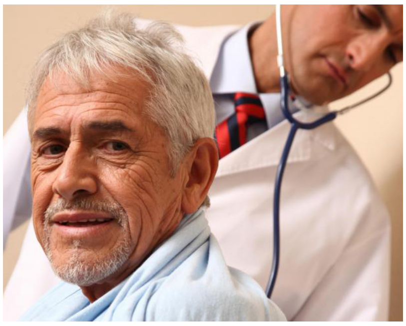
Making Income Rise as Health Declines

By Kerry Pechter *Thu, Oct 3, 2019*

A fee-only adviser in Philadelphia used 'medically underwritten' or impaired annuities from Mutual of Omaha to increase the retirement incomes of older, single men in declining health.

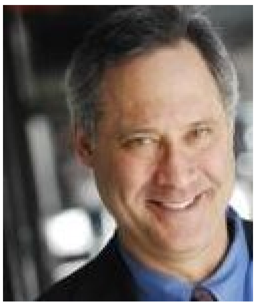


Pilates lovers, vegetarians and never-smokers are not the only people who should, can, or do buy life-contingent income annuities. People in poor health can get attractive annuity payouts by purchasing so-called impaired or "medically underwritten" income annuities.

Such purchases are rare in the U.S., to be sure. Only Mutual of Omaha offers a single premium income annuity with an impaired option, and its sales in this niche are slim. (Genworth dropped its offering last May when it suspended intermediary-sold products.)

But sales of impaired annuities aren't entirely theoretical. Russell Wild, a fee-only planner in Philadelphia, has helped guide two clients—both older men in poor health without spouses, children or other legacy concerns—through the annuity purchase process, in part by showing them that the heightened yield from an impaired annuity would lighten the necessary withdrawal rate from their liquid investments.

A 7.32% annual yield



Russell Wild

One such client was a 68-year-old optometrist with a 50/50 portfolio of no-load funds from Vanguard and State Street Global Advisors that was worth about $700,000. "For a portfolio of that size I usually recommend 12 or 13 funds and ETFs," said Wild, who is the author of ***Investing in ETFs for Dummies*** (Wiley, 2015) and other financial books.

"He was planning to retire that year because he had had several heart operations. He'd been in and out of the hospital," said Wild, who worked with the client on an hourly fee basis, as he often does. "I thought that he might qualify for a 'medical markup' on an annuity, so I sent him to **immediateannuities.com** for a quote." When the client called the agent, Wild was on the call too.

After submitting a sheaf of medical records to Mutual of Omaha for review, the client's actuarial age was adjusted upwards by six years, to age 74. In other words, he received the same payout rate as a 74-year-old man. The annuity income plus Social Security would be more than the $50,000 that he was still earning by working part-time.

The client wanted $60,000 a year. "So we decided to use $300,000 of his IRA money to buy an impaired life annuity with a starting payout of $1,830 a month and a 2% annual cost of living adjustment (COLA), for a 7.32% yield. I suggested he take Social Security at age 69, which would give him another inflation-adjusted $2,650 a month."

After an underwriting process of about six weeks, the client bought the annuity. The combined Social Security and annuity income was $53,764. To reach the desired $60,000, he would draw just over $6,000 a year from the $400,000 that remained in mutual funds and ETFs. The annual withdrawal rate on the 70% equities/30% fixed income funds would be about 1.6%.

[At today's rates, a $300,000 immediate life-only fixed income annuity for a 74-year-old man pays about 22% more per month than would an identical annuity for a 68-year-old man, according to immediateannuities.com.]

"When I mention annuities to a client, the first thing I say is, 'This is not a variable annuity,'" Wild told *RIJ*. "That puts them at ease. People are aware that annuities can have high commissions and are not always in the best interests of clients. I emphasized the simplicity of a SPIA contract. For comparison, I researched the income figures without the mark-up.

"But I was still on-the-fence myself about whether to recommend the annuity. My client could have withdrawn about five or six percent of his savings for life, which I thought wouldn't be more than 20 years," he told *RIJ*. Regarding the annuity inflation rider, Wild said he wasn't "wed to having an inflation-rider or no inflation rider."

A 12.63% annual yield

In a separate case, Wild arranged the sale of an impaired annuity to a 77-year-old widower who had recently been in and out of the hospital with various ailments. After reviewing his medical records, Mutual of Omaha rated his age at 82. “That made a substantial difference in price, because the mortality curve is steeper at that age. So we were looking at a 13% yield,” Wild said.

At the time, the client’s $600,000 portfolio was conservatively allocated to 40% stocks and 60% bonds. He already owned an income annuity paying $1,440 a month. He received an additional $2,505 a month from Social Security. To reach a desired income of about $90,000, he needed about $40,800 more per year. He could have achieved that by withdrawing about 6.8% a year from his portfolio.

Wild thought 6.8% “was pushing” the limits of safe withdrawal from a $600,000, so they explored the idea of taking pressure off the withdrawal rate by buying a medically underwritten annuity. They used $100,000 from the client’s own IRA and $100,000 from an IRA he inherited from his late spouse.

The impaired annuity would produce $2,105 per month or $25,260 each year for a yield of 12.63%. To reach his income goal (above the two annuities and Social Security), the client would need to withdraw only about $16,000 from his remaining $400,000 portfolio, for a withdrawal rate of just 4% a year.

Wild said the impaired annuities helped his clients cover all their basic living expenses at a reduced cost, and that the chance still exists that they will outlive actuarial expectations. “I know a woman with stage four breast cancer,” he told *RIJ*. “Doctors told her she’d be dead in six months. That was 10 years ago.”

The underwriting process

Mutual of Omaha’s Ultra Income SPIA is the product that Wild’s clients purchased. The contract itself is not built for health-compromised clients, but “income enhancement is available for impaired risks,” according to contract information provided to *RIJ* by the insurer. The underwriting process works as follows:

- The producer completes the SPIA quote application, choosing “rated-age SPIA.”
- The application and pertinent medical information are emailed to the home office. Medical information should include at least 12 months of pertinent medical records.

For example, if the client has a history of heart disease and cancer, include cardiology and oncology records.

- The application and medical records are reviewed by a Medical Director. Based on his or her review, the Medical Director assigns a rated age. The rated age reflects the life expectancy of the applicant based on their age, sex and medical condition. For example, a 65-year-old male applicant might have a heart condition that makes his life expectancy the same as a 70-year-old male’s. The rated age in this example would be 70.
- The rated age is reported back to the producer, who runs a new illustration using the rated age to determine the annuity payout for the selected income option and presents this to the client. Continuing the example above, the illustrated payout for a 70-year-old male would be higher than that for a 65-year-old male. The difference between the annuity payout for the rated age and the annuity payout for the actual age is the income enhancement provided for by the impaired risk underwriting process.
- If acceptable to the client, the producer then submits the rated age quote with the formal application for final review and issuance of the policy.