the contract will be passed onto his heirs. Should David pass away before income payments begin, his $125,000 premium will be returned to his beneficiaries. If he passes away after income payments have begun but before those payments are cumulatively $125,000, his beneficiaries will receive $125,000 less the total income payments made.



QLAC rates based on $125,000 New York Life life-only policies with and without return of premium and death benefit riders for a male aged-65 with income starting at age 85. Rates as of 2/2/2017.

Buying Tips

Buying a QLAC is a long-term commitment, so dedicate enough time and attention to doing it right! In addition to being available to help walk you through the process, Abaris has compiled a list of things to keep in mind:

QLAC Designation

Annuities must be specifically designated as QLACs to qualify for this special treatment. If you bought a product that wasn't labeled a QLAC, it can't be reclassified.

Available Carriers

There are now about a dozen companies that offer QLACs, including New York Life (rated A++ by A.M. Best), Guardian Life (A++), Pacific Life (A+), Lincoln Financial (A+), Mutual of Omaha (A+) and Foresters (A). Before you buy, you'll want to compare quotes and product features — and remember, not all companies sell all products in all states.

Where To Buy A QLAC

QLACs are sold via insurance agents, brokers, and financial advisors. It's also possible to shop for a QLAC online via our website. We limit our product offerings to only those sold by top-rated insurers (A.M. Best rating of at least A), and our Quote Tool allows you to easily compare quotes side-by-side.

Consider Your Agent/Broker's Incentives

The Department of Labor has been working for nearly a decade to reform the requirements for giving financial retirement advice. The goal is to ensure that advisors, agents, and brokers put their clients' best interests before their own. Regardless of whether the reforms are implemented, make sure you consider your agent or broker's incentives. How are they compensated on the sale? How do they select the products they're showing you? Do they work with only one or a handful of insurance companies? Are they acting in your best interest?

Compare Quotes Apples-to-Apples

Some financial products are too unique to be compared to one another, but this isn't the case with QLACs. You should be able to see quotes from different carriers that are exactly the same in all major respects except two: price and credit rating.

Credit Ratings Matter

It can be enticing to just go with the company that offers the highest payout, but be careful. The value of a QLAC is undeniably linked to the claims-paying ability of the insurance company. The insurer needs to be around at least as long as you are! Buying from only highly-rated insurers is the way to go.

Consider Buying In Chunks Or As A Subscription Over Time

If you're still years away from retirement, are optimistic about pricing improving, and/or would like to diversify across carriers, you can buy QLACs in pieces over time. Keep in mind that, all else being equal, waiting to buy will reduce the amount of income the insurance company can offer. In addition, the pricing usually isn't quite as good at smaller purchase sizes.

Options For Buying With 401(k) Funds

401(k) plan sponsors are currently not required to offer QLACs to their employees and adoption has been slow. If you are looking to use funds in your 401(k) to buy a QLAC, you have a few options:

- Roll your 401(k) funds into an IRA. You will then have to wait until January 1st of the next calendar year to purchase your QLAC. Don't forget the value caps that apply, so ensure you are transferring enough into an IRA account that allows you to purchase a QLAC for the value you want. For example, in order to purchase a $125,000 QLAC, you'd need to have at least $500,000 in your IRA.
- Talk to your benefits department and ask them for more retirement income options within your 401(k). Supply follows demand!
- Have Abaris write a letter to your plan sponsor. We are happy to send benefits departments more information on the QLAC product and why it makes sense to include in 401(k) plans. Just send us an email (lauren@myabaris.com); we'd love to hear from you.

MYGAs

Multi-Year Guaranteed Annuities

A safe, guaranteed and tax-deferred way to grow your retirement savings

Introduction

Like many Americans, you've taken your retirement seriously and have been contributing to your 401(k) and IRA. As qualified retirement savings vehicles, they allow us to save pre-tax money and let it accumulate on a tax-deferred basis until retirement. But, there are limits to how much we can contribute annually.

Let's say you are getting closer to your retirement age goal, you've maxed out your contributions but have more money you'd like to invest. A decent return with a minimal amount of risk would be ideal. You like the security of a CD but wish you could get a better return. The good news is there is another option.

A Multi-Year Guaranteed Annuity, or MYGA, is essentially a Certificate of Deposit (CD) sold by an insurance company. While CDs are great for low-risk short-term savings, MYGAs are more suited to retirement savings, offering:

- Higher crediting rates over longer time horizons,
- tax-deferred growth,
- the ability to annuitize upon maturity, and
- liquidity via penalty-free partial withdrawals.

Contents

Multi-Year Guaranteed Annuities (MYGAs) are also known as fixed rate annuities, fixed deferred annuities, and single premium deferred annuities.

In this guide, we'll provide an overview of MYGAs, covering how they work, what makes them an appropriate (or inappropriate) investment for you, and how to approach the buying process.

Abaris | www.myabaris.com | (888) 248-8995 lauren@myabaris.com

What is a MYGA?

A Multi-Year Guaranteed Annuity (MYGA) is a tax-deferred retirement savings vehicle that provides fixed asset accumulation, much like a CD. With a MYGA, you can invest your savings over a specified time horizon (typically 3 to 10 years), earning a fixed return. The interest earned in your MYGA is not taxed until withdrawn, and your principal is guaranteed.

Because annuity terminology – and the fact that a MYGA is an annuity in the first place – is confusing, let's break it down:

A MYGA is… an **annuity**.

> An annuity is an insurance vehicle where a lump-sum amount is exchanged for a stream of payments going forward. What makes a MYGA an annuity is that it has the *option* to annuitize at the end of the contract term. You can also choose to leave your money invested at a renewable rate, withdraw all or a portion, or roll it over into a new MYGA. The distinction of being an annuity gives it tax-deferred status.

More specifically, a MYGA is… an **accumulation** annuity.

> An accumulation annuity is bought for the growth potential of the money invested, and not as much for the ability to turn that money into income (as is the case with an income annuity). During the accumulation, or deferral, period your money will be invested with an insurance company and grow on a tax-deferred basis. You will have some access to your money – typically 10% of your balance – while it's invested. Accumulation annuities grow either at a fixed rate (like MYGAs) or grow based on market performance (as with VAs and FIAs).

And finally, a MYGA is… a **multi-year guaranteed** annuity.

> MYGAs earn a fixed rate over a multi-year time horizon. The interest rate will be specified upfront and will vary based on the amount you're investing, your investment horizon, the credit rating of the insurer, and market conditions at the time of purchase. At the end of the guarantee period, the rate may change.

In summary, a MYGA is an annuity that operates much like a CD, offering low-risk tax-deferred accumulation at a fixed rate.

MYGAs vs. CDs

Multi-Year Guaranteed Annuities operate very similarly to CDs. Both vehicles offer a safe way to save money, crediting higher interest rates than available through savings accounts by requiring you to lock your money away for a period of time. However, MYGAs have longer-term investment horizons and tax-preferential treatment, making them a better choice for retirement savings. As CDs are the more well known of the two products, it can be easier to understand MYGAs using a side-by-side comparison:

	MYGA	CD
Sold By	Insurance Companies	Banks
Size	$2,500 - $1,000,000	Virtually any denomination
Term	3 years – 10 years	3 months – 5 years
Interest Rates	Vary by term and size but typically higher than CD rates	Vary by term and size but typically lower than MYGA rates
Taxes	Taxes on interest gains deferred until money is withdrawn	Interest taxable annually as earned
Liquidity	Typically, a portion of the account balance is available for withdrawal annually	Generally no (free) access to account balance is available
Withdrawal Provisions	Can generally withdraw accumulated interest or 10-15% of cash value for free if aged-59½ or older	All withdrawals are charged, typically equal to a portion of the interest you've earned
Financial Protection	MYGAs are backed primarily by the issuing insurance company, and additionally by State Guaranty Funds	CDs are insured by the FDIC (up to $250,000 total per bank)
Legacy	Asset passed directly to beneficiary without going through probate process	Probate process required to pass asset to heirs

Does not cover all products or all companies. Specific information available by product upon request. Updated as of February 2017.

Another key difference is that MYGAs can be annuitized at the end of the contract term. Annuitization is the process of turning a lump-sum of savings into a stream of steady income, guaranteed to last a number of years or for life. This feature is what makes annuities good for retirement income and qualifies them for tax-preferential treatment.

Benefits

MYGAs are a useful tool for retirement savings. They provide a safe, tax-advantaged way to earn a good return on savings needed in the near future. They are very similar to CDs, with added benefits:

✓ Guaranteed, Strong Return

The money you invest in a MYGA will accumulate at a fixed rate, which is specified upfront and guaranteed for the entire contract. MYGAs generally offer higher rates than CDs with the same contract length.

✓ Tax-Deferred Growth

From the government's perspective, an annuity is a retirement savings vehicle. As such, it receives similar tax treatment as IRAs: no taxes are paid until distributions are made. For a MYGA, this means that interest will accumulate and compound without incurring annual taxes, as is the case for a CD.

✓ Principal Protection

Unlike with most other investments, there is no market risk associated with a MYGA. Your principal is protected and guaranteed to accumulate at a fixed rate, making MYGAs a good place to park retirement money you'll need in the near future.

✓ Some Liquidity

MYGAs provide some liquidity, typically making 10% of the contract's cash value available penalty-free annually if you're over 59½.

✓ Simple & Easy To Understand

There are a lot of complex products, but a MYGA is one of the simple ones. Assuming you leave your money in the MYGA until maturity, all you need to know is (1) how long until your money is available and (2) what your return will be over that period of time. There are no hidden fees that you need to worry about.

Drawbacks

Despite these benefits, MYGAs are not good for everyone or for all situations. Here are some of the drawbacks:

✗ Penalties For Withdrawals Under Age 59½

MYGAs are really meant to be used for retirement savings. The IRS issues a 10% penalty on gains withdrawn from a MYGA for account holders under age 59½ .

✗ Not For Generating Income

While the MYGA has a lot of great benefits, it's not the most effective way to generate income in retirement. Instead, MYGAs are typically used for accumulation. There are other products that are better for converting assets into income, like DIAs, SPIAs and QLACs.

Typical Buyers

Just like with any product, MYGAs might make sense for you, or they might not. We've compiled a quick checklist to help you figure out whether a MYGA fits your investment needs.

Consider buying a MYGA if...

✓ You have money to invest for at least 3 years but want access to it within 10 years
✓ The money you're investing is earmarked for retirement or to be passed on to heirs
✓ You've already maxed out your IRA or 401(k) contributions
✓ You want greater certainty and principal protection
✓ You have other assets in the market exposed to higher expected returns
✓ You want to preserve some liquidity

A MYGA is probably not the right product for you if...

✗ You need to access your money within 3 years or before age 59½
✗ You aren't maxing out IRA or 401(k) contributions
✗ You're interested in high risk investments and willing to risk principal to achieve it
✗ You're interested in generating income in retirement

MYGA Rates

MYGA interest rates will vary over time as market conditions change, being driven most notably by longer-term Treasury and investment grade corporate bond yields. In addition, the size of your investment, length of time you're willing to lock away your money, and the credit rating of the carrier will impact the rate. As of February 2017, highly-rated carriers are offering the following MYGA rates, shown below as the annual yield to maturity.

A.M. Best Credit Rating	Investment Term							
	3-yr	4-yr	5-yr	6-yr	7-yr	8-yr	9-yr	10-yr
A+	1.85%	2.05%	2.70%	2.45%	2.70%	2.85%	2.95%	3.05%
A	1.85%	2.05%	2.70%	2.90%	2.99%	3.05%	2.97%	3.05%
A-	2.10%	2.45%	2.85%	2.90%	3.00%	3.10%	3.20%	3.30%

MYGA yields to maturity shown for high-band contracts with the MVA option offered by carriers with at least credit rating shown. Rates as of 2/2/2017.

Understanding how the premium, investment term, and carrier's credit rating drive interest rates will help you to select the MYGA that best suits your needs. Expect to have to think about the following:

Premium: The higher the premium, the higher the rate. Larger MYGA premiums will have access to higher interest rates. A portion of the insurance company's expenses are fixed per contract such that incremental premium can essentially be invested without costing more. Said another way, there is a bonus for larger premium deposits.

Investment Term: The longer the contract term, the higher the rate. When an insurance company invests your funds, a longer time horizon gives them more flexibility for investing your money and weathering any market fluctuations. As is the case for bonds and other fixed income instruments, investors have the right to demand higher returns the longer their money is locked away.

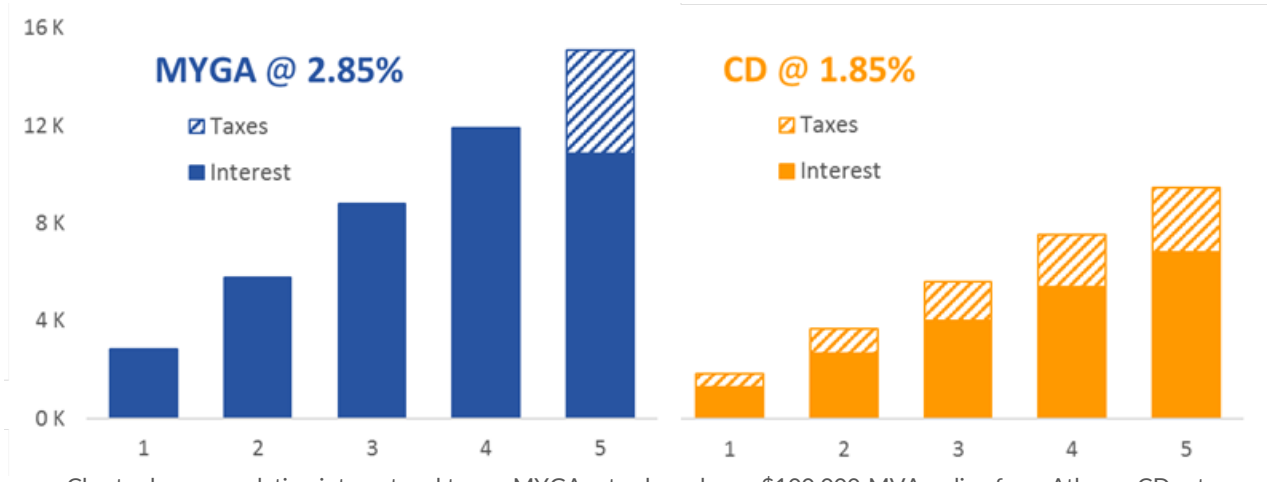
Insurer's Credit Rating: The higher the insurer's credit rating, the lower the rate, but the safer the investment. Given that MYGAs are not backed by the FDIC and instead by guaranty funds which vary by state, it's an important factor to consider.

Financial Value

A MYGA is a CD-like investment which credits a fixed interest rate over a specified period of time. On a pre-tax basis, the value of the MYGA is understood simply by its interest rate, or the rate at which you'll earn a return. But, MYGAs are even more valuable on an after-tax basis. Unlike CDs, interest earned on a MYGA is not taxed until money is withdrawn from the contract. This not only means lower taxable income for you during the accumulation period, but also additional compounded interest.

To illustrate the value of a MYGA, let's take Kelli, a 55-year-old starting to prepare for retirement, as an example. Kelli has $800,000 of post-tax savings that she's set aside for retirement. It's currently invested in the stock market, but she'd like to move $100,000 to something safer. She's considering a 5-year CD or MYGA.

During her search, Kelli finds a 5-year MYGA returning 2.85%, significantly more than the 1.85% her bank is offering for a 5-year CD. This chart compares the growth of the two products and illustrates the power of the MYGA's tax-deferred growth.



Charts show cumulative interest and taxes. MYGA rates based on a $100,000 MVA policy from Athene. CD rates based on a $100,000 investment with Goldman Sachs. Rates as of 2/2/2017.

The MYGA will produce an extra $5,600 pre-tax ($4,000 post-tax) over the 5-year period.

Considering Kelli's age, timeline, and her plans to use the money for retirement, the MYGA is the more sensible investment for her. Plus, if she decides to roll the money over into another annuity in 5 years, she'll be able to extend the tax-deferral.

Taxation

In our discussion of MYGAs thus far, we've assumed that the purchase was made with after-tax personal savings. However, it's also possible to buy a MYGA with qualified funds, such as within an IRA. In this case, the MYGA doesn't provide any additional tax benefits beyond what the IRA offers, which is tax-deferral of gains until money is withdrawn.

Continuing with the original assumption that the MYGA is being purchased with non-qualified funds, let's dig deeper into the tax treatment at each phase of the contract:

- **There are no taxes due during the contract term.** Your money isn't subject to taxation while it's growing. Not paying taxes means that you're able to keep more money invested and earning interest. And, this benefit continues as long as you keep your money in the contract, which can be beyond maturity.

- **Instead, you pay taxes once money is withdrawn** whether during, at the end of, or after maturity of the contract. Assuming the MYGA was purchased with after-tax savings, only the interest gain portion of your withdrawal will be taxable at ordinary income rates. (If your MYGA is held in an IRA, all withdrawals will be taxable.) Waiting until you're in retirement, or in a lower tax bracket, to withdraw can reduce the taxes you owe. Note that you will incur penalties if you withdraw money before age 59½ or more than what's allowed in your contract.

- **You can continue your tax-deferral by rolling over your MYGA into a new annuity.** When your MYGA matures, you're not obligated to withdraw your funds. You can choose to roll it over into another MYGA or a different type of annuity through a tax-free 1035 exchange.

Tax treatment of these payments can be tricky, so be sure to reach out to a tax advisor for a complete explanation.

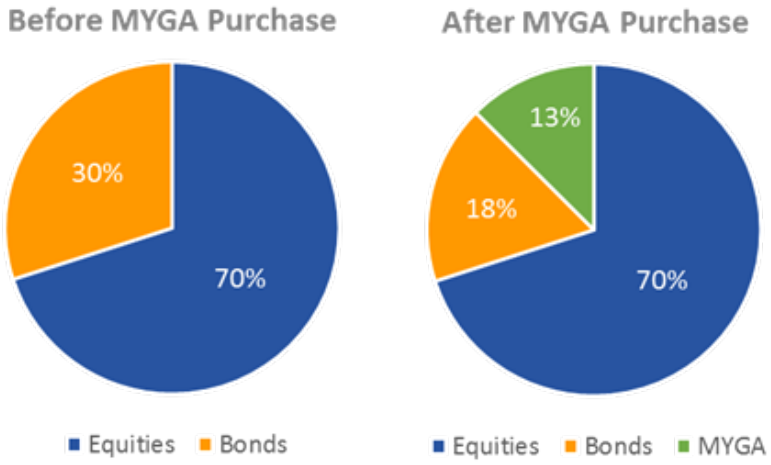
Portfolio Strategies

Investment decisions should not be made individually or in isolation. Instead, consider your entire financial portfolio and situation when investing. Here are some ways to think about a MYGA fitting into your portfolio strategy.

Diversification

When diversifying your retirement portfolio, you will likely select a combination of equities and bonds that's appropriate for both your risk-appetite and your age/investment horizon. As a fixed income investment, MYGAs have a place in any well-diversified portfolio. Consider your MYGA purchase as portion of your assets you'd otherwise have allocated to bonds.

55-year-old Kelli's $800,000 in savings are currently invested at a 70/30 mix of stocks and bonds. She wants to maintain her equity exposure and overall investment mix when she purchases a $100,000 5-year MYGA.



How does she do it? At a 70/30 mix, Kelli had $560,000 (70%) invested in equities and $240,000 (30%) invested in bonds. After transferring $100,000 to a MYGA, Kelli will have to rebalance the remaining $700,000 to an 80/20 mix. Doing so maintains her $560,000 exposure to equities and decreases her investment in bonds to $140,000. Once adding back in the $100,000 MYGA, which acts as a fixed income investment, Kelli has maintained her desired 70/30 portfolio diversification.

Laddering

Breaking up your purchase into multiple MYGAs with different contract terms is a useful strategy in a low interest rate environment. A MYGA laddering strategy accomplishes two things: you're able to secure a higher interest rate today that's only available for longer time commitments while also creating multiple opportunities to reinvest at potentially higher future rates. For example, instead of buying one 5-year MYGA, you could buy 3 MYGAs with maturities of 4-years, 5-years, and 6-years. The money locked in for longer will be eligible for higher rates today. And, you'll have liquidity available at multiple dates in the future, which makes it more likely that you'll catch rising rates.

If Kelli employs this strategy, she'll split her $100,000 purchase into multiple smaller purchases, keeping the average investment term close to 5 years. Based on current rates and her personal circumstances, Kelli decides to split her investment evenly between 4-year, 5-year, and 6-year MYGAs, crediting 2.45%, 2.70%, and 2.90% respectively. This way, she'll have funds maturing annually for 3 years, giving her more reinvestment opportunities.

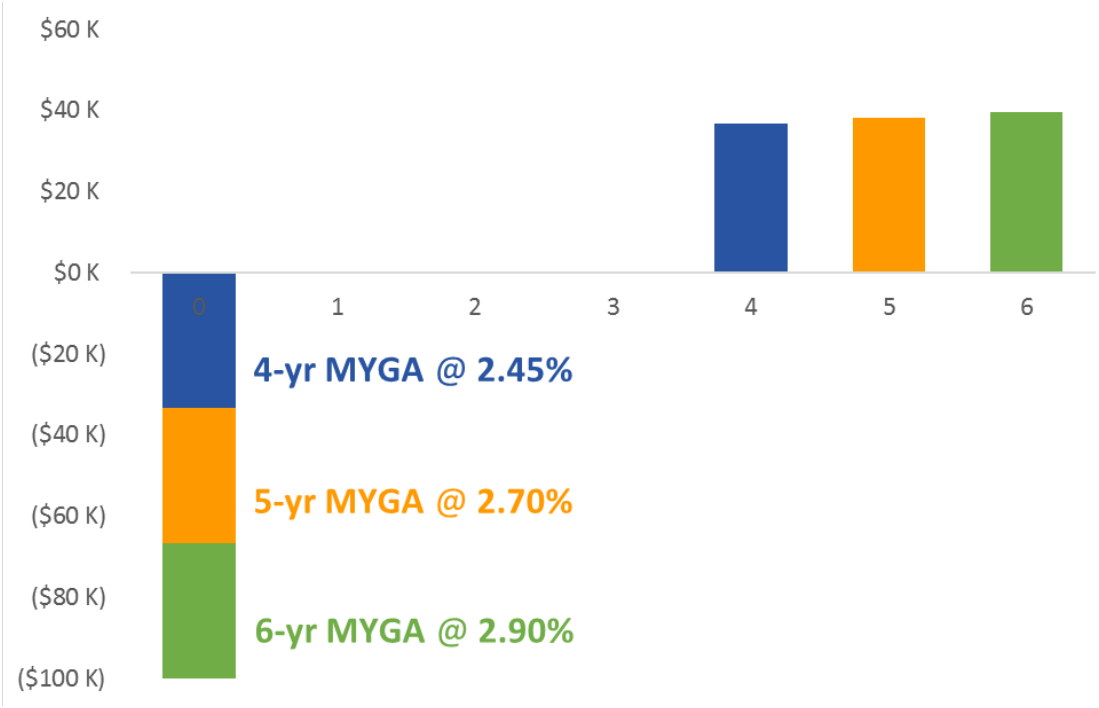


Chart shows investment and cumulative pre-tax interest. MYGAs rates based on three $33,333 MVA policies from Oxford Life. Rates as of 2/2/2017.

MYGA + Annuitization vs. Deferred Income Annuity

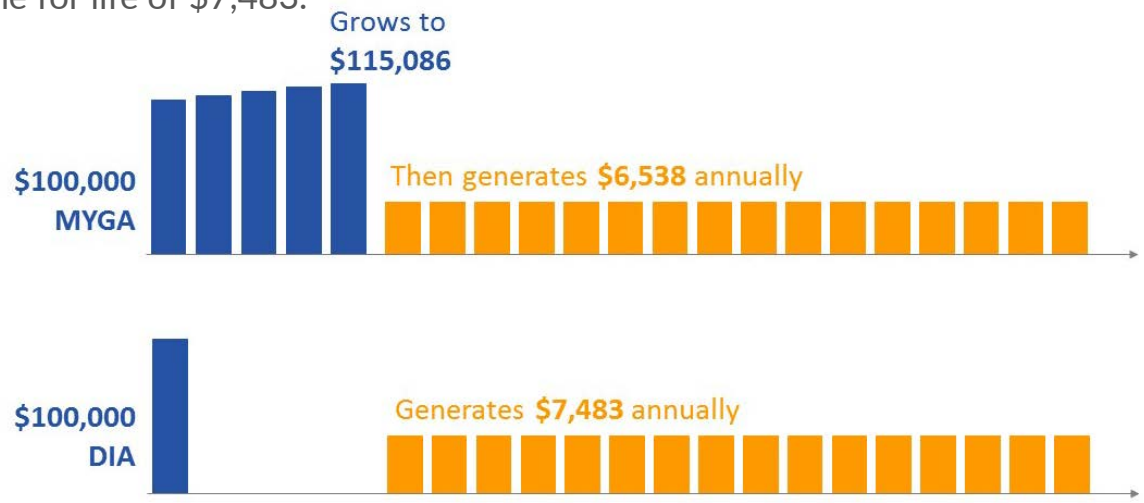
With your MYGA, you have several options upon maturity. If you are planning to annuitize your MYGA, you may be better off purchasing a Deferred Income Annuity (DIA) today. The money you invest in a DIA will produce a guaranteed lifetime income stream starting at some point in the future, resembling what your annuitized MYGA will look like.

Whereas the MYGA will become liquid at the end of the contract term, the DIA is locked-in, and its value can only be accessed through income payments. A MYGA plus annuitization strategy has more liquidity and optionality, but a DIA will offer higher income payments.

Let's revisit Kelli's decision to buy a $100,000 5-year MYGA at age 55, maturing at age 60. Kelli is aware of the MYGA's annuitization option and thinks it might be a good way to convert a portion of her retirement savings into lifetime income. Knowing that generating income is important to her, Kelli is advised to consider purchasing a DIA instead today, which – all else being equal – will offer higher future income paychecks.

To compare the two strategies, let's assume that income annuity rates remain constant over the next 5 years. Kelli's first option is to purchase a $100,000 5-year MYGA today and in 5 years convert the proceeds into a single premium immediate annuity (SPIA). Kelli's second option is to use the $100,000 to purchase a DIA with income payments starting in 5 years.

If she goes with the first option, her $100,000 will accumulate in a MYGA at 2.85% to $115,086 in 5 years. Then, she will annuitize by converting the $115,086 to a SPIA, which pays $6,538 annually for life. In the second option, Kelli buys a $100,000 DIA today, gives up her liquidity, but is able to get a 14% higher annual income for life of $7,483.



(1) 5-year MVA MYGA from Athene offering 2.85% then buys a American National SPIA life with cash refund policy for a 60-year-old female. (2) Mutual of Omaha DIA life with cash refund policy for a 55-year-old female with income starting at age 60. All rates as of 2/2/2017.

The two strategies are summarized in the table below.

	MYGA + Annuitization	DIA
Purchase	Money is invested in a MYGA	Money is invested in a DIA
Deferral Phase	Account accumulates with interest. Some liquidity is available.	Insurance company invests your money, but its growth is invisible and illiquid.
Maturity	Money is as available. Annuitization option elected, effectively purchasing a SPIA.	N/A
Payout Phase	Income payments begin immediately and continue for life.	Income payments begin at the end of the deferral period and continue for life.

Features & Riders

MYGAs are relatively simple investments, but there's still some terminology, features, and riders that you'll need to understand. We've outlined some key concepts for you here.

Interest Rates

When you buy a MYGA, you are locking in a return that's guaranteed for the contract term. The MYGA could be structured to offer the same crediting rate every year or a different rate in the first year, which is higher than in subsequent years. Ultimately, and assuming you won't be cashing out early, what matters is the yield to maturity/surrender, or the annual effective return you're earning over the full locked-in period. Finally, at the end of the contract, you'll have the option for continue the MYGA with an annually renewable rate. Here's how the rates will be identified:

- **Base Rate**: annual interest rate credited to your account during the contract term
- **Additional First Year Interest Rate Bonus**: additional interest rate that might be added to the base rate in the first year
- **Yield To Surrender/Maturity**: the effective annual interest rate when spreading the bonus rate evenly over every year
- **Renewal Rate**: after the contract term ends, your money will continue to earn interest at the prevailing renewal rate, which moves according to market conditions
- **Guaranteed Minimum Renewal Rate**: the lowest renewal rate possible (floor)

Surrender/Contract/Guarantee Period & Rates

The contract term for a MYGA is actually the period during which surrender charges apply. During these years, if you withdraw more than what's allowed – typically 10% of your account value – fees will be assessed. Most MYGAs have pre-set declining surrender charge schedule which can start as high as 10% in the first year and will then decline by typically 1% per year. Here's how the surrender charge period will be identified:

- **Surrender Charge Period**: years during which you'll be charged to access anything greater than the free withdrawal
- **Surrender Charges**: Rates applied to amount surrendered above free allowance for each year of the surrender charge period

Note that typically the surrender charge period will be the same as the rate guarantee period, but products are occasionally structured to have a longer surrender charge period. In this case, the guaranteed rate will be in effect for only a few years, after which you'll earn the renewal rate until the surrender charge period ends. This option could make sense if you expect interest rates to increase, but it's generally not something we'd recommend.

Free Withdrawals

MYGAs typically allow you to access a portion of your money penalty-free. The allowance will differ from carrier to carrier, but it's often 10% of the account balance. You should only plan to take advantage of these withdrawals if you're at least 59½, as the IRS imposes a 10% penalty on withdrawals made before you reach that age.

Note that if your MYGA is qualified and was purchased within a 401(k) or IRA, any applicable Required Minimum Distributions will be withdrawable penalty-free.

Market Value Adjustment vs. Book Value

There are two types of MYGAs: those with a market value adjustment (MVA) or without, known as book value (BV). The MVA or BV classifications only impact you if you decide to withdraw funds early. In the case of a book value MYGA, the amount you're able to withdraw will simply be the account value less surrender charges described above. However, a MYGA with a market value adjustment could reduce the amount you're able to access upon surrender.

The market value adjustment will, as the name suggests, adjust the amount you're able to surrender based on market conditions at that time. If interest rates have gone up since purchase, an additional fee will be assessed that lowers the withdrawal value. The reverse is also true. If interest rates have gone down since purchase, the amount you're able to withdraw will actually increase.

While seemingly bizarre, MYGAs with MVAs are actually very common and well-liked, offering higher interest rates than their BV counterparts. The market value adjustment protects the insurance company from adverse behavior by charging you for surrendering in a rising rate environment. That's because the insurance company would otherwise lose money liquidating assets to fund your surrender (bond prices go down when interest rates go up). Having this downside protection means they can offer you a higher rate.

For example, let's assume that Kelli decides to surrender her 5-year MYGA with MVA at the end of year 4 to take advantage of the increasing interest rate environment. To measure the change in interest rates over those 4 years, the insurance company uses a corporate bond index. At purchase, that index showed a rate of 3%, which 4 years later has increased to 5%. For simplicity, we'll assume that the insurance company calculates the MVA adjustment as {(1 + Initial Index)/(1+ Current Index) – 1}, which in this case produces {1.03/1.05 – 1}, or -0.019.

At the end of year 4, Kelli's MYGA is worth $111,897, of which she's allowed to take 10%, or $11,190 for free. The rest, $100,707, will be subject to a surrender charge and the MVA adjustment calculated above. If the applicable surrender charge rate is 2%, then Kelli's charges would be:

Surrender: -0.02 * $100,707 = -$2,014
MVA: -0.019 * $100,707 = -$1,918

giving her a net surrender of $111,897 – $2,014 – $1,918 = $107,964.

MYGA Balance	**$111,897**	
– Free Withdrawal	(11,190)	← 10% x MYGA Balance
Chargeable Balance	100,707	
– Surrender Charge	(2,014)	← 2% x Chargeable Balance
– MVA Charge	(1,918)	← -0.019 x Chargeable Balance
Surrender Value	**107,964**	

$$= \frac{1.03}{1.05} - 1$$

Purchase Index: 3%
Today's Index: 5%

MVA calculation for illustration purposes only and not representative of any particular insurance company's process. Assumes $100,000 5-year MVA accumulates at 2.85% per year, 10% free withdrawal provision, and year 4 surrender charge of 2%. Makes use of simplified MVA of (1 + Purchase Index)/(1 + Today's Index) - 1, with assumed index of 3% at purchase and 5% today.

Note that this is a basic, simplified illustration of the MVA functionality. Each insurance company will have its own formula and underlying index. Also not illustrated here but potentially applicable is a floor for the surrender value of the premium accumulated at the guaranteed minimum interest rate in the contract.

Finally, some MYGAs offer a return of premium (ROP), which guarantees that you'll always be able to get at least your original premium out of the contract at any time. In other words, surrender charges and market value adjustments will be capped at the interest you've accumulated.

Payout Options

When your contract matures, you have several options:

- **Lump-Sum Withdrawal**: You can take entire balance of your matured MYGA in a one-time payment.
- **Periodic or Scheduled Withdrawals**: You can leave your money in the MYGA earning the renewal rate and withdraw as needed or following a pre-determined schedule.
- **Annuitization**: You can convert your account balance into a Single Premium Immediate Annuity (SPIA) that offers a guaranteed lifetime paycheck you can't outlive.
- **Rollover**: Through a 1035 exchange, you can rollover your MYGA into another annuity, MYGA or otherwise, penalty- and tax-free.

Riders

While it varies from carrier to carrier, MYGAs can offer riders that are either included or added to the contract at an additional cost. Here are some of the options you might see:

- **Living Needs Benefit/Unemployment Rider**: Should you start living at a health care facility, become terminally ill, become disabled, or lose your job, additional or full liquidity of your contract will be available.
- **Home Health Care Rider**: If you begin to receive home health care recommended by your doctor, you may be able to access your balance without penalty.
- **Interest Opportunity Rider**: For a fee or a lower guaranteed rate, you may be able to participate in a rising rate environment.
- **Enhanced Beneficiary Benefit Rider**: Your beneficiaries may receive additional funds to help offset death expenses, such as tax obligations.
- **Enhanced Spousal Continuation Rider**: If your spouse is your sole primary beneficiary, he or she can continue your policy upon your death as the new owner.

Buying Tips

Buying a MYGA is easier when you're equipped with the right information. In addition to being available to help walk you through the process, Abaris has compiled a list of things to keep in mind:

Ways To Buy A MYGA

MYGAs are sold via insurance agents, brokers, and financial advisors. Abaris is registered with insurance companies in all 50 states and can help you with your purchase. In addition to finding the MYGA with the best return at the credit rating you're comfortable with, we can help you optimize your retirement strategy.

Focus On Interest Rate & Credit Rating

MYGAs are largely uniform from carrier to carrier, meaning you can make your decision based on just two things: the interest rate being offered and the insurer's credit rating. An insurer's credit rating, similar to a bond's rating measures their financial strength and ability to meet future obligations. Like bonds, the higher the credit rating, the lower the rate. Buy the product that offers the best rate at the rating that's right for you.

Consider Your Agent/Broker's Incentives

The Department of Labor has been working for nearly a decade to reform the requirements for giving financial retirement advice. The goal is to ensure that advisors, agents, and brokers put their clients' best interests before their own. Regardless of whether the reforms are implemented, make sure you consider your agent or broker's incentives. How are they compensated on the sale? How do they select the products they're showing you? Do they work with only one or a handful of insurance companies? Are they acting in your best interest?

Laddering Strategy

Just like with CDs, you can use a laddering strategy by buying multiple MYGAs with staggered terms, i.e. 3-, 4-, 5- and 6-year terms. Because they come due at different dates, the hope is that you'll be able to take advantage of an upswing in interest rates.

Don't Be Scared Of Market Based Adjustments

If you know you'll be able to keep your money invested for the full MYGA term, go with a market value adjusted (MVA) MYGA. You'll get a better rate and will only be penalized if you surrender early (which we just decided you're not going to do!).

Your Plans At Maturity Might Change What You Buy Today

What are you going to do with your money when your MYGA matures? You could roll it over into a new annuity, annuitize it, or withdraw it. Plan ahead so that you can anticipate the taxes you'll owe under each scenario. And, if annuitization is a possibility, you'll generally do better by buying a DIA today instead.

FIAs

Fixed Indexed Annuities

An annuity that claims to offer longevity protection along with liquidity and upside potential but doesn't do any of it well

Introduction

The annuity market is constantly evolving to create new "multi-tasking" products, and along with them, confusion. Historically, the word **annuity** meant one thing: an exchange of money today for a stream of steady payments in the future. There was some room for customization, such as choosing when payments would start (now or later), and how long they would continue (set period or for life).

Contents

The primary function that these annuities served – and the reason why an insurance company was the one issuing them – was to protect against longevity risk, or the possibility of running out of money late in life. By promising to continue payments until death, income annuities still offer this classic, simple, and crucial protection today.

The primary function of an annuity is to protect against longevity risk, or the possibility of running out of money late in life.

Effectively providing this type of protection means losing control of the assets you convert to an annuity. Income annuities are illiquid, meaning the only access you have to your money is through the scheduled income payments. From the insurer's perspective, limiting access allows them to provide coverage at more favorable rates. But, some consumers find this discomforting.

Enter new, "multi-tasking" products, such as Variable Annuities (VAs) and Fixed Indexed Annuities (FIAs), which claim to offer longevity protection along with liquidity and upside potential, all in one product. But…they don't do any of these things well.

In this guide, we'll explain how FIAs work, why they are not good products for consumers, and what your other options are for creating a secure retirement.

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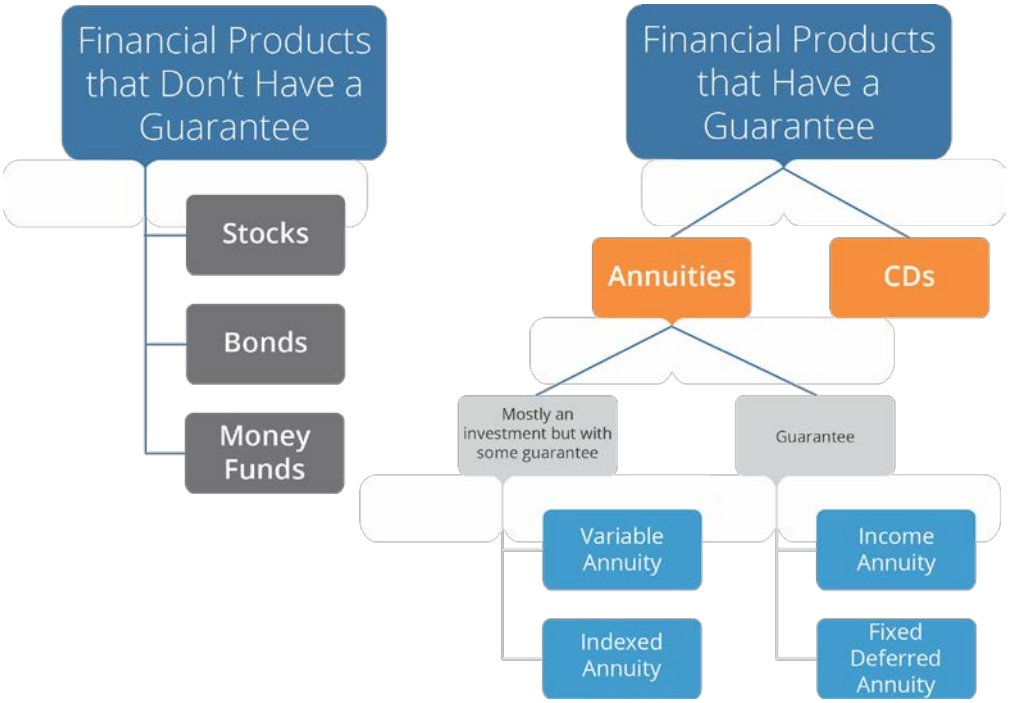
Annuity Basics

Before we explain how Fixed Indexed Annuities work, it's useful to go back and define what an annuity is at its most basic level.

Technically, an annuity is a financial vehicle where a lump-sum amount is exchanged for a stream of guaranteed payments going forward. Most commonly, the guaranteed payments continue for as long as you're alive, demanding insurance company backing. While some annuities are designed to do this and only this, others have been created to offer other types of guarantees and investment opportunities. The result is that you have many products that are called annuities – all with at least the option to create a lifetime stream of income – with very different guarantees and value propositions.

There are three types of annuity guarantees offered:

1. The guarantee of a pre-determined lifetime income stream (an income annuity)
2. A guaranteed interest rate for a certain period of time (a fixed deferred annuity or MYGA)
3. A guarantee to not lose money while providing the opportunity of some upside if the market does well (fixed indexed and variable annuities)



In general, the existence of upside potential, or the ability to benefit from good market performance, reduces the value of the guarantee. The reverse is true as well: the more valuable the guarantee, the less attractive the upside potential.

Importantly, products that have a relatively low-value guarantee and are issued by a lower-rated insurance company tend to be less useful in a well-diversified financial portfolio because they tend to look similar to market-based products like ETFs, mutual funds or bond funds with financial risk that is nearly as high and fees that are generally much higher.

With that overview in mind, let's dive into the Fixed Indexed Annuity.

What is a FIA?

A Fixed Indexed Annuity (FIA) is a tax-deferred retirement savings vehicle that provides the guarantee of a fixed return plus the potential for a higher variable return based on market performance. The structure of a FIA is based on that of a simple fixed deferred annuity, known more commonly as a Multi-Year Guaranteed Annuity (MYGA), so let's start there.

Multi-Year Guaranteed Annuities

Multi-Year Guaranteed Annuities (MYGAs) are very similar to CDs. With a MYGA, you can invest your savings over a specified time horizon (typically 3 to 10 years), earning a fixed return. MYGAs are issued by insurance companies instead of banks and typically offer higher guaranteed interest rates, as well as the ability to be converted into a lifelong stream of income. The latter is what makes a MYGA an annuity. Also differing from a CD, the interest earned in your MYGA is not taxed until withdrawn, but the withdrawal needs to happen at age 59½ or later. That's because MYGAs, along with all annuities, are meant for retirement.

Fixed Indexed Annuities

The structure of a Fixed Indexed Annuity is based on that of a MYGA, as it also offers a guaranteed interest rate over a set period of time. In addition, it offers you the opportunity to participate in the market by investing your funds across various indices. So, if the market does well, your money could grow at a higher rate than the guarantee. But, if the market doesn't do well, your money will still accumulate at the guarantee.

This upside potential and promise of not losing money comes at a cost. First, the guaranteed interest rate will likely be lower than that of a comparable MYGA. Second, the upside potential you're offered by investing in indices is severely limited by "caps," "spreads," and "participation rates." These are all ways the insurance company takes a portion of your account growth in the good years to cover the costs they incur in meeting their guarantees in the bad years. We'll dive into these in more detail later on.

Fixed Indexed Annuities also offer optional riders to create guaranteed income streams, like those available through income annuities. These are typically called Income Riders or Lifetime Withdrawal Benefits, and they come at a cost. In exchange for the potential to convert your assets into a permanent, lifelong income stream, you will be charged an annual fee and also essentially give up the liquidity that made a FIA look attractive in the first place. We'll also cover how this happens later.

One FIA can look very different from another, as they vary by:

a. the index;
b. how you participate in gains and losses (in annuity jargon, these are defined as the participation rates, caps, and spreads);
c. the credit rating of the insurer;
d. bonuses that are offered at the time of purchase; and
e. riders (that might provide income in the future or a death benefit).

Recently sales of FIAs have boomed. This has been led by a combination of several factors. First, those with fresh memories from the 2008 financial crisis liked the idea of a product where you can't lose money. Second, low interest rates have made income annuities and fixed deferred annuities look relatively less attractive in recent years. Third, those who have witnessed the bull market from 2009 through today want to participate in the upside. Lastly, and quite importantly, they typically offer higher commissions to the distributor (agent, broker, financial adviser) than other annuities.

FIA vs Other Annuities

In the table below, we provide a quick overview of the differences between popular annuities.

Product	What Is It?	Who Pays Fees?	Frequency Of Fees
Income Annuity	In exchange for a lump-sum premium, creates a guaranteed source of lifetime income. Returns are generally slightly better than corporate bonds if you live to the median expected lifespan.	Insurer	One time
Fixed Deferred Annuity (a.k.a. MYGA)	Similar to a CD, but generally with a higher interest rate, tax-deferred accumulation and a longer period over which you are required to keep your money put.	Insurer	One time
Fixed Indexed Annuity	Investment/insurance hybrid product where you can be invested in market indices without the potential to lose money. Also offers the ability to create lifetime income.	You	Annual
Variable Annuity	Investment/insurance hybrid product where you can be invested in the market through various subaccounts without the potential to lose money. Also offers the ability to create lifetime income.	You	Annual

The FIA Pitch

Fixed Indexed Annuities (FIAs) are often pitched as products with upside potential, no downside, liquidity, and the option of guaranteed income for life. But how exactly do these products provide you with all of these promises?

Upside Potential

When you choose to purchase a FIA your premium is invested in different funds that track a stock market index (often the S&P 500). The growth of your accumulation value (i.e. your cash balance) is based on the underlying indexes that you choose. However, your upside is limited through features called participation rates, caps, and spreads.

Participation Rate

This is the percentage to which you participate in the upside of the index. For example if your participation rate was 80% and the index was up 10% that year, your accumulation value would only have access to 8% of that growth.

Cap

A cap sets the maximum amount of growth you can get for any increase in the index. For example if there is a 5% cap and the index was up 10% that year, you would only get the benefit of 5%.

Spread

A spread is the fee applied to any growth in the index. For example if there is a 1% spread and the index was up 10% that year, you would only get the benefit of 9%.

One additional complication is that each index your money is invested in can have more than one of these features. Meaning you could be subject to participation rates, caps and spreads at the same time. The effect is a dramatic reduction in your upside potential.

Downside Protection

If the market takes a tumble, most FIA products promise that you won't lose money. Generally that is the case but if you have any additional riders added to the policy (like a guaranteed income rider) your account is still charged that annual fee.

Guaranteed Income Rider

FIAs generally have the option of adding a Guaranteed Income Rider that promises to pay you a fixed amount for as long as you live. The payments you receive are determined by multiplying a payout percentage (fixed at the outset of your policy for specific ages) by the guaranteed benefit amount in your policy. Often these products will have guaranteed growth rates that will be applied to your policy for the purpose of determining your benefit. However, there are a few important factors to keep in mind:

1. **There is a fee associated with this rider.** Depending on the insurance carrier, the fee to have this option can be as high as 1.5%, charged annually as a deduction to your account value.
2. **The income may not last your entire life.** If you ever take a distribution above the allowed amounts from your policy or decide you want to access the accumulation value once income has started, your payments are no longer guaranteed for life. That means that you can only access market-based growth in your policy by sacrificing your lifetime income stream.
3. **The income reduces your accumulation value over time.** Once your policy begins paying you guaranteed lifetime income, the accumulation value (i.e. how much cash you could access) reduces over time. Once your accumulation value has reached zero, assuming you have not made any extra withdrawals, your income would continue but you would have no other value in the policy.

Liquidity

The lack of access to the money you invest in an income annuity is the biggest detractor for most people. So, the FIA attempted to address it by providing access to the contract's accumulation value. But, accessing your money winds up being a bad idea for two reasons:

1. **During the early years, you'll pay a surrender charge.** Depending on the carrier and the year of your withdraw/surrender, you could be charged somewhere around 10% of your account value.
2. **Withdrawals erode the Income Rider benefit.** If you've added an income rider, it will never be financially advantageous to take withdrawals beyond the stipulated income amount. Doing so reduces your income benefit (which you're paying for via an annual fee) and could mean that the income would no longer continue for life.

A Real Life Example

So how do you compare a Fixed Indexed Annuity to other options available? The best way is to look at an example that compares these options over a historical period.

To start off with, let's talk about the two options available if you're interested in guaranteed lifetime income, as well growth through market upside:

Option 1

Purchase a Fixed Indexed Annuity with a Guaranteed Income Rider.

Option 2

Purchase a Deferred Income Annuity with less money, and leave the rest of your money in the market.

To compare these two options, let's use Adam as an example. Adam, 45-years-old, is considering investing $100,000 in a Fixed Indexed Annuity. His goals are to (1) create a guaranteed income stream starting at age 60, and (2) grow his funds by participating in the market.

Option 1: Buy a $100,000 Fixed Indexed Annuity with a Guaranteed Lifetime Income Rider starting at age 60. This rider will produce an income benefit of $7,000 per year.

Option 2: Spend $67,000 to buy a Deferred Income Annuity that produces an identical income stream, and leaves the rest of his money in the market.

For this analysis, Option 1 will be based on the Voya Quest 7 with the Voya myIncome Withdrawal Benefit (Guaranteed Income Rider) with rates as of 2/2/2017. Option 2 uses the Mutual of Omaha Deferred Income Protector with Cash Refund with rates as of 2/2/2017, along with the Vanguard 500 Funds which tracks the S&P 500 and charges a 0.05% annual fee. For both scenarios, the first 15 years will be based on historical S&P 500 performance between 2002-2016, after which a conservative assumption of 4% growth is used.

So how did each of these strategies do over time?

Income Benefit

First, let's compare the income benefit available. The guaranteed income generated by each of these two strategies is exactly the same: $7,000 per year starting at age 60 and continuing for as long as he's alive.

For the Deferred Income Annuity in Option 2, there is absolutely nothing he can do to risk or lose this benefit. But, for the Fixed Indexed Annuity in Option 1, any withdrawals made above the allowable amount will substantially reduce the guaranteed income benefit and cancel the guarantee that it continues for life.

For the Fixed Indexed Annuity in Option 1, there is also an opportunity for the income benefit to increase if the accumulation value grows to be greater than the guaranteed withdrawal base. If this is the case on a policy anniversary, the guaranteed withdrawal base would "ratchet" up to meet the accumulation value. This would also mean a higher income benefit. This is extremely unlikely to happen.

Understanding the Guaranteed Withdrawal Base

Fixed Indexed Annuities with Income Riders have two account values: the Accumulation Value and the Guaranteed Withdrawal Base

Accumulation Value

This is similar to an investment's account balance. It is invested in the market (but limited by participation rates and caps), charged fees and spreads, and available to be withdrawn (subject to surrender charges). This is what we've been discussing so far.

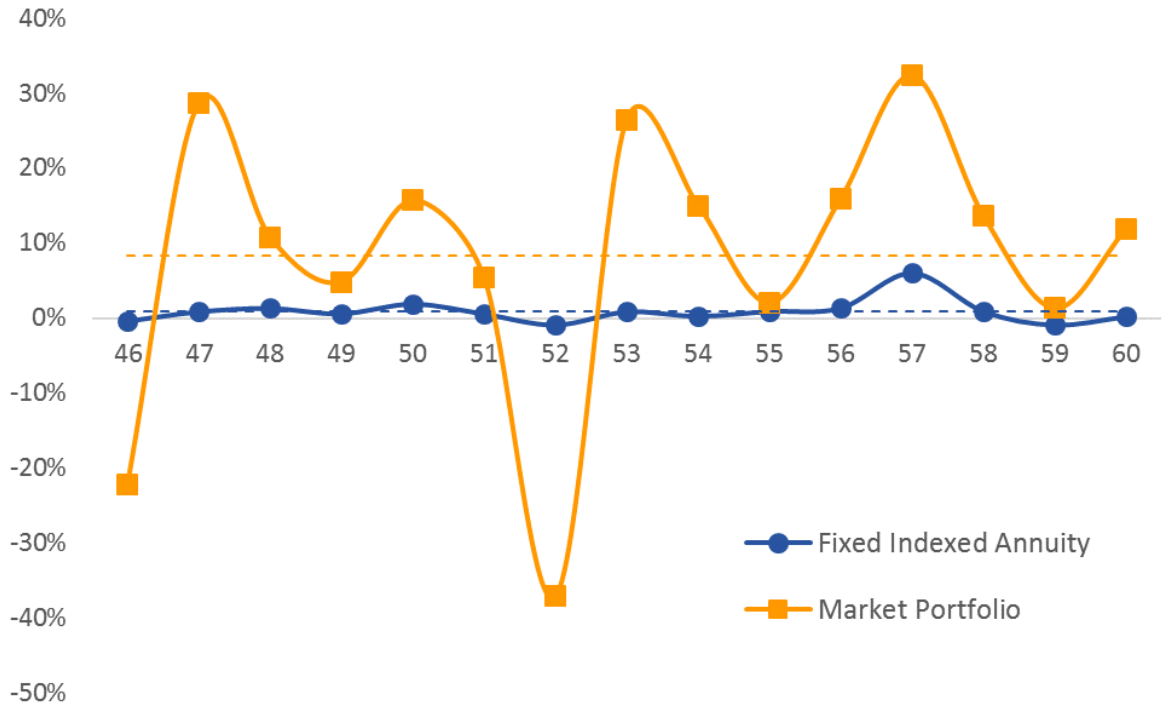
Guaranteed Withdrawal Base

Alongside the Accumulation Value is another account which determines the guaranteed income benefit available. It's "phantom" in that its value can't be accessed directly. Typically, it grows at a fixed, pre-determined, rollup rate for a set period of time and then remains constant but could increase to the level of the Accumulation Value if it is ever higher. For this to happen, the market performance would have to be extraordinary such that the Accumulation Value growth, after participation rates, caps, spreads, and fees are applied, exceeds the rollup rate. It is extremely unlikely.

Market Upside

Next, let's look at the growth of the assets. For Option 1, this is the same $100,000 that's invested in the Fixed Indexed Annuity, which is supposed to provide access to market upside and produce a guaranteed income stream. For Option 2, this is the $33,000 leftover from the Deferred Income Annuity purchase that can be invested directly in the market.

The following chart shows the annual return for the funds invested from ages 45 to 60 using historical S&P performance from 2002 to 2016.

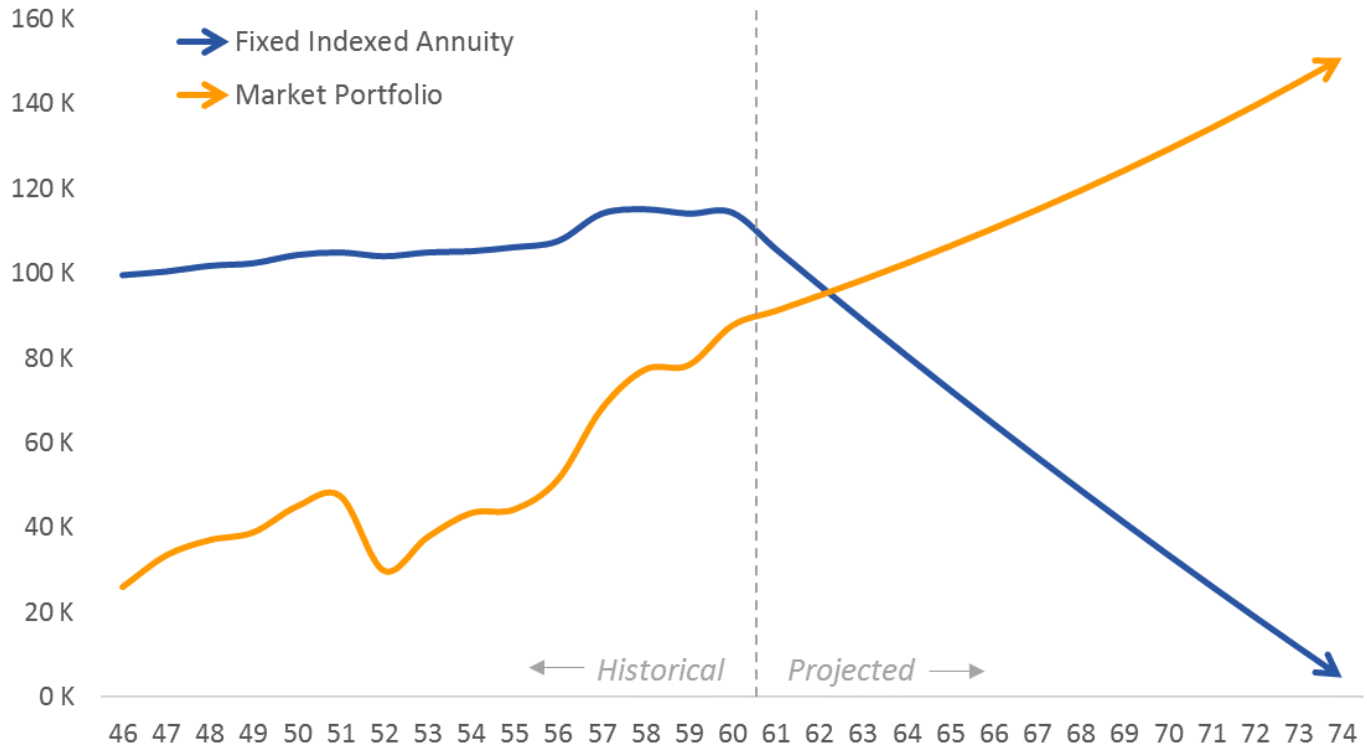


Fixed Income Annuity performance modeled using the Voya Quest 7 with the Voya myIncome Withdrawal Benefit using historical S&P performance from 2002-2016. Market Portfolio modeled using the Vanguard 500 Funds which tracks the S&P 500 and charges a 0.05% annual fee.

The performance of the S&P market portfolio was strong, while volatile, averaging an 8.3% annual return. While much steadier, the Fixed Indexed Annuity accumulation value grew only 0.9% per year during this period. The vast majority of growth was not captured by the FIA due to the mixture of participation rates, caps, spreads, and fees. While the FIA did not experience any decline in value during bad years, a significant amount of market upside was lost over the 15-year period.

Value & Liquidity

And lastly, let's take a look at how the FIA accumulation value compares to the market portfolio. The chart below compares the two accounts using historical returns for the first 15 years (accumulation phase of the FIA), and projected returns thereafter (withdrawal phase for the FIA).



Fixed Income Annuity performance modeled using the Voya Quest 7 with the Voya myIncome Withdrawal Benefit. Market Portfolio modeled using the Vanguard 500 Funds which tracks the S&P 500 and charges a 0.05% annual fee. Both use historical S&P performance from 2002-2016 and a conservative assumption of 4% thereafter.

The market portfolio more than doubled in the first 15 years, benefiting fully from the index's growth (offset only by a minimal 0.05% investment fee). In comparison, the FIA accumulation value, which was invested in the same underlying index, experienced growth of only 14% after applying the participation rates, caps, spreads, and fees.

The market portfolio continues to grow indefinitely, whereas the FIA accumulation value begins to decline once income benefits begin at age 60. From that point forward, there's no potential for growth, and instead just charges against the account for each withdrawal and for rider fees. In this example, all of the FIA accumulation value is depleted by 75.

Choosing An Approach

So what's the right approach?

In every category above, Option 1 underperforms Option 2, that is the FIA provides an inferior outcome to using an income annuity and a market based portfolio.

In fact, no matter what the goal, Fixed Indexed Annuities are typically an inferior solution.

1. **Generating Income** For the same investment, FIAs generate less income than a pure income annuity.

2. **Market Upside** FIAs limit your gains through participation rates, fees, and caps. In comparison, investing directly in an S&P index costs as little as 0.05% per year.

3. **Maintaining Some Liquidity** FIAs limit your access to funds in early years, and all withdrawals won't make sense because you'd substantially reduce, or even eliminate, your income benefit.

If you are looking for an income stream and market upside, in the long-run you're better off purchasing an income annuity and leaving the rest in a low cost market portfolio.

In trying to cover three objectives into one product, the Fixed Indexed Annuity winds up being costly, complicated and suboptimal.

At Abaris, we only sell annuities for their guarantees, never for their potential. So stick with low-cost diversified funds for market upside and income annuities for a guaranteed paycheck for life.

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To Buy Or Not To Buy

Is a Fixed Indexed Annuity right for you? The short answer is probably not. There are at least four reasons to be leery of purchasing a Fixed Indexed Annuity.

1. **Ratings** Fixed Indexed Annuity providers tend to not be as highly rated as income annuity providers. No large fixed indexed underwriter has an A++ rating, while the largest income annuity underwriters do. If you are looking for a highly rated carrier, Allianz is the leading fixed indexed underwriter and rated A+ by A.M. Best as of the time of this writing.

2. **Generating Income** If you're looking to create a source of lifetime income, you'll do better by taking a smaller portion of your money and buying a Deferred Income Annuity because income rates are higher.

3. **Market Upside** If you're looking for market upside, the participation rates and caps mean that in most years you'll have done far better with your money in the market. A well-diversified portfolio for someone nearing or in retirement should have both guaranteed income and market upside, but it's not necessarily the best idea to have both attributes with one product. Doing so can make the products complex and almost impossible to compare.

4. **Regulation** The Department of Labor is working to reform the "investment advice fiduciary" rules in a specific attempt to discourage indexed annuity sales, while treating simpler fixed deferred and income annuities much more favorably in order to promote adoption.

There's a lot of appeal to the marketing message for Fixed Indexed Annuities — market upside with no downside. But here's the reality — if you want market upside, be in the market with low-cost index funds or mutual funds. If you want protection from market downturns, supplement the market part of your portfolio with simple income annuities. Don't try to do everything with one product because you'll end up with a product that doesn't do anything well and is most likely relatively expensive.

The Department of Labor's efforts to reform fiduciary standards are not yet in effect, so in the meantime proceed with caution. Make sure you understand how the Fixed Indexed Annuity you're considering works, how much guaranteed income it provides, and what the credit rating is of the insurer selling the product.

About Us

Our Mission

> **"Modernize retirement security through trust, transparency, and by putting the customer first."**

What It Means

A few years ago, we were a small team with a simple and straightforward belief — that the decision to buy an annuity should be easy, unbiased, and all about you.

That belief is reinforced every day as we continue to grow and connect with people all over the United States that we're able to help in ways large and small. Sometimes, helping out means saying it doesn't make sense to buy an annuity. And of course that means less business for us. But we're OK with that because the way we see it, the most valuable thing we can build is trust.

If you're considering purchasing an annuity for your retirement, you won't find better product selection and a more informed team than the one at Abaris. We hope to have the opportunity to demonstrate that to you.

Here's what we promise to everyone who works with us:

- No sales pitch
- Information on retirement income products in plain English
- Only high-quality annuities from highly-rated, trustworthy companies
- Sophisticated and tailored advice from our team and our technology solutions

Press

Forbes

The established way for insurance companies to move investment products is to send agents out for long, thoughtful discussions over the kitchen table. The Web is a threat to that system. For now the door to electronic sales of retirement policies is open just a crack. Abaris, a Philadelphia business started in March by two young Wharton graduates and a fellow University of Pennsylvania alum, wants to open it wider. Through its site you can get quotes from competing annuity vendors.

- November 2015

corporate insight

Abaris stands out for its modern and innovative annuity quote tool. The tool is mobile- and tablet-optimized, with five clearly outlined steps that allow prospects to obtain quotes for deferred income annuities, longevity insurance or QLACs funded by their IRA, personal accounts, 401(k) plan or other tax deferred plans.

- October 2015

PBS

If you keep your portfolio in stocks and bonds, you're guessing about your own longevity...how long you're going to live. That's a question a lot of people have and that's a hard question to answer.

- April 2016

The Philadelphia Inquirer

Abaris' pitch is that it offers a transparent online marketplace for longevity annuities. Next month, he says, retirees will be able to shop there for IRS-qualified versions using tax-deferred savings. But the site is already running for those with other savings to set aside.

- May 2015