Energize a SPIA with Equities: Cannex

By Kerry Pechter *Tue, Feb 1, 2022*

A new Cannex white paper shows how a single-premium immediate annuity (SPIA) combined with a strong equity allocation can make savings last longer in retirement and still provide a substantial legacy.

If common sense were more common, most people would easily recognize that if they bought a lifelong income annuity with a chunk of their savings, they'd be less likely ever to run out of money.

But some people are from Missouri, or other skeptical regions where you have to "Show Me." So scholars like Moshe Milevsky of York University and Wade Pfau of The American College have demonstrated, with mathematical precision that people who add income-generating annuities to their retirement portfolios will reduce their "longevity risk"—their chance of running short of their target income before they die.

Now, in a recent white paper, Tamiko Toland of Cannex, the source of current annuity rates and other retirement resources, has reiterated the logic of income annuities. She uses the Cannex PrARI (Product Allocation for Retirement Income) modeling tool to show how an annuity can improve the Retirement Sustainability Quotient (RSQ, or probability of maintaining the target income for life) of a typical equities-and-fixed income retirement portfolio.

Tamiko Toland

Cannex hypothesized the RSQ and residual wealth of a 65-year-old man with $1 million in savings and a target annual income of $50,000 (in addition to Social Security benefits). With zero to $300,000, he buys a single premium immediate annuity (SPIA) with a 2% annual inflation rider that pays out an initial $4,950 per year per $100,000.

By my count, Cannex tested 42 possible allocations. Seven different amounts are allocated to the annuity (zero to $300,000) and the annuity is either paired with a balanced fund of $1 million (allocated 30%, 60% or 70% equities and the rest allocated to bonds) or it replaces part of the bond allocation in a $1 million portfolio.

You can see all the details in the **report**. It suggests that a portfolio of $700,000 in equities and a $300,000 annuity would optimize the portfolio's likelihood (about 85%) of generating a $50,000 annual income over the man's lifetime while providing the largest possible legacy ($265,000) to his heirs or beneficiaries when he died.

In every simulation, adding the annuity to a blend of stocks and bonds reduced the man's legacy but, as expected, raised his RSQ. To use a sailing metaphor, a ship carrying extra ballast in the hull (the annuity), sails faster when you add extra canvas (equities).

Toland favors SPIAs over variable annuities (VA) or fixed indexed annuities (FIA) with living benefit riders. "The FIA has a shady history and often uses esoteric indexes that are difficult to understand and impossible to compare," she writes.

"The VA is expensive and the guarantee is complicated… the client ends up paying for the cost of a benefit (even when [the cost] is not explicit, as is the case with many FIAs) whether they end up using it for its intended purpose or not."

In saying, "The FIA has a shady history," I assume Toland is referring to the reasons why state attorney generals, the Securities and Exchange Commission and the Department of Labor each tried to regulate FIAs at some point during the past 20 years. Annuity industry opposition stopped the SEC's and the DoL's attempts in 2007 and 2018, respectively, to regulate FIAs more closely.

If SPIAs are so great, why don't more people buy them? Some observers blame low interest rates, which reduce the payout rates of SPIAs. But SPIAs were no more popular when interest rates were higher than they are today. A big part of the answer is that SPIAs aren't lucrative enough for most insurance agents or for most life insurance companies.

SPIAs don’t pay very high commissions to independent agents and brokers. And, as a product category, they don’t yield the double-digit profit levels that shareholders of publicly traded life insurance companies demand.

That’s why mutual insurance companies like New York Life and MassMutual—owned by their policyholders—sell the most SPIAs, especially through their employee-agent force. While mutual companies need to be profitable (and pay a consistent dividend to policyholders), their business models allow them to sell modest products like SPIAs.