Income Riders and Parachutes

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So much of the innovation taking place in the annuity industry today is on the income side of the equation. With lower caps, the accumulation story is not a very compelling one; however, the income story is one that is both compelling and vital to your confidence that your retirement money will live as long as you do.

The optional income riders that are available on most fixed and fixed index annuity products today are the chief supporting actors in the income story. You, of course, are always the main actor in your story. Understanding the potential value of annuities and income riders as supporting actors will influence whether you decide to include them in your retirement income strategy.

Let's look at the three key questions you, as a consumer, need to understand when it comes to income riders:

1. What are they?
2. What is their value to a retirement?
3. Are they worth the cost of the fees that are charged?

What are they? Although they come in many shapes and sizes, income riders at their core are designed to give you a contractual promise from the issuing insurance company that a stipulated amount of income will be paid to you for the rest of your life, even if the contract value of the annuity were to go all the way down to zero. There is typically both a deferral guarantee and a withdrawal guarantee built into an income rider. In the years that the annuity is being left alone to grow, there is an income account value that is growing each year.

Importantly, it is crucial that you understand that this income account value is not available as a lump sum withdrawal in the way that your annuity contract value is (potentially subject to penalties for early withdrawal). When you are ready to begin receiving income, a withdrawal rate is applied to that income account value to determine how much income you can enjoy.

What is their value in retirement? So much of what is done today in retirement planning is based upon projections: "*If* the market does this, and *if* inflation does that, *then* retirement will be a comfortable one for you." Income riders on an annuity are based **not** upon projections, but upon predictability.

Consider a hypothetical scenario. Let's consider a 55-year old person who wants to retire in ten years at age 65. He has $250,000 that he places in a fixed index annuity with an income rider that has a 6% annual rollup during deferral, and a 5% withdrawal guarantee when he begins to receive income. In ten years, the income account value would be $447,711. A 5% withdrawal guarantee would produce $22,385 in annual income that the client could never outlive, assuming he abides by the terms of the annuity contract.

Ask yourself: is there any other financial product that can, with that degree of predictability, produce that much in guaranteed future income?

Are they worth the cost of the fees that are charged? You may have thought to yourself: "Why do I need an income rider when all the insurance company is doing is sending me my own money?" Well, that is absolutely true, and you would be correct in thinking that you could withdraw your own money for income from lots of other financial products without paying the fee associated with an annuity income rider. But in a world of exploding longevity and increasing economic turbulence, will those other products continue to send you a check each month *even if there is a zero balance left on the contract*?

That is the value of the income rider. I am a believer in worst case scenario planning. We can hope for the best, but it is important to plan for the worst. When you hit a zero balance in any other financial product, the worst case scenario is that there is no money left in the account and the income that is needed for retirement stops. With a fixed index annuity with an income rider guarantee, only the first part of that worst case scenario would apply, because the income checks would continue for the rest of your life.

Let me close with an analogy. Imagine you were going to go skydiving. You drive to a skydiving school and, after signing lots of documents that state that if you end up doing an imitation of a pancake on the airport tarmac, you blame no one but yourself, you reach for your checkbook to pay the $200 fee. As you are about to fill in the dollar amount, you nervously look up and ask the instructor, "Has anyone ever died doing this?"

He answers you by saying, "Yes. A few people have died, but there is a 98% chance that your chute will open and you'll be fine. However, for an additional $20, you can rent an extra backup chute that would give you a 100% chance of your chute opening."

Let me ask you: after hearing that, would you be writing a check for $200, or for $220?

I thought so. Me, too.

That is the value of an income rider. Without it, you may very well never run out of money. With it, you can rest assured knowing that you won't.

About the Author

Shawn Moran is the founder and president of Retirement Planning Group of West Virginia. He also serves as Tarkenton Financial's Director of Product Strategy. He is a 10-time qualifying member of the prestigious Million Dollar Roundtable, with seven Court of the Table qualifications and one Top of the Table qualification. He lives with his wife Julia and their son Samuel in Charleston, West Virginia.