Some Factors to Consider When Clients Choose a Guaranteed Minimum Withdrawal Benefit

For some clients, protected lifetime income is important, but so is growth potential. Today's variable annuities may offer guaranteed minimum withdrawal benefits but they are not all alike. Let's discuss a few factors to consider in making a choice.

In addition to Social Security retirement benefits and pensions, some clients may need the additional lifetime income an annuity can provide. But permanently converting the annuity contract to income (which is called annuitization) means clients must give up both control of the asset and continued potential for market-based growth. A Guaranteed Minimum Withdrawal Benefit (GMWB) allows clients to receive income guaranteed by the full faith and credit of the insurance company and keep assets allocated to the variable annuity's investment options. While not appropriate for every client, some clients may find this solution a good combination of income guarantees and equity exposure.

What Is a GMWB?

A GMWB is an optional protected income benefit that may be available for an additional cost when purchasing a variable annuity. The benefit typically provides a guaranteed withdrawal percentage based on specific ages or age bands. Withdrawal percentages are not applied to the annuity's contract value. They are applied, instead, to a protected income base, which is independent from the contract value. Some GMWBs feature a credit added to that base for each year a client waits to start income, generally up to a set number of years. A GMWB functions to help ensure that a client's future income is not reduced due to market volatility. And that can be an attractive proposition for your clients.

The withdrawal percentage and credit for waiting are important, but there are additional points a client may want to consider. Let's focus on three that might affect a client's decision.

Some Considerations for Choosing a GMWB

1. Step-ups to the protected payment base and the withdrawal percentage.

Some GMWBs offer a step-up to the protected payment base to match a new contract value, effectively increasing future income. Generally, the base can step up to a higher amount when the contract value on an anniversary exceeds the base. For example:

- A client purchases a variable annuity with $100,000, which then also becomes the initial protected payment base amount.
- On the next contract anniversary, the hypothetical account value is $110,000, higher than that base (and higher than what a credit would have resulted in; see more detail on credits below).
- The protected income base steps up to $110,000.

A GMWB also may include a step-up to the withdrawal percentage after the client begins income. Here's how that works:

- The client starts taking income at a certain age, say 65, receiving income based on the withdrawal percentage for that age.
- A step-up to the protected payment base occurs when the client is in a higher age band with a higher percentage; for example, age 71.

- The withdrawal percentage then increases to the percentage designated for that higher age band, elevating the client's income as a result of both the new percentage and the stepped-up base.

2. Fixed versus stackable credit. As noted, some GMWBs offer a credit while a client waits to take any distributions or start income, unless a step-up occurs that increases the contract value to a higher amount than the credit would result in. Typical credit percentages are 5% or 6%. There are two types of credits. Both examples below assume a **5% credit**, a **$100,000 purchase payment**.

- A fixed credit applies the hypothetical 5% to the purchase payment amount every year. In five years, the credits would result in a protected payment base of $125,000 (increasing by 5% of $100,000 each year).
- A **stackable credit** works differently. The term "stackable" applies when a reset of the protected payment base occurs. A reset take place when the contract value is greater than the protected payment base plus the annual fixed credit. Once a reset occurs, the annual credit amount is based on the higher protected payment base established by the reset. For example: In year 2, the contract value reaches $110,000, which is higher than the previous fixed credit of $105,000. As a result, a reset occurs, and future fixed credits will now be based on $110,000 instead of the original $100,000.

3. Fee for the protected income benefit. Fees do matter. They are deducted from the contract value and in a low-growth year, could impact whether a step-up of the base occurs due to an increase in the contract value. The fee is usually a fixed percentage that will apply for the life of the contract, for example 1.5%. The fee is most often applied as a percentage of the protected payment base, but it also may be a percentage of the contract value.

Help Clients Make Thoughtful Choices for Income

Planning for lifetime income can be challenging for clients. As a financial professional, your guidance is important when clients are considering how to create lifetime income. A comparison of various factors can help you guide clients as they navigate this decision.

ACTIONS YOU CAN TAKE RIGHT NOW

- **Identify clients who are within five years of retirement or currently taking income.**
- **Review planned or current withdrawal strategies.**
- **Determine whether a variable annuity with a GMWB might be a fit for a client's specific goals.**

Additional Resources and Links

[Retirement Income Gap Calculator]

[Skip the Chocolates: Give Clients the Gift of Tax Control]

[A Lifetime of Work Deserves a Lifetime of Income]

For more information about retirement planning, please contact our Retirement Strategies Group at RSG@PacificLife.com or (800) 722-2333, ext. 3939.

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