

Insurance and
Actuarial Advisory Services

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Introduction to Financial Planning Tools

2006 IABA Annual Meeting

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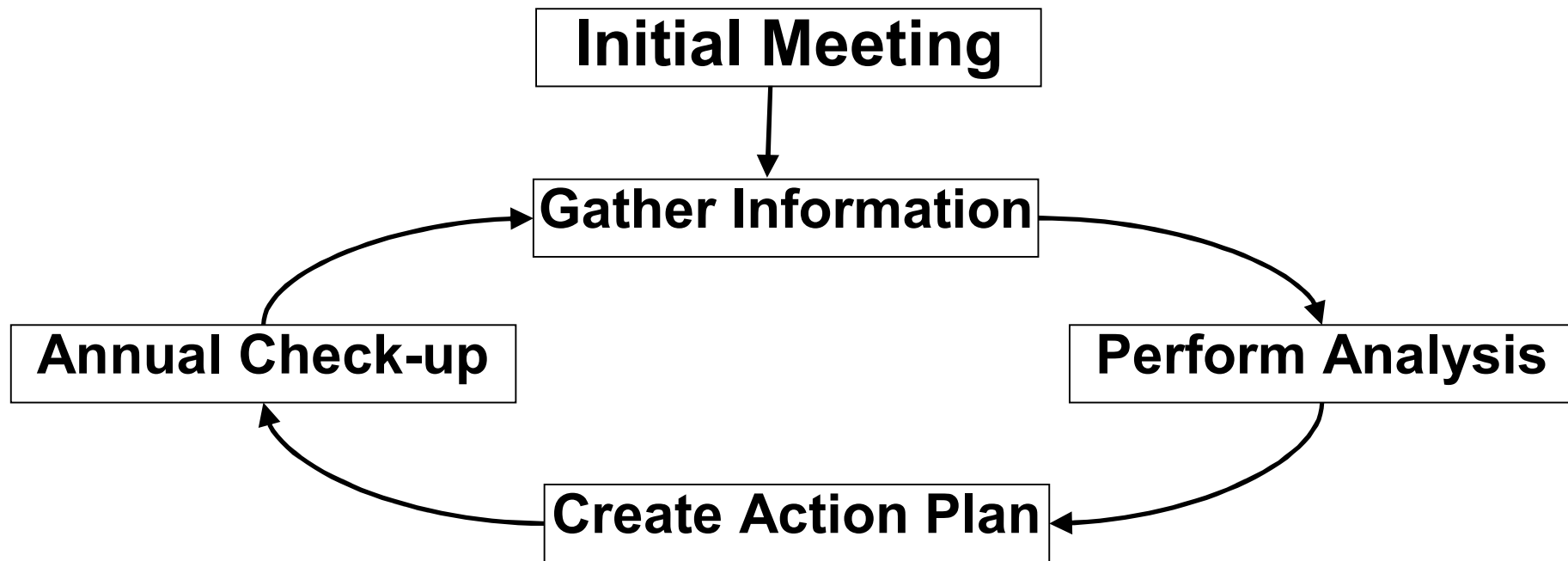
Agenda

- **Financial Planning Tools Overview**
- **Focus on the Retirement Planning Market**
- **The New Planning Paradigm**
- **The Actuary's Role**
- **Questions**



Financial Planning Overview

Circle of Life (Financial Planning Style)



**Financial Planning Tools Drive the Analysis,
Hence the Action Plan**

Key Planning Events

- **Key events individuals typically plan for**
 - Purchase of home
 - Children
 - College
 - Retirement
 - Death
- **Different tools for each event**

Retirement planning currently incorporates the simplest advice and tools



Focus On the Retirement Market

Understanding the Current Basis for Analysis of Retirement Plans

- “Retirement Planning Software” – LIMRA, SOA, INFRE, a 2003 report
- “Retirement Income: Positioning for Success” – Cerulli Associates, a 2005 report
- “The Forrester Wave™: Financial Planning Software, Q2 2005”, a 2005 report

The Baby Boomers are Coming

- **77 million baby boomers**
 - The leading edge of the wave is turning 60
 - Behavioral finance says they will be different
 - Consumption oriented
 - Goal oriented
 - More income
 - More debt
- **Three distinct groups**
 - Low Wealth
 - Middle Wealth
 - High Wealth

An Uncertain Retirement Market

- **Individuals are on their own**
 - Defined benefit plans
 - 401(k)
 - Social Security
- **Expected lifetimes increasing**
- **Uncertain financial markets**

During the Accumulation Phase

- **Goal: Save \$X by age Y**
- **Planning Assumptions**
 - Contribution rate
 - Investment returns
- **Simplified assumptions are ok**
 - Time is on your side
- **Worse case scenario – work an extra year**

During the Decumulation Phase

- **The standard goal: Never run out of money**
- **Current Planning Assumptions**
 - Investment Returns
 - Time Horizon
 - Inflation
 - Expenses
- **Currently simplified assumptions**
- **Worse case scenario – who knows?**

The Proof is in the Pudding

- **The “silent” retired received this advice**
 - Retired in the mid-1990s
 - Advice and planning consisted of
 - Individual investments (perhaps)
 - Asset allocation (more likely)
 - Recommended withdrawal percentage (most definitely)
 - First, suffered through market turmoil from 1999
 - Asset base was halved
 - Then, advised to reduce withdrawal rate by more than half to the current “safe” level of 4%!

“Planning” like this fails to add value

The Majority of Planning Tools Remain Rooted in Accumulation Thinking

- **Investment risk is THE major risk considered**
- **Other risks are treated simply or ignored**
- **Target dates and amounts are the focus**
- **“Yes/No” answers**
- **Single solution**

A “Safe” Withdrawal Rate Remains the Typical Strategy

Continued...

The Majority of Planning Tools Remain Rooted in Accumulation Thinking

- **Some tools still**
 - Use fixed rates of return and inflation
- **Virtually all tools**
 - Pick a planning horizon or a specific age of death
 - Fail to consider the impact of lifestyle or health
 - Fail to consider order of death risk
- **Even the best tools fail to reflect**
 - Catastrophic health risks
 - Product performance



The New Planning Paradigm

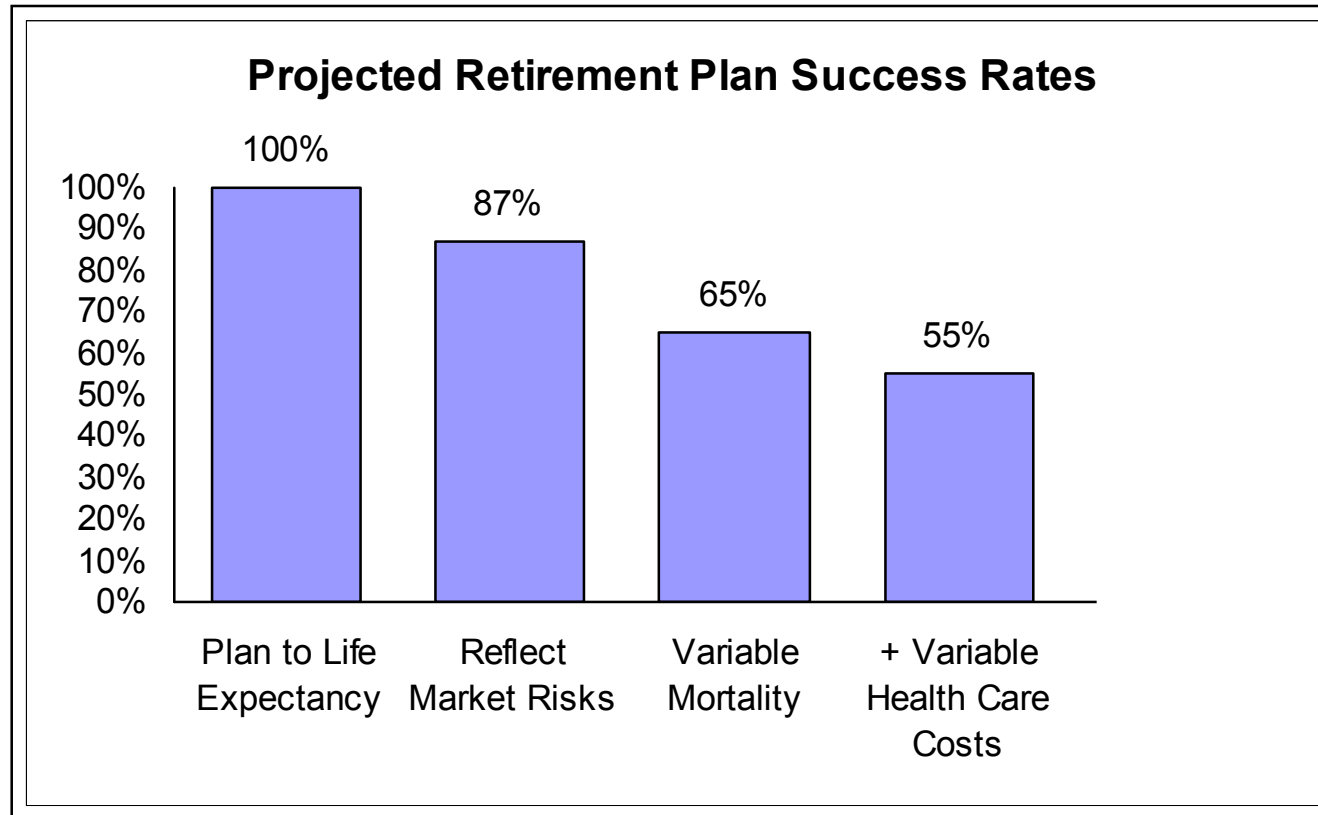
The New Planning Paradigm Will Recognize Risk Appropriately

- **Mortality Risk**
 - Order of death
 - Longevity
- **Investment Risk**
 - Market Risk
 - Interest Rate Risk
- **Inflation Risk**
- **Health Care Costs**
- **Long-term Care Costs**

A good retirement planning tool addresses all of these risks, as well as solutions to mitigate them.

“Retirement Planning Software” – LIMRA, SOA, INFRE, a 2003 report

Retirement Analytics™ Demonstrates that “Other” Risks Need to be Recognized



Key Tenets of an Effective Platform in the New Paradigm

- **Holistic in Nature**
 - Wealth
 - Needs
 - Risks
- **Realistically captures the elements of risk related events**
 - Timing, likelihood, and severity of the risks
- **Provides a true decision-making framework**
- **Agnostic**
- **Allows for product demonstration NOT illustration**

Product Illustration vs. Value Demonstration

- **Traditional sales illustration not adequate**
- **Need to show how consumer is better off, or not, with a specific product**
- **Need to show how multiple products/strategies/solutions can interact**

Traditional Sales Illustration - Longevity

| Age | Cash Flow |
|-------|-------------|
| 65 | \$ (58,000) |
| 66 | \$ - |
| 67 | \$ - |
| 68-82 | |
| 83 | \$ - |
| 84 | \$ - |
| 85 | \$ 35,000 |
| 86 | \$ 35,000 |
| 87 | \$ 35,000 |
| 88 | \$ 35,000 |
| 89 | \$ 35,000 |
| 90 | \$ 35,000 |
| 91+ | \$ 35,000 |

- Illustration of cashflows
- Measure of value typically IRR
 - To age 85 – 0%
 - To age 95 – 8%
 - To age 105 – 9%
- A difficult sell – IRR to expected lifetime is 0%

Value Demonstration - Longevity

- **Demonstration of Value**
- **Measure of value:**
 - Success rate
 - Estate value at death
 - Shortfall Measures
- **Ability to show multiple strategies and solutions**

Value Demonstration - Longevity

- Female – age 65
- \$500,000 Conservatively invested
- Initial income goal of \$25,000 (5% SWP)
- Company offering longevity insurance - \$35,000 kicking in at age 85 – cost \$58,000

| | 5% SWP | Longevity | Longevity - Aggressive |
|--------------------------------|------------|------------|------------------------|
| Success Rate | 65% | 73% | 82% |
| Estate @ Death | \$ 268,061 | \$ 240,800 | \$ 588,459 |
| Total Average Shortfall | \$ 294,296 | \$ 101,408 | \$ 139,799 |
| Years of Shortfall | 6 | 8 | 9 |
| Shortfall Per Year | \$ 47,570 | \$ 15,208 | \$ 18,492 |



The Actuary's Role

The Actuary's Role

- Risk Champions
- Tool Selection
- Product Development and Marketing

Why Actuaries?

- **Unique knowledge for modeling:**
 - Mortality risk
 - Catastrophic health risk
- **Ability to design, utilize products to mitigate risks**
- **Need to bring risk management techniques to these individuals**

Summary

- **Current financial planning tools for retirement are not adequate**
 - Simplified, if any approach to key retirement risks
 - Lack of product integration with planning
- **Good financial planning tool**
 - Holistic
 - Demonstrate value of products/solutions/strategies
 - Directly compares strategies
 - Provides information used to make decisions
- **Actuaries must act to help their companies capture the opportunity.**



Questions

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