‘Guaranteed income’ preferred over ‘annuities’

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The insurance industry recognizes that the word 'annuity' is not always received well. But that's only part of what hampers the products, according to two recent reports.

Annuities have existed as a concept for thousands of years, but they aren’t used very often by today’s retirees — and part of that has to do with their name.

A recent survey of more than 1,000 U.S. residents over the age of 30 found that calling products a “guaranteed stream of income” made people more willing to buy them and to put more of their money in, versus when the product is called an annuity. That report, published last Friday by Morningstar, found a nearly 2% variance in preference for annuities when they were labeled guaranteed income.

The nomenclature, particularly for people who said they were worried about running out of money in retirement, was associated with significantly more comfort in having annuities as part of a 401(k)’s default investment and a willingness to put more of their assets into the products, Stan Treger, a behavioral scientist at Morningstar, said during a presentation Tuesday about the findings.

“People are more open to guaranteed income than an annuity,” Treger said.

The survey showed that people overwhelmingly prefer immediate annuities over deferred ones, at 78% to 22%, he said. However, when people are prompted to think about the possibility of running out of money in retirement, their preference for deferred annuities increased by more than 8%, he noted.

This isn’t the first research to show that people are not keen on the word “annuity.” Other surveys have indicated that there’s a stigma attached to it.

LOW USE

The first guaranteed income products appeared was early as 1700 B.C. in Egypt, “predating the birth of the insurance company by thousands of years,” Jasmin Sethi, associate director of policy research at Morningstar, wrote in a separate recent report.

Despite that lengthy history, less than 5% of people in U.S. households own annuities, and the products are included as options in anywhere from 1.5% to 10% of employer-sponsored retirement plans, the report noted. A clearer estimate is difficult because of the variation in reporting requirements.

“They’ve had a lot of historical issues with fraud, which has not totally gone away, although they are more regulated than they have been in the past,” Sethi said during Tuesday’s presentation. “Annuities are not used very much today.”

However, the guaranteed income they provide has the potential to make people happier, Sethi said.

“People like to know how much they can spend. They like to not have to guess,” she said. “People also have a very hard time dealing with longevity risk.”

What keeps some people from opting for annuities are complexity and a lack of transparency, both of which make it difficult to compare products, Sethi said.

“Financial professionals can provide a lot of value there in helping their clients,” she said.

The fact that annuities aren’t available within workplace retirement plans also keeps them from being used more, although survey data show that people prefer to choose annuities on their own rather than having them selected by an employer, according to the reports.

Having guaranteed income products included within a retirement plan’s qualified default investment option, such as a target-date fund or managed account service, would make them much more accessible, Sethi said. Although some target-date products have done so, few are on the market. Managed accounts could be more effective in helping select appropriate products for retirees and showing them how much of their savings to allocate, Sethi noted.

Further, having a third-party service provider vet the products before they are included on a plan menu would alleviate fiduciary liability for plan sponsors and make them more likely to opt for annuities or other guaranteed income options, she said.

REGULATIONS GALORE

The patchwork of oversight is a constraint on annuities in general, Sethi said. Because they are insurance products, they are governed by state regulations, which vary. Variable annuities are a security, so they are also covered by the SEC. The Department of Labor oversees recommendations in 401(k)s and rollovers to IRAs, and the forthcoming fiduciary rule from that regulator will almost certainly change things.

The SECURE Act included provisions to make it easier for plans to incorporate annuities, such as through a safe harbor for product selection, and future legislation could do more.

For the SEC’s part, requirements to make VAs easier to compare, such as through simple charts about riders and costs, would benefit consumers, Sethi said.

“While we support a variety of products in the marketplace and investors who are sufficiently sophisticated should have choices to customize their retirement plans, we do not believe that public policy should incentivize all annuity products regardless of their comparative benefits,” she wrote in the recent report.

Morningstar, a ratings and financial services firm, isn’t fond of fixed indexed annuities, for example.

“A conservative fund portfolio can achieve comparable returns without these additional complexities; these annuity products are associated with high fees, do not offer any advantages in the form of longevity risk management, and often truncate the distribution of returns by capping the upside that investors could otherwise achieve by investing directly in a mutual fund,” the report noted.