
'Annuitize Part and Invest the Difference'

By Curtis Cloke Tue, Sep 21, 2010

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After reading in Retirement Income Journal about the recent government hearings on so-called [401\(k\) annuities](#), it amazes me how often the proverbial myths of "loss of control" and no "liquidity" continue to be spewed about the use of annuitization. The reality is that annuitization, properly positioned, gives retirees more liquidity and more control over their money.

Those who favor guaranteed lifetime withdrawal benefits (GLWBs) on deferred variable or fixed indexed annuities typically focus on the "life only" feature of income annuities. But that is rarely the most optimal or appropriate annuitization option. By using Period Certain, Life or Joint Life with Period Certain, or Installment Refund payouts, retirees can often create income solutions that require even less investment than GLWBs to produce the same level of income.

Those options are the foundation of what I call the "Annuitize Part and Invest the Difference" story.

Many of the single-premium immediate (SPIA) and deferred income (DIA) annuity contracts that my clients purchase allow "living commuted value" to the annuity owner. This means that the annuity owner has the option of withdrawing cash from the annuity if he or she decides, at some future date, that liquidity is more important than preserving the income stream the client originally purchased.

The liquidity options of these living commuted withdrawal options usually have some limitations or restrictions. But the same can be said of deferred annuities with GLWBs, which may have surrender periods or roll-ups that are cancelled by withdrawals.

Since the income annuity may cost less (to generate the same amount of income) than a deferred annuity with a GLWB, the remainder of the portfolio isn't hostage to those restrictions. It can be used for additional liquidity or potential long-term growth without harming the future income stream. The longer the client can let the unfettered asset to grow, the more liquidity they can provide.

At the same time, thanks to the Period Certain feature, much of the future income from the contract annuity comes back either to the owner or the heirs. When the Period Certain is combined with a Life or Joint Life option, the contract owner earns "mortality credits" that bring income up to the same level as the income stream from a GLWB.

The argument for the deferred variable (or fixed indexed) annuity with a GLWB is that the entire sum is liquid. This is a Catch-22. I call this type of thinking "psychonomics," not economics, because the liquidity comes at a severe price. The anticipated level of income shrinks if too much of the money under the income rider is withdrawn.

Under the typical GLWB, if a retiree withdraws more assets in a single year than the contract permits, it diminishes the benefits. The “Annuitize and Invest the Difference” option, on the other hand, creates liquidity that does not cannibalize the income or consume the portfolio—as long as the client’s combination of income annuities and at-risk investments are properly positioned relative to the client’s age.

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