SmartMoney

SmartMoney Magazine by Elizabeth O'Brien Published April 7, 2010

Annuities: Their Surprising Comeback

Also See: Annuities for Retirement -- The Best, and the Rest [1]

When Karin Kuder retired in 2007 from her career as an occupational nurse, she hardly imagined she'd wind up writing a six-figure check to an insurance company and signing away control of her nest egg. But after she lost tens of thousands of dollars in one scary swoop in 2008, she found herself enduring sleepless nights. So Kuder, who's 62, put more than $150,000 in a fixed annuity, where it grows at a steady rate and can't shrink if the market drops. "I don't worry about that money," Kuder says. "It's safe."

They can be a nightmare to understand, even harder to shop for. And yet the inscrutable annuity, a product that's been around for centuries, is fast becoming the country's most tempting retirement investment, offering the kind of security that financial advisers say aging baby boomers are grasping for. For years, of course, annuities have been picked apart by critics, and even by some advisers who sell them, for their high fees and bewildering rules. (The number of pages in a typical prospectus for one kind of annuity: 700.) But as economic insecurity lingers, some experts are seeing annuities as a product that can deliver the kind of guaranteed monthly paycheck—in good times and bad—that our parents enjoyed in the age of the company pension.

In a twist that fits a cautious era, it's the least sexy of these investments that have fared the best. In 2009 so-called fixed annuities attracted $108 billion in assets, 48 percent more than they did two years prior, according to Limra, an insurance trade organization. Although sales slacked off somewhat as the stock market recovered, Americans have still sunk their money into these investments at a rate of about $300 million a day, and the insurers that sell them are pouncing. Major annuity sellers have stepped up their efforts to get employers and mutual fund companies to include annuities in workers' 401(k) plans. And advisers who've backed annuities all along are saying they told us so. Jean Fullerton, a planner in Manchester, N.H., says the number of her clients buying annuities has surged in the past year. "Now that we've had the market crash," she says, "they've finally caught up to my thinking

The industry certainly has momentum on its side. Most investors haven't recouped the savings they lost in the crash. In a recent survey by the Employee Benefit Research Institute, roughly one in four people said they might postpone retirement for financial reasons. Annuity providers say they're prepared to cover that gap; they often cite a study by Wharton School professor David Babbel, who concluded that a retiree who didn't annuitize some savings would need a nest egg 25 to 40 percent larger than someone with annuities in his portfolio. That study was financed by the insurance industry, but it has swayed some skeptics—even the Obama administration has since given annuities an implicit endorsement.

Still, annuities haven't gotten any less complicated, and there's no easy way to compare investments whose features and costs vary depending on who's selling them and whose prospectuses can rival War and Peace. With these issues in mind, we put together our first-ever ranking of the top annuities. We combed through more than 100 annuity offerings from two dozen major insurers, ferreting out details about their prices and features; we also turned to researchers at Morningstar and A.M. Best to help us gauge their financial strength and uncover hidden fees.

Making the "Mortality" Wager

For many years, basic annuities were an afterthought: They were briefly in vogue after the tech bust, but as stocks heated up mid-decade, their popularity receded. The latest crash, of course, changed investors' attitudes—and prompted an unexpected shout-out from the White House. In January the president's Middle Class Task Force, charged with helping average Joes repair their bank accounts, said that fixed annuities could reduce the "risks that retirees will outlive their savings, or that their living standards will be eroded by investment losses or inflation." Today the Labor and Treasury departments are mulling over proposals for bringing annuities into the retirement-savings mainstream.

Fixed annuities play a security-blanket role by setting up a slightly creepy wager: The customer gives the insurer a chunk of money, the insurer bets that the customer will die before she gets her money back, and the customer bets she'll outlive her money and then some. The older the customer is, the more likely it is the insurer will win. That calculus gets converted into a payout through "mortality credits," explains Chris Blunt, executive vice president of annuity giant New York Life. So a man who buys an annuity at age 70 might get paid 8 percent a year, while a man who buys at 50 would earn less than 6 percent.

What troubles some investors is that fixed really means fixed—as in set in stone, like Medusa's victims. If the stock market goes up 50 percent, an annuity owner's annual 8 percent can feel measly by comparison. That's why for most of the past decade, variable annuities, which invest the customer's money in mutual funds and potentially pay more, were the hotter investment. Though still an option, those annuities got into some hot water during the crash, inflicting losses on companies that sold them. Today many advisers look more carefully at an insurance company's financial strength. These ratings are issued by third-party companies; advisers and insurers will disclose them to customers who ask. Grade inflation is rampant in this world, however: B or B+ is the lowest score that most insurers post, and there can be a big difference between a single-A-rated company and a top-rated, A++ company, says Clifford Michaels, a financial adviser in New York City.

Experts also say that fixed annuities aren't always quite as restrictive as they sound. More companies now allow the buyer's heirs to keep receiving payments if the buyer dies earlier than expected. Investors can also get payments that rise to adjust for inflation. These features come at a price, in the form of lower monthly income, notes Judith Alexander, director of sales and marketing at annuity consultants Beacon Research. But annuity companies, including New York Life and Nationwide Financial, say they're doing more to make those features more flexible and, potentially, cheaper.

Still, even financial planners who love annuities don't sell them to all their customers. They seldom make sense for people in poor health. And for younger buyers, the meager payouts aren't usually worth the loss of control. The sweet spot for investors begins when they're in their early 60s. But advisers stress that even then most investors should stash, at most, 40 percent of their assets in annuities, with the remainder in other investments—they need to keep their portfolios growing and have cash on hand for emergencies. Indeed, for a long time, advisers and investors thought of annuities and other investments as an either-or proposition, says Eric Henderson, senior vice president for individual investments at Nationwide: "More and more, people are saying it's 'this-and.'"

[1] http://www.smartmoney.com/personal-finance/retirement/annuities-for-retirement-the-best-and-the-rest/

URL for this article:
http://www.smartmoney.com/personal-finance/retirement/annuities-their-surprising-comeback/