Conditions fertile for annuities if industry can connect with investors

A number of factors — DOL fiduciary, low interest rates and longevity — are coming together in favor of annuities if certain impediments are eliminated

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Most investors want guaranteed, pension-like income yet are reluctant to buy an investment that can provide it: an annuity.

That reluctance, the so-called annuity puzzle, may be closer to being resolved as a combination of factors — fewer sources of sufficient retirement income amid low interest rates, **greater longevity** and regulation — come together in ways that may tip the scales in favor of annuities if certain impediments are eliminated.

“There is probably larger latent demand for annuities than advisers and insurers realize,” said Michael Finke, dean and chief academic officer at **The American College of Financial Services** in Bryn Mawr, Pa. Many advisers currently don't have the tools to explain annuities properly or to make the client's purchase decision less stressful, he said.

Mr. Finke recently did a survey of investors asking about preferences regarding pensions and investments, and 50% to 75% of respondents preferred a pension to drawing income from investments, yet “most didn't understand that an annuity is essentially a private pension.”

Advisers and their firms, which traditionally viewed annuities as products that would divert client assets — and hence reduce fees — and whose income properties could be duplicated through bond ladders and other investment strategies, now are changing their minds, said Robert DeChellis, president of Allianz Life Financial Services in Minneapolis.

“What's different now is that the capital markets people at firms are coming to see that in an environment where interest rates may rise and equity values are high, annuities may be the only way to produce a higher degree of outcome certainty for part of the portfolio,” he said.

Mr. DeChellis, who says there is a strong argument for considering annuities a separate asset class, also noted that a greater interest in annuities is likely to be an unintended consequence of **the new Department of Labor fiduciary rule**.

“With the move to more fee-based business and a greater emphasis on financial and retirement planning, more advisers and clients will become aware of their need for retirement income and the level of assets required to generate that income,” he said.

(More: Advisers should be rewarded for their expertise, not sales skills)

“Annuities can reduce pressure on investment portfolios and can give advisers greater latitude with the remaining assets to create portfolios that better serve clients over the long run,” Mr. DeChellis said.

“The 'secret' ingredient in annuities, of course, is the mortality credits,” said annuity expert Moshe Milevsky, associate professor in finance at the Schulich School of Business at York University in Toronto. He said that due to this unique feature — resulting from a pooling of assets drawn down only by survivors, which produces greater income than a similar-size bond portfolio — annuities can play an important role in portfolio construction and providing retirement income.

But “the devil is in the details,” he said, referring to the complexity and costs associated with annuities, as well as the variety of offerings that all come under the annuity umbrella.

“When people talk about annuities, they can mean anything. Are we talking about SPIAs (single-premium immediate annuities)? Variable annuities? The word is meaningless,” Mr. Milevsky said. “Annuities can be important, but the industry has to remove the gotchas.”

(More: Complaints surface at Finra over buffer annuities)

Mr. Finke believes that the insurance industry should standardize annuity products so buyers better understand what they're getting and so insurers don't compete by adding features that increase complexity and befuddle advisers and clients alike.

Wade Pfau, a professor of retirement income at The American College, said that for many investors, annuities are probably most valuable — and can be best explained by advisers — as a secure supplement to Social Security benefits to cover a retiree's basic living expenses.

“Sequence-of-return risk can start digging a hole for retirees that can be hard to overcome without the mortality credits of annuities,” he said. “They provide bond-like returns without having to worry about longevity and running out of money.”

One type of annuity that many retirees might find attractive if they knew about it or understood it is the QLAC, or **qualified longevity annuity contract**. Approved by the government in 2014, QLACs are deferred annuities funded with an investment from a qualified retirement plan or IRA.

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“QLACs are the single most underused retirement investment,” said Mr. Finke. “You get the greatest bang for your buck by annuitizing later in life, and the QLAC structure provides a tax break by avoiding RMDs between ages 70-1/2 and 85. This tax savings is usually enough to cover the insurance company's expenses for anyone in a 28% tax bracket. It's like getting a valuable insurance product at no cost, and pricing is very competitive right now.”