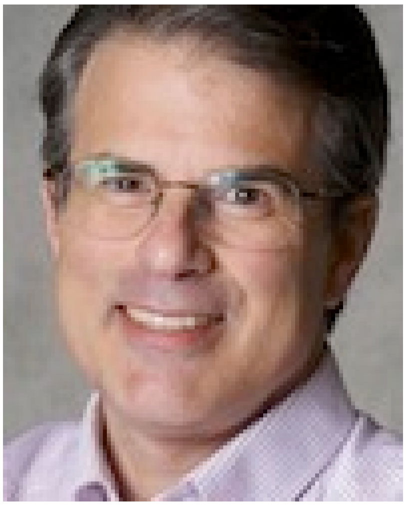
The Reason for SPIAs, from Pfau and Finke

By Kerry Pechter *Thu, Apr 25, 2019*

In a new whitepaper sponsored by Principal Financial Group, the two retirement experts from The American College use hypothetical cases to show the advantages of using deferred and immediate income annuities to reduce risk in retirement.



The benefits of using income annuities in retirement is the topic of a new **whitepaper**, written by Michael Finke and Wade Pfau of The American College and sponsored by Principal Financial Group. This paper provokes a couple of observations.

First, Principal is a publicly held retirement company. It's promoting income annuities. That's slightly counter-intuitive, since public life insurers usually don't promote income annuities. They prefer indexed or variable annuities.

Second, the whitepaper provides a rationale for income annuities that we've all heard many times before, from the same credible sources. Why does the income annuity story need constant retelling?

Let's address that second observation first. Does the Boomer audience not understand the value of longevity risk pooling? Are they not listening? Are the competing voices simply louder? Or has the no one yet written a slogan or tag line powerful enough to compel near-retirees to think about buying an annuity—any annuity?

As a writer of annuity marketing/educational materials for nine years, I struggled to compose a phrase or a sentence whose mere utterance would buckle knees nationwide, and awaken people in cities, towns, suburbs, and rural villages to the atomic power of mortality credits.

I tried humor. I paired an existing tag line ("We *guarantee* you won't outlive your income") with the vintage photo of a 19th century lynch mob about to hang a horse thief from a cottonwood tree. No one thought that was even worth sharing with the rest of the marketing team, let alone the compliance department. "Don't eat cat food in retirement!" was more popular.

But sometimes I felt close to a solution. There were days when I thought phrases like “personal pension” or “retirement paycheck” would begin to open doors and close deals. I tried concepts like:

Annuities: The most income, the lowest cost.

Get more bang for your retirement buck.

As much income as the 4% rule, at two-thirds the cost.

Put half your money in an annuity–and invest the rest in stocks.

Cut the cost of retirement by 30%. Here’s how.

Is retirement keeping you up at night? An annuity can help you sleep tight.

But none had the stuff that makes a slogan immortal. I wanted to convey what few people realize: that the monthly payments from a fixed income annuity contain a bit of appreciation, a bit of principal and a risk-pooling credit that accrues not only to those who live an extra long time, but to every contract owner in every payment, starting with the first one. You get “cash back rewards” from dead people *even if you don’t outlive them!*

Well, you can see why I left marketing and went back to journalism.

Principal’s whitepaper reinforces what is largely self-evident by now—that longevity insurance can lower your risk of running short of money in your old age—with mathematical projections and Monte Carlo simulations from two of America’s leading retirement professors.

In the paper, Finke and Pfau, the chief academic officer and director of the Retirement Income Certified Professional program at The American College, respectively, offer three hypothetical cases:

- Case 1: A married couple ten years before retirement.
- Case 2: A married couple at their retirement date.
- Case 3: A widow ten years into retirement.

In each case, the clients were assigning $100,000 to the creation of a monthly income. Finke and Pfau demonstrated that if they put half of that money into either a deferred income annuity (Case 1) or a single-premium immediate annuity (Cases 2 and 3) they could produce the desired income (from annuity payments and distributions from savings) with much less risk of running short of money by age 95 than if they put the entire $100,000 in a 40% stock, 60% bond portfolio.

Pfau and Finke's calculations showed that even if future market returns were either average or above-average, the half-annuity strategy still produced more residual wealth at age 95 than the systematic withdrawal plan did. (The argument for an all-investment approach might have looked stronger if the allocation to stocks were 60% instead of 40% and the expected longevity was 85 instead of 95. But that would have made the market risk and longevity risk of that approach higher than the risks of the half-annuity approach.)

The dilemma facing income annuity issuers is that few investors hear this kind of presentation. Some advisors do offer income annuities when a client clearly can't meet his income goals without one. But most agents and advisers would rather sell products that pay higher commissions; they may also avoid recommending income annuities because they can't charge a management fee on their value.

So retirees rarely see side-by-side comparisons of several income-generation methods at once. At the same time, most public life insurers would rather sell variable or index annuities, which are more profitable. As a result, captive or affiliated agents at mutual companies tend to sell most income annuities.

So why does Principal, a public company, promoting income annuities? Because, despite having gone public in 2001, it still behaves like a mutual. It also still has an affiliated cadre of advisor representatives, Principal Advisor Network, in addition to third-party distribution.

"For a long time, we were a mutual insurance company in the heart of the Midwest, with Main Street values," said Sri Reddy, senior vice president of retirement and income solutions at Principal since last summer. "We're a public company that's still based on the idea of serving Main Street America. That ethic guides the way we behave. Our products—SPIAs, DIAs and our Personal Pension Builder for retirement plans—are plain vanilla. There are still a lot of mutual-era people here. Our chairman and CEO, for instance, has been here for 35 years."

Hence Principal's sponsorship of a whitepaper on SPIAs and DIAs. "We said, 'Let's have some academics take a look at this problem and see if you can drive the efficient frontier up to the left a bit with income annuities," said Reddy. In other words, could income annuities help deliver more income in retirement for the same or less risk than a balanced investment portfolio?

Before joining Principal nine months ago, Reddy was a senior executive in Prudential Retirement, in charge of promoting IncomeFlex, a guaranteed lifetime withdrawal benefit for plan participants. Now he’s promoting income annuities to advisors and to Principal’s plan participants. (Principal’s recent acquisition of Wells Fargo’s retirement business makes it the third largest US retirement plan provider in numbers of participants, after Fidelity and Empower.)

“The guaranteed lifetime withdrawal benefit has a role to play for investors in the years leading up to retirement,” Reddy told *RIJ*. “It takes market risk off the table. But the income annuity is for people entering retirement today and creating income today.” I noticed, by the way, that the title of Principal’s whitepaper is *It’s more than money*. As annuity tag lines go, that’s not bad.