Retirement Income
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Unsolved Mystery

By Kerry Pechter *Wed, Oct 21, 2009*

In Matt Greenwald's "mystery shopper" experiment, near-retirement couples met with eight financial advisors to find out if they would recommend income annuities. None did.

Mathew Greenwald

The "mystery shopper" is one of the oldest and most effective research tools. You can learn a lot simply by having someone pose as a naïve consumer and catch a seller off-guard.

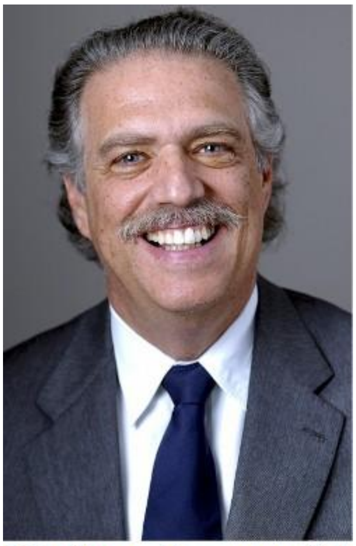
Journalists use this trick. Industrial spies use it. The Drug Enforcement Agency, obviously, uses it. So do market researchers.

A couple of years ago, the Washington researcher and consultant Mathew Greenwald deployed mystery shoppers to help annuity manufacturers and marketers learn why more Americans don't buy life annuities to finance their old age.

In a two-part experiment, Greenwald first asked a bunch of academic economists whether the typical Boomer retiree should buy an annuity. "We know that annuitization is rarely used, and all kinds of reasons have been given for that, but I wanted get some insights into the desirability of an annuity," Greenwald told RIJ recently.

In other words, if no one at all vouches for annuities, further research would be pointless. "Game over," as it were. But all of the academics recommended annuities.

"I interviewed 11 economists and others who are not involved in selling annuities," Greenwald continued. "They all had different opinions about the circumstances that call for annuities. Some thought you should buy one at retirement. Some thought you should wait until age 70 when the payouts are higher, or that you should buy longevity insurance that starts when you're 85."


Mathew Greenwald

But, small differences aside, the academics unanimously supported annuities.

In the second part of the experiment, Greenwald recruited eight mystery shoppers and assigned each of them to approach an investment advisor and ask for help in creating a financial plan for retirement. "They went to advisers and said, I'm close to retirement, and I'd like your advice on how I should manage money in retirement."

The mystery shoppers were all real near-retirees with assets of roughly $600,000 to $3 million. The advisors were registered reps at large broker-dealers such as Wachovia, Morgan Stanley or Raymond James. The meetings between clients and advisors were not a sham. The shoppers presented real account statements and, in some cases, financial plans were drawn up and fees were paid.

Not one of the advisors mentioned annuities, the shoppers told Greenwald. Instead, every advisor suggested a systematic drawdown from a diversified portfolio of stock or bond mutual funds.

Most of the advisors assumed an average positive growth rate for stocks and bonds. Their calculations and projections showed, typically, that the retirees would grow increasingly rich over the next 30 years and leave a large bequest—in addition to receiving an income.

This type of evidence is more qualitative than quantitative, Greenwald said, but it can be enlightening when combined with other data. "It's the juxtaposition that's of interest," he said. "Theorists come to a different conclusion than practitioners. It informs other work we're doing."

Similar findings

Advisor attitudes toward annuities were also part of a study conducted by Brightwork Partners LLC at the beginning of 2009. Most of the survey participants were advisors at wirehouses, insurance companies, and independent broker dealers. Together, they represented 20 to 25 percent of the active registered rep community.

The findings of the Brightwork study support the findings of Greenwald's mystery shopping experiment. Only 53% of advisors (and 68% of insurance company advisors only) in the Brightwork study said they recommended a period-certain income annuity to their retirement clients "almost always or sometimes."

Advisers were more likely to recommend systematic withdrawal plans, income-oriented mutual funds, bond or CD ladders, variable annuities with lifetime income riders, long-term care insurance or "working longer" as solutions to retirement income needs.

Only nine percent of the advisers said basic payout annuities were "very" attractive. An additional 42% said they were "somewhat" attractive. That percentage jumped to 80% or more, however if the annuity included coverage for a surviving spouse, a guaranteed return of premium, or a provision to pay long-term care costs.

Advisors apparently believe they can plan for retirement income without using annuities, which they consider to be a very expensive solution to the problem, Brightwork's Ronald L. Bush told RIJ.

For a client with $800,000, for instance, they would tend to self-insure against longevity risk. They might set $200,000 aside in a "granny fund," not to be opened until age 85, if necessary, and tap the other $600,000 between ages 65 and 85. Annuities are seen rather as "packaged solutions" for retirees with less money under management and a greater need for income.

A survey of 503 advisors nationwide conducted by Allianz Global Investors last August delved into the retirement income question but the word "annuities" didn't come up.

Nearly nine of 10 (89%) of advisors think their clients would be receptive to the idea of products that provide guaranteed lifetime income, but just 50% of advisors have talked to their clients about such products, according to the survey.

Advisors were far less optimistic than their clients about the performance of equities in the years ahead. But 74% of advisors felt their clients could protect themselves by focusing on alternative investments like Treasury Inflation-Protected Securities or commodities.

Compensation factor

What explains the popularity of annuities among academics but not among advisors? Greenwald did not believe that the academics' position reflects a belief that annuities represent the "greatest good for the greatest number."

That is, nothing in his discussions with academics suggested that they recommended annuities because they believe that mortality pooling, on which annuity payouts are based, are a society's most efficient way to avoid a future epidemic of impoverished old people.

Rather, he said, the academics have done the math and believe that income annuities—their illiquidity notwithstanding—actually give their owners more spending power in retirement than they can get by keeping all their money at risk in the financial markets.

“I don’t think these people were thinking about what is good societally,” Greenwald said. “I think they believed annuities were more effective for individuals. I did an experiment once where we compared income from annuities with income from bonds.

“A 70-year-old man with $235,000 could get an income of $1,000 a month by investing it in a bond paying five percent, or he could get the same income by putting $130,000 in a life annuity and investing the other $105,000 in a side fund.” If the man lived longer than 10 years and the side fund earned eight percent a year, the annuity would be the better solution.

Income annuities might sell better, some say, if advisors were better compensated for selling them. With three percent commissions and, in some cases, a 0.25% trail, income annuities don’t pay a transaction-oriented rep as well as mutual funds or a variable deferred annuities do. Fee-based advisors fare even worse: an income annuity reduces the level of assets under management.

Neither Bush nor Greenwald asked advisors directly about a link between low income annuity sales and compensation, in part because it’s a delicate topic. But they offered their insights into the issue.

“From the qualitative work we’ve done with advisors, even the insurance company affiliated advisor will say, ‘You know, annuities are fine for certain clients but I don’t use them because I want to continue to manage the money,’” Bush told RIJ.

“I think advisors are receptive to innovative products or new product solutions but they have to get paid,” he added. “They have a compensation goal in mind, and they’ll try to make their compensation goal with each client. It depends on their target market. If they’re seeing a high volume of clients without a lot of assets, they’ll look for a packaged solution that gets the job done quickly.”

Greenwald acknowledged the impact of compensation, noting that it makes a difference whether the advisor has a fiduciary responsibility or not. “Are there some people who are not doing what’s in the best interest of their clients because of compensation? That’s the direction this issue leads you in. If so, that would be unfortunate.”