Extend Your Retirement Savings

By Aleksandra Todorova
June 14, 2006

OUTLIVING ONE'S RETIREMENT SAVINGS is many investors' worst nightmare. Now, some insurance companies are rolling out products that cater to that fear.

"Longevity insurance" provides guaranteed income typically starting after you turn 85, in exchange for an initial investment made some 20 years earlier. Payouts are fixed and cover you and your spouse for as long as you live. With some variations of this product, you can also opt for a death benefit, which guarantees that your account will hold a certain value that can be paid out to your heirs if you die before the payout age.

The products are a new spin on deferred fixed annuities, which are typically tax-deferred investment vehicles set up to provide a guaranteed income stream starting at a predetermined point in the future. Longevity insurance is "an old product that's been dressed up in new clothing," says Steve Weisbart, an economist with the Insurance Information Institute, a New York-based industry group. In other words, it's an annuity with a few new features set up to emphasize a lifetime income guarantee.

If you're someone who loses sleep over the prospect of outliving your savings, you may want to consider longevity insurance. But you also need to be fully aware of the downsides, which include the distinct possibility that you may not live long enough to see one dime in the way of return on your investment. Here's what to consider.

The Basics
Here, in a nutshell, is the pitch:

Say you're 65 years old, and worried that you've only saved enough to last for about 20 years. The solution: Use part of your savings to purchase a longevity insurance product, which will start providing income 20 years from now.

The main advantage of this product over a regular deferred annuity is that the income payouts are higher. How much higher? Here's an example: If you bought a $10,000 deferred fixed-income annuity from MetLife at age 65, in 20 years that annuity will start paying $137 a month, assuming the investment grows at the minimum guaranteed 3%. But with MetLife's Retirement Income Insurance — its basic longevity product that starts income payments at age 85 and has no death benefit or withdrawal options like the annuity — your monthly payout would be $710.

So what's the catch? To offer that sort of payment, the insurance companies have stripped many of the flexibilities of deferred annuities. For example, with a deferred annuity you are typically guaranteed a minimum annual return on your investment — and may earn more than that depending on market conditions. With longevity insurance, you'll get the same payout regardless of how the stock and bond market performs over the next 20 years. The product also has no inflation adjustment built in, which means 20 years from now the income you imagined receiving may be worth considerably less.

Most importantly, longevity insurance typically has no death benefit and doesn't allow any withdrawals before age 85. With the life expectancy of a 65-year-old male at 82 years and that of a 65-year-old woman at 85, according to the National Center for Health Statistics, you may not even live to see your initial investment pay back.

"What the insurance companies are doing here is taking money from a lot of people who'll never live to get anything," says Steven Podnos, a fee-only Certified Financial Planner (CFP) with Wealth Care in Merritt Island, Fla. "To me, it makes a lot more sense — if you're interested in an annuity product — to have a traditional deferred annuity and have flexibility."

The insurance companies are aware of these concerns, of course, and have added on longevity products with more features — some including death benefits — but higher costs, as well. The Hartford Financial Services Group, for example, offers a

longevity product that allows investors to start receiving payouts before they hit the 85 mark. Of course, the younger you choose to start your income stream, the lower the payouts will be. A $10,000 policy bought at 65 with income starting at age 75, for example, would pay out $166 a month vs. $638 a month if income starts when you turn 85. Add on a death benefit option, and your monthly income decreases to $137 starting at 75 or $448 at age 85.

The Alternatives

You could, of course, simply invest the money that you would spend on this type of insurance on your own — and in many scenarios come out ahead. If you took your $10,000 and invested it in the stock market for 20 years, for example, assuming 6% growth per year — a conservative assumption — you would end up with $32,000. With $710 monthly withdrawals, the money would last nearly four years — if it didn't grow at all when you started collecting. So even without an insurance policy, you'd be covered until age 89.

"Longevity insurance becomes worthwhile only once you cross over into your 90s," says Tom Orecchio, a fee-only CFP with Greenbaum and Orecchio in Old Tappan, N.J., who recently did a comparison between Hartford's longevity product and a regular fixed-income annuity. Before you hit 92 or 93, an annuity or investing on your own makes more sense.

If You're Going to Buy....

No matter what, longevity insurance should be, at best, only a small part of your long-term financial plan.

"Longevity insurance is a particularly effective product if you couple it with an investment strategy," says Chris Raham, a longevity expert with Ernst & Young. His advice: Use 10% to 15% of your assets to purchase a longevity product and leave the rest in your portfolio to provide income until it kicks in. With a guaranteed income starting at a predetermined point in time, you'll basically take the biggest unknown out of your retirement-planning strategy, namely how long your money should last. You could be more aggressive with your investments and fine-tune the size of your withdrawals without the fear of running out of money.

Finally, when choosing a product, remember that you're buying income that will not kick in for 20 years or more. So be sure to go with a company with a good reputation and solid financials. You can check a company's credit rating with services like Standard & Poor's[1] and A.M. Best[2].

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