
New Income Solutions for Long Retirements

By Editor Test *Thu, Jan 20, 2011*

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As Americans live longer—20, 30 or even 40 years into retirement—and depend less on Social Security and defined benefit plans for income, the need for longer-term retirement income solutions is greater than ever.

Longevity insurance annuities, also known as deferred income annuities, may provide part of the solution. These annuities are usually purchased at retirement, but don't make their first income payment until a pre-determined future date, typically 10 or 20 years later.

For example, a 65-year-old might buy an annuity that provides a monthly distribution check starting at age 80 or 85. The older the contract owner is when payments begin, the less the annuity will cost initially. Longevity insurance annuities may therefore help provide a source of guaranteed income for people who live beyond the average life expectancy.

This income stream is life-contingent, however. That is, the annuities generally have no cash value if the owner dies before the income start date. This may be one of the principal reasons few financial advisors have considered them, and why they do not appear on many investment platforms. But, with the numbers of people over age 100 growing rapidly—more rapidly than any other age group— there is an equally growing need for advisors to consider an array of retirement income solutions.

Longevity Annuities—Often Overlooked

Although privately purchased annuities are the only commercial source of guaranteed longevity protection, they still aren't widely available on the platforms through which most advisors deliver retirement products and services to individuals. Most asset allocation models, for instance, have no "longevity bucket" that reserves a spot for annuities in an individual's retirement income plan.

At the same time, longevity insurance products don't easily fit the fee-based compensation structure toward which more advisors are moving. Simply put, fee-based advisors get paid based on assets under management, and pure longevity insurance isn't a liquid, quantifiable asset. So even those advisors who might believe longevity insurance is right for their clients must leave the managed account structure to purchase it.

If longevity insurance were an asset class in the traditional sense, incorporating them into existing platforms might be easier. But, while stocks, bonds and commodities are all classified by the levels of *market risk* to which they are exposed to, there is no traditional classification for the longevity risk—the risk of outliving one's savings—that deferred income annuities address.

Longevity Insurance and Managed Account Platforms

Despite significant effort, the wirehouse brokerage community has been slow to integrate longevity products into its asset allocation models. We estimate that only about 10% of wirehouse advisors and 25% of independent advisors regularly sell annuities. In other words, 75% to 90% of advisors may have clients who want or need longevity insurance but aren't getting it. While there has been some innovation by smaller brokerage firms, wire houses tend to be extremely proprietary with asset allocation models and resistant to outside asset allocation methodologies.

We expect a variety of non-insurance financial firms to design and build new products incorporating or complementing longevity insurance and income annuities. The aim of such new products wouldn't be to displace existing annuity providers—most investors don't use annuities anyway—but to reach the clients who have unmet needs for longevity protection.

These new products would likely provide flexibility, liquidity, and resistance to inflation—as well as the ability to reside on the platforms that managed-money advisors use. It will undoubtedly be a challenge to incorporate these products into existing asset allocation and optimization models as well as brokerage platforms. But in the long run, the resulting benefits for retirees, advisors, and providers should make the effort worthwhile.

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