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Why Income 'Bucket Planning' is a House of Cards

by Mitchell Maynard

For years I have had many intuitive thoughts regarding the weaknesses of the income planning strategy that uses staggered or laddered annuities scheduled for annuitization; also referred to as Bucket Planning. I have been very concerned that consumers who are buying into this strategy (and the agents who are using it) are unaware of the alternatives available to them for income planning that are far less problematic.

The concepts that are implemented during a buckets strategy have many failings. First, using average rates of return for the forecasting of future values has many weaknesses in itself. The use of average returns implies a steady rate of return earned each and every year. Like a house of cards, the use of average rates of returns implies certainty where it does not actually exist. There are superior methods available: Monte Carlo Simulations and historical backtesting are two.

Second, annuitization of laddered deferred annuities also implies safety and security for the customer where it doesn't exist. Since the deferred growth is being projected based on an average rate of return, there is little if any confidence of the promised income projection becoming reality.

Third, it is overblown that the reduction of income taxes for non-qualified accounts provides substantial benefits for the customer. In my analysis the tax savings were minimal and never compensated for the loss of interest earned had the entire principal been in a deferred state. I also found no tax benefits to the beneficiary.

My research is summarized below. For a copy of the complete 20-page analysis, please use the link below to contact Dorice and she'd be happy to email you a copy at no charge.

For the Bucket Planning scenario, I chose to use EIA products commonly sold and that in literature received from a national FMO, were specifically recommended for agent use in bucket strategies (for exact products used, refer to my Bucket Analysis white paper).

Bucket Planning Scenario

Bucket Leg / Income Years / Annuity Type

Leg #1 / 1 - 5 / Immediate Annuity

Leg #2 / 6 - 10 / Deferred EIA Annuity

Leg #3 / 11 - 15 / Deferred EIA Annuity

Leg #4 / 16 - 20 / Deferred EIA Annuity

Leg #5 / 20+ Replacement / Deferred EIA Annuity

For the Annual Withdrawal Scenario, I used a deferred EIA product selected after

analysis made using specialized software. This is also disclosed in the white paper.

The analysis included \$50,000 of savings assets that are either entirely qualified or entirely non-qualified. Income produced from the qualified investments was 'taxed' at an annual rate of \$2,000. This applied to the entire income from the Withdrawal Plan and Qualified Bucket Plan.

Annual Income Schedule

Non-Qualified Bucket / Qualified Bucket / Deferred EIA

\$ 20,000 / \$ 22,000 / \$ 22,000

The analysis performed for the white paper covers two twenty-year time periods: 1970-1990 and 1985-2005 to test the plans over two very different market environments and I have shared just the results of the latter period here. I found no empirical evidence that the Bucket Planning strategy offers superior income planning results for a very typical client scenario.

Non-Qualified Account Results

Scenario 1985 - 2005	Bucket Strategy	Withdrawal Strategy	Difference
Ending Value	\$ 1,126,141	\$ 1,466,683	\$ 340,542
Tax Basis	\$ 269,699	\$ 480,000	\$ 210,301
Beneficiary Tax (40%)	\$ 342,576	\$ 394,673	\$ 52,097
Net Total (After Tax)	\$ 783,565	\$ 1,072,010	\$ 288,445

Qualified Account Results

Scenario 1985 - 2005	Bucket Strategy	Withdrawal Strategy	Difference
Ending Value	\$ 1,029,754	\$ 1,466,683	\$ 436,929
Tax Basis	\$ 0	\$ 0	\$ 0
Beneficiary Tax (40%)	\$ 411,902	\$ 586,673	\$ 174,771
Net Total (After Tax)	\$ 617,852	\$ 880,010	\$ 262,158

The evidence and analysis clearly points to the use of a deferred annuity and that income needs met with simple withdrawals is superior to Bucket Planning. In the analysis, every advantage was given to Bucket Planning. However, not only is there substantially less money at the end of all 20 year scenarios, but the draw-down on Bucket Planning is greater. This leads one to the conclusion that not only is the bucket strategy inferior by prospects for growth, but it carries with it greater risk. This makes it highly inefficient: truly a financial planning house of cards.

The use of stocks for the final leg is also discussed in the white paper - and my reasons why this can not be expected to improve results.

In conclusion: Please don't find yourself lured to the potential returns offered by the use of average rates of return in income planning as it can be disastrous for both you and your clients. Monte Carlo Simulations (which applies randomly-selected rates of return in random order) and historical backtesting (which looks at actual returns over different time periods) are far superior methods. My hope is that that you can take these results and allow them to impact your income planning solutions used in the future.

[Request the complete White Paper](#)

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