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YOUR MONEY
The Unloved Annuity Gets a Hug From Obama

By RON LIEBER

Annuities: The official retirement vehicle of the Obama administration.

As slogans go, it's hardly "Keep Hope Alive," or even "Change We Can Believe In."

But there were annuities, in a report from the administration's Middle Class Task Force that came out this week. They are among the tools the administration is promoting as it tries to give Americans a better shot at a more secure retirement.

At its simplest, which is how the White House seems to want to keep it, an annuity is something you buy with a large pile of cash in exchange for a monthly check for the rest of your life.

If the biggest risk in retirement is running out of money, an annuity can help guarantee that you won't. In effect, it allows you to buy the pension that your employer has probably stopped offering, and it can help pick up where Social Security leaves off.

President Obama did not discuss annuities in his State of the Union address on Wednesday night, probably figuring that viewers had enough problems staying awake. But the mere mention of them by the task force was enough to send executives at the insurance companies that sell the products into paroxysms of glee.

"I never thought I'd have the president as a wholesaler for us," said Christopher O. Blunt, executive vice president of retirement income security at the New York Life Insurance Company. "This is awesome. I'm trying to see if I can get him to do a big broker meeting for us."

He's unlikely to turn up for such an event just yet. After all, the announcement from the White House did make it clear that the administration was looking to promote "annuities and other forms of guaranteed lifetime income." That suggests the administration is open to other solutions, though there are not many others that are as simple as the basic fixed immediate annuity (also known as a single premium immediate annuity) that delivers a regular check for life.

Still, all of this attention from the president is a stunning turn of events for a rather unloved product. Many consumers reflexively run in fear when salesmen turn up pitching high-cost and complex variable annuities, which evolved from their simpler siblings decades ago. Today, the Securities and Exchange Commission maintains an extensive warning document on its Web site for investors considering the variable variety.

Meanwhile, almost all employees on the precipice of retirement who have access to annuities as a payout option steer clear when their companies offer them. While various surveys show that roughly 15 to 25 percent of corporations offer annuities to workers who are retiring, including big employers like I.B.M., a 2009 Hewitt Associates study reported that just 1 percent of workers actually bought one.

“I joke sometimes that we’re the best ice hockey players in Ecuador,” said Mr. Blunt of New York Life, which sells more fixed annuities than any other company, according to Limra, a research firm that tracks the industry.

So what are these soon-to-be retirees so afraid of? And what makes the White House so sure it can change their minds?

Let’s start with the fears. Early on, the knock on annuities was that once you died, the money was gone. So let’s say a 65-year-old man in Illinois turned over $100,000 in exchange for $632 a month for life, a recent quote from immediateannuities.com. If he died at 67, his heirs would get nothing while he would have collected only about $15,000. (On the other hand, it would take him until age 78 to get $100,000 back, but that doesn’t take inflation into account.)

The industry solved this by coming up with variations on the policy, allowing people to include a spouse in the annuity or guarantee that payouts to beneficiaries would last at least 10 or 20 years. This costs extra, of course, meaning your monthly payment is lower.

Others worried about inflation, so now there are annuities whose payments rise a few percentage points each year or are pegged to the Consumer Price Index. These cost extra, too (often a lot extra).

You see the pattern here. Every time someone had an objection — the need for a bunch of payments at once, a lump sum in an emergency or concern about rising interest rates — the industry created a rider to add to policies to make the concern go away (and make the monthly payment smaller).

Besides, people need to have saved enough to purchase a decent monthly annuity payout in the first place. But plenty of retirees haven't been saving in a 401(k) or individual retirement account long enough to have a good-size lump sum.

There are also stockbrokers and financial planners standing in the way. Once money goes into an annuity, they can't earn commissions from trading it anymore and may not be able to charge fees for managing it. Financial advisers have a charming term for this phenomenon — annuicide. You insure, and their revenue dies. So, many of them will try to talk you out of it.

One reasonable point they might make is that insurance companies can die, leaving your annuity worthless. State guaranty agencies exist, but they may cover only $100,000 to $500,000. I've linked to a list of the agencies in the Web version of this column so you can see what they insure.

Even if you get over all these mental hurdles, however, the hardest one may be the difficulty of seeing a big number suddenly turn small.

"It's the wealth illusion, the sense that my 401(k) account balance is the largest wad of dollars I'll ever see in my lifetime, and I feel pretty good about having that," said J. Mark Iwry, senior adviser to the secretary and deputy assistant secretary for retirement and health policy for the Treasury Department. "Meanwhile, I feel pretty bad about the seemingly small amount of annuity income that large balance would purchase and about the prospect of handing it over to an entity that will keep it all if I'm hit by the proverbial bus after walking out of their office." So how might the Obama administration solve this? It could get behind a Senate bill that would require retirement plan administrators to give account holders an annual estimate of what sort of annuity check their savings would buy. That way, people would get used to thinking about their lump sum as a monthly stream.

Tax incentives could help, too. A recent House bill called for waiving 50 percent of the taxes on the first $10,000 in annuity payouts each year. "If this is behavior that the administration is trying to inspire, then it's not that long of a leap to think that maybe they'll start to promote some version of these bills," said Craig Hemke, president of BuyaPension.com, which sells basic annuities (and offers some good educational material for people who are trying to learn about the products).

Mr. Iwry, who is one of the intellectual architects of the administration's examination of annuities, wouldn't say much about what might happen next. But one paper he co-wrote two years ago suggests a clue.

As the treatise suggests, the administration could nudge employers into automatically depositing, say, half of new retirees' lump sums into a basic annuity or other lifetime income product, unless they opt out. Then, they could test the thing out for two years and see how that monthly paycheck felt. If they liked it, they could keep the annuity. If not, they could cancel it without penalty and get the rest of their money back.

Annuities won't be right for everyone (people in poor health should probably steer clear). And they're not right for everything because it rarely makes sense to put all of your money in a single product or investment.

You could, for instance, use an annuity to cover the basic expenses that your Social Security check doesn't cover. You might also use the money to buy long-term care insurance, which would keep nursing home bills from becoming a budget-destroyer.

But the president has one thing right: The basic annuity is almost certainly underused. Sure, you may be able to arrange a better income stream on your own, but not without a lot of help from a financial planner or a lot of time managing it yourself. Then there's the possibility, however small, that you'll spend too much in spite of yourself or run into a once-in-a-generation market event that will cause you to run out of money sooner than you expected.

All of that makes basic annuities the ultimate test of risk aversion. If you buy some, you and your heirs may have less money than if you'd kept your retirement savings in investments. Then again, if you guarantee enough of your retirement income, you — and those same heirs — won't have to worry about how you're going to meet your basic needs.