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Annuitization Doesn't Have to Be a Bad Word

by Garth Bernard

Income (i.e., immediate) annuities are insurance products that benefit from mortality pooling, so they can generate the highest level of lifetime "income now" per dollar of retirement assets put to work. Including an income annuity as a portion of a retirement portfolio often results in an immediate increase in the level of income generated by that portfolio while at the same time ensuring that a portion of the total income is payable for a lifetime.

However, income annuities are the most under-appreciated financial instruments that exist in a financial advisor's tool-kit today. Annuitization is treated as a bad word. Many advisors will not recommend an immediate annuity because of misperceptions associated with the product and a lack of awareness about the value they provide, and when and how to use them.

So the real question is how to overcome these misperceptions. The answer is education. Here are the common misperceptions and the basic answers that advisors need to know so that they can do the best possible job for their clients:

- **Comparing apples to oranges. Advisors confuse "income now" with "income later."** For example, GMIB and GMWB features protect "income later" from market downside risk. If the market goes down when you eventually need "income now", you would be happy that you had purchased that protection because of the minimum safety net of income provided. However, if the market goes up, you would not necessarily want to exercise the option since the minimum guarantee would likely be substantially lower than alternative ways of deploying your account value to generate lifetime income.
- **All-or-nothing.** The biggest misperception is thinking that the entire retirement portfolio should be used to purchase an immediate annuity. This is likely to be unsuitable, and frankly makes no sense. It's not whether to annuitize, but what portion of the portfolio to annuitize and when to do so.
- **Lack of liquidity.** It's true that the traditional immediate fixed annuity has no liquidity. But, the portion of the portfolio not allocated to the income annuity can serve as the source of liquidity. Also, innovations in income annuity design are providing substantial liquidity for the portion of the portfolio allocated to the income annuity.
- **Loss of "unspent" inheritance on early death.** Certain income types that have always been available, such as lifetime income with a guarantee period, installment and cash refund annuities, can guarantee that the entire amount allocated to the income annuity is returned to the client and their heirs in the form of income payments in the event of premature death even while longevity remains protected.

- **Loss of control of assets.** Immediate variable annuities give the client investment choices upon which income payments are based. These choices are as diverse as those now available in deferred variable annuities.
- **Purchasing an income annuity is an irrevocable choice.** There are several income annuities available today that provide full revocability during a two- to five-year time frame. This is a form of "buyer's remorse" and allows the client ample time to decide if the purchase decision was right for them.
- **Does not keep up with inflation.** Any alternative that does adjusts for inflation will have to start with a lower initial initial income, and will take a long time to catch up. An immediate variable annuity provides the potential for income payments to outperform inflation with a suitable choice of investment mix from among the funding options of the annuity.
- **Immediate variable annuities expose the client to possible loss of income.** Look for an immediate variable annuity that can provide a floor on the income payments. These floors can be a level or increasing percentage of the initial income payment, or they can be provided indirectly via an allocation of the income payments to the general account.
- **Producers and advisors are not adequately compensated for the income annuity recommendation.** This is a fair comment. Income solutions potentially require more time and effort on the part of producers. Many producers have built an "asset book" on which they receive trailing commissions based on assets under management. If that "asset book" is converted to an "income book," these income trails are lost. Thus innovation in the area of compensation is demanded. A recent development is the creation of "income trails," which is a form of compensation based on a percentage of the income payments generated by the income annuity.

Perhaps the biggest benefit of allocating a portion of the retirement portfolio to income annuities is the efficiency. Assets not needed to generate income to be used to service other critical retirement financial needs such as healthcare and long-term care, as well as estate preservation and other needs.

In conclusion, advisors are faced with a unique opportunity to address a major challenge that will arise in the financial lifetimes of tens of millions of retirees and those approaching retirement. It is important that advisors understand the exceptional value proposition income annuities bring to the table and how these products relate to alternative solutions such as guaranteed living benefits on variable deferred annuities and systematic withdrawal programs.

However, in order for advisors to become more comfortable and confident with the income annuity products, carriers must describe the value proposition in a more compelling fashion than has been done historically. Carriers must also provide the support such as sales training, storyboards and sales aids that demonstrate how these products can be used as part of a total retirement solution to enhance the results for clients. In other words, carriers must engage advisors with specific support to demonstrate that including these products will more effectively meet their clients' retirement needs, and that not including these products within a solution exposes advisors to loss of their clients to those who provide more effective advice. ☐

Garth A. Bernard, Sr, FSA, MAAA, is vice president and actuary with Met Life Insurance Company in Boston, MA. He can be reached at gbernard@metlife.com.