Inflation-Adjusted Income Annuities Pay Off, Study Asserts

By Editor Test *Sun, Jun 7, 2009*

People who assume 3% average inflation—a common standard—when planning for retirement may have far less purchasing power in retirement than they anticipated, says Felix Schirripa.

Two-thirds of all retirement periods since 1915 have seen an average annual inflation rate higher than 3%, and inflation averaged more than 4% for almost half of all retirements in that period. The last 30-year retirement period to experience inflation of 3% or less ran from 1938 to 1968.

Given that record, people who assume 3% average inflation—a common standard—when planning for retirement may have far less purchasing power in retirement than they anticipated, according to a new study by Felix Schirripa, a pension actuary whose website, **ELM Income Group**, advocates inflation-adjusted income annuities.

"History indicates that inflation during a 30-year retirement period will run closer to 4% than 2% or even 3%," Shirripa said. During 768 30-year retirement periods over the 94 years to be above 3% for 64% of the periods, and above 4% for 45% of the periods, he found.

In his study, **"Immediate Annuity: Fixed vs. Inflation-Protected, A Cost Comparison,"** Schirripa compared annuities with and without an inflation rider on a pre-tax and post-tax basis under various assumptions and found that "the difference between 3% inflation and 4% inflation sounds small but can compound over time to a very significant difference. After 15 years in retirement, for example, there is a 16% difference in purchasing power. After 20 years, it's 21%.

Although the starting payments of inflation-protected annuities are typically 25% lower than the comparable SPIAs on a pre-tax basis, this difference is much less on an after-tax basis (for non-qualified purchases) and then shrinks as the inflation-protected annuity payments increased with inflation.

For example, if a fixed annuity has pre-tax monthly payments of $1,000, an inflation-protected annuity might start with payments of only $750, or 25% less. But Schirripa claims that on an after-tax basis (for annuities purchased with non-qualified money) the difference would be as narrow as 17%, depending on the annuitant's tax bracket. In one high-inflation example he cited, an inflation-adjusted annuity paid 25% more income over 25 years than a level payout annuity does.