



IS BUYING AN ANNUITY IN A ZERO INTEREST RATE ENVIRONMENT A GOOD IDEA?

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The Federal Reserve's decision to cut its benchmark federal funds rate from 2.5% in 2019 to near-0% in 2020 raises significant questions for those reassessing their retirement nest egg—a common occurrence following a dramatic selloff in equities according to research conducted by Indiana University's Alessandro Previtero—and the value of annuities in providing guaranteed lifetime income.

Historically low interest rates are often used as a reason to avoid annuitizing at the present and forever locking in current interest rates. The logic is that interest rates could increase in the future, which would help support a higher subsequent payout rate from annuities if one waits. This idea is worth a discussion, as it is not correct in the context of a full retirement plan.

In addition, deferred annuities that use lifetime income protections without immediately annuitizing the assets do not have this problem. Even for the income annuity, which does lock in the current environment at purchase, the case for its use becomes stronger in a low interest rate environment for someone who is already retired and spending from assets.

With low interest rates, the mortality credit or risk pooling component of the annuity payout becomes even more important, making annuities even more attractive relative to bonds. The bond interest component for spending is reduced for both tools as interest rates decrease, however annuities are hurt less by lowering interest rates, since the mortality credit component for spending is not impacted by interest rates.

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Essentially, while the cost of funding retirement with an annuity increases as interest rates decline, the cost of funding retirement in other ways increases even faster than for the annuity. Therefore, the annuity becomes a better relative deal.

As well, if we consider changing interest rates and their associated risk, increasing interest rates would mean capital losses for bonds. One could not simply sell bonds for their earlier value to take advantage of the higher annuity rates. While waiting for rates to rise, if that happens, the retiree will be spending their principal when spending exceeds interest and dividends. The likelihood of needing to dip into the principal increases.

Even if rates do rise, retirees may not be able to purchase more income as they are

multiplying a higher rate by a smaller pool of assets at this stage. If interest rates do not rise, bonds do not have capital losses, but the annuity payout rates do not increase. The bottom-line? Waiting entails risk. For retirees investing conservatively like the insurance company, it is likely that one burns through assets fast enough to not benefit from any possible future increased annuity payout rate. Retirees also give up some mortality credits by waiting.

In conclusion, for those who still have the potential to fund their goals in spite of recent market losses, and especially for those who think stocks are too risky and would rather leave their funds in cash, an annuity can still provide a way to lock-in a successful retirement income plan no matter what else the future may bring.

This article originally ran in Forbes on April 2, 2020.

Annuities are long-term investments designed for retirement purposes. The value of variable annuities is subject to market risk and will fluctuate. Product guarantees are subject to the claims-paying ability of the issuing insurance company. Earnings, when withdrawn, are subject to federal and/or state income tax, including a 10% tax penalty for withdrawals before age 59½. Some income guarantees offered with annuities take the form of optional riders and carry charges in addition to the fees and charges associated with annuity products.

There is no guarantee that any investment will achieve its objectives, generate positive returns, or avoid losses. Investments in annuity contracts may not be suitable for all investors.

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