

# Investors take a shine to fixed and immediate annuities

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Immediate fixed annuities and deferred fixed annuities are finding a growing market in the wake of the financial market meltdown. It's no wonder. Their guaranteed payout rates are more than 8 percent and 5 percent, respectively at a time when the equity market is a seesaw of volatility.

New York Life, the leading seller of immediate fixed annuities, reported an 80 percent increase in immediately annuity sales in the first quarter of 2009 versus the prior year. Chris Blunt, executive vice president at New York Life, says fixed immediate annuity sales are soaring because people want secure income—and that should continue. Over at MetLife, the jump in sales of fixed deferred annuities is even more astounding: First quarter sales (deposits) totaled \$3.6 billion, up from just \$272 million a year ago. That translates into a 1,200 percent increase.

"For the first time, I can remember the sales of fixed annuities are bigger than variable annuities," adds Mike Farrell, executive vice president of retirement and wealth strategies at MetLife, New York. "Market turbulence and a flight to safety are driving sales. People want guarantees."

An April 2009 report by Conning Research, Hartford, says increasing sales of fixed annuities are a harbinger of things to come. The recession hit just as the Baby Boomer generation began to draw down their assets in retirement, igniting concerns about the preservation of capital and reliability of income, the report says—both things that are promised by fixed and immediate annuities.

But it can't hurt that registered reps get attractive compensation for selling these instruments, either, and that so many of them are badly in need of some extra revenue right now since revenue from fees on assets is way down. Immediate fixed annuities pay a 4 percent upfront commission. Some carriers, however, have trailing commissions. On the deferred fixed annuity side, commissions run about 2 percent with no trails and another 2 percent when the rate renews.

With an immediate fixed annuity, which is irrevocable, policyholders invest a lump sum in return for insurance company guaranteed income, generally monthly, for as long as they live. Only about 40 percent of the income is taxable. The rest is considered a return of principal, according to the IRS. By contrast, deferred fixed annuities pay a declared rate of interest for a specific period. The money grows tax deferred until maturity. Unless the assets are rolled over into another annuity, the policyholder pays ordinary income taxes on the earnings. If the annuity is cashed out prior to maturity, the policyholder pays back-end surrender charges.

Last year was a ground breaking year for fixed annuities. Industry wide, immediate fixed annuity sales hit \$2.4 billion in 2008, representing a 30 percent increase over 2007, according to Beacon Research, based in Evanston, Ill. While sales of all types of fixed annuities hit \$107 billion in 2008, a 60 percent increase versus 2007.

Blunt of New York Life expects strong sales of immediate annuities to continue. Average middle income individuals, who are at least 65 years old, have lost a lot of money in their retirement accounts, he says. They are putting money into immediate annuities for guaranteed income to cover basic expenses such as food and shelter. Meanwhile, affluent individuals are turning to immediate fixed annuities as a proxy for bonds. Immediate fixed annuities provide higher income than bonds with less volatility. Registered reps also can use short-term immediate annuities for

monthly income until their clients collect social security. This way, social security payments can be delayed, allowing retirees to reap higher payments later in life.

A 65 year-old, Blunt says, can expect to get \$650 to \$700 per month for life with a \$100,000 lump sum investment. That translates into a payout rate of 8 percent, based on the person's life expectancy and insurance company earnings in the fixed income market.

Fixed annuities (both immediate and deferred) tend to sell well in bear markets, especially when they are able to offer rates that are higher than bank certificate of deposits and Treasuries, says Judith Alexander, spokesperson for Beacon Research. "They (insurance companies) are able to do this when the yield curve is positive and/or corporate bonds are paying significantly more than Treasuries," she says.

Blunt of New York Life recommends anchoring a client's retirement portfolio with guaranteed sources of income. Then policyholders can tap other investments to help maintain current lifestyles and grow wealth to keep pace with inflation. For registered reps concerned about high inflation and interest rates, he also suggests laddering immediate annuities or investing in an inflation-indexed immediate annuity. With a ladder, annuity purchases are staggered over time. So when interest rates rise, the retiree can lock into a higher payout rate for life. Other investors can park money in a shorter-term fixed deferred annuity, and then will do 1035 exchanges into an immediate annuity when interest rates and payout rates rise.

Separate studies, by Conning Research, Hartford, and Moshe Milevsky, finance professor at York University, Toronto, indicate that adding an annuity to a portfolio of stocks, bonds and mutual funds decreases the probability that a retiree will run out of money. Plus the overall portfolio's risk-adjusted rate of return is higher than that of a portfolio without an immediate annuity, they reported.

About 15 percent of immediate fixed annuity sales and over 25 percent of deferred fixed annuity sales come from the broker-dealer network, according to Beacon Research and LIMRA International, Windsor, Conn. Alexander, however, says the broker-dealers' share of this market may be higher because most broker-dealers run some sales through independent marketing organizations.

The most popular terms for fixed annuities are 3, 5 or 10 years, the company says. The payout rates on these annuities are 5 percent or more. Farrell of MetLife says the average investor in fixed annuities is 57 years old and the average investment, \$60,000. IRA and 401 (K) rollovers account for 50 percent of fixed annuity sales.

Fixed rate annuities with market value adjustments (MVA) are also popular, particularly in the broker-dealer channel, Alexander reports. Generally, these products pay higher rates of interest, however clients assume more interest rate risk if they withdraw during the surrender charge period. The value of the client's principal is based on the change in a stated interest rate benchmark, such as Treasuries, since the contract was issued. If rates are higher when the client withdraws, the account value declines, based on the formula. If rates are lower, the account value is greater.

Unfortunately, there is no free lunch when it comes to immediate or fixed annuities. Many states nationwide have been cracking down on the sale of annuities and investment products--particularly to seniors. Policyholders also pay state premium taxes on their purchase. The tax is factored into premium payments. Once someone signs an immediate annuity insurance contract, the policy can't be surrendered. Some products however offer the policyholder a window to withdraw cash in exchange for lower payout rates. On the fixed annuity side, investors pay back-end surrender charges and ordinary income tax on the earnings unless they roll the matured fixed annuity into a new one.

John Catalfamo, president of Primoris Capital Management, a Palm Beach Gardens, FL-based tax and money management firm, says he's met with a lot of seniors, stuck in low fixed rate annuities due to steep surrender charges. In addition, many are unaware they owe taxes on the annuity income when it matures.

"We had people come in at tax time that don't have the cash on hand to pay the income tax on the annuity," he says. "They reinvested the annuity proceeds in other types of investments." In addition, insurance companies, which guarantee the annuity contracts, have been hitting hard times. It is important for your client to stick with the financially strongest insurance companies, rated A+ to A++ by A.M.Best.