Kiplinger's PERSONAL FINANCE
OCTOBER 2013
www.kiplinger.com

MONEY // COVER STORY

Add an Annuity to the Mix

Use our strategies to lock in higher lifetime payouts. BY KIMBERLY LANKFORD

A NUMBER OF STRATEGIES CAN HELP you stretch your retirement savings over your lifetime. But when it comes to choices you control, only an annuity guarantees that your income—or a portion of your income—will continue no matter how long you live.

You can integrate an annuity into your retirement income strategy in a variety of ways. One popular method is to add up your regular expenses (such as housing, food, utilities, insurance premiums and out-of-pocket health care costs) and subtract any guaranteed sources of income (such as a pension and Social Security). Then buy an immediate annuity to provide enough income to fill in the gap. Once you know those costs are covered, you can invest the rest of your money more aggressively—providing extra funds to keep up with inflation, cover emergencies and other large outlays, or leave to your heirs.

The simplest way to provide lifetime income is with a single-premium immediate annuity: You hand over a lump sum to an insurance company when you retire, and it pays you a regular check for life (or for as long as you and a joint annuitant live) starting right away. (With a deferred variable annuity with lifetime income benefits, another flavor of annuity usually sold to preretirees, you invest a chunk of money in variable investment options in exchange for a promise of a stream of income in the future.)[1]

Immediate annuities may be simple, but they come with a couple of caveats: Because this type of annuity has fixed payouts that usually aren't adjusted for inflation, and because you can't reclaim the money once you commit it, you should invest only enough to help cover regular expenses and no more. More problematic are today's low interest rates; now is not a good time to lock in a fixed payout for the rest of your life.

"Because of historically low interest rates, an investor who purchases an immediate annuity now may be solving an emotional dilemma—fear of market risk or fear of loss of income—at the expense of their financial best interest," says Tim Maurer, a certified financial planner in Hunt Valley, Md. For example, if a 65-year-old man invests $100,000 in an immediate annuity now, he'll receive about $6,900 per year for life—about $1,800 a year less than if a 65-year-old had bought the annuity five years ago. Low rates translate into lower payouts because the insurer earns less on its money.

You can combat lower payouts a couple of ways: by laddering annuities or by buying a relatively new product that guarantees heftier payments if you pick a date down the road to begin receiving them.

THE ANNUITY LADDER

One way to avoid locking in too much money at low rates is to buy an immediate annuity now with a portion of your savings and invest more in annuities every few years. Payouts will be higher because you'll be older; they'll also increase if interest rates rise.

Michael Ritschel of Colorado Springs retired four years ago as a financial consultant. He receives a small pension and Social Security, but most of his retirement income comes from his own savings. Ritschel, who is 73, has 20% of his portfolio in fixed-income investments and 60% in dividend-paying stocks. He plans to put the rest of his savings in immediate annuities to cover living expenses for himself and his wife. He recently bought his first annuity and plans to make two more purchases over the next six years. "My goal is to have enough income to cover the necessities and to provide growth with income that will keep up with inflation," he says.

The older you are when you buy an annuity, the higher the annual payouts—assuming interest rates don't fall further. For example, a 73-year-old man who invests $100,000 in an immediate annuity now could get $8,820 per year for life; a 75-year-old could get $9,432 per year for life; and a 77-year-old could get $10,200 per year for life. If interest rates rise by the time the man purchases the annuities, the payouts will be even higher.

You'll receive the highest payouts if you choose a life-only annuity, which stops paying when you die. (Ritschel chose that version because he already has a universal life insurance policy, with his wife as the beneficiary.) You'll receive a lower annual payout if you buy an annuity that pays out as long as you or your spouse lives. If you're worried that you might both die early, you can choose an option that guarantees payments (to you or your heirs) for at least

[1]Variable annuities are long-term investments, subject to market risk, including loss of principal.

ten years. A 70-year-old man who invests $100,000 in a single-life annuity could get $7,956 per year, or he could get $6,684 for payouts that continue as long as either he or his wife (also 70) lives. The income would be $6,588 per year if payouts continue as long as either spouse lives or for at least ten years.

Having the annuities to cover his retirement expenses allows Ritschel to feel comfortable investing his remaining savings more aggressively, because he won't need to sell his investments in a down market to pay his bills.

DEFER THE INCOME?

Annuities can protect against outliving your income, but you don't really benefit from that protection early in retirement. For that reason, academics and actuaries have embraced products that delay payouts until much later—typically your seventies or eighties—when you're most concerned about outliving your savings. "If you focus your longevity-risk thinking on those later years, it's less expensive," says Tom Terry, president-elect of the American Academy of Actuaries.

Several years ago, a few insurers introduced "longevity insurance" annuities that paid out beginning when you turned 80 or 85. The payouts were high because many people didn't live that long—and as a result received nothing. But few consumers were willing to take the risk of losing the money if they died before payouts began.

New York Life was among the first to revise the product to allow people to start receiving income much earlier. You may choose to defer the payments for from two to 40 years (although you may have to start taking payments by age 70½ if the money is in a retirement plan subject to required minimum distributions. The longer you defer the payments, the higher the annual income. (You can usually change the date once before payouts begin.) In the meantime, you know the rest of your money needs to last only until the annuity payouts begin. These deferred-income annuities have become popular, with more than $1 billion in sales in 2012.

If a 65-year-old man invests $100,000 in New York Life's Guaranteed Future Income Annuity and defers payments until age 70, he'll receive $10,370 per year for life. If he defers payments until age 75, he'll get $17,270 per year. Plus, unlike the earlier versions of longevity insurance, you may choose a cash refund option, which promises that you or your heirs will get back at least as much as you originally invested, even if you die early. But the annual payouts are much lower than they are with the version that stops payments as soon as you die—which can be a good option if you have life insurance or if your spouse isn't dependent on the income. Choose the version with the refund option and you'll get $8,800 per year starting at age 70 or $13,840 per year starting at age 75.

In 2003, Barbara and Wallace Tucker, both college administrators, bought a ranch overlooking a small lake in Wolfe City, Tex. They retired there in 2006, when they were both 62. They didn't have pensions and wanted income to help pay their bills, but they didn't know if they would return to work or make other big changes, so they didn't want to tie up too much money in a life annuity. The Tuckers worked with Northwestern Mutual adviser Tom Weilert to convert their retirement savings into income.

Weilert advised them to take one-third of their retirement savings, which had been invested in stock funds, and shift it into a seven-year fixed annuity to help cover their expenses during the early years of retirement. With enough income to pay their bills, they didn't have to sell stocks during the market downturn of 2008. The term on their fixed annuity is nearing an end, so they invested one-third of their remaining retirement savings in a deferred-income annuity from Northwestern Mutual that will provide guaranteed payouts later on.

Nine companies now offer deferred-income annuities, and at least another eight are planning to offer them in the next year or so, says Jafor Iqbal, associate managing director of retirement research for Limra, an insurance research and consulting firm. Fidelity has a marketplace for these annuities in which you can compare versions from four insurers: New York Life, MassMutual, Guardian and Principal (go to www.fidelity.com/annuities/deferred-fixed-income-annuities/compare).

Northwestern Mutual has a policy that also pays dividends, which the Tuckers bought. Each year, you can choose either to reinvest the dividends or to receive all or part of the dividends as additional payouts, for extra flexibility. Barbara returned to work in 2011 to set up a nursing program at the Texas A&M Commerce campus, so the Tuckers plan to defer the payouts for several years. Meanwhile, they're reinvesting the dividends. "We'll see what our needs are and whether we'll be self-sufficient without the dividends," says Barbara.[2]

KipTip

Where to Shop

COMPARE PRICES FOR IMMEDIATE annuities at www.immediateannuities.com, which provides payout quotes for many top annuity companies. A 70-year-old man who invests $100,000 in a single-life immediate annuity now can get annual payouts ranging from $7,140 to $8,148, depending on the company. Immediate annuities are generally structured the same, so you can usually pick the annuity with the most generous payout. But be sure to look at the insurer's financial-strength rating, because you may need the payouts to continue for 20 or 30 years. ImmediateAnnuities.com provides three financial-strength ratings for each insurer from which you get quotes. Also look at the ratings in relation to other insurers that are offering similar payouts. You may want to go with an insurer that has a slightly lower payout if it has a much higher financial-strength rating.

Note: The annual payout amounts shown in this article are for illustrative purposes only and may not reflect current available payout amounts. Actual payout amounts vary by company and depend, in part, on then current interest rate assumptions.
[2]Dividends are not guaranteed.

Guarantees associated with annuities are backed solely by the claims paying ability of the issuer.

(#78372) Excerpted with permission from the October 2013 issue of **Kiplinger's Personal Finance**. © 2013 The Kiplinger Washington Editors Inc.
For more information about reprints from Kiplinger's Personal Finance, visit PARS International Corp. at www.kiplingerreprints.com.