
Letting the GLWB Out of Its Cage

By Editor Test Wed, Dec 9, 2009

The "Ruin-Contingent Life Annuity" proposed by Moshe Milevsky's QWeMA Group would liberate the guaranteed lifetime withdrawal benefit from the confines of variable annuities and separately-managed accounts.

The [QWeMA Group Inc.](#), the Toronto-based financial engineering group led by Moshe Milevsky, plans to launch an index that will enable retirees to buy a type of annuity that they can get today only by purchasing a variable annuity or a separate account with a living benefit rider.

The index, to be introduced January 1, 2010, will allow the development of a new type of ultra-inexpensive deferred income annuity that QWeMA calls a Ruin-Continent Life Annuity (RCLA). It will be the subject of Milevsky's column in *Research* magazine next month.

The RCLA would resemble a variable annuity lifetime withdrawal benefit, which pays the insured parties an income for life only if their accounts are exhausted by a combination of systematic withdrawals and poor market performance before they die.

Where a VA living benefit or even a SALB (stand-alone living benefit) is triggered by a decline in the client's account balance, however, the RCLA payout would be triggered by a decline in QWeMA's "sustainable portfolio withdrawal index," which would mimic a decumulating portfolio.

To look at it another way, the RCLA would be like an advanced life deferred annuity (ALDA), only much cheaper. An ALDA pays out if the annuitant reaches some advanced age, such as 80 or 85. An RCLA would be cheaper because it wouldn't pay out unless the index had also dropped to its trigger point while the insured was still alive.

"We propose an ALDA in which distinct risk valves must be triggered before an annuitant gets paid," wrote Milevsky and QWeMA colleagues Huaxiong Huang and Thomas S. Salisbury in an article in the [Journal of Wealth Management](#) last spring.

"First and obviously the individual (or spouse) must be alive. But second, to make a claim on their insurance policy, they must have the ill fortune to experience under-average market returns during the years surrounding retirement."

"The impetus for creating stand-alone RCLA products is that they might appeal to the many soon-to-be-retired baby boomers who are 1) not interested in paying for the entire variable annuity package, and 2) would be willing to consider annuitization, but only as a worst case "Plan B" scenario for financing retirement," wrote Milevsky and the same co-authors in a January 16, 2009 paper entitled, ["Complete Market Valuation for the Ruin-Contingent Life Annuity."](#)

The index could show investors if they were spending their savings at too high or low a rate, Milevsky said. The insured investor could invest any way he liked or spend at any rate he

liked—the trigger point would depend on the index rather than on his account value.

In effect, the insurance would protect retirees from the risk of experiencing terrible returns shortly before or after retirement—so-called sequence-of-returns risk—as well as longevity risk, or the risk of living too long. Although the client would not face direct investment restrictions, as he or she would with a GLWB, the index itself would incorporate benchmark withdrawal rates and asset allocations.

“It’s not like buying fire insurance on your house, where the policy is based on whether your house burns down or not,” Milevsky told RIJ. “It’s more like buying a policy based on the temperature in the neighborhood. It’s an annuity that’s linked to an index that everyone can see every day, so that anti-selection is reduced.”

An RCLA would be priced higher for someone who opts for a higher withdrawal rate than those who choose a lower withdrawal rate, and lower for older retirees than for younger ones. The price would also depend on whether the index was linked to the performance of, for instance, the S&P 500 or of a less-risky balanced portfolio.

“There’s a need for an independent index for benchmarking in retirement,” Milevsky said. “People don’t know what to compare themselves to. Say they retired two years ago and their portfolio is down severely. Is it down because they’re withdrawing too much, or because of the markets? The index would tell them. Advisors could also compare themselves to the index.”