
Five Questions to Ask about DIAs

By Kerry Pechter *Sat, Jan 19, 2013*

If you're determined to think of DIAs as investments, they're probably not for you. But if you think of them as insurance against longevity risk, they can make sense for clients with \$500,000 to \$1 million in investable assets.

In their quest for low-risk yield, investors and advisors have looked into every financial nook and cranny that they can dream of. That search has helped to turn a former step-child of the annuity world into a Cinderella.

We're talking now about deferred income annuities (DIA), aka Advanced Life Deferred Annuities (ALDAs), aka longevity insurance. If your client has a good chance of living to age 90 or 95, he or she might consider buying this.

Until mid-2011, few people other than annuity wonks like [Moshe Milevsky](#) of York University or [Jason Scott](#) of Financial Engines championed DIAs, which allow a person to fund an income that starts up to 40 years after purchase. Advisors and the public largely ignored it.

Things began to change in 2011, after New York Life introduced a DIA called the Guaranteed Future Income Annuity. Sales rapidly crossed the \$1 billion mark, which is lemonade-stand money on Wall Street but a large sum in the income annuity world. Soon MetLife, Symetra, MassMutual, American General (AIG) and Guardian were dusting off existing DIAs or christening new ones. Just last week, Fidelity announced that it had added MassMutual's RetireEase Choice DIA to its Fidelity Insurance Network platform, along with the New York Life Guaranteed Future Income Annuity II.

Why the surge? Part of the explanation has to be that, in a low-yield era, people can get an attractive discount on future income by buying it a decade or more in advance. A life insurer who issues the contract can offer a discount for two reasons: because the premium generates interest during the deferral period and because (in the case of a life-contingent DIA) the annuitant may not live to collect.

If you're determined to think of DIAs and other income annuities purely as *investments*, and you hear an internal voice asking what their IRRs are, they're probably not for you. But if you think of them as *insurance* that relieves your client of the need to hoard cash against the possibility that he or she *might* live to age 90 or 95, then DIAs can make a lot of sense... at least in principle.

Consider the [Guardian Life SecureFuture DIA](#). Today, if a man plops down \$100,000 at age 45 for a Guardian DIA, he can get \$22,386 a year for life at age 75, with income guaranteed for at least 10 years. The contract pays a cash refund if he dies during the deferral period. Time is money, of course: If your client has just turned 60 and wants to buy that DIA, he will get only about \$13,100 a year at age 75, thanks to the shorter deferral period.

To get the maximum value out of a DIA, you should do what few people choose to do in practice: take a life-only DIA contract that doesn't pay out until after age 85, when a 65-year-old's chance of still being alive is

about 50/50. For instance, for \$100,000 at age 60, [MetLife](#) will provide a man with a single life-only contract that pays \$42,400 (for a woman, it's \$41,000) starting at age 85.

You can buy a DIA with either after-tax or qualified money, but the required minimum distribution requirements add a wrinkle (though not necessarily a serious obstacle) to the use of qualified money. If you're looking for a deep-dive analysis of the DIA, and a comparison between DIAs and GLWBs, I recommend papers that Joe Tomlinson, CFP, wrote for *Advisor Perspectives* in [March](#) and [April](#) of 2012.

One nice feature of most of the current products is that they allow flexible premiums. A person can open a DIA for as little as \$5,000 or \$10,000 at age 40, say, and add to it over time. Contract owners don't have to commit all of the money during today's low-rate environment.

Given the long-dated nature of the guarantee, you naturally need to buy from a life insurer with stellar financial strength ratings. Independent advisors who make their living from a percentage of AUM may still be able to earn a fee, albeit a smaller one, from the money that goes into the DIA. But that's a topic for another day.

Questions you might ask your or your client when considering a DIA:

1. Does your client have \$500,000 to \$1 million in investable assets? If so, he probably has enough liquidity to apply 10% to 20% toward eliminating his risk of living a very long time, and not so much wealth that he can easily self-insure against longevity risk.

2. Is your client, or your client's spouse, a healthy, non-smoking woman? If so, there's a good chance she will be alive for five to 10 years after age 85, and able to collect the benefit. Like diamonds, a DIA can be a girl's best friend.

3. If you decide to buy, how should you design the contract? DIAs come with most of the same options that you'll find in single-premium immediate annuities, including cash refunds, joint-and-survivor payouts, periods certain, and inflation adjustments. The product costs the least (and, conversely, has the highest risk of forfeiture) when there's no cash value and income starts after age 85. Most clients will choose to give up some income in favor of some protection against forfeiture.

4. Does your client have a strong bequest wish? This is a trick question. Under the typical scenario, someone who wants to maximize his bequest to heirs is a terrible candidate for a life-contingent annuity. On the other hand, someone who knows he has an income starting at age 85 may, as mentioned above, feel less pressure to hoard wealth right up until the time he dies. He can be more generous during his lifetime.

5. Do you think a longevity annuity would allow you to invest the client's remaining money with more freedom? The biggest benefit of a DIA, or any income annuity, may be the added risk it allows a client to take with the rest of his money. A 60-year-old client with \$1 million and no DIA has to be careful with his money. A 60-year-old with \$900,000 and an annuity that pays \$40,000 a year in 25 years can arguably take on more investment risk and worry less about the future during the interim. The potential gains from greater risk-taking could offset the price of the annuity. On the other hand, if your client intends

to be cautious with his \$1 million anyway, and has a strong “bequest motive,” there may be little opportunity lost by foregoing the annuity.

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