Annuity Market Overview

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The market for annuities is large but not limitless. The mere fact that someone wants to save for retirement does not necessarily make a deferred annuity the best answer, nor is it necessary to buy an immediate annuity to make one's savings last a lifetime. Suitability is determined by the annuity buyer's reasons for purchasing the annuity and the degree to which the owner understands it.

Suitability Determined on Individual Basis

Why might an individual buy an annuity? The common denominator that ties all annuities together is the need for a guaranteed stream of income. There are various ways to spread out one's retirement savings to last a lifetime, but only an insured annuity guarantees a level income that cannot be outlived. This makes the annuity a logical choice in retirement planning for the buyer who is healthy, anticipates a long life, and wants the peace of mind that guaranteed income brings. If the buyer is married, a joint and survivor option will make sure income continues while either spouse is still alive.

Consumers who are saving for retirement have a variety of options from which to choose. Qualified arrangements, including individual retirement accounts of various types as well as 401(k) plans, offer the benefit of immediate tax reduction as well as tax deferral of gain. For those who are not eligible for a qualified savings arrangement, or have contributed the maximum possible, yet want to save more, a deferred annuity is an attractive consideration. Tax-deferred growth is the key benefit afforded deferred annuities, but possible surrender charges and tax penalties on early distributions are caution flags for the consumer who may need to withdraw money before retirement.

Though their design makes insured annuities well suited for retirement planning needs, this is not their only purpose for existence. Annuities are the basis of many lottery prizes, and structured settlements resulting from lawsuit judgments rely on annuities to provide plaintiffs with lifetime income. Nonetheless this course is concerned with the annuity's role in retirement planning, from both the accumulation and income perspectives.

It is a fact that Americans will increasingly find themselves relying on their own savings to afford a financially secure retirement. With pensions fading from the qualified plan field, the need to personally save for retirement is more important than ever. As noted above, there are many ways to save for retirement; the insured annuity is not appropriate for every savings accumulation or distribution need, but for the right individuals it is the ideal solution.

The Retirement Planning Market

In the next two decades the baby boomers will retire. Some 77 million strong, they will bring with them needs and demands calling for creative ways to distribute the personal savings amassed in their IRAs, 401(k)s, and other retirement savings programs. And the distribution need is not limited to qualified plan money. With billions in assets held by the senior generation, it is inevitable that many baby boomers will be the beneficiaries of inheritance bequests that, for many, will be the basis of their own retirement income. Others, empty nesters downsizing to smaller quarters, will find themselves with sizeable gains realized on the sale of their houses.
Whatever the source of the money, the fact is there's a huge market of potential customers for annuities. The key word here is *potential*. Every case must be judged on its individual merits to determine if the purchase of an annuity is the best solution to a financial need. The following points can be used to identify situations where annuities are most appropriate.

- Has the individual exhausted his qualified savings alternatives (including Roth IRAs)? All qualified plan accounts have the tax-deferred growth feature of deferred annuities, but they also provide immediate tax reduction benefits, too. Best suited for an annuity are individuals with substantial amounts of nonqualified money and those who are "maxed out" on their qualified plan savings options.

- Is the individual interested in a guaranteed stream of income versus income that is estimated to last a lifetime? If yes, does the individual fully understand that with some forms of annuity the undistributed principal may be forfeited to the insurance company at the annuitant's death? Also, does the individual understand there are insurance charges associated with this guarantee?

- Does the individual understand that once annuitization commences the decision to own an annuity is irrevocable? This rule allows the insurer to guarantee payments for life, but it can still create problems for all parties if less than fully understood by the contract owner.

- Will the individual need the money for any reason before the annuity starting date? If so, will the deferred annuity's surrender charge be applicable? Seniors who purchase a deferred annuity must clearly understand that withdrawals in the early years may be subject to substantial surrender charges.

- Does the individual really intend to simply hold the money in the deferred annuity to death and pass it on to heirs? If so, does the individual know there is no step-up in basis with an annuity at death (while there is a step-up with most other forms of capital investment), and that income taxes will be payable by the estate on the "gain" in the annuity's value?

- Is the annuity being purchased with funds gained by surrendering an existing deferred annuity contract? Unless there can be clearly demonstrated a financial benefit to be gained under current and realistic assumptions, the replacement of one annuity by another may justifiably bring into question the producer's motives and violate the replacement provisions of SB 620.

- Is the purchase of the annuity being recommended as a device for qualifying for a social welfare program's benefits, like Medi-Cal? Aside from raising ethical questions, improper use of an annuity to "hide" countable assets can lead to adverse legal and financial consequences. Senate Bill 620 expressly prohibits the purchase of an annuity for the purpose of qualifying for Medi-Cal.

These rules notwithstanding, there are still plenty of individuals for whom the unique features and character of an annuity will be perfectly suitable to their needs. It is the agent and broker's responsibility to separate the right reasons from the wrong.