The New York Times

SundayBusiness

SUNDAY, JANUARY 23, 2005

Sunday Money/Planning

An Annuity With a Twist: Pay Just Once, Then Collect

By ROBERT D. HERSHEY Jr.

IMAGINE how new retirees might respond if, in return for a lump-sum payment, a reputable insurance company promised to send them a sizable check every month for the rest of their lives.

It would come with a yield that was better than prevailing market interest rates, and, as an option, retirees could guarantee that their initial payment was returned entirely, either to them or their heirs. Better yet, there would be no direct sales commission.

Well, the deal has been around for about a century. So far, it has been largely ignored.

What's being offered is an annuity — a term covering a vast array of products that together have become mired in popular perception as highly complex, expensive and, in the worst case, a good way to lose all your money (not to mention that you would be dead as well).

Much of the poor reputation, however, involves so-called deferred annuities — tax-advantaged vehicles intended for the gradual accumulation of assets, often involving mutual funds or stocks to be cashed in upon retirement many years in the future.

But there is another version, called an immediate annuity, that is not as well known and is designed to convert today's lump sum into a stream of payments that provides retirement income right away. Although this type was around long before today's hot product, the variable deferred annuity, became popular in the 1980's, it accounts for only about 2.5 percent of the annuity market. "People aren't aware that these exist," said Eric Sondergeld, director of retirement research at Limra International, a trade group for insurance marketing, in Windsor, Conn. "We've all been totally focused on retirement savings and not as much on what do you do when you get there."

Insurance agents earn relatively little for selling immediate annuities, some experts noted, and it can be hard to persuade potential buyers to hand over a big chunk of their life savings for an insurance contract — not an investment — that represents a wager that they will live longer than a giant insurance company thinks they will.

Paying a Premium for Safety

People shopping for immediate annuities have many choices. Policies from companies with higher credit ratings often cost more. Here are some prices for one type of policy from some of the biggest annuity companies. The **lighter bars** indicate the lowest prices, the **darker bars**, the highest ones. Prices are most recent for each company.

	Insurance ratings From A.M. Best	$1,000 A MONTH FOR LIFE			
		MAN		WOMAN	
		Age 55	Age 65	Age 55	Age 65
United of Omaha	A	**$179,003**	**$148,045**	**$189,448**	**$161,243**
Fidelity & Guaranty	A	179,789	148,327	195,092	165,853
GE Capital	A+	180,343	150,519	188,957	162,655
John Hancock	A++	185,790	155,665	198,704	169,836
Lincoln Benefit	A+	186,999	156,168	196,682	168,167
American General	A++	189,426	154,706	199,265	166,407
Jefferson Pilot	A++	**191,278**	**160,719**	**201,692**	**171,957**
Average		*184,661*	*153,450*	*195,691*	*166,588*

Source: TotalReturnAnnuities.com

There are some signs that immediate annuities are gaining popularity. One reason is the declining availability of traditional fixed corporate pensions; another is that baby boomers, the oldest of whom turn 60 next year, are approaching retirement.

Immediate annuities are straightforward. You shop among companies strong enough to make payments indefinitely and see which charges the least for a specified amount of income — say, $1,000 a month.

"There's only one sensible way to evaluate" offers, said Hersh L. Stern, a broker of immediate annuities who runs WebAnnuities.com in Monroe Township, N.J. "It's how much you pay for what you get each month."

As a rule of thumb, according to Ethan E. Kra, chief retirement actuary for Mercer Human Resource Consulting, the cost for a 65-year-old these days is about 13 times the annual benefit. A policy paying $1,000 a month — or $12,000 a year — would therefore cost someone of this age about $156,000. That works out to an annual interest rate of almost 8 percent — nearly double the current rate on 10-year Treasury bonds.

Not surprisingly, the older you are, the less you pay. Some experts advise waiting a few years after retiring to buy an immediate annuity to get a firmer grasp on financial needs as well as to minimize the cost.

You can also prevent the insurance company from reaping a windfall if you have an early death. For additional cash, you can buy a period-certain annuity, so that a beneficiary collects what you did not for, say, the balance of 5, 10, 15 or 20 years. Another option would return to your beneficiary the remainder of the money originally paid in.

Each monthly payment is partly returned capital and partly earnings. An annual statement provides all you need to know for income-tax purposes.

"They're not complex," Ron Gebhardtsbauer, senior pension fellow for the American Academy of Actuaries, said of immediate annuities. He said he talked his mother into getting one when she turned 70 and faced having to withdraw a monthly minimum from her I.R.A., a process that would make it eventually dwindle to nothing.

Women typically have greater need for annuities and must pay more for them than men — except in corporate groups, where unisex mortality tables are mandated by law. Sixty percent of women who reach 65 survive to 85, according to the actuarial academy, while only 47 percent of 65-year-old men reach that milestone.

"Women often have less money — and they live longer," said M. Cindy Hounsell, executive director of the Women's Institute for a Secure Retirement. "We're big fans of the immediate annuities."

Generally annuities are quoted not in percentages but in the number of dollars for specified terms, which can change weekly or even daily. That can make for some tricky comparison shopping.

One standardization effort is a calculation of "implied longevity yield" being devised by Cannex Financial Exchanges of Toronto. Cannex's calculations are meant to help an investor compare the return on an annuity to that of an alternate investment, like a portfolio of stocks and bonds. That might help in deciding whether to buy an annuity now or to delay. The longer you wait, the less an immediate, fixed annuity generally costs — because your life expectancy is shorter and the insurance company assumes that it will pay out less money.

While divergences in cost are not usually large, insurance companies are free to use established mortality tables or their own proprietary ones. Mr. Stern cautioned, for example, that TIAA-CREF, which in most investment areas is one of the lowest-cost financial groups, offers annuities that are priced higher than others because its mainly academic constituents tend to have longer-than-average life spans.

Sales agents do not charge a commission for immediate annuities, but they typically earn 2 or 3 percent of the initial amount from the insurance companies; this is factored into the price, specialists said.

Despite their appealing features, annuities of any type have yet to win over most financial planners.

"There's too many fingers in the pie to have it make sense," said Robert E. Hurley, a principal at the Stoddard Management Company in Rockland, Mass. He said he could do better for clients by investing money directly in government agency bonds.

ANOTHER skeptical financial planner is Carol A. Wilson of Wilson Financial Advisors in Salt Lake City. Like Mr. Hurley, she makes a living from hourly fees rather than commissions on sales.

The cost of an annuity is too high for Mrs. Wilson's taste. For less money, she said, you can have professionals manage a portfolio containing stocks that can perform much better.

Nevertheless, she acknowledged that such resistance was starting to melt a bit "because of people living longer." She said she recently sold an annuity to a woman who could no longer stand the stock market's gyrations.

Even proponents caution against committing all of one's assets to contracts from which it would be costly or impossible to withdraw. They also recommend that potential heirs be consulted.

"Because it's not liquid," Mr. Stern said, "you need to be wary of putting every last penny in."