

Immediate annuities something to consider

Steven Podnos

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QUESTION: Can you explain how to use an immediate annuity for retirement?

Podnos: Immediate annuities involve giving an insurance company some money in exchange for an immediate income stream. The income is usually paid monthly, and can be guaranteed for a period of time, a lifetime, or a joint lifetime (or a combination of a term period and lifetime).

A typical immediate annuity for a 65 year old today might offer a 6 percent return (\$500 a month on a \$100,000 deposit) for a single lifetime guarantee, and slightly less for a joint lifetime. It would offer slightly more for a 10-year year period.

Note that with a lifetime or joint lifetime product, the stream of income ends on death, even if the annuity is new. All the money given to the company is gone. The fact that you have a large number of people buying these

annuities and some of them dying early is what allows the redistribution of this “lost” money to those lucky enough to live longer than expected. It is what allows the insurance company to pay a 6 percent return instead the 4 percent withdrawal rate I might recommend from an invested retirement portfolio.

Immediate annuities carry several risks. First, most of the time the payment amounts are fixed and do not adjust for inflation. If you are depending on the income for several decades, you may be pinched with a progressively lower purchasing power. Inflation adjusted annuities are available but at markedly lower rates of return.

Second, they are dependent on the insurance company remaining solvent over a long period of time. This risk can be partially mitigated by buying smaller annuities from a greater number of companies.

Finally, unless you buy an annuity with a guaranteed term of benefits regardless of when you die, the termination of the contract at an untimely death is hard for most people to accept. If you take the guaranteed term, you pay for it with reduced income, in a sense reducing the rationale for buying the annuity in the first place. Remember, if they are paying you a 5 percent rate of return, they are using your money to pay you for the first 20 years!

There are many other factors to consider in the purchase of immediate annuities. One of the more positive features is that they put all your money to work in a sense early on-there are rarely large commissions to sales people (which is why you don't hear much about them). Some recent research suggests that immediate annuities might be a better choice in retirement portfolios than bonds.

The optimal use for these products are for individuals and couples that are at least 70 years old and who need a significantly higher withdrawal rate from a retirement portfolio than is felt to be safe.

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