Retirement Income
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Get Smart

By Editor Test *Wed, Oct 21, 2009*

With its inflation-adjustments and liquidity features, Lincoln's new SmartIncome SPIA is designed to answer the usual objections to income annuities.

It's never been dumb to call a product "Smart." There are Smart Cars from Daimler AG, Smart Menus at McDonald's, a Smart Payment Program at Fidelity, Smart Balance margarine, and even Smart Toilets that take your vital signs when you're not looking.

Not to mention *SmartMoney* magazine. And who can forget the "Smart. Very Smart." commercials that the Smothers Brothers made for Magnavox compact disc players in the late 1980s.

When Lincoln Financial Group introduced its SmartIncome single-premium immediate annuity (SPIA) in 2007, the campaign didn't initially look very smart. With the Iraq War/real estate bull market near its dizzy peak, investors were chasing risk, not running from it.

But since the 2008-2009 crash, Boomers' appetite—or curiosity, at least—regarding income annuities appears to have quickened. Hints of demand for products like SmartIncome inspired Lincoln to support it with a new marketing push this fall.

"Pockets of the market have started looking at the product," said Kris Kattman, vice president and associate actuary at Lincoln, who helped design SmartIncome. "We still have a way to go to penetrate the wider market. But we've steadily seen more interest and more applications all year long."

SmartIncome was designed to overcome the usual objections to income annuities. People don't like the forfeiture inherent in life annuities, so SmartIncome pays a lump-sum death benefit equal to the unpaid premium, if any, when the owners die.

People don't like the illiquidity of income annuities, or the level payments of fixed income annuities. SmartIncome lets the owners access up to 10% of their unspent premium each year without penalty. As for inflation, both the monthly payments and the death benefit are indexed to the Consumer Price Index-Urban.

"We recognize that people don't like to give up control, so we said, you can take up to 10 percent with no surrender charge. Beyond 10% we charge the equivalent of a surrender charge," Kattmann said. "If the owners want to liquidate the contract entirely, they can."

Such flexibility inevitably comes at the expense of the payout rates, however, and the interest generated by all the new flexibility is likely to die when prospects find out how low the initial payments will be.

For instance, the current average payout for an inflexible, no-cash value SPIA is about $650 a month for a 65-year-old man with a $100,000 premium. Lincoln didn't quote prices on SmartIncome, but the payout of a roughly comparable inflation-protected SPIA with a cash refund feature from Vanguard is currently only $436. Moreover, Kattmann said the payout from SmartIncome, with its 10% annual withdrawal feature, would probably pay about “10 to 15 basis points” less than the typical inflation-adjusted, cash refund SPIA.

SmartIncome is available through all of Lincoln’s distribution channels, Kattman said. “Not many broker dealers have added it to their lists, but we’re working on that,” she said. The product offers intermediaries a choice of compensation streams: three percent upfront commissions with a 0.25% annual trail or an annual one percent trail. Both are comparable to similar products offered by other issuers.

In recent years, other insurance companies have tried to achieve a compromise between liquidity and payout rates in income annuities. But that’s a tall order, since annuities are like Chinese finger puzzles—they tighten as the stretch. Like the bonds on which they are based, their yields are inversely related to their liquidity.

New York Life, the most prolific seller of immediate annuities, offers a cornucopia of options on its SPIAs, including one where the payout rate resets if the 10-year Treasury rate has risen by two percentage points or more by the fifth contract anniversary. Presidential Life recently introduced a two-tier joint-life SPIA that perks up payout rates by limiting the duration of the second annuitant’s payments to life or a period certain, whichever comes first.

There’s a market for such products, but not as large a one as many economists believe there should be, given the gradual disappearance of corporate defined benefit pensions. For the first half of 2009, SPIA premiums were only $3.8 billion, or about three percent of the annuity market, which itself is only a small fraction of the mutual fund market. Academics have a name for feeble SPIA sales. They call it “the annuity puzzle.”