Single Life Annuity Plan Designs

Overview:
Getting the best rate on an annuity is the easiest aspect of our work. Getting the right plan design is equally important when considering immediate annuities for providing income. **Single Life Annuities** are contracts issued by insurance companies that provide income for the life of one annuitant. Like all life annuities, the single life annuity is tied to life expectancy and interest rates. Single Life Annuities are usually purchased by individuals that are single or manage their finances separately from their spouse or partner.

Single Life Annuities may also be appropriate for couples where there are differences in age and income sources at death instead of the more popular joint and survivor annuity that covers two lives. For example, if one of the annuitants has income that would stop at his or her death thereby depriving the other annuitant of income, the Single Life Annuity may be more economical than a Joint & Survivor Annuity that covers two lives. For example, husband and wife are in a second marriage. The husband has a pension plan that stops at his death. A Single Life Annuity on the wife should be compared to the joint and survivor as it may provide more income for a given investment.

The joint and survivor plan, maybe more appropriate in other circumstances than the Single Life Annuity. For this reason, when looking at married couples and domestic partners, income sources before and after specific deaths need to be examined to determine if the single life or joint and survivor is more economical.

Single Life Only (1):
This annuity pays for the life of the annuitant and discontinues payments irrespective of the number of payments made. This type of Single Life Annuity pays the most income for a given investment. However, at the younger ages, where life expectancy is high, there is little difference between this and other types of Single Life Annuities. It is at the older ages (mid 70's or higher) where this type of annuity tends to provide a large difference in income over other Single Life Annuities where there is a guaranteed number of payments should the annuitant die early. This type of annuity is most popular with those that have no heirs they are concerned with and are looking to maximize income. It is also very popular with those that feel they have a long life expectancy and wish to maximize their income. The big issue most find with this type of annuity is that should the annuitant die early; the insurance company gets to keep the unused principal. On this latter point, it is irrelevant to the insurance company as they price this probability into the contract. This type of annuity is also popular with annuitants that feel they are leaving other assets to their heirs. Many annuitants with heirs opt for this option because of the leverage provided by the annuity itself. Because this type of annuity guarantees lifetime income significantly in excess of other safe investments, less capital needs to be devoted to providing income. The excess capital is therefore available for other uses such as growth in more aggressive investments and gifts. For example, if a CD is providing $3,000 a year income

on a $100,000 deposit and an annuity only requires $40,000 to provide the same income, $60,000 of capital is freed up to make gifts now or to invest more aggressively.

For annuitants that are using their IRA or other pension money to buy the annuity, many times feel that the taxation of the benefit to the heirs diminishes the value of the residual left. They therefore choose other assets to leave their heirs that don't have the income tax burden of the IRA. This "**freed up capital**" will benefit heirs now through gifts or in the future as it grows. In the end based on my experience, for those that have heirs to worry about it usually comes down to the desire to take care of income needs or inheritance goals.

Some companies do not offer this type of annuity for annuitants at various cutoff ages starting in the mid 70's. For this reason, some companies will not show up in our survey for Life Only Annuities.

Single Life Installment Refund (2):

This annuity guarantees payments for the longer of life or until the original investment is returned. Should the annuitant die before receiving back in total payments the original investment, payments are continued to the named beneficiary until the total of payments during life and to the heirs equals the original investment. The refund is made in installment payments hence the name **Installment Refund**. This is the most popular Single Life Annuity as it takes some of the worry out of early loss of life. In effect, it assures that the worst case scenario is a loss of the use of money should the annuitant lose their life early. Annuitants with heirs and little in other assets to leave them usually find this annuity appealing. The difference in Refund Annuity and the Life Only is marginal in the 60's and becomes significant starting in the mid 70's.

Single Life with Cash Refund (3):

This annuity pays for the life of the annuitant as all other Single Life Annuities. However, if death occurs before the annuitant has received the full original investment, then the difference is refunded in cash to the beneficiaries. For example, if $50,000 in total payments were collected on a $100,000 annuity, the heirs would get $50,000 in cash. This type of annuity provides less income than the Life Only and Installment Refund Annuity. This type of annuity, based on my experience is used mostly where annuitants or their family want to get cash to the beneficiaries to settle the estate. I have mostly seen this opted for in cases where the annuity is being used to make assisted living payments and there are multiple beneficiaries. The annuity assures that the payments are made for life and beneficiaries get any residual quickly so the estate can be closed. Some annuitants just like the idea that the money gets paid out quickly.

If the annuity is being purchased by an IRA or other type of pension plan, I caution using this option as lump sum payments to beneficiaries can erode the benefit of the cash quickly if it puts the heirs in a higher tax bracket since all of the cash payment is income taxable to the beneficiary.

Single Life with Period Certain (4):

This annuity guarantees the payments for life or a certain number of years with the period certain chosen optionally at the time of the original investment. For example, a life with 15 years certain guarantees payment for the longer of life or 15 years. If death occurs before 15 years, payments continue until the end of the 15th year. If death occurs in year 17, the payment stops at loss of life. This plan allows annuitants to guarantee the payment for life issues. For example, an annuitant may be older than her husband and his pension starts in 10 years. A life with 10 yrs. certain assures that the income will be there at least until the husband's pension starts. This **Period Certain Annuity** arrangement may be more attractive than buying a Joint and Survivor Annuity which pays for both lives. Where I have seen this choice used most successfully is where one spouse has impaired health and low life expectancy. These partners want to provide for the healthy spouse but fear that the healthy spouse will die unexpectedly before the impaired spouse. Having a 10 yr. certain on the healthy spouse would assure that payments are made for at least 10 years or any other period certain chosen. This type of annuity may be more economical than a Joint and Survivor Annuity that covers both lives since the insurance company gives no credit for the impaired life expectancy of the ailing spouse. If the ailing spouse is younger than the healthy spouse the difference over the Joint and Survivor Annuity will be significant.

Selecting an Insurance Company:

There are a small number of insurance companies that offer Immediate Annuities and even fewer that are consistently competitive in the market. Rates from companies vary weekly depending on insurance company investment opportunities and current reserve levels. Companies therefore literally come in and out of the market weekly. Some of the insurance companies use more refined actuarial tables for different types of annuitants and therefore maybe more competitive in these actuarial circumstances. This is particularly true with Single Life Annuities and at the later ages (80+).

Rates are only one factor in company selection. Company strength or credit ratings are important as well. In looking at ratings, we feel it is important to look at all of the rating agencies, not just one. A.M. Best, Standard and Poors (S&P), Moodys and Fitch are the major rating agencies that analyze the credit quality of insurance companies. We prefer to look at all of the agencies as they may have done their analysis at different times and may have opinions we should be concerned about. The problem with using the multiple rating agencies is they all use a different rating scheme. For example, A+ is the second highest rating for A.M. Best. However, an A+ rating from S&P is the fifth highest rating. For this reason, insurance insiders use the Comdex score.

The Comdex score is not a rating but a score which normalizes the different rating agency ratings and expresses them numerically. A Comdex score of 90 for example means that the company has a stronger financial profile than 90% of all companies rated. We feel that the Comdex score pays attention to all ratings, normalizes those ratings and expresses the score in a form that has meaning. While we quote companies with low scores, we prefer companies 90 or better. Very few companies provide significantly different rates for larger annuity investments. For this reason, it may be desirable to purchase multiple policies from different companies. Since most annuitants have their monthly payment deposited to their checking account, purchasing multiple annuities is only extra work for the agent. If it costs you little to diversify companies, it certainly makes sense to do so. Moreover, each state has an insurance guarantee association that limits the amount of benefit they provide for companies that may become insolvent. Purchasing multiple companies to stay in the limit for a state may make sense if it does not cost much in reduced overall payment.

Additional information on the Comdex score can be obtained at the following two links on the internet. http://www.ebixlife.com/vitalsigns/comdexconfus.aspx , http://www.lifelinkcorp.com/vitalsigns/comdex_ps.asp?nb=29&sb=11

Information about state guarantee associations may be obtained at the following link where you can get information on your state guarantee association and coverage limits. http://www.nolhga.com/factsandfigures/main.cfm/location/stateinfo.

Conclusion:

Most prospective annuitants are so focused on getting a quote for the best rate and eliminating sales pressure that they do not discuss the issues that may make a difference in the plan design and hence the guaranteed income from the annuity. Selecting the right design of annuity involves looking at income sources both current and in the future and how those income sources change at death in the case of married couples and domestic partners. In the case of single annuitants, a balancing of income needs and testamentary goals needs to be considered. Our experience is that prospects are so focused on getting the best rate that they don't consider the simple options available.