Lifting The Cloud Over Annuities

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Fresh messages about the value of annuities have started to flow from a variety of sources
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These headlines, taken from different articles about annuities in the personal finance media, illustrate a bias against these retirement savings and income products. Few financial writers have embraced annuities as a financial planning tool; some have been downright hostile to the concept.

But anyone who sells annuities knows two things to be true: annuities can deliver significant value to clients and they are also one of the most misunderstood financial products on the market. Perhaps that's why it was such big news when the Government Accountability Office (GAO) weighed in on the topic and extolled the value of annuities to retirees.

The GAO, in its June 2011 report to the U.S. Senate's Special Committee on Aging, helped lift what some viewed as a dark cloud around annuities by making several specific recommendations to help protect or improve retirees' lifestyles:

- Middle-income retirees should consider converting at least part of their savings into an inflation-adjusted annuity or choose a guaranteed stream of income from an annuity instead of a lump-sum from their employer-sponsored defined benefit plan.
- As life expectancies increase, Americans should consider putting off retirement until a later age, continuing to work and save, if possible.
- Americans should consider taking Social Security payments at a later age, say age 65 or 66, when they are eligible for full payments. Nearly three in four Americans begin taking income from Social Security when they turn 62 instead of waiting until age 65 or older to begin taking full benefits.
- The federal government needs to step up efforts to promote financial literacy.

The GAO report encouraged the use of annuities within defined contribution plans such as 401(k)s. But, as those who sell annuities know, most annuity sales are made individually to clients for a wide variety of asset accumulation, income and protection needs. The report's recommendations highlight many of the key benefits of annuities and provide an outstanding platform to help advisors educate their clients about how annuities can help them accomplish their retirement goals.

Your clients who are close to retirement are no doubt thinking about some basic questions:

- Can I afford to retire when I want?
- How can I ensure that I will have an income for as long as I live?
- How can I create a predictable income to cover my basic living expenses?

These are all smart questions, especially with the recent market volatility so fresh in many people's minds. Accumulating dollars is important, but of equal importance is making those dollars last throughout your clients' retirements. Most deferred annuities, fixed or variable, offer basic features such as tax-deferred growth, protection benefits and a choice of payout options. Variable annuities also offer a range of professionally managed investment options from which to choose. But, it is the payout potential of annuities, that is getting the most attention.

There are many different ways to generate income from annuities. They can provide a stream of income that lasts for a specific number of years or for life. They can guarantee a minimum level of income payments or asset level, regardless of market performance, allow income to be taken at a client's discretion, or a combination of different tactics. Some annuities even allow consumers to defer the start of income payments by years or even decades, reducing the ultimate cost of generating income.

Some of the most popular payout options available on today's market enables clients to exercise "living benefits," which guarantee a minimum income or asset level to draw income from, no matter what happens in the equity markets. There are many choices of "living benefits," depending upon the client's goals. The guarantees are based on the claims-paying ability of the issuing company. Which guarantee a client ultimately selects can make all the difference when it comes to a secure retirement.

Some insurers have been limiting the types of guarantees they offer, while others have been expanding their availability. Some of the newer variable annuities on the market enable advisors and their clients to choose from a range of different guarantees within the same product. But whether your client is considering a product that offers a single guarantee or multiple guarantees, each one provides specific advantages to meet different retirement goals:

Principal Protection: Guaranteed Minimum Accumulation Benefits (GMABs) can be advantageous to clients who want to secure their investment principal with the potential to grow their income base. These types of guarantees often make sense for investors who have a longer-term horizon and the goal of generating income down the road, typically 10 years or more from when they make their original investment.

Income Protection with equity participation: Clients who want to secure a future lifetime income stream while maintaining the ability to grow their income for a specific period often gravitate to Guaranteed Minimum Withdrawal Benefits (GMWBs) that allow participation in the equity markets. "Best-in-class" products offer a bonus feature for as many as 10 years and sometimes provide a market-based step-up for income.

GMWBs have proven to be the most popular form of guarantees chosen by pre-retirees and retirees. They account for more than two-thirds of the living benefits market, according to a recent survey by LIMRA. Many advisors recommend GMWBs in the belief that they make a great deal of sense for many people who want to ensure their retirement income will never fall below a specific floor.

Guaranteed Minimum Income Benefits (GMIBs) can make sense for clients who want to secure a minimum income at retirement and have a longer-term horizon, typically 10 years or more, before they anticipate taking income. A GMIB provides a guaranteed minimum level of annuity payments regardless of how the annuity performs.

Income Protection without equity participation: GMWBs that eschew equity participation are designed to create a predictable, guaranteed lifetime income stream. They avoid equity exposure and the volatility that can be associated with it. These types of guarantees are most appropriate for clients who have lower tolerance for risk, shorter investment horizons, and whose top priority is return of principal.

As the government and the media have come to better understand these income benefits, fresh messages about the value of annuities have started to flow from a variety of sources. But don't assume that your clients are aware of the GAO's report or educational efforts, or have even discovered the virtues of annuities from their favorite personal finance magazines. Make sure you review your clients' income needs and take the time to explain their options yourself. You may just clear up a few misunderstandings in the process.

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