

# Immediate Annuities

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Convert your retirement savings into a  
guaranteed lifetime income stream

# Immediate Annuity Guide

## 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The situation you're finding yourself in is an unfortunate reality for today's retiree as pensions have been replaced by IRAs and 401(k)s. These defined contribution retirement plans are great for accumulation but don't offer a clear path for turning those assets into income.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.

There is good news, though, and it's called a single premium immediate annuity (SPIA) or just immediate annuity for short. An immediate annuity 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.

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

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

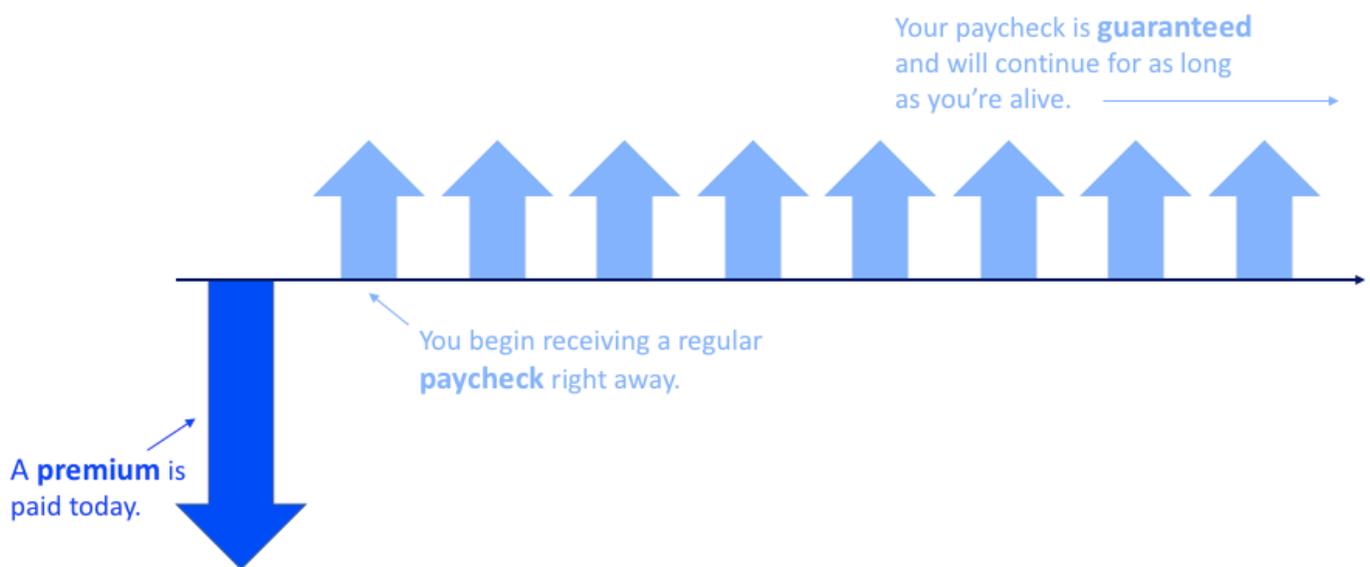
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## WHAT IS AN IMMEDIATE ANNUITY?

An immediate annuity is guaranteed retirement income you can purchase to protect your longevity and minimize the risk of outliving your savings. When you buy an immediate annuity, 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, an immediate annuity turns your assets into guaranteed income for life. You can think of it like a pension you buy for yourself.



An immediate annuity 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, an immediate annuity 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, immediate annuities can only be funded with a single premium, leaving no room for future contributions.

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And finally, an immediate annuity can be... **qualified** or **non-qualified**.

Qualified immediate annuities 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 immediate annuities 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 immediate annuity twice.

In summary, an immediate annuity 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 an immediate annuity 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 immediate annuity offers a more pleasant kind of protection: longevity insurance. The longer you live, the more financial value the immediate annuity provides.

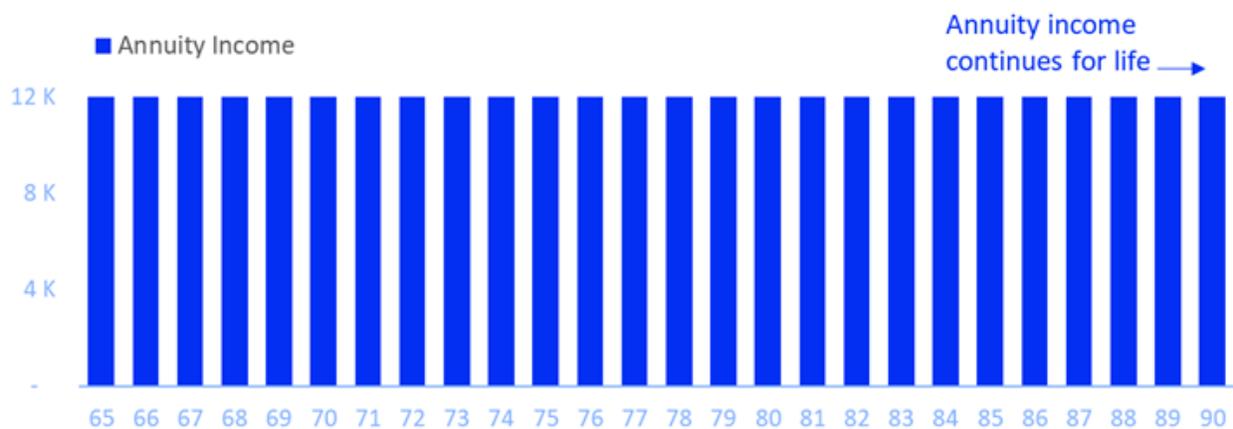
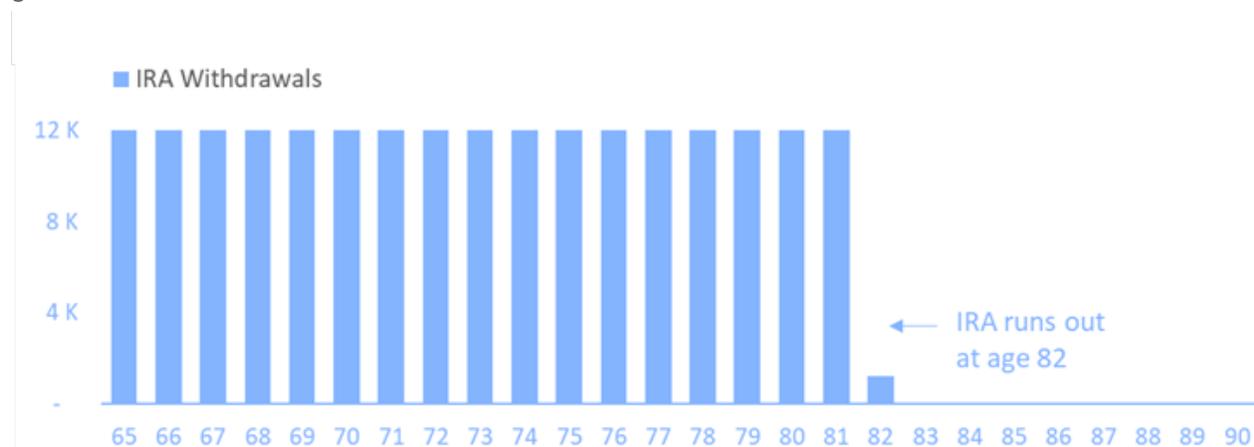
### ✓ Alternative Fixed Income Investment

While immediate annuities 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 immediate annuity will make your money last longer.

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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 an immediate annuity.

Matthew will take \$172,000 of his IRA that's currently earning only 2% and use it to purchase an immediate annuity. Starting in one month, the annuity 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.



Immediate annuity rates based on a \$172,370 Integrity life-only policy for a male aged-65 with income starting immediately. Rates as of 10/11/2018.

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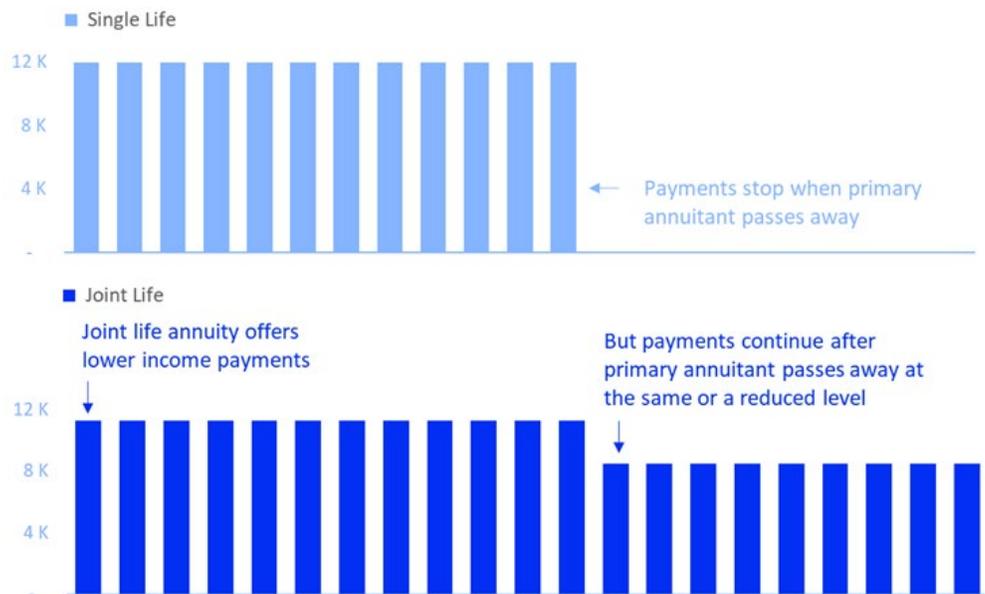
## ✓ Simplified Asset Management

Adding an immediate annuity 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

Immediate annuities 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 immediate annuity. 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.



Immediate annuity rates based on \$172,370 Integrity single and joint life-only policies for a male aged-65 and a female aged-62 with income starting immediately. Rates as of 10/11/2018.

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## ✓ Principal Protection

The savings that you allocate to an immediate annuity 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 immediate annuities 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, and guidelines exist around when and how often the policyholder can take advantage of this liquidity.

## ✓ Clear Product Structure

The immediate annuity 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, immediate annuities are not good for everyone or for all situations. Here are some of the drawbacks:

### X Limited Liquidity & No Cash Value

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

### X 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.

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## TYPICAL BUYERS

An immediate annuity 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 Blueprint Income to help you think about whether an immediate annuity may (or may not) be a fit for you:

### Consider buying an immediate annuity 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

### An immediate annuity is probably not the right product for you if...

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

A common objection to immediate annuities 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 an immediate annuity leaves the rest of your assets to provide liquidity and market upside.

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## IMMEDIATE ANNUITY RATES

The income offered on immediate annuities 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 October 2018, highly-rated carriers are offering the following immediate annuity annual income payments for a \$100,000 purchase:

Age	Male	Female	Joint
55	\$5,670	\$5,490	\$5,570
60	\$6,140	\$5,910	\$6,010
65	\$6,880	\$6,560	\$6,720
70	\$7,940	\$7,490	\$7,740
75	\$9,620	\$8,910	\$9,310

Immediate annuity quotes shown as annual income for a \$100,000 premium as of 10/1/2018. 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 an immediate annuity:

**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.

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**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 immediate annuities 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 Blueprint Income 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.

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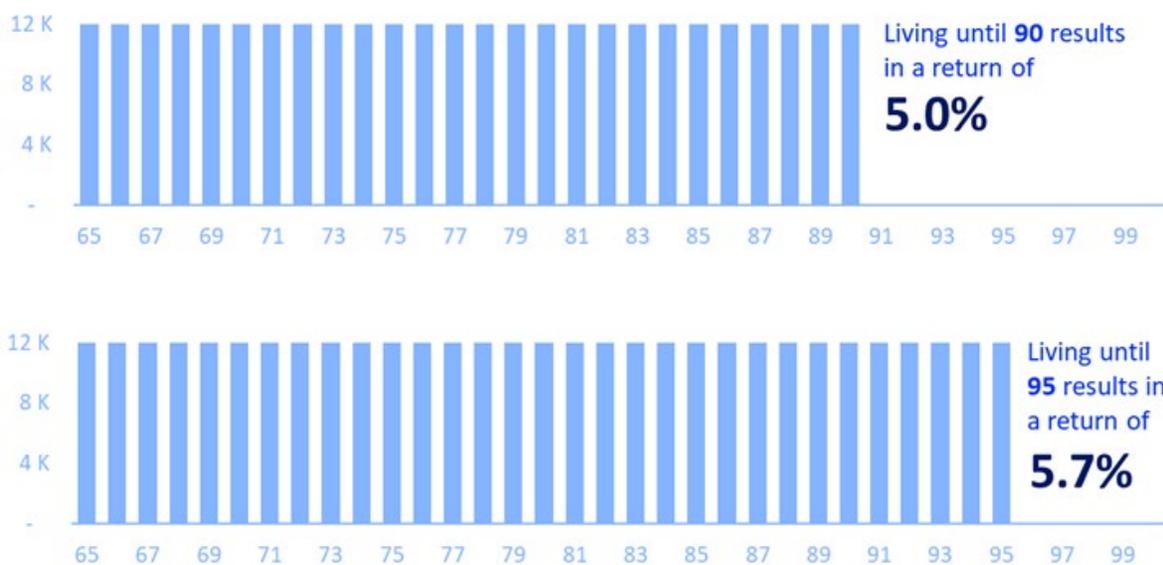
## FINANCIAL VALUE

A common question asked when considering moving some of your retirement assets into an immediate annuity 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 an immediate annuity 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 immediate annuity 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 immediate annuity could wind up generating a 5.0% return if he lives until 90, which increases to 5.7% at age 95 and 6.1% at age 100.



Immediate annuity rates based on a \$172,370 Integrity life-only policy for a male aged-65 with income starting immediately. Rates as of 10/11/2018.

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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 immediate annuities 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 Immediate Annuities

Because a non-qualified immediate annuity 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.

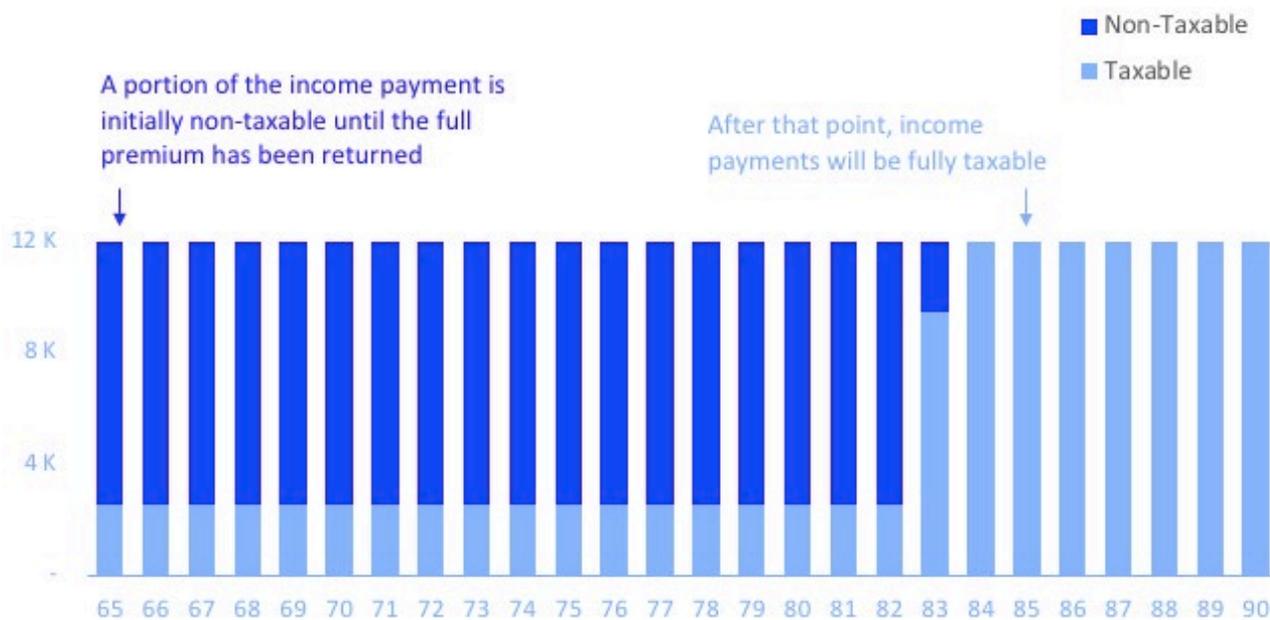
$$\text{Exclusion Ratio} = \text{Investment in the Contract} \div \text{Expected Return}$$

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.

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

The exclusion ratio for Matthew's policy is 79%. The insurance company calculated this as the ratio between his investment in the contract (\$172,000) and the total amount of income they expect to pay him (\$219,000 in this case). Thus 79% of his income payments will be excluded from his taxable income until a total of \$172,000 has been excluded. For Matthew, this will be the case once he's received 19 years worth of payments, after which the immediate annuity income will be fully taxable at ordinary income rates.



Immediate annuity rates based on a \$172,370 Integrity life-only policy for a male aged-65 with income starting immediately. Rates as of 10/11/2018.

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.

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## 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 an immediate annuity 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 an immediate annuity can generate comparable returns (see the Financial Value section) and reduce your longevity risk.

In fact, adding the security of an immediate annuity to your portfolio can enable you to earn a higher rate of return with the rest of your portfolio. If your immediate annuity 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 immediate annuity 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:

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## Single vs. Joint Life

Immediate annuity 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

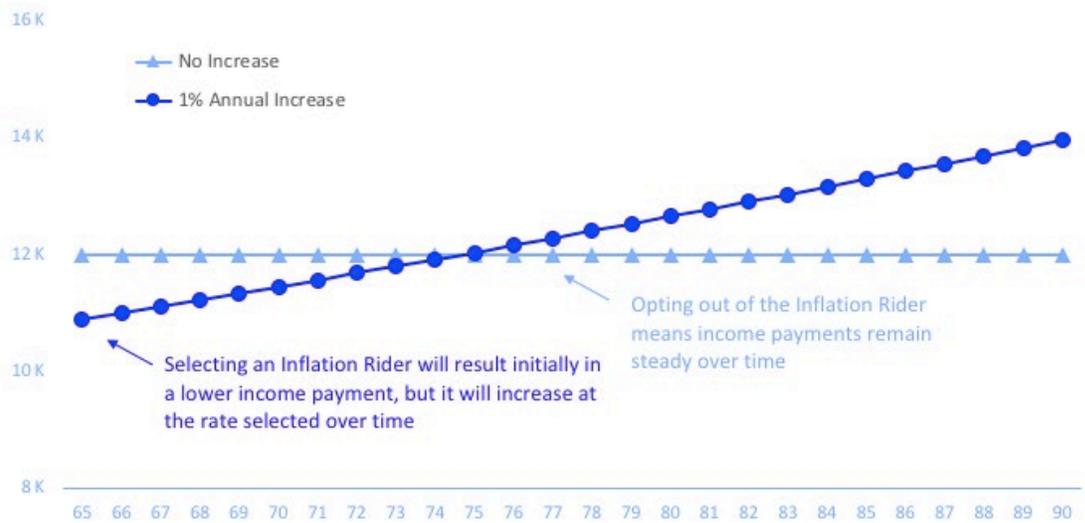
Income payments can be made monthly, quarterly, semi-annually, or annually.

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## Inflation Protection

Most insurance carriers offer an inflation adjustment or annual increase rider that will adjust the immediate annuity 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 \$172,000 immediate annuity. 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.



Immediate annuity rates based on \$172,370 Integrity life-only policies with and without a 1% increase rider for a male aged-65 with income starting immediately. Rates as of 10/11/2018.

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.

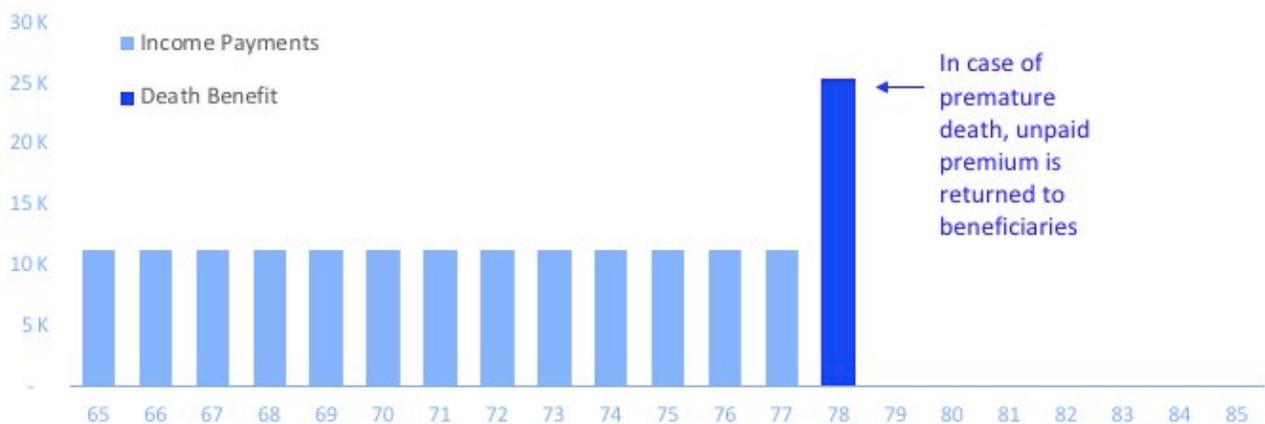
Adding an inflation rider to your immediate annuity is one way to mitigate the risk of declining purchase power, but it's probably not the most efficient way as the extra protection will come at a cost. Consider instead more direct ways to earn inflation-adjusted dollars. Your Social Security benefit, 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.

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## 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 immediate annuity 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 \$172,000 in cumulative income payments, his beneficiaries will receive \$172,000 less the total income payments made.



Immediate annuity rates based on \$172,370 Integrity life-only policies with and without a death benefit rider for a male aged-65 with income starting immediately. Rates as of 10/11/2018.

## Payment Acceleration

While immediate annuities 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.

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## BUYING TIPS

Buying an immediate annuity 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, Blueprint Income has compiled a list of things to keep in mind:

### Available Carriers

Immediate 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 An Immediate Annuity

Immediate annuities are sold via insurance agents, brokers, and financial advisors. It's also possible to shop for an immediate annuity 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?

### Compare Quotes Apples-to-Apples

Some financial products are too unique to be compared to one another, but this isn't the case with immediate annuities. 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 an immediate annuity 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.