Rebutting Senseless Views On Index Annuities

BY THOMAS K. BRUECKNER

INDEX ANNUITIES, like all the tools in an advisor's tool box, are neither good nor bad; they are merely one tool among many, which—when properly used—can solve a myriad of problems for older baby boomer clients.

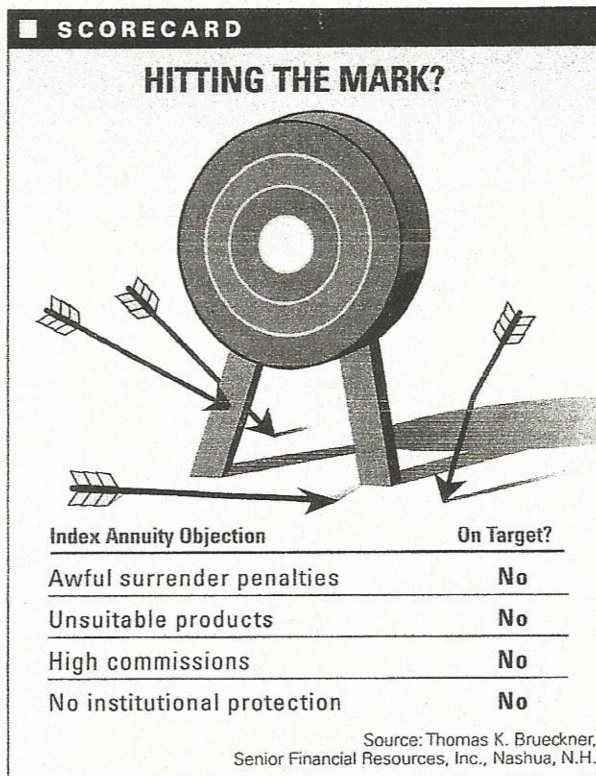
Example: On our recommendation, my client, a retired Army colonel, invested in several securities products from 1997 to 2000, doubling her individual retirement account. Then we recommended, and she agreed, to move into cash. Later, in July 2002, we recommended she move into an index annuity. In the next 7 years, her index annuity account credited over 49% interest—this during a period when the S&P 500 actually lost 4% (July 1, 2002 to July 1, 2009).

Thus, this retired officer has out-earned the S&P index by an astounding 53% in 7 years, earning index-linked interest during the gain years, and retaining that interest during the current recession.

She is typical of many in our client family. Yet despite many such stories, annuity-averse advisors still disparage and even vilify index annuities. Some say the products have no place whatsoever in a baby boomer's retirement portfolio.

Let's examine several of their favorite objections:

Those awful surrender penalties. Most annuities allow account owners to take up to 10% of contract value out each year, penalty-free, after which they will incur a surrender penalty on the excess. Logic dictates that retirees who spend down 10% of their IRA each year will run out of funds within 12 years; far sooner than the +20-year retirement most plan for.



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HITTING THE MARK?

Index Annuity Objection	On Target?
Awful surrender penalties	No
Unsuitable products	No
High commissions	No
No institutional protection	No

Source: Thomas K. Brueckner, Senior Financial Resources, Inc., Nashua, N.H.

By comparison, if a boomer were to lose—as many have—30% to 40% of their life savings in equities, wouldn't that also "penalize," even jeopardize, that boomers' latter retirement years?

Those unsuitable products. Critics ignore the fact that the Model Suitability Regulations that the National Association of Insurance Commissioners passed in 2007 established suitability guidelines. Indeed, today's insurers often reject business that places more than 50% of a client's investable assets into any annuity.

While the insurance industry is often turning away excess allocations to the safety of indexed annuities, some within the broker-dealer community are all too happy to place and keep as much as 85% of a 71-year-old's assets at risk in stocks, exchange traded funds, and mutual funds.

Many older boomers routinely tell us they have left advisors they've been with for 10+ years because those advisors refused to move them from risk to cash, even after repeated insistence to do so.

Those high commissions. Industry researchers say the average commission paid over the life of a typical 7- to 10-year indexed annuity is less than 7% of the initial value. Compare that to how advisors are typically paid for mutual fund sales.

On a $100,000 initial deposit, the typical mutual fund with an up-front load (A-share) followed by only a 1% annual management fee would yield over $17,000 in commissions to a registered rep. Meanwhile, an annuity agent would be paid less than $7,000 over that same 10-year period, assuming the $100,000 grows to $200,000 during that decade. The annuity might do this without risk to principal or each year's interest credits, but the mutual fund's values would be at constant risk to a market downturn. So, since commissions "ultimately come at the consumer's expense," which of these sums—under $7,000 or over $17,000—would most boomers prefer to pay over the next 10 years?

No institutional protection. In terms of long-term financial protection, all annuities are backed by the insurer's financial strength in addition to the capital reserve requirements of the 50 states, plus the state guaranty funds which provide a safety net that varies by state in a range of $100,000 to $300,000. Equities, including variable annuities, aren't protected by either.

The big question to ask boomers considering index annuities for a portion of their retirement is this: "What would you rather experience at age 71: 'missing out' on some of a gain, or watching nearly half of your life savings washed away by a stock broker's insistence that you're still 'a long-term investor at that age?"

Index annuities have never cost a single client a market-based loss, and they have spared millions of retirees the devastating losses that "stay-the-course" advisors have inflicted upon others. They are one tool among many, which—when properly used—can solve a myriad of problems for older baby boomer clients.

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