
Remember the Alamo... and the Annuities

By Editor Test *Wed, Oct 3, 2012*

At the Financial Planning Association conference in San Antonio, it was hard to forget The Alamo, only a few blocks away. But people had amnesia about annuities.

The flour tortillas, refried beans and jalapeno peppers that they served at the Financial Planning Association Experience 2012 conference in San Antonio this week were piping hot and on everyone's lips. The same could not be said for the topic of annuities.

I had traveled southwest to the home of The Alamo on Saturday to pay homage to Davy Crockett, king of the wild frontier and 1950s pop culture icon, and to learn what advisors think about retirement income in these famously uncertain times.

For many CFPs, annuities are apparently not front-of-mind—unless you mean the universal inflation-indexed annuity sponsored by Uncle Sam. On Sunday, for instance, CFPs packed a medium-sized ballroom to hear William Meyer and William Reichenstein explain how to squeeze the most income out of the Social Security entitlement.

Did you know that two giant “rat-holes”—low spots in the deferral premium curve—are hidden in the Social Security claiming calendar, and that if you claim at the wrong time—say, close to Full Retirement Age—you can fall into one of them?

“Ninety-five percent of advisors screw this up,” warned Bill Meyer. He confessed that he himself had screwed it up for years before he and Reichenstein wrote a book [“Social Security Strategies” (self-published, 2011)] and software about how to do Social Security right.

The short version of their talk: Your clients should claim at age 70 if they or their spouses expect to live past age 80½. And they should never claim benefits during the “rat-holes” (from age 62 yrs, 1 mo to age 63 yrs, 11 mos, and from age 65 yrs, 5 mos to age 66 yrs, 7 mos).

Only seven years ago, at the start of a bull market in equities, the nation flirted with privatizing Social Security. But at a time when interest rates are vanishingly low, it's little wonder that appreciation for the 75-year-old New Deal relic has grown. (It's also little wonder that, with a government-sponsored annuity as rich as Social Security, so few people buy private annuities.)

Despite the fact that at the conference the FPA honored Wade Pfau, Ph.D., the young Princeton-trained economist who has calculated the [benefits](#) of blending systematic withdrawal and life annuities for maximum retirement income, most CFPs and registered investment advisors (RIAs) still don't devote much mental space to retail annuities or to the so-called survivorship credit that they offer.

For instance, during the Q&A after their session on “Integrating Retirement Planning Research into Your Financial Plan Implementation and Client Communication,” Jonathan Guyton and Dave Yeske were asked

why they hadn't mentioned annuities.

"I focus on the value of flexibility. I hate making irrevocable decisions with my clients' money. I have a bias against annuities for that reason," said Yeske. Guyton, who has written extensively on safe withdrawal rates, suggested that if markets get bad enough, even insurers might not be able to fulfill their guarantees. He also believes that annuities are too expensive.

"When clients see how much money they have to give up for a given income," they lose interest in life annuities, he said. As for variable annuities, he added, "The guaranteed lifetime withdrawal benefit is almost certainly a fixed income strategy" because the fees make step-ups in the income base unlikely, especially during the payout stage.

Later on Monday, Guyton gave a presentation on the 4% rule, in which he reviewed his own widely published formulas for adjusting clients' recommended payout rates up or down at regular intervals to reflect changes in the anticipated inflation rate and trends in equity valuations. During the Q&A, Guyton was asked if his strategy was indifferent to any floor income that his clients expected from Social Security and pensions.

He said it was; his response suggested to me that the 4% method is primarily an accumulation strategy adapted to retirement rather than a true decumulation strategy. It keeps the advisor's focus on investment risk rather than re-directing it to income-adequacy risk. For that reason, it is probably best suited to people who aren't actually in danger of ever running short of money.

No variable annuity manufacturer appeared to have sponsored a booth at FPA Experience 2012. (I can't say for sure whether or not they have in prior years.) That's too bad: annuity issuers have put a lot of effort recently into building RIA-friendly no-load contracts. Given all the retrenchment in the variable annuity industry this year, however, it made perfect sense.

That's not to say that fresh ideas about retirement income were entirely absent from the conference. Two retirement income-oriented companies, OneReverse Mortgage and Noble Royalties, Inc., were among the exhibitors in San Antonio. OneReverse recently sponsored a study by Harold Evensky and others on using a reverse mortgage line of credit for financial emergencies in retirement. David Vasquez of Noble Royalties made a pitch for sourcing income from mineral royalties. I met only one representative of an annuity-related company in San Antonio: Bill Atherton of Cannex, the Toronto-based vendor of income annuity pricing information and other data.

A principal sponsor of this year's FPA Experience was TD Ameritrade Institutional, whose brightly lit hospitality cube glittered at the center of the exhibition floor. The unit of the well-known discount brokerage recently added variable annuities with living benefits from Great-West and Transamerica as well as income annuities from MassMutual and New York Life to its RIA platform. (See today's RIJ cover story.) The seeds for future annuity sales by fee-based planners may thus be planted, perhaps to germinate when interest rates rise.

Supplemental information: ¶ "The sky is not falling," said Bill Meyer regarding the viability of Social

Security. ¶ With regard to the “4% rule,” one advisor quipped that it was hard enough convincing one spendthrift retiree to lower his spending rate from 14% to 7%, let alone 4%. ¶ Most fascinating statistics heard: One percent of Americans owns almost half of all domestic financial assets and 20% own 93%. The remaining 80% of Americans live outside the realm of investment advice. ¶ On Saturday, Mary Matalin and James Carville, the campaign-consulting couple and former “Crossfire” co-hosts who work opposite slopes of the continental political divide, delivered entertaining and radically different interpretations of the dynamics of this year’s presidential contest. Afterwards, they signed copies of their recent book. ¶ Stephanie Kelton, a “heterodox economist” from the University of Missouri-Kansas City, received a surprisingly warm reception after explaining that, at the federal level (though not at the state and local levels), taxes do not fund the government. Instead, the federal government relies on taxes to prevent inflation and shape public policy.

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