Build a Ladder of SPIVAs

By Editor Test *Sun, Jun 7, 2009*

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Variable payout annuities have never captured much wallet-share among retirees, but a lot of pension wonks still regard them as an ideal retirement income solution. Like fixed income annuities, they offer the "survival credit" that comes from mortality risk pooling. Like VAs with living benefits, they offer exposure to a mix of stocks and bonds throughout retirement. Their only drawback: insufficient liquidity.

But a new research paper, published in the February 2009 issue of the *Journal of Pension Economic and Finance* shows that retirees can work around that liquidity problem by transferring assets incrementally from non-annuity accounts to single premium income variable annuities (SPIVAs) in retirement and by adjusting the asset allocation of both types of accounts to suit personal risk tolerances.

The paper, "Variable payout annuities and dynamic portfolio choice in retirement," was co-written by **Wolfram J. Horneff**, **Raimond H. Maurer** and **Michael Z. Stamos** of **Goethe Universit**y in Frankfurt, Germany, and by **Olivia S. Mitchell** of the **Wharton School** at the **University of Pennsylvania**.

"We show that a rational investor would not fully annuitize all her money immediately at retirement even without any bequest motive" because of the illiquidity of income annuities, the authors wrote. "Instead, she will initially annuitize only a portion of her money, and then gradually buys more annuities throughout retirement. Furthermore, she will optimally replace stocks with bonds over time in both her liquid savings and annuities."

This strategy gives retirees access to the "equity premium" associated with stock ownership and the survival credit offered by income annuities. The researchers assumed that a person of moderate wealth and moderate risk-tolerance with no intent to leave a bequest would put 75% of her wealth in variable payout annuities at retirement and gradually annuitize the rest by age 80/

"Ultimately, our work suggests that policymakers as well as designers of defined contribution pensions and individual retirement accounts would do well to add variable payout annuities to the set of payout options, in order to boost the efficiency of retirement decumulation strategies," the paper said. "In sum, combined investment and insurance solutions offer efficient and attractive ways to finance retirement."