Can Annuities Boost Retiree Returns?

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Although interest rates are rising they're still pretty low by historical measures, so it's hard to get a safe, reliable return on savings—especially for retirees who may have a relatively short timeframe. Variable annuities, which invest in mutual fund-like sub-accounts, can post decent gains depending on the vagaries of the market, but they're also subject to market volatility. What about the more secure portion of a retirement plan? Can fixed-rate annuities help build returns?

Annuity Benefits

Philip Chao, chief investment offer and principal at Experiential Wealth in Cabin John, Md., notes that fixed annuities typically credit accounts at a higher rate than money market or government bond funds. That's because the insurance companies behind them can invest client premiums in a diversified portfolio, including longer-term instruments. "This allows them to credit above market returns," he said.

Todd Giesing, senior director of annuity research at data tracker Secure Retirement Institute in Windsor, Conn., said fixed-rate deferred annuities were big sellers in 2020—clocking in at nearly $52 billion for the year, the highest recorded sales record since the Great Recession.

"Continued market uncertainty made [them] attractive for investors looking for safe, short-term investment growth," he said. "Because these are short-term contracts, investors can reevaluate their strategy when interest rates return to normal levels."

Single premium fixed-rate annuities, sometimes called multiyear guaranteed annuities (MYGAs), are "definitely worth considering as part of the fixed income/safe portion of an older investor's portfolio," said David Blanchett, head of retirement research at Morningstar. Where some fixed annuities might guarantee an interest rate for only part of the contract term, MYGAs guarantee the rate for the entire contracted term, like CDs. Though they are not FDIC-insured like CDs, they are contractually guaranteed and many come from carriers with high credit ratings.

Other Benefits

Moreover, annuities "offer unique tax-deferral opportunities," says Dylan Tyson, president of Prudential Annuities, a unit of Newark, N.J.-based Prudential Financial.

Specifically, unlike with CDs or bond funds, the interest comes tax-free until you take distributions.

Michael Guillemette, an assistant professor at Texas Tech University's School of Personal Financial Planning in Lubbock, Tex., noted that bonds, in comparison, have "no upside potential due to the low interest rate environment."

At the moment, in fact, bonds present some added risk. If interest rates rise (as expected), bond prices fall. "As we saw at the end of 2020," said Craig Borkovec, a financial advisor at Los Angeles-based Miracle Mile Advisors, "bond prices fell while the income component of that bond went unchanged."

Yet another feature of many annuities is that clients can only take out so much at a time. The annuity "protects the investor from making early withdrawals that are too large," observes Paul Samuelson, co-founder of LifeYield, a wealth management firm in Boston. He added that some may consider that a disadvantage.

Indexed Annuities

But other annuities may also serve as low-risk options for improving yields.

"Annuities that allow participation in market-like returns while providing contractual guarantees against loss can boost a retiree’s return on that still-safe portion of their portfolio," said Martin Powell, head of annuity distribution at CUNA Mutual Group in Madison, Wisc.

A popular example is the fixed indexed annuity (FIA). Frank O’Connor, vice president of research at the Insured Retirement Institute in Washington, D.C., said FIAs can offer "a higher return than comparably termed CDs, and since the crediting rate is derived from changes in price of one or more market indexes, rather than prevailing interest rates, they don’t carry the interest rate risk of government or corporate bonds."

In addition, FIAs "typically protect principal while offering the best opportunity to outperform inflation and grow savings," said Paula Nelson, co-head of individual markets at Global Atlantic in Minneapolis.

Other Structured Or Buffered Products

For those who can stomach a little more risk, Eric Henderson, president of Nationwide Annuity at Nationwide Financial in Columbus, Ohio, points to registered index-linked annuities (RILAs). In general, RILAs differ from FIAs in that they offer less downside protection in exchange for a more generous cap.

"While RILAs don't provide full principal protection like FIAs," he said, "clients can still benefit from a level of protection."

Last year, RILA sales surged 37% from the prior year, as measured by the Secure Retirement Institute. "The appeal is being able to access more of the growth potential of equities, with a partial buffer against market corrections," explained Pete Golden, chief sales and distribution officer for individual retirement at New York-based Equitable, which pioneered RILAs in 2010.

These products, said Brian Kroll, head of annuity solutions at Radnor, Pa.-based Lincoln Financial Group, are "uniquely designed to do just this."

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