



## Joint & Survivor 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. **Joint and Survivor Annuities** are contracts issued by insurance companies that provide income for the lives of two annuitants. While most joint annuitants are husband and wife, joint and survivor annuities can be issued on any two lives.

Like all life annuities, the Joint and Survivor Annuity is tied to life expectancy and interest rates. The life expectancy is for two lives. These annuities have practical appeal for two individuals whose lives are tied in economically. As compared to **Single Life Annuities**, the presence of two lives typically provides less income for a given investment.

The rate on a joint and survivor annuity is typically dominated by the younger annuitant, particularly if that person is a female. When two people are living off the same investment, the joint and survivor is usually warranted. However, Single Life Annuities may make more sense if one of the annuitants has income that would stop at his or her death thereby depriving the other annuitant of income. For example, husband and wife are widowed. 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, while very popular, is sometimes inappropriate when the need is to replace or maintain income that is reduced or discontinued at the death of one of the two prospective annuitants. For this reason, income sources before and after specific deaths need to be examined.

### **Joint and Survivor Life Only (1):**

This plan guarantees a monthly income until the last death of the two annuitants named in the policy irrespective to how many payments were made during the annuitants joint lives. After the first death of the two annuitants, the income continues at either 100% of the original monthly guaranteed payment or optionally at a reduced level such as 25, 33.3, or 50% reduction in income.

The **Joint and Survivor Life Only Annuity** provides the most guaranteed income for all of the joint and survivor plans. This annuity has considerable appeal to those that are looking to maximize income and are not concerned with leaving any residual to their heirs either because they have no heirs they are concerned with and or they feel they have other assets that their beneficiaries will inherit.

Annuitants using their IRA or pension money to buy Joint and Survivor Annuities sometimes feel that leaving pension money that is income taxed to their beneficiaries is of little value. Instead,

they prefer to leave assets that have a stepped up income tax basis. These annuitants are focused on taking care of each other. From my experience, some annuitants are so confident in their long life expectancy that they feel that sacrificing income for life to benefit the heirs is not warranted.

### **Joint and Survivor with Period Certain Annuity (2):**

This annuity guarantees monthly income for the longer of the death of the last annuitant or for the guaranteed or “certain” number of years opted for in the policy. For example, a joint and survivor with 15 years certain guarantees payments for a minimum of 15 years. If both annuitants die before the 15th year, the payments continue to the heirs until the end of the 15th year. If the last annuitant dies in year 20, payments would stop at that time since 15 yrs of payments have already been made. This type of annuity is well suited for those that fear they may die before collecting their original investment back and prefer their heirs to get the balance of payments. It is also preferred by those annuitants that feel they need to leave as much as possible to their heirs.

The certain or guarantee period can be selected to permit a refund of the original investment or to achieve some time oriented goal that the annuitants have. An example of the latter is a family raising a grandchild that is now 7. A 15 yr. certain joint and survivor assures that the income is there until the child is 22. The longer the certain or guarantee period, the lower the monthly investment that is provided for a given investment. The number of years guaranteed in this type of annuity can be geared to assure a full return of the original premium. For example, an annuity that provides for \$700 per month on a \$100,000 investment for 12 yrs. certain would guarantee a minimum of \$100,800, slightly more than the original investment.

Many companies do not offer a Joint & Survivor refund annuity (this is an annuity that guarantees a minimum of the original investment back on early loss of life). To get a quote from these companies selecting a period certain makes sense as there are then more opportunities to get a better rate. Over the years we have found that annuitants select this period certain option for several reasons. First and foremost is the desire to leave money to the heirs. Second, they may feel uncertain about their health and life expectancy. Finally, they hate to see the insurance company collect so much money should they die early. On this latter point, the insurance company determines the rates actuarially and provides less income for a certain period. It is irrelevant to the insurance company as they adjust the payout to match the option. It should be remembered if one selects the period certain option over the life only option then the reduced income is payable for life. For this reason, those confident in their longevity tend to gravitate to the life only option.

### **Income Options at the First Death with Joint & Survivor Annuities (reducing income vs. maintaining income after one of the annuitants dies):**

Most Joint and Survivor Annuities are set up so that after the first death, the income continues uninterrupted for the surviving spouse. We refer to this as a joint and 100% annuity. This annuity does not reduce the income after the first death. This may be appropriate for most

situations but can be a poor choice in other situations. A Joint and Survivor Annuity can optionally be reduced after the first death to provide less income to the survivor. Alternatively, annuitants can select a joint and 2/3 annuity, joint and 50% annuity or a joint and 75% annuity. For example, a joint and 2/3 annuity that provided \$1,000 per month while both annuitants are alive would provide \$666.66 per month to the survivor after the first death. This reducing income option is independent of the life vs. the period certain option. This reducing income arrangement can be very attractive if it fits in with the goals of the annuitants as it would provide more income for a fixed initial investment than the joint and 100% annuity.

The larger the spread in age between the two annuitants named in the contract, then the larger the difference in the income over the joint and 100% annuity. The potential for larger income for the same investment has a lot of appeal and therefore prospective joint annuity investors should think carefully about this option. The simple logic is that two people require more income than one, therefore, less income is required after the first death. This is only one factor in the analysis. Life is more complicated and it may not be that simple. An important consideration is the sources of income and what happens to that income on the death of either annuitant. The two annuitants may have different income sources that terminate at death. In second marriages for example, both spouses may have pensions that terminate at each spouse's death. This set of circumstances would not favor a reduced income after the first death. On the other hand, if income, other than the annuity, remains in full force after the first death, then the reduced income benefit should be considered. This option can bring about a very meaningful increase in income, particularly if the spread in ages of the annuitants is large.

Prospective annuitants need to think very carefully about the sources of income they now have and what happens to the level of that income at either death. If it is practical to live on less income, then the annuity that reduces on the first death should be considered. Based on experience, we have found that the reducing annuity option is selected in several situations. First, where there is a definitely determined reduced need for income after the first death and the difference in income from the reducing annuity is meaningful. Second, some annuitants are confident that their probability of longevity is so great jointly that they feel that they are unlikely to spend many years living alone on the reduced income. Third, and most importantly, many annuitants want to maximize income early in life. These annuitants simply feel that they need income now while they are in good health and can enjoy the extra income. These annuitants feel that they are in better health now, have more opportunities for travel and entertainment and therefore need the additional income at this time. They would rather take the reduction in income later in life when they do not have the same opportunities and quality of life and when they are living alone. The problem with these annuities that reduce on the first death is that many companies do not offer them. Therefore, there may be fewer quotes available. It is possible to target the reduction in income to a specific annuitant's death. For example, a wife may have a pension that terminates at her death while her husband's pension continues to the wife should he die first. In this case, we would want an annuity that only reduced if the husband died first as his and the wife's pension would continue if he was the first to die. An annuity that reduced on his first death only could be obtained. These types of targeted reduction of income annuities are even less available than annuities that reduce on

each death. In many cases the difference in income over a non-reducing annuity is too small to make a big difference. We are able however to make these annuities possible by combining the single life with the joint live non-reducing annuity. In the example above where the wife has a pension that terminates at death, we simply buy a single life annuity on the husband's life and a non-reducing joint and survivor pension on both lives. If the husband dies first, the single life annuity stops while the wife's pension continues. If the wife dies first, both annuities continue to pay while the wife's pension stops.

### **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.

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. 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](http://www.lifelinkcorp.com/vitalsigns/comdex_ps.asp?nb=29&sb=11)

**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. We think that the prospective annuity investors should think through the options on the joint and survivor annuity price them out and decide what is practical for them. There are not many options on the joint and survivor annuity so considering all of them is not a big chore. Our experience is that prospects are so focused on getting the best rate that they don't consider the simple options available.