Time to Give Annuities a Second Look?

By Andrew Welsch May 07, 2014, 5:30 p.m. EDT

BOSTON The overriding fear for clients approaching retirement is that they will spend more than their portfolio can return. To help allay these concerns, Moshe Milevsky, a well-known professor of finance at York University in Toronto, argues that advisors should consider adding annuities to their clients' portfolios.

An annuity's guaranteed returns can provide a degree of comfort to worried clients, Milevsky told attendees at IMCA's annual conference here this week. But he says the size of the annuity and the portion of the client's portfolio that it represents depend on the individual client's needs, likely longevity and risk tolerance.

Milevsky, author of "The 7 Most Important Equations for Your Retirement," took a break from the conference proceedings to sit down with *On Wall Street* and discuss why advisors should give annuities a second look.

OWS: Why is it important to talk about longevity and wealth management now?

Milevsky: I think there are several reasons. One of them is baby boomers who are entering retirement. You can't look at this without taking longevity into account.

But it's more than that. There is a greater awareness now that defined benefit pensions are not part of the standard retirement package.

You used go to work and get a cubicle, a couple days of vacation, a chair and a pension. Today it's not like that. Now saving for retirement is like saying you have to bring your own chair to work. It's a new reality, and today you have to manage your retirement yourslef.

Second, I think financial markets have evolved to the point where someone can do something about it. In the old days what kind of financial products did we have? They were more limited.

People always want to know what the next big thing is. Well, it's retirement income products.

OWS: Why do many advisors dislike annuities?

Milevsky: I understand why some advisors are reluctant to embrace them. The visceral reaction to it is 'It's irreversible. I lose liquidity. I lose commission.' I understand that.

But annuities have been around for hundreds of years. They will continue to be around, and they will be the bedrock of retirement income plans, although I think there will also be a lot of innovation involving these products.

Too much of the discussion focuses on numbers. An advisor sits down, pulls up a spreadsheet and says, 'Look, the internal rate of return for this annuity even if I live to 97 is going to be 8%. I can do better than that.'

But one of the things the advisor doesn't realize about the annuity is the non-financial benefit. There is scary research about living into your 90s. You see the statistics, the millions of people living into very old age. What percent of them are not suffering from some form of Alzheimer's and dementia? The answer is that that percentage starts to grow over time. And by the time they reach 95, most of these people will have some form of dementia.

What that means is that when I'm 90 I will be a very different investor than I am at 47. Today I love trading, I love looking at my portfolio. Should I be more international or less? I hope to still be doing that twenty years from now when I'm 67. But at 77, will I still be able to do that? At 90 will I still be looking at growth and values? I don't know. At 95 I'll be happy if I can get a decent bowl movement at that age.

I need my check coming in on auto-pilot. How am I going to arrange that? I want a big solid company to send me a check for the rest of my life. That surety, that benefit is hard to quantify.

It's a compass for spending, an anchor, as behavioral finance researchers would say. Here's what I get every month, let me build around that.

Those are some of the non-financial benefits that do not get enough play.

OWS: How should advisors frame this discussion with their clients?

Milevsky: I think the conversation has to start with pensions. I would get to the word 'annuity' at the last possible moment.

Why? Because the word has annuity has unfortunately been completely bastardized, and it means different things to different people. It's almost meaningless. It's like saying 'funds.'

I'd start the conversation around pensions. Do you have a pension? Does your spouse have one? Do you know how a pension works?

OWS: Are there advisors who embrace this point of view?

Milevsky: Yes and not just in North America. I came back from Sydney recently, and they're facing this problem too. I'm talking about and hearing the same things everywhere. This is a global conversation; it's not going away.

OWS: What advice do you have for advisors who weren't at the conference today?

Milevsky: It's time to take themselves out of the asset management business and think more holistically about the risks the client faces. Too many people are trying to solve problems with a pile of money, without looking at the broader picture.

This interview was conducted and edited by Andrew Welsch.