ED SLOTT'S IRA ADVISOR

Tax & Estate Planning For Your Retirement Savings

A Stress-Free Retirement Income Plan: The Benefits of Annuities in an IRA

Guest IRA Expert

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It is not uncommon for financial advisors to have adverse opinions of annuities. The benefits of annuities are consistently debated among industry professionals. Some argue that the long-term benefits and available riders – *like guaranteed income* – far outweigh the negatives.

Those on the opposite side insist annuities are too complicated for most retirees to understand, the fees are too high, and that a good advisor can find asset appreciation and income in other sources. Nevertheless, the annuity-IRA connection can be a powerful investment tool. I personally own five annuities, including two in Roth IRAs and one in my company's defined benefit plan.

During my career, I have written close to $100,000,000 worth of annuities for my clients. Over 75% of those annuities are held in traditional IRAs and Roth IRAs. Most are rollovers or direct transfers from 401(k)s, Thrift Savings Plans (TSPs), Defined Benefit (DB) plans, and lump-sum distributions from previous employers. Annuities play a key role in many of my clients' retirement accounts.

Safety First

Why use annuities in IRAs? Because most retirees and pre-retirees have the same two primary concerns: (1) they don't want to lose their principal; and (2) they want access to lifetime income if and when they need it. A well-chosen annuity can solve these concerns by protecting them from losing hard-earned money while providing an income stream that they can never outlive.

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Indeed, outliving one's money can be a valid concern. According to *The Centenarian* (thecentenarian.co.uk/how-many-people-live-to-hundred-across-the-globe.html), people who reach age 100 are currently the fastest growing part of the population. Estimates of centenarians in the U.S. go as high as 72,000; if the population of centenarians continues to increase at its current rate, there could be close to 1 million people reaching age 100 or older residing in the U.S by 2050.

It is very common today for people to live 30 years past the day they retire and an even longer life span is increasingly possible. Retirees who haven't planned for advanced age could experience economic distress. If the Social Security system doesn't vanish, clients won't run out of money in old age, but if they go through all their financial assets and rely mainly on Social Security, they can run short of money, sacrificing their dream retirement.

Here is where the right type of annuity comes into the picture. An annuity can be an insurance policy for their life's savings. Clients already insure their home, their cars, their health, and their life. *Why wouldn't they insure their life savings and retirement income?*

For true insurance, an annuity within an IRA can guarantee future cash flow, whether clients live to age 70 or beyond age 100. Many annuity providers do so by offering an income rider, which may be added to the annuity to guarantee set amounts of lifelong cash flow.

Two for the Money

An annuity's income rider may be called a Lifetime Income Benefit Rider (LIBR) or a Guaranteed Lifetime Withdrawal Benefit (GLWB). Essentially, an LIBR and a GLWB are the same thing, differing mainly because of the issuer's terminology. Either way, the rider is guaranteeing clients a future payment stream of which they can never outlive.

Clients don't need to annuitize their contract to get this guaranteed income stream. When someone annuitizes an account, he or she gives up control of those funds.

That same client can trigger the income rider payments from an LIBR or a GLWB without annuitizing, thus retaining control of those funds and permitting the remaining cash value to pass on to named beneficiaries.

When an annuity is combined with an income rider, clients are faced with two account values: one for the basic annuity contract value and one for the income rider value, on which the guaranteed payments will be based.

The better advisors understand this structure, the better they can explain the arrangement to clients and avoid future misunderstandings. Typically, the income rider will call for future cash flow to be stable or increase, even through years of stock market turmoil.

Comparing Costs

Most companies offer different LIBRs and GLWBs. Some of them have "no fees," but there are costs embedded in any added benefit, and clients get what they pay for.

For example, one annuity provider offers a 4% LIBR with no fee. For each year that the contract holder does not take a withdrawal, the guaranteed future income rider value compounds at 4%. There is never a deduction from the cash value for this benefit, even after guaranteed payouts begin.

The same company offers a 6% compounded LIBR for an annual fee of 1.1%, which is deducted from the cash value of the account for the life of the account, as well as a 7.25% simple (not compounded) LIBR for the same ongoing 1.1% annual fee. Knowledgeable advisors can evaluate such choices and make appropriate recommendations.

Either way, the [annuity income] rider is guaranteeing clients a future payment stream of which they can never outlive.

Besides lifelong cash flow, some clients will be attracted to "Well Being Riders," another option that comes with an annual cost. Here, if a contract holder becomes unable to perform 2 of 6 Activities of Daily Living (ADLs), the guaranteed payment will increase, perhaps to twice the base income amount.

Riders truly depend on the company and product. Advisors should get to know their clients' personal goals and desires for their retirement funds and find the best options for them and their families.

Fixed Indexed Annuities

Just as there are different types of guaranteed income riders, there also are different types of annuities that may be reasonable holdings for IRAs. For myself and my clients, I prefer fixed index annuities (FIAs).

Retirees and pre-retirees tend to be in the portfolio preservation or distribution stage of life, where safety and income are more important than risk-taking for maximum returns.

For them, an FIA can be a good fit for a portion of their portfolio. FIAs offer downside protection with upside potential. If the chosen market index(es) produce negative returns for a year, FIA owners do not lose any principal. If the index goes up, they participate in a portion of that gain. (Various caps on returns vary from company to company and product to product.)

Clients also can choose an upfront bonus with most FIAs, from 4% to as high as 25%. The bonus is most often added to the cash value of the contact, becoming a death benefit, but also can be added to the LIBR for future income.

As is the case when shopping for cars or clothes or anything else, annuity bells and whistles will vary in price. Advisors who help clients combine the right annuity with the right income rider can deliver life changing results.

Annuity issuers are very creative and competitive. They know the greatest fear of many seniors is running short on money at an advanced age, so there are various types of riders that can be attached to an annuity to provide sought after benefits.

Advisors who become educated about annuities and their income riders can custom fit clients' IRAs to include desirable benefits and features while avoiding the pitfalls.

For example, *Will the income rider payment continue at the same level after one spouse dies, or will the survivor receive much lower payments? Does the income rider allow for joint lifetime income covering the lives of both spouses?*

Some clients might not know that annuities can provide retirement accounts with the safety and income advantages as described throughout this article. Those clients might say, *"Such products don't exist. That's too good to be true!"*

Advisors who are willing to do a bit of research and explore annuities with income riders can learn the truth and deliver useful recommendations for clients' unique situations.

I have owned FIAs for over a decade and I know firsthand just how real and powerful they can be within IRAs and other plans. For a portion of your clients' portfolios, the right type of annuity can provide lifetime income and help address the foremost fear — *a financial failure*. You can give your clients a stress-free retirement and help them sleep well at night.

Advisor Action Plan

- Determine which clients prioritize portfolio safety and income over maximum returns.
- Ask those clients if they would be receptive to holding deferred annuities in their IRA.
- If so, explain that income riders are available, with downside protection and guaranteed lifelong income.
- Learn which annuities and available income riders offer suitable benefits for clients, including surviving spouses, at a reasonable cost. ■

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Brad graduated with a BS in Education from Arkansas Tech in 1993. He holds his Life and Health and P&C Licenses in Missouri and Arkansas. Brad has been a member of Ed Slott's Master Elite IRA Advisor group from 2010-2019. He is a member of the MDRT – Million Dollar Round Table, "The Premier Association of Financial Professionals," and was awarded "Top of the Table" honors in 2015-2019.

Brad is also the author of the #1 best-selling book, *Safe Money Matters*, and he hosts *Safe Money Radio* each week on several stations in Missouri and Arkansas. He was named the 2018 Safe Money Radio Advisor of the Year.

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