

Life Insurers Profit as Retirees Fear Outliving Cash

By Alexis Leondis

April 13 (Bloomberg) -- Sales of so-called immediate annuities are climbing as retirees are drawn to lifetime payments guaranteed by U.S. insurance companies.

Immediate annuities pay a periodic fixed amount of money for life in exchange for a lump-sum payment. New York Life Insurance Co., the largest policyholder-owned U.S. life insurer, reported an 80 percent increase in sales of the contracts during the first quarter from a year earlier.

"This is just the tip of the iceberg," said Chris Blunt, executive vice president of retirement income security at New York Life. "As more baby boomers need to turn assets into income, they'll choose income annuities to guarantee they can at least cover basic expenses."

Sales of immediate annuities, which start making payments to investors within 13 months from when they're purchased, rose 30 percent to \$8.6 billion in 2008, according to estimates by industry analysts at Beacon Research in Evanston, Illinois. The gain compares with the 15 percent decline in sales of variable annuities last year and the overall 50 percent increase in sales of fixed annuities, said the New York-based Insurance Information Institute, which uses data from LIMRA International Inc.

Insurers are counting on revenue from annuities to counter investment writedowns from the collapse of the U.S. mortgage market. Industry-wide losses have been more than \$190 billion since the beginning of 2007, according to data compiled by Bloomberg. There have been a total of 30 downgrades to companies within the life insurance industry by Standard & Poor's since 2008, including multiple downgrades to some companies.

Irrevocable Control

Retirement planners say that because of fixed payouts and loss of control over initial investments, immediate annuities shouldn't be the only savings plans consumers consider. Since an immediate annuity contract gives irrevocable control of the lump-sum payment to the insurance company, retirees can no longer access their cash.

As life expectancies increase, more people want cash flow they won't outlive and protection from unpredictable market swings, said Cathy Weatherford, chief executive officer of NAVA, the Reston, Virginia-based industry trade group for annuity and variable life insurance products.

Payout rates for immediate annuities vary based on factors such as age, gender

and size of the initial investment.

A 65-year-old male who gives \$100,000 would get \$650 a month, or \$7,800 annually, for life, by purchasing an immediate annuity from New York Life, which invests the money primarily in high-grade corporate bonds. That equals an annual payout rate of about 8 percent, according to Blunt.

The annual payout rate is closer to 6 percent because retirees must take into account the return of their \$100,000 principal over life expectancy, said Peter Katt, a life insurance adviser in Mattawan, Michigan.

Lock in Rates

One major drawback of an immediate annuity is that it locks in current interest rates, said Katt. "With massive, unprecedented debt, we might have 12 to 14 percent interest rates in a couple of years," which would erode the value of future payouts, Katt said. The average inflation rate was 2.8 percent during the past 10 years, according to Bloomberg data.

Inflation-adjusted immediate annuities are offered by some providers, at a cost. Retirees will get lower periodic payments if they opt for inflation protection or extend the payments after death to benefit a spouse. If a 65-year-old male wanted a 3 percent annual inflation adjustment, his monthly payout of \$650 from New York Life would decrease to \$488 for the first year.

State Guaranty

The insurers' strength is crucial because the investor gives control of the money to the company, said David Schiff, editor of Schiff's Insurance Observer, a New York-based industry newsletter. If consumers are concerned about credit risk, they should purchase annuities from several insurers, Schiff said.

When an insurance company is declared insolvent, the state guaranty association will usually make payments to annuity holders until the contracts are transferred to another insurance company or will continue payments up to the benefit limits in each state, said Sean McKenna, a spokesman for the National Organization of Life & Health Insurance Guaranty Associations in Herndon, Virginia.

Coverage limits vary by state with all providing at least \$100,000, McKenna said.

Adding Capital

The U.S. Treasury said April 8 that some life insurers are eligible for capital infusions under the federal rescue program and applications are under review. The companies, which hold about \$1 trillion of corporate debt, need Treasury aid to help the nation's credit markets by buying more bank bonds, according to the American Council of Life Insurers.

Payouts among insurers vary significantly, said Weatherford of NAVA. Monthly payments range from \$629 to \$745 for a \$100,000 investment by a 65-year-old male, according to a survey of six issuers by Hueler Companies, a Minneapolis-based data research firm and provider of an independent annuity platform.

If an immediate annuity is funded by a 401(k) or Individual Retirement Account, the periodic payment will be taxed as ordinary income because the retirement fund

money has never been taxed, said Scott Ford, a registered financial consultant at Cornerstone Wealth Management Group in Hagerstown, Maryland.

When money that already has been taxed is used to purchase the immediate annuity, only the portion of the payout determined to be interest instead of original principal is taxed, Ford said.

'Personal Pension'

"Immediate annuities are like your own personal pension," said Gail Buckner, a certified financial planner at San Mateo, California-based Franklin Resources Inc. "They can provide a floor, but you need growth."

Buckner recommended using immediate annuities to pay for daily fixed expenses not covered by income from Social Security or pensions and then being more growth-oriented with other investments to overcome inflation.

"The downside of immediate annuities is inflation risk, but I have clients who sleep more comfortably at night knowing other investments can fluctuate because their basic necessities are covered by immediate annuities," said Ford of Cornerstone.

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