The case for fixed index annuities

Investment professionals today, especially those who list retirement planning as a core component of their practice, are challenged with volatile markets, low interest rates, rising health care costs and the fact that married couples today have a 25 to 50 percent change of living well into their 90s. These factors, when considered in the aggregate, can present an insurmountable series of roadblocks unless there is proper and efficient allocation of retiree's assets.

Once upon a time, retirement planning was fairly easy. After a working career ended, many people were covered by a lifetime pension. Bonds and bank accounts paid 5 percent to 7 percent on average, creating comfortable flows of income.

Those days are long gone. Today, pensions are few and far between with only 25 percent of U.S.-based companies currently offering them down from more than 90 percent in 1998, according to workforce.com. Considering this trend along with increased longevity, money has to last longer than it ever has before.

Meanwhile, interest rates on shorter term bonds and bank accounts hover between zero and 2 percent. The stock market has risen to a point that is overvalued by most standards. Translation: a crapshoot for the retired person.

Long-term care wasn't as critical an issue 30 years ago with mortality rates in the mid-70s. Nursing home populations in America were a fraction of what they are today and the cost for such care was in the hundreds of dollars per month, **compared to today's costs which can approach $10,000 per month.**

Many consumers are well aware of the benefits annuities provide but have become extremely risk averse and cost conscious, making the fixed index annuity an attractive alternative to variable annuities where the costs can exceed 4 percent when an income rider is part of the policy — which is the case in 70 to 80 percent of contracts written.

Annuities and comprehensive retirement planning

With this list of current concerns, we have a Dickensian scenario reminiscent of A Tale of Two Cities where it appears to be both "the worst of times but also the best of times," given the availability and breadth of today's investment solutions. Today's retirement planning specialists generally agree you must have the ability to address the following in any sound plan:

- Liquidity
- Lifetime income, both near term and long term (preferably guaranteed)
- Long-term growth capital and emergency capital

Beyond these, advisors differ greatly in their priorities. Some wish to address potential health concerns and emphasize a long-term care provision. Some retirees want to leave more for beneficiaries requiring a greater emphasis on life insurance. No matter what your idea of a solid financial plan is, fiduciary protocol dictates the following be covered at a minimum:

1. Preserve capital to the best possible degree and for the longest time possible.
2. Create a reliable and sustainable income that cannot be outlived.
3. Maintain ample liquidity as well as investments that have the potential to grow over the long term in order to offset inflation.
4. Ensure important outcomes like long-term care, money for beneficiaries, and extra income to battle inflation down the road.

In addressing these particular objectives, a variety of investment options serve as worthy solutions, as each form of financial vehicle addresses a different goal. For example, when looking for potential diversified growth over long periods of time, mutual funds and ETFs may be the vehicles of choice. On the other hand, if you're looking for a secure floor under your money with protection of principal, mutual funds and ETFs won't do.

Bank CDs and treasury bonds can address guarantees of principal, but with current rates at generational lows, they may not be deemed as viable as they fail to yield the rates of return "retirees" have come to expect. When it comes to generating income that cannot be outlived, only an annuity can provide the level of returns on a guaranteed basis that are both reliable and sustainable.

Annuities come in a number of versions and as mentioned earlier, fixed index annuities are gathering favor and are being placed in portfolios as a result of clients becoming more risk averse and cost conscious. The current economic backdrop and consumer mindset are the drivers behind the growth of FIAs as these products yield the highest amount of potential income at the lowest cost while not subjecting clients to market risk.

Today's fixed index annuities offer a value proposition that makes them highly suitable for many pre- and post-retirement investors, specifically a benefit suite that combines income predictability and growth potential with downside protection of principal.

In 2010, six PhDs at the Wharton School of Business conducted a two-year study of FIAs, comparing them to four other asset classes over the prior 14 years. In an interview after the study concluded, the lead author, Dr. David Babbel, stated that the FIAs "performed quite well ... indeed they dominated the alternatives," and that "some have performed better ... than (bonds), equity-funds, (and) money markets in any combination."

We have seen an embracing of FIAs by the Wall Street community and with variable annuity carriers either limiting their availability or leaving the space altogether, it bodes well for the upward trend in FIA sales to continue for the foreseeable future.

The benefits of positioning fixed index annuities

- A floor on the premium placed in a fixed index annuity as this money isn't subject to loss in the event of a downturn in the equity markets.
- Ability to participate in the potential for higher returns relative to other principal protection vehicles.
- Ability to participate in a percentage of the upside movement of the equity markets and locking in those gains as a result of the annual reset feature.
- A fee structure which is transparent at a percentage of the cost of a comparable variable annuity.
- Many FIAs provide for the income base to be passed on to beneficiaries upon owner's death.
- Deferring income in an FIA for just 3-5 years can result in a significant increase of withdrawal rates for a 60-year-old from 4 to 6 percent at age 65 and for a 70-year-old from 6 to 8 percent at age 75.
- Ability to address concerns of longevity, outliving one's money, disability, incapacitation, future health care costs and income multipliers for long-term care.