BARRON'S

Annuities Have Long Gotten a Bad Rap. Retirement Experts Now Say Savers Should Consider Basic Options for Guaranteed Income

July 20, 2020

Financial planners long have counseled retirement savers to keep a blend of bonds and stocks in their portfolios. The bonds kick off income and the stocks provide growth.

That advice now looks in need of a refresh. **Bond yields have been bumping around historical lows** for around a decade. And stocks provided strong growth during the longest bull market in U.S. history, which ended earlier this year. Stocks have rebounded so strongly since then that they're now expensive again, and due for a period of below-average returns. This has left retirees with some tough portfolio choices at a time when many face an income shortfall.

Annuities could be a savior, many researchers say, providing **stable income for retirees even if markets plummet and as lifespans lengthen**. And the Secure Act passed late last year means that annuities should be available in more 401(k) accounts.

There is one big hurdle to the widespread adoption of annuities: their reputation.

Many consumers and financial planners shun them. That's partly because insurers have muddied the waters by selling complicated annuities with high fees and surrender charges for consumers who try to cash them in. The opaque pricing made it difficult for consumers to comparison-shop.

"I'm fairly biased against annuities," says Cicily Maton, a Chicago financial planner, citing the fees and big up-front investment. Nonetheless, she says low-fee income annuities make sense for retirees who have a history of overspending or who won't be able to tolerate market gyrations.

Retirement researchers, however, say many of these concerns don't apply to life income annuities, which have simple pricing and minimal fees. Numerous top-rated insurers offer them. Consumers can easily comparison-shop them by going on websites like immediateannuities.com.

David Blanchett, Morningstar's head of retirement research, says that retirees whose basic expenses aren't covered by Social Security should consider buying an annuity to bridge the gap.

Suppose a 70-year-old married couple with a $1 million portfolio figures it needs $60,000 a year to cover essential expenses but will get only $50,000 a year in Social Security. The couple could purchase a $200,000 annuity from a top-rated insurer yielding 5.5% to bridge the gap. That annuity would kick off an extra $11,000 a year in income as long as either spouse was alive.

After buying the $200,000 annuity, the couple would still retain $800,000 in their portfolio to cover unexpected expenses plus the niceties of life, like vacations or restaurant meals.

“I wouldn’t annuitize everything,” Blanchett says. “You need a sizable portfolio in case you need a new roof or something happens.”

Until recently, employers were reluctant to offer annuities in their 401(k) plans because they feared liability if they picked an insurer that ran into financial problems years later. But the Secure Act provides safe harbor to employers who offer an annuity from insurers whose financial health has been approved by state insurance regulators. Experts expect annuities soon will become commonly available in 401(k) plans.

Kerry Simons of Scottsdale, Ariz., bought his second annuity last year for $190,000. The 68-year-old will get a $1,135 check each month for the rest of his life. He will get an additional $780 a month from his earlier annuity starting at age 70.

He plans to use the two annuities for travel and savings. Meanwhile, the $2,674 he receives each month from Social Security will cover basic expenses.

“I just wanted a guaranteed income for the rest of my life so I don’t have to worry about the market going up or down,” said Simons, who owned a computer products business before retiring in December. “I just don’t need the stress.”

Simons says people don’t talk a lot about the low-fee income annuities that he purchased and confuse them with high-fee variable annuities. “Every time I told someone I was getting annuities, they said, ‘Don’t do it. You’re getting ripped off.’ ”

Blanchett says he **often runs into opposition to the product from financial advisors**. “They assume they’re all bad,” Blanchett says. “There are some very bad annuities. But there are some very good ones.”

Annuities typically deliver higher payouts than bonds because of their so-called mortality premium. Bluntly put, insurers know that retirees all die eventually and their annuity payments to them will end. And even if someone buys an annuity at age 65 and lives for 40 more years, other customers will buy an annuity at the same age and die in a few years. In essence, the customers who die younger subsidize those who live longer.

Before buying a private annuity, retirement researchers say retirees ought to consider delaying Social Security until age 70 even if it means spending down their retirement portfolio. That’s because Social Security is priced more attractively than private annuities—its payments rise 8% for each year beneficiaries wait after hitting their full retirement age.

What’s more, Social Security payments rise with inflation, typically getting a cost-of-living increase each October. “It’s the best annuity out there,” says Wade Pfau, a professor at the American College of Financial Services and author of the book *Safety First Retirement Planning.*

Just as many Americans balk at deferring Social Security, many seniors hate the idea of plunging a big chunk of their nest egg into an annuity. They worry that they will die in a few years and the money spent on the annuity won’t go to their heirs.

This is the wrong way to view an annuity, experts say. Seniors should think of it more like car insurance. If they don't have any accidents, they're subsidizing those who do. Does that mean they'd want to drive without insurance, even if it were legal? Probably not. An income annuity is an insurance product that protects retirees from bumpy markets and outliving their portfolio.

To calm retirees' concerns, insurers have been pitching annuities that refund money to a senior's heirs if he or she dies early. One popular variant guarantees if the payments made total less than the annuity price, the remaining money goes to the heirs.

These guarantees have boosted annuity sales, says Dylan Huang, head of retail annuities at New York Life. Currently, a 65-year-old male buying a $100,000 life annuity from New York Life would get about $482 a month. If he opted for the refund guarantee, the monthly payment would drop to $431.

Nonetheless, Huang maintains the annuity without the money-back guarantee offers the most bang for the buck for consumers. "I think it is the most efficient type of annuity," he says, "because it takes the mortality pool and uses that to maximize the payouts to consumers."

Annuities don't make sense for everybody. Some retirees are already getting plenty of money to cover their basic expenses through Social Security or pensions. Other affluent retirees have adequate assets to ride out market downturns.

Once retirees have covered their basic needs through secure sources of income like annuities, they can be more aggressive with their investment portfolio, investing more heavily in stocks, says Pfau. "At that point, that money is more for legacy and upside," he says. "It's not really part of day-to-day needs."

In effect, annuities end up replacing the bonds in a retiree's portfolio. **"Instead of thinking of retirement as stocks and bonds,"** Pfau says, **"think about retirement as stocks and annuities."**