

THE WALL STREET JOURNAL.

WEDNESDAY, JULY 22, 2009

© 2009 Dow Jones & Company, Inc. All Rights Reserved.

Long Derided, This Investment Now Looks Wise

Thanks to Guarantees, Variable Annuities Paid Even When Stocks Didn't

By **LESLIE SCISM**

One of the best investments of the past decade was one of the most derided: the variable annuity. But investors who want in on the action now are in for a shock, as the juiciest deals have disappeared from the market.

Variable annuities, a tax-advantaged investment account that holds a type of mutual fund, are sold by insurers, and most offer some form of investment guarantee for an additional fee. For years, they were attacked for being too expensive. Why pay for a guarantee to protect against a stock-market decline, the argument went, when stocks continued their inexorable march upward?

Then stocks plunged, and variable-annuity guarantees no longer looked expensive. In fact, insurers, in a move to build market share, had underpriced many of them. Suppose an investor owned a variable annuity that tanked in value last year. No matter. Under the most-generous contracts, insurers pledged to pay customers lifetime retirement income based on past market gains in their underlying funds, plus minimum annual increases in years the market is sluggish or down.

Because of such guarantees, many holders of variable annuities actually saw their accounts increase 6% or more in value last year, when the Standard & Poor's 500-stock index dropped nearly 39%.

"When I watch friends bemoaning the market, I feel guilty saying anything, actually," says Amy White, a 67-year-old retired accountant in Dallas. She and her late husband invested hundreds of thousands of dollars in variable annuities early this

decade, and their funds rose as the market neared its 2007 peak. While they fell last year, the guaranteed amount—on which Ms. White's retirement-income checks will be based—is still more than double the invested amount.

"I know that I'm doing quite well," she says, while her friends are "experiencing real pain."

An estimated \$300 billion of these retirement-income guarantees are outstanding, compared with \$3.7 trillion in stock mutual funds.

Variable annuities still have some notable drawbacks. Among the biggest: There is no lump-sum option for cashing out the guaranteed amount. Instead, the higher guaranteed amount is payable by the insurer over time, with 5%-a-year payouts common for those in their 60s when they start receiving checks. If you cash out all at once, you get only the shrunken sum that remains in your funds. Another concern: The insurers have to stay healthy enough to cut all those checks.

So far, though, it is the issuers' stockholders who are getting the raw end of the deal. To meet their annuity obligations, the roughly two dozen insurers who dominate the field have boosted their claims reserves, which has hurt earnings, and have raised fresh capital, which dilutes existing shareholders. Hartford Financial Services Group Inc. and Lincoln National Corp., two big issuers of variable annuities, also have accepted money from the U.S. government's Troubled Asset Relief Program.

Variable-annuity sales were down 27% in the first quarter, as stock investments of many sorts took a dive. Those buying typically are in their 60s, says Thomas Hamlin, a top broker at

Raymond James Financial Inc., though 40- and 50-year-olds are increasingly interested. "People are sick of sliding back down to the base camp after they felt like they were about to put their flag in the top of the mountain," Mr. Hamlin says, and the guarantees are the investment-world equivalent of "rope and ice spikes."

The guarantees are no longer as sweet, yet what is still for sale is "better than the alternative: mutual funds with no downside protection," says Mr. Hamlin.

In scaling back the products, many insurers are reducing the size of the minimum annual boosts to the guaranteed income base—or the value of the underlying investments combined with any investment gains and minimum annual boosts. For instance, the "Accumulator" variable annuity of AXA SA's AXA Equitable Life Insurance Co., a year ago offered an income-base guarantee calculated with a 6.5% minimum annual-growth factor, while the new version uses 5%. Many also are reducing the annual withdrawal payouts by about one percentage point, while fees are up about a fifth of a percentage point, according to Milliman Inc.

Some formerly big players have suspended sales of guaranteed variable annuities entirely. Of those still available, MetLife, like AXA Equitable, promises to boost the income base by 5% a year in most states, if there aren't investment gains greater than that on contract anniversary dates. Ohio National Life Insurance Co. also has an offering with a 5% minimum annual income-base boost, and 6% versions still for sale in some states.

Around since the 1950s, variable annuities originally were

From Loathed To Loved

Guaranteed-minimum variable annuities have turned out to be a smart buy for many investors. Here are some key considerations:

- The issuer is on the hook to make up for investment losses.
- Investors can't withdraw the guaranteed amount in a lump sum. It is paid out over years.
- Investors should buy from insurers with high ratings.

pitched for their tax-deferred buildup of investment earnings; they're akin to 401(k) plans in that taxes are paid as the money is withdrawn. Insurers in the 1980s began tossing in a "death benefit": If your underlying funds perform badly, your heirs will receive at least your original principal, less withdrawals.

Critics included Moshe Milevsky, a finance professor at the Schulich School of Business at York University in Toronto, who crunched data in the 1990s and concluded that consumers were being "grossly overcharged." At the time, variable-annuity fees approached 3% of the account balance, more than twice that of a typical mutual fund.

His findings were widely circu-

(over please)

lated among consumer advocates, financial commentators, regulators and plaintiff lawyers. One of the big beefs has been that many insurers pay big commissions to salespeople, which may encourage them to push the products regardless of their suitability, including to many elderly people who would need access to their money during periods when surrender penalties apply.

In recent years, the landscape has shifted. In a bid to cash in on baby boomers' fears of outliving their savings, insurers were adding "living benefits"—investment guarantees that kick in while the owner is still alive. So two and a half years ago, Prof. Milevsky updated his research, making an about-face: "Some

insurance companies are not charging enough," given the cost of risk-management instruments that insurers can buy to protect themselves, he wrote in 2007 in *Research Magazine*.

Some on Wall Street, seeing a bargain, bought annuities for their personal portfolios. Consider Colin Devine, an insurance-stock analyst at Citigroup Global Markets. He has been bearish on some insurers as stock investments because of the guarantees, even as he owns guaranteed variable annuities from MetLife Inc., Lincoln, ING Groep NV, Manulife Financial Corp.'s John Hancock Life Insurance Co. unit and Pacific Life Insurance Co.

Prof. Milevsky recommends that individuals who lack old-fashioned

pensions put a portion of their savings into the products to create personal pension plans. Even with the cutbacks, "overall, I still believe that these products make sense for individuals approaching retirement," he says.

Many in the industry are eager to see consumers' response to John Hancock's newly launched "AnnuityNote." The investor's money is invested in an indexed stock and bond portfolio. After five years, the contract guarantees a 5%-a-year lifetime withdrawal based on the total amount invested or the value of the fund investments at the fifth contract anniversary, whichever is higher. There is no automatic income-base boost in bad market years. Total annual fees: 1.74%.

Such streamlined guarantees are expected to proliferate. Just this week, MetLife introduced "Simple Solutions," to be sold through banks, which similarly locks in investment gains annually but promises no minimum income-base boost.

Erin Botsford, president of Botsford Group in Frisco, Texas, used to be an "anti-variable-annuity person," but became a convert after the tech-stock crash. Advisers often focus on performance and fees, she says, when the client really wants to know: "Where should I invest my hard-earned savings in order to ensure I can have a comfortable retirement that I cannot outlive?"