
The Missing Sockdolager

By Editor Test *Wed, Jan 11, 2012*

An article appeared yesterday under the headline, "Variable-annuity guarantees disappoint over time." I think the jury is still out on that.

Yesterday, my friend and fellow journalist Bob Powell at *Marketwatch* published an interview with Ward Pfau, a retirement specialist whose articles I've cited in RIJ. "Variable-annuity guarantees disappoint over time," the headline read.

Perhaps you read the interview online. If you're in PR at one of the big VA issuers, perhaps your day was spoiled. Or perhaps you felt, when you finished reading, that the content didn't really make the headline stick.

A young academic and CFP who has published papers in the *Journal of Financial Planning*, Pfau voiced criticisms that were valid and familiar. Yes, insurance is expensive. No, it's not for everybody.

But the story didn't contain the sockdolager it seemed to promise.*

On the contrary, the interviewee praised variable annuities with faint damns. At one point, he seemed to make a case for variable annuities for the mass-affluent.

One sentence in particular stuck out: "If you have saved enough that you can meet your retirement spending goals with a low enough withdrawal rate (such as 2% or 3%), then you probably do not have any need to pay the rider fee for the GLWB," Pfau told Powell.

By that formula, a household would need \$1 million after taxes to generate a mere \$30,000 a year in retirement on top of Social Security. Not many Americans will retire that much liquid wealth.

Did Pfau mean that anyone with less than \$1 million in savings and no pension should consider a variable annuity with a guaranteed lifetime withdrawal benefit? If so, that's an endorsement, not a put-down.

That wasn't Pfau's only non-discouraging word. Asked to name the "pros" of variable annuities, he conceded that they "could help risk-averse retirees to sleep better at night and help them to stay the course with their asset allocation and not engage in panic selling after market declines. GLWBs could also be more helpful for retirees who have limited access to other guaranteed income sources, such as a corporate defined-benefit pension."

You could find identical language in a pro-VA story.

But, as I said above, Pfau pointed out valid VA weaknesses. "The guaranteed withdrawals are not inflation-adjusted and the fee structures can be quite complicated and expensive," he told Powell.

Point taken. To get inflation protection from a GLWB, your account value typically has to post new highs. When the contract owner is withdrawing 5% a year and the issuer is taking another 3%, the account value will have a hard time hitting new highs during the life of the contract, no matter how much risk the owner can take with his or her subaccounts.

In the interest of balance, however, Pfau might have referred (or the interview might have included) to the optional deferral bonuses in VAs that can legitimately protect people from sequence risk—the risk that ill-time market losses will permanently cripple a portfolio.

I'm convinced that advisors and clients love the VA value proposition that says if they put in \$100,000 today, they can start pulling out \$10,000 for life in 10 years. Friends of mine out West called me the other night to say they were considering a VA that offered that kind of deal. They are successful, fit, PhD-level, self-employed people in their mid-50s who are financially risk-averse. They like the sound of a product that can give them a minimum 10% payout from age 65 to whenever. With that assurance, they're relatively unconcerned about fees. (They're also considering a deferred income annuity.)

In the end, Pfau was perfectly right to tell Powell, "You must really decide on a personal level whether you value that protection more than the fees you must pay for that protection." Many rational people do. Others, equally rational, do not. Go figure.

So, do variable-annuity guarantees disappoint over time? Call me in 20 years. I'll have a definitive answer.

*Sockdolager: Something that settles a matter; a decisive blow or answer; finisher.

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