Annuitization Report for Mr./Mrs. Rhett I. Erment

Report produced November 25, 2002

What is "annuitization"?

Annuitization simply means converting a lump of money into a stream of income. In the current analysis, we are looking at "life annuities," meaning streams of income that last as long as you live, no matter how long that is. When a lump sum has been accumulated in an employer-sponsored plan, you can think of annuitization as trading the lump sum for a lifetime pension. When the lump sum comes from personal funds, the concept is the same — but you have more options.

Should you annuitize?

There are both pros and cons to annuitization.

Key benefits:

#1 Guaranteed income for as long as you live (and for as long as your partner lives, depending on the type of annuity you use).

#2 Higher monthly income, typically, than you can safely provide for your yourself. The annuity uses your principal, with the financial company assuming the risk that you will live "too long." If you do it yourself, you can't afford to run out of principal, so you need to be more conservative.

#3 Guaranteed minimum monthly income amount — with a provision for future increases.

Key concerns:

#1 You no longer have access to your principal — you generally cannot get at it (except for your monthly check) even for emergency needs.

#2 If death comes prematurely to the person(s) covered by an annuity, benefits may end — although different kinds of annuities guarantee benefits for a certain number of years, or to a survivor for life.

Since there are legitimate issues on both sides of the discussion, it is often wisest to balance your approach: annuitize some, but not all, of the available funds. This assures you that you will always have income, no matter how long you live, but it also leaves some funds that are potentially available for medical or other emergencies, for discretionary extra expenses, or to leave behind.

How much should you annuitize?

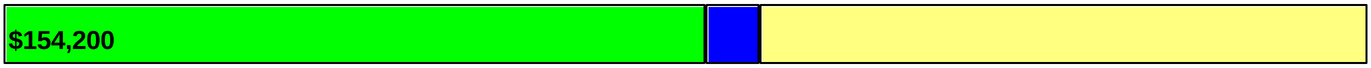
The amount to be annuitized depends on the type of annuity. Annuities that provide continuing income to beneficiaries after one's death have a higher cost than those that do not. Whether the trade-offs are worth it depends in large part on unpredictable future events. But the present goal, which is to meet your income needs, plus the desired cash availability at time of death, dictates the proper balance, which is likely to be different for you than for other people.

The chart on the following page illustrates suggested annuitization amounts for different annuity types.

Suggested Amounts to Be Annuitized

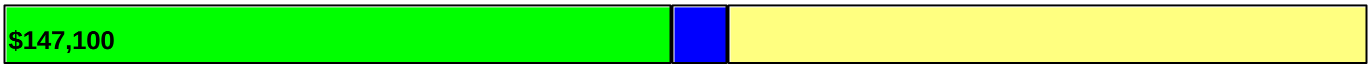
Legend: Annuitized amount | Reserved amount | Unreserved amount

Individual Life Annuities



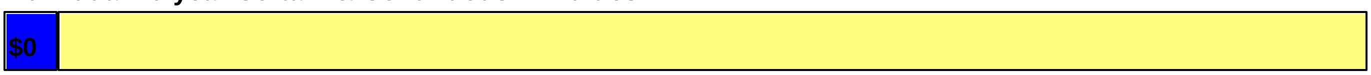
Pays $801.20/mo. for as long as the client lives, plus pays $1,025/mo. for as long as the second retiree lives.

Individual 5-year Certain & Continuous Annuities



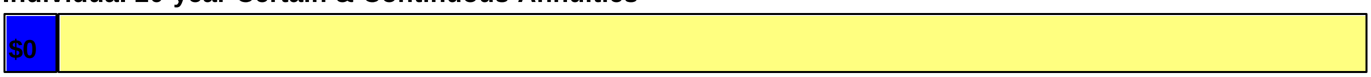
Pays $720.12/mo. for as long as the client lives (with a guaranteed minimum of 60 monthly payments), plus pays $881/mo. for as long as the second retiree lives (with a guaranteed minimum of 60 monthly payments).

Individual 10-year Certain & Continuous Annuities



Pays $0.00/mo. for as long as the client lives (with a guaranteed minimum of 120 monthly payments), plus pays $0/mo. for as long as the second retiree lives (with a guaranteed minimum of 120 monthly payments).

Individual 20-year Certain & Continuous Annuities



Pays $0.00/mo. for as long as the client lives (with a guaranteed minimum of 120 monthly payments), plus pays $0/mo. for as long as the second retiree lives (with a guaranteed minimum of 240 monthly payments).

Joint and 100% Survivor Annuity

Pays $1,447.48/mo. for as long as either the client or the second retiree lives.

Joint 3/4 Survivor Annuity

Pays $1,546.04/mo. for as long as both the client or the second retiree live, and $1,159.53/mo. for as long as the survivor lives.

Joint 2/3 Survivor Annuity

Pays $1,686.33/mo. for as long as both the client or the second retiree live, and $1,124.22/mo. for as long as the survivor lives.

Joint 1/2 Survivor Annuity

Pays $1,931.54/mo. for as long as both the client or the second retiree live, and $965.77/mo. for as long as the survivor lives.

Note that the horizontal bars represent alternative options. You may, if you wish, mix and match them, but only if you reduce the annuitization amounts in proportion. If you select two options, therefore, the recommendation would be to annuitize one-half the amount displayed above for each.

Higher annuitization amounts usually indicate better options, but not if they leave no unreserved funds at all. Higher amounts mean that, even in adverse circumstances, annuitization is expected to be more beneficial in meeting the household's financial needs. But an absence of unreserved funds means that annuitization has been maximized because basic needs are not being met, so any such options are not as good!

The “Reserved amount” illustrated above is the amount needed to fund $10,000 for your heirs plus $5,000 for final medical expenses for each of you. This amount, which is in constant (non-inflated) dollars, has been discounted by 3% a year from your life expectancy on the assumption that this amount is set aside to grow, and is therefore equal to $12,122 today.

Any “Unreserved amount” represents assets not reserved for legacies or medical expenses, but are also not recommended for annuitization. Unreserved amounts combined with annuitized amounts indicate that you probably do not need to maximize guaranteed income to meet future expenses, even if you live a long time.

Appendix: Monthly Cash Income

	Client - Now	2nd Retiree - Now
Salary, wages and tips	0	0
Investments (balance: $400,000)	800	800
Employer pensions	1,200	0
Social Security benefits	700	650
Monthly annuity payments received	0	425
Rental, business and/or farm income	0	0
Alimony received	0	0
Other regular monthly income	0	150
Total per month	2,700	2,025

Notes:

The Appendix above displays the financial details that you have provided for this analysis. In addition, it is assumed that an annual net rate of return on your savings and investments equal to 3% above inflation will be achievable without your taking undue risk. Such a rate of return is hypothetical, however, and is not intended to represent the performance of any particular product. Your returns may be higher or lower than that rate. Since you have not indicated expense details, we are using the assumption that your expenses, like most people’s, will be lower in late retirement than they are in early retirement. We assume that overall expenses will drop 1% a year (excluding inflation) until age 80, at which point we assume that they level off. We further assume that expenses will increase by $10,000 in the year of each death (with half of the legacy to heirs occurring at each death, for calculation purposes), but that after the first death ongoing expenses will decrease by one-third. Your actual expenses are likely to differ from these assumptions.

The various scenarios we have tested take into account the risk of death occuring at various ages. We have used the following assumptions in calculating the likelihood of death at any given age:

Client: Male, born March 3, 1933, Non-Smoker, No health impairments indicated.

2nd Retiree: Female, born April 4, 1940, Smoker, Mortality = 150% of normal.

Mortality Table: 1985-1990 Individual Life Insurance Experience adjusted for smoking status and decreases in mortality over time.

This analysis attempts to meet all of your specified financial needs up until an age that you have no more than a 5% chance of exceeding. For most people, this age occurs in their late nineties. Annuitization will, of course, assure you of continued income even beyond this age, if you need it.