Retirement Income
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Buenos DIAs

By Kerry Pechter *Wed, May 1, 2013*

It's morning in America for manufacturers of deferred income annuities, or DIAs. Are they a passing fancy, or do they offer the perfect balance between risk and reward?

"I just don't see the appeal of those products," said the executive of a large issuer of variable deferred annuities with lifetime income benefits. He was sipping coffee on the first morning of the recent Retirement Industry Conference in New Orleans and responding to a question about deferred income annuities, or DIAs.

In one respect, his comment was surprising. His company has sold billions of dollars worth of VAs with guaranteed minimum income benefit riders, which resemble DIAs. On the other hand, his comment wasn't all that surprising, because no one seems to have seen this product coming.

But it's here. A half-dozen insurers, some publicly held and some mutually owned, are marketing DIAs. Sales of DIAs are still barely a blip compared to sales of variable annuities or even indexed annuities. Nonetheless, it's the fastest-growing type of annuity, if only by virtue of having started from a base of virtually zero in 2011.

Anecdotally, DIA sellers say that near-retirees are buying DIAs for "pension replacement." If that's true, it would be heartening news for annuity marketers. It implies that a certain number of Boomers are now seeking products whose main purpose is retirement income, as distinguished from products that merely offer an income option. The beginning of the Boomer income bonanza may finally be at hand.

Or DIAs might be a passing fad. Their success may be a symptom of setbacks in the variable annuity space. The reductions in VA rider generosity may have left a small vacuum in the lifetime income market. Rising risk-aversion among both manufacturers and investors may also help explain why DIAs are attracting attention.

The principal irony of the DIA's newfound fame is that such a product has always been hiding in plain sight. Anyone could buy a seven-year fixed deferred annuity, for example, hold it to maturity and convert it to a customized lifetime income stream. But very few people ever did. Every deferred annuity was a potential DIA, albeit not one where the owner could lock in a future rate of income today.

A couple of observations about the emerging DIA market:

DIAs have eclipsed ALDAs. As recently as 2007 or 2008, academics were keen about a type of DIA that they called ALDAs (Advanced Life Deferred Annuities). These were long-dated, no cash value, life-contingent annuities that offered retirees an inexpensive way to isolate and eliminate the risk of living past age 85 or so. Only a few firms marketed them.

Actuaries, who tend to evaluate products in terms of their predictable aggregate benefits, loved ALDAs.

But individuals, whose experiences are unique, didn’t grasp their appeal. What worked in the lab doesn’t necessarily work in the marketplace. Curiously, DIAs are selling better today at lower payout rates than ALDAs did a few years ago at significantly higher payout rates. At that time, Boomers were still too obsessed with stocks to pay attention to an annuity with no link to equities.

The iPad of annuities. Instead of taking income within 13 months, as they do with a SPIA, or after 15 or 20 years, as they would with an ALDA, investors are using DIAs to set up an income stream that begins within five to 10 years after purchase. DIAs occupy a middle ground between SPIAs and ALDAs, in the way that the iPad and other tablet computers occupy a middle ground between the iPhone and the notebook computer. Few people predicted the wild success of the tablet, and few seem to have foreseen the modest success of the DIA.

Liquidity trumps income. Somewhat counter-intuitively, purchasers of DIAs are not maximizing the advantages that the product can potentially provide. According to reports from manufacturers, most DIAs are purchased not only with death benefits that return premium if the owner dies during the deferral period but also cash refund provisions after income begins. By choosing these options, purchasers eliminate at least part of the credit or dividend that mortality pooling can provide. People seem to prefer protecting their beneficiaries to maximizing their monthly payment.

Channel preference. The energy around DIAs seems to emanate mainly from the mutual companies that sell them through a career- or captive-agent force, and less so from the public companies that distribute their DIAs through third-parties or through a combination of career agents and third-parties. It’s possible that the DIA, like the single-premium income annuity, may lend itself more to the career agent channel, where insurance products are a familiar component of lifecycle financial planning, than to the more investment-oriented independent advisor channel.

Like the income annuity, the DIA may also not have the huge sales potential that publicly-held insurers need in order to satisfy shareholders’ appetite for earnings. The margins of the DIA may also be slimmer than those of variable deferred annuities, and therefore less able to support the kinds of sales incentives required for a product to compete for the attention of independent agents, broker-dealer reps and advisors.

What comes next? One could easily envision a retail client or a plan participant using a flexible-premium DIA to build a future pension over the course of a lifetime. The contributions could be assigned either to separate accounts for equity exposure or to discrete purchases of future income, priced at a steep discount.Several of the new DIAs offer deferral periods as long as 40 years or more, even though no assets are currently available to match such long-dated liabilities exactly.

The short-lived SponsorMatch partnership between MetLife and BlackRock would have created exactly that type of vehicle. Today’s DIAs are interesting, but, as currently structured and used, with such a short period between the purchase date and the income start date, they deliver less value than they’re capable of. Of course, annuities can’t deliver any value at all unless people are willing to buy them.