TWO BITES OF THE APPLE

A Unique Method for Popularizing Annuitization

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Why don't more people annuitize?

The answer may be simpler than you think.

The best way to sell the lifetime income payments of annuitization is by letting clients take "two bites of the apple." The reason many advisors fail to sell lifetime annuitization, including innovative forms like longevity insurance, is that they go straight for the jugular ... they push the product. They try to get clients to swallow the entire apple in one bite. That just leads to choking.

Most clients do not believe they will live past average life expectancy. So you have to work with them on their terms rather than starting off the conversation with an academic dispute over longevity.

The first question you should ask is, "How long do you think you will live?" The response a client provides is what you need to solve for. Then you give them annuitized income guaranteed for only that period. That is the first bite of the apple. It will consume significant assets, but they may be very comfortable spending money on the time frame they "know for sure" that they will need to cover, especially when that income is guaranteed.

Now that they have taken the first bite of the apple, it is a lot easier to have them take the second bite! You simply ask, "What would happen if you lived just one year beyond the time frame you felt you would live for sure?" Even though the risk is huge – the typical client greatly underestimates longevity risk - in the client's mind, it now becomes a risk they are willing to view as a pure insurance risk.

Now you can talk about insuring that risk without objection. Given that it would now cost a mere fraction of what they just spent on the period certain annuity - pure longevity insurance is really cheap - they will not only take the second bite of the apple, they will savor the taste. Now the client understands why they are buying it, and it is a mere fraction of what they just spent on the guaranteed income. They will feel smart. And they will never ask, "What happens if I die tomorrow?" They know that the second bite is pure insurance, which they don't expect to get back, and if they died tomorrow the guaranteed payments, the first bite, will go to their heirs and not to the insurance company (another misperception.)

The first bite is like building a house, and the second bite is like buying fire insurance on that house. Instead, what is happening today is that many advisors are trying to sell the house and the fire insurance together and with an intense focus on the fire insurance, or worse yet, trying to sell the fire insurance before the house is even built. The client was only trying to figure out how to build the house. Thus to successfully sell guaranteed lifetime income using annuitization, you should first sell a period-certain guaranteed annuity, then sell the pure longevity insurance (or if you're less bold you sell it with the death benefit) on the back end.

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Two additional objections may arise in practice. The first is regarding the illiquidity of annuitization. There are two simple ways to address this objection. First, no one should ever put all of their eggs in one basket, annuitization or otherwise. Only a portion of the portfolio should be annuitized. The remaining portfolio is where liquidity is found.

From the client's perspective, you can use the imagery of the illiquid annuitized part of the portfolio as akin to a cement foundation poured into the bottom of a glass, and the liquid part of the portfolio as water above it in the glass. Thus when the client needs to drink of the liquidity, simply point out that the liquid assets are at the top of the glass and will need to be fully consumed before the cement at the bottom is reached. In fact, what is the chance that they will need to consume all the liquid assets to hit the cement foundation of their retirement plan?

The other objection is one that arises from advisors themselves. There is a belief that they will earn much less on a sale that involves annuitization. The truth, in fact, is exactly the opposite and advisors have been "leaving money on the table" by not including annuitization in the retirement solutions they offer! The reason is simple. The fact that annuitization is illiquid means that it is cheap. In other words, liquidity has a cost. Removing liquidity where it is not needed increases the internal rate of return on assets annuitized over a longer period certain. This is even more pronounced when the tax exclusion ratio on non-qualified annuitizations is taken into account.

Since the annuitization is cheap and provides the income needed, it means that assets are left over to grow, unhindered by the sequence of returns! In the end, the free-to-grow assets could substantially outperform a portfolio that excludes annuitization. Some advisors appear to have forgotten the magic of compound interest – at just a 5% net return, assets under management will quadruple over a 30 year retirement horizon. And all this while the income guarantees are working their emotional magic on the client. Thus, if half the portfolio is annuitized, the other half will double the *initial* portfolio over 30 years at only a 5% net rate of return!

Here is an example: Sam, a 55 year old male with $300,000 plans to retire in 10 years. He wants to generate an income stream of $1,000 per month at retirement increasing at 3% per year for 20 years. A delayed income annuity (DIA) from the Hartford would guarantee this income for a cost of about $118,166. Sam is concerned that he may outlive age 85, so he purchases a "longevity insurance" income annuity starting at age 85 that pays $1,806.11 per month ($1,806.11 is the amount that $1,000 would have inflated to at 3% per year) and also increasing at 3% per year for the rest of his life. This guaranteed annuity contract, *with a death benefit* from the Hartford, costs about $16,634. This is about 15% of what he spent on the period certain annuity and just 6% of the total portfolio.

Sam spent a total of $134,800 on the income annuities that would guarantee a $1,000 monthly stream of income with a 3% annual increase starting on his retirement date and continuing for his lifetime. His heirs are guaranteed to receive at least 20 years of payments. The total of the income payments guaranteed is $322,444. Many advisors may recognize this payout stream as a "20-year period certain and life" income annuity contract, but the ability to delay the start of the income payments and the fact that it was sold in two parts may be a new sales experience. Finally, Sam now has $165,200 left to invest. With no withdrawals hampering the growth, and assuming that Sam can achieve a modest 5% net average rate of return over the next 30 years, he will have close to $714,000 by age 85, more than double what he started with. If Sam lives to age 95, he would have accumulated $1,163,000 and the total income payments would be $571,000.

The likelihood that a retirement income solution that excludes annuitization could perform these feats is near zero. Yet, while an apple a day keeps the doctor away, two bites of that apple are much better than one. This unique approach and the guarantees provided could lead to more satisfied clients and more assets under management for advisors.

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"*The Thrive® Income Distribution System* is designed to help clients achieve three critical goals for their retirement: inflation adjusted guaranteed income, high internal rates of return, and tax-efficiency. Clients have the opportunity to effectively use their retirement assets for both guaranteed income and asset growth."

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