



FINANCIAL SERVICES
FOR THE GREATER GOOD®

Life Annuities: What They’re Saying Isn’t So

By Benjamin Goodman and Mary Pat Campbell

Some financial services professionals say that converting retirement savings into a life annuity is a bad deal. In their desire to manage all your money, they may be downplaying a product that can add stability to your retirement income portfolio.

“Don’t buy an annuity; you’ll lose all your money,” some financial services professionals tell older people to keep them from converting a portion of their retirement savings to an immediate annuity. And the business and financial press advise readers against annuities in general, citing high costs, even though there are reputable companies offering annuities with low costs and no sales commissions.

In this article, we’ll dispel the myth that you’ll lose your money if you die early. You’ll learn about the protections a life annuity provides and the stabilizing role it can play when you include it as part of your retirement income portfolio.

What Is a Life Annuity?

Also called an immediate annuity, a life annuity is “long-life insurance.” You pay an insurance company a sum of money to guarantee that you will receive a series of income payments that lasts as long as you do, even if you exceed your life expectancy. (See life expectancy tables, P. 3.) **Note that once you purchase a life annuity, you lose control of your principal.**

Life annuities are either fixed or variable. A fixed annuity guarantees principal and a specified interest rate and may also offer dividends. A variable annuity’s returns fluctuate according to the market performance of an underlying securities portfolio; principal repayment and rate of return aren’t guaranteed.

Let's begin with the typical "scare" scenario:

You're age 65, feeling great and looking forward to retirement. You want to make sure you won't outlive your savings, so you decide to buy an annuity to guarantee income for life.

But right after finalizing the contract with the insurance company, you walk outside, get hit by a meteorite and die. Because your life annuity makes payments during your lifetime only, your beneficiaries will get nothing. This part of your retirement savings has been completely lost, retained by the insurance company.

If you purchase a "guarantee period," this won't happen.

A Guarantee Period Protects Your Estate

The guarantee period ensures that you — or someone you designate — will receive annuity payments for *at least* a certain period of time. If you die during that period, your beneficiary will receive the annuity payments remaining in the period. If you die after the guarantee period, your payments cease. But, of course, payments will continue to you throughout your life. (All guarantees are subject to the claims-paying ability of the issuing insurance company.)

Let's go back to the "scare" scenario. This time, you choose a life annuity with a 15-year guarantee; you designate your sister as beneficiary, and then the meteorite hits you. What happens now? For the next 15 years, your sister will receive the annuity payments that you would have gotten. Similarly, if you die after receiving five years of payments, she will receive 10 years of payments. If you live beyond 15 years, payments will still be made to you, ceasing only after your death — which could be 20, 30, or even 40 years after you start taking annuity income.

What does a guarantee period cost?

When you choose a guarantee period, you are effectively buying "insurance" on the annuity. The "price" of this insurance is that annuity payments will be somewhat lower. For most people, adding the guarantee period won't lower payments by very much.

For example, let's take a \$100,000 fixed single-life annuity (for one person) and assume an annual 5% interest rate. The table below shows how much age affects the monthly payments and how much payments differ with no guarantee period versus a 10- and a 20-year guarantee period.

Annuity Payments With and Without a Guarantee

Age	No Guarantee	10-Year Guarantee	20-Year Guarantee
55	\$536	\$531	\$518
60	\$576	\$568	\$545
65	\$631	\$616	\$575
70	\$708	\$679	\$605

Note: Illustrations and calculations are based on a hypothetical annuity with a 5% fixed payout using a mortality table chosen by the authors. In actual practice, results could differ. **These figures are assumed to be net after expenses and fees.**

The reduction is smaller for those who buy an annuity at younger ages. A 55-year-old’s payment is reduced by just 1% in exchange for a 10-year guarantee, and by just 3% for a 20-year guarantee. In contrast, a 70-year-old faces a 15% reduction in exchange for 20 years of guaranteed payments. That’s because of the difference in life expectancy.

We have been talking about single-life annuities, for one person. This same guarantee period concept can be applied to the purchase of “joint-life” annuities, for a couple.

In summary, then, think of a life annuity as a very conservative investment that can play a stabilizing role in your overall retirement income plan.

How Long Will You Live?

Life expectancies for TIAA-CREF annuitants are longer than for the general U.S. working population.* Since the TIAA-CREF annuitants’ life expectancy table is gender neutral, women should figure on living longer than the average ages shown below.

*Based on 2005 TIAA total payment mortality.

TIAA-CREF Annuitant Life Expectancy Tables
(gender neutral, TIAA-CREF annuitants)

Current Age	Life Expectancy
50	86.8
55	87.2
60	87.8
65	88.4
70	89.3
75	90.5
80	92.0

Are Annuities a Good Investment?

When you turn your retirement savings into a life annuity, you're guaranteed an income for life — payments will continue even if your savings wouldn't have been sufficient to generate them! Fine, but now let's look at whether the guarantee period — if you choose one — makes the annuity a reasonable *investment*. What kind of return do you actually get? Are you at least getting back what you've put in?

Let's take a "fixed" annuity as an example. The payment amount is set at the time of purchase and will remain level until your death or the end of the guarantee period. You can be sure you're getting a positive investment return if the sum of the guaranteed payments is greater than your initial investment.

For variable annuities, it is more difficult to demonstrate a positive return, because payments by definition change from year to year, or month to month. However, you can get a rough idea of the potential returns by assuming that all future annuity payments are equal to the initial payment.

When does an annuity start returning more than you paid?

To calculate the number of payments it would take to break even (to equal your initial investment), divide the amount of money you paid for the annuity by the annuity payment amount.

Let's assume that at age 60, a person paid \$100,000 for a *fixed*-life annuity and that the payments were based on a 5% interest rate. The following table shows the amount of monthly payment and number of payments to break even with no guarantee period, a 10-year guarantee period, and a 20-year guarantee period.

Break-Even Points

	No Guarantee Period	10-Year Guarantee Period	20-Year Guarantee Period
Monthly Payment	\$576	\$568	\$545
Number of Payments to Break Even	174	176	184
Actual Number of Payments in Period (guaranteed)	N/A	120	240 56 extra payments

Note: These hypothetical returns are for illustrative purposes only and do not reflect actual performance. **These numbers are assumed to be net after expenses and fees.**

With no guarantee period, the person would receive payments of \$576 a month,* and the person would need $\$100,000 \div \576 , or 174 payments, to break even.

With a 20-year guarantee, the person's payments would be \$545 a month,* and the person would need $\$100,000 \div \545 , or 184 payments to break even. (That's only 15 years and 4 months, not 20

years.) Since the guarantee is 240 months (20 x 12), the person would receive *at a minimum* 56 extra payments (240 – 184 = 56) — unquestionably, a positive return on your investment.

Since the annuitant or beneficiary is guaranteed to receive at least 240 payments of \$545 on a \$100,000 initial investment, the minimum return (that is, death occurs within the first 20 years) is approximately 2.9%. The expected return (that is, if death occurs at the “expected” age) is approximately 5%. And if the annuitant lives well past life expectancy, the return on this investment can be as high as 6.3%. You can calculate these positive returns using a financial calculator or spreadsheet.

A 65-year-old who purchases a Single Life Annuity with a 20-year guarantee has a monthly payment of \$575.* The minimum return of this payment stream is 2.9%, with a maximum return of 6.3%.

A life annuity with a fixed payment and a guarantee period is a low-risk investment, with a very narrow range of potential results, that protects against outliving income. We believe it should be a part of every healthy retiree’s portfolio.

***Under this hypothetical illustration. Actual results may differ.**

Benjamin Goodman is a director, Actuarial Consulting Services, TIAA-CREF.

Mary Pat Campbell is a senior actuarial assistant, TIAA-CREF.

Get quotes for annuity payments for different guarantee periods before you buy a life annuity. Then you can check to see if you’ll do better than break even.

TIAA-CREF Individual & Institutional Services, LLC, and Teachers Personal Investors Services, Inc., distribute securities products. **Consider the investment objectives, risks, charges and expenses carefully before investing. Call 877 518-9161, or go to www.tiaa-cref.org for a current prospectus that contains this and other information. Please read the prospectus carefully before investing.** TIAA (Teachers Insurance and Annuity Association), New York, N.Y., and TIAA-CREF Life Insurance Co., New York, N.Y., issue insurance and annuities.

© 2007 Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF), New York, N.Y. 10017

C38430