SPECIAL REPORT

What They Are Saying:
A Collection of Expert Perspectives on the Value of Annuities

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In association with Tarkenton Financial, LLC

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Solutions for Retirement

We are living in a remarkable time, with people retiring earlier and earlier and living longer and longer. With that longevity comes many blessings and opportunities, to not only live longer, but to dream bigger, travel more and to invest more in the lives of those we love. With that longevity, however, comes a challenge, and that is to find a way for our money to live as long as we do. One study (conducted by Allianz Life) surveyed 3257 adults ages 44-75, asking them whether their greatest fear was of dying or of running out of money while they were alive. 61% said their greatest fear was of running out of money.

What can be done? I believe that annuities, when properly integrated into a diversified retirement plan, can be powerful tools in helping a retiree to be confident that their money won't die before they do. We purchase life insurance in case we die too soon, to make sure that our children can still be able to go to college. We purchase annuities in case we live too long, helping make sure that we will be able to enjoy our retirement years.

In my own practice, I don't "sell" annuities any more than a carpenter "sells" a hammer. What a carpenter tries to create is a vision of what a beautiful completed home will look like. A hammer is simply a tool to help him accomplish that. What I and my peers are trying to create is a vision of a well-provided-for retirement. The annuity is simply a tool to accomplish that task, and in my view, to accomplish it with extraordinary effectiveness. This brief compendium demonstrates that the high view that I hold of annuities as effective tools for retirement income is a view that is increasingly shared in the media and in the academic community.

The poet Goethe once said that we should never let the things that matter least get in the way of the things that matter most. When it comes to retirement, nothing matters more than having a plan for our money to live as long as we do. Retirement for our clients is not a dress rehearsal. It is a one-act play, with one chance to get it right. Annuities can be a powerful tool in helping them to get it right.

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On annuities and the fear of running out of money in retirement:

Death may be frightening, but to a majority of older Americans, the possibility of outliving their savings is even worse. In a new poll of people ages 44 to 75, more than three in five (61 percent) said they fear depleting their assets more than they fear dying. "One of the things in the study that was surprising to us was the level of fear" among respondents, says Katie Libbe, vice president of consumer marketing for Allianz Life Insurance Co. of North America, which conducted the poll of 3,257 people. "It was greater than we anticipated."

--*www.AARP.org, July 1, 2010*

The findings of the original Retirement Vulnerability Report revealed that a majority of middle-class Americans are likely to outlive their financial resources in retirement. A significant, guaranteed, lifetime income outside of Social Security, as provided by such retirement vehicles as a lifetime annuity, was a way to help secure one's retirement future. The updated study reveals that the financial market downturn which began in the middle of 2008 makes this conclusion even truer today.

--*Ernst and Young, Retirement Vulnerability Analysis, June, 2009*

The need for lifetime income is huge and growing as life expectancies continue to increase and traditional sources of guaranteed income disappear. For a 65-year-old couple, there's a 25% chance that one spouse will live until age 97, yet fewer people are retiring with pensions, and Social Security covers only a small portion of most people's expenses. Many retirees who had planned to fill the income gap with their savings are wondering where to turn after suffering through two severe market downturns over the past decade. An annuity may be the answer, but not all annuities are alike, and some may not be appropriate for you.

--*Kiplinger's Personal Finance Magazine, Lock In Your Retirement Income, May, 2010*

There are now more than 53,000 Americans who are 100 years old or older. As a point of reference, in 1950 there were just 2300 people who had reached that same age … this represents an increase of 2200%! Due to medical advances, we are a society that is living longer and longer. This represents both an opportunity and a challenge. The opportunity is that we now have far more time than previous generations to dream bigger and accomplish the things we dream about. Whether it is travel, time spent with family or efforts to leave the world a better place, the increased longevity we now enjoy is a blessing. The challenge is obvious, and that is to make sure that our money lives as long as we do. Having a written plan for retirement income has never been more important, and annuities that can guarantee a significant portion of that income should be an important component of that plan for many people.

--*Shawn Moran at www.swanretirement.com*

On the safety of annuities:

"When you deposit a dollar in a bank account, the bank, by law, must keep a certain amount on reserve. That amount depends on the type of account but ranges from zero to 10 cents on the dollar. When you purchase a fixed-rate annuity, the insurance company, by law, must set aside over a dollar in reserves. The insurer can only use these excess reserves to settle the withdrawals and redemptions of annuity owners. The money cannot be used to settle insurance claims, pay overhead, settle bad debts, or take care of any other nonrelated annuity item … During the Great Depression, it was not the U.S. Government that bailed out the banking industry – it was U.S. insurance companies. If there were ever a financial collapse in the United States, the insurance industry would be the second to the last entity to fold (second only to the government). This 'second billing' is because the government has taxing power and, of course, the ability to print money."

--Best-selling author Gordon Williamson, All About Annuities

The Institution of life insurance has gradually and spontaneously taken place over the past two hundred years. It is based on a series of technical, actuarial, financial and juridical principles of business behavior which have enabled it to perform its mission perfectly and survive economic crises and recessions which other institutions, especially banking, have been unable to overcome … Thus life insurance companies tend to underestimate their assets, overestimate their liabilities, and reach a level of static and dynamic solvency which makes them immune to the deepest stages of the recessions that recur with economic cycles. In fact, when the value of financial assets and capital goods plunges in the most serious stages of recession in every cycle, life insurance companies are not usually affected given the reduced book value they record for their investments. With respect to the amount of their liabilities, insurers calculate their mathematical reserves at interest rates much lower than those actually charged in the market.

--Economist Jesus Hoerta de Soto in Money, Bank Credit and Economic Cycles

On interest earning potential in a fixed index annuity:

The S&P 500 index as of August of 2009 finally reached 1,000. It has taken 12 years for the S&P 500 index to break even due to the volatility and risk with the two economic bubbles experienced from technology stocks and the real estate crisis. While the S&P 500 index has produced near zero total return over 12 years, the Fixed Index Annuity using the S&P 500 index on average produced returns of 5.79% using a 5-year annualized rolling return from 1997-2007. Even if you add taxable dividends to the index, the Fixed Index Annuity has performed better, at least based on the data we have reviewed.

--Wharton Financial Institutions Center white paper, Real World Index Annuity Returns, October, 2009

The average reporting index annuity credited 4.06% annualized for the five year period from 9/30/06 to 9/30/11, which compares favorably with the 2.3% you would have earned in 1-year CDs, but is slightly less than the 4.2% 5 year CD rate you might have chosen. Whether the stock market was better depended on whether you chose stocks or bonds. An index fund with reinvested dividends lost 1.3% a year over the last 5 years and the average stock fund also lost money. However, putting all of your money into taxable bonds returned 4.8% annualized; a 50/50 mix of stock and bond funds gave you a 3.6% overall return.

--www.indexannuity.org, November, 2011

On the value of annuities for retirement income:

George Bernard Shaw once quipped, "If you laid all the economists end to end, they still wouldn't reach a conclusion." Well, that time-honored adage has changed, at least in one area, because economists have come to agreement from Germany to New Zealand, and from Israel to Canada, that annuitization of a substantial portion of retirement wealth is the best way to go. The list of economists who have discovered this includes some of the most prominent in the world, among whom are Nobel Prize winners. Studies supporting this conclusion have been conducted at such heralded universities and business schools as MIT, The Wharton School, Berkeley, Chicago, Yale, Harvard, London Business School, Illinois, Hebrew University, and Carnegie Mellon, just to name a few. The value of annuities in retirement seems to be a rare area of consensus among economists.

--David Babbel, Wharton Business School, Investing Your Lump Sum At Retirement, July 2007

When David Babbel, 62, retires in three years, the University of Pennsylvania Wharton School professor plans to put about half of his retirement savings into an immediate annuity. 'I'm going to annuitize enough so that, together with Social Security, I will have enough income to maintain the lifestyle I want,' he says. Professor Babbel says he will divide the rest of his savings into five equal amounts and purchase fixed deferred annuities. These are akin to bank CDs, with three added benefits: Earnings grow tax-deferred, interest rates are often higher, and the money can typically be converted, tax-free, to an immediate annuity.

--Wall Street Journal, Is It Time To Buy An Annuity?, May 16, 2011

With retirement outlooks growing increasingly uncertain, the safety of guaranteed income streams looks more attractive each day. Annuities can provide such guarantees, so let's take a look at them and consider whether they make sense for you. Simply stated, an annuity is a financial product sold by insurance companies that allows you to put aside money and "buy" a stream of lifetime income. You can start the payments right away or defer them. If you set aside money now but defer the income to a later date, any earnings on your premiums accrue tax free. Future payments are taxed as ordinary income. Unlike IRAs, there is no income limitation on how much you can place in an annuity. The marketing phrase that insurers like to use about annuities is that they produce an income stream you can't outlive. And that can be true. Also, by being in a pool of other annuity customers, insurers can offer returns to annuity holders that may be higher than they could get on their own.

--Money Magazine, How To Use Annuities for Retirement Income, August 2, 2011

Which brings us to the central difference about generating income from your savings by yourself vs. buying an annuity: unless you're willing to take more investment risk, you as an individual can't match the guaranteed income an immediate annuity can provide. This is probably one of the few statements that you can get most economists to agree on, as two Wharton finance professors pointed out in this policy brief on investing for retirement.

--CNN, When Is An Annuity Worth It?, May 4, 2010. money.cnn.com.

What the government is saying about annuities and retirement planning:

Annuities can help to mitigate some of the risk faced by retirees. In particular, annuities protect retirees against the risk of outliving assets. This risk is substantial. In 2007, the average 65 year-old male could expect to live an additional 17.2 years, but many will live much longer; nearly a fifth of 65 year-old men could expect to live to at least age 90. As already noted, at older ages, a significant share of individuals have essentially exhausted their other assets and are almost entirely dependent upon their Social Security benefits. For those individuals with the good fortune to live long lives, annuities augment the longevity insurance provided by Social Security benefits.

Access to annuities is a particularly salient issue for women. Even though women's participation rate in retirement plans is equal to that of men, women tend to have significantly lower overall retirement income and retirement assets than men, due in part to lower wages and lower rates of full-time employment among women during their working lives. If anything, these facts understate the need for improved retirement security among elderly women, since women have longer life expectancies, and more uncertainty about lifespans, than men. The average American female turning age 65 in 2007 could expect to live 19.9 additional years—2.7 more years than the average American male. In addition, women are much more likely to reach advanced ages. Among 65 year-old women in 2007, 30.7 percent will live to at least age 90, much higher than the share of 65 year-old men who are expected to reach age 90. Moreover, average lifespans have been increasing. Between 1970 and 2007, the average life expectancy for a 65-yearold female increased from 82.1 years to 84.9 years, while the average life expectancy for a 65-year-old male rose from 78.1 years to 82.2 years. And elderly women are more likely to live in poverty than elderly men. In 2008, 17 percent of unmarried women age 60 and over were poor, and an additional 20 percent were nearly poor, with incomes between 100 and 150 percent of the official poverty level. The disparity for women becomes particularly pronounced at older ages: at age 75 and above, 12 percent of (married and unmarried) women lived below the poverty level in 2010, compared with only seven percent of men. All of these factors create additional urgency for women to ensure a secure stream of income throughout retirement.

--White House Council of Economic Advisors, Supporting Retirement for American Families, February 2012

What the academic community is saying about annuities and retirement income:

"Ensuring retirement security for an aging population is one of the most compelling challenges facing the nation. The main focus these days is ensuring that retirees have a large enough nest egg. However, to achieve real security in retirement, households need to get as much as possible out of their nest eggs during the drawdown period. Annuities guarantee that households do not outlive their money. Finally, annuities provide more monthly income than other approaches, such as the 4 percent Rule or living off the interest of assets."

--Boston College, National Risk Index Study
October 2010

The study assumed a 65 year old married couple, with a 4% withdrawal rate for retirement income. The study looked at 1001 different product allocations, and used 200 Monte Carlo simulations for each allocation, seeking to determine what allocation would have the highest statistical likelihood for success. The study concluded that the allocation with the highest likelihood for success was one consisting of 50% stock and 50% in fixed annuities.

--The American College, "An Efficient Frontier for Retirement Income"
September 24, 2012