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EDITORIAL & OPINION

Want to write your own retirement check?

Insurance annuity, combined with other tools, can help

WEALTH MANAGEMENT

BY MONTGOMERY TAYLOR

As Ben Bernanke retires, you can bet he will be tapping his annuities to replace his paycheck. Unlike many of us, he will also enjoy a monthly pension check from the Federal Reserve. While our fathers and grandfathers, for the most part, received pension checks in their mail boxes on the first of every month after retiring with many years of service, not many employers still provide pensions to their retiring employees.

What in the world will we do?

Well, we can actually create our own uninterrupted pension system. In order to trust that our system will deliver a paycheck every month for the rest of our lives, however, it takes some careful consideration and design. We could consider seeking the assistance of a bank, an insurance company or an investment firm.

The investment firm provides a stock portfolio with no guarantees of monthly retirement checks. The bank provides interest on deposits with rates so low we'd never be satisfied. That leaves insurance companies, and they, incidentally, are the ones who have the wherewithal to guarantee us a monthly check for the rest of our lives. Now, how can they assist us in the design of our uninterrupted pension system (UPS)?

To construct this system, your money is spread among different buckets or "portfolios," ensuring that no matter what happens your retirement income will never cease. UPS employs a technique of laddering various types of annuities and capturing the advantages of annuities without the disadvantages. One of the buckets is actually a pension-type account, with a guaranteed compound interest.

Let's take a closer look at the Fixed Indexed Annuity.

The fixed indexed annuity is a special contract with an insurance company. The insurance company says to you, "Give us some money, and we'll guarantee that your principal outlay will never be lost. You will receive either a stated annual interest rate or participate with us in the growth of the stock market without risk of loss." They have been making and keeping that promise of principal protection to their clients for over 120 years.

Imagine that you gave the insurance guys $1,000 to invest this year in a fixed indexed annuity. They guarantee that you will not lose the $1,000, and you choose whether you want to receive the declared interest rate for one year (say, 4%) or to participate in the gains of a stock market index (like the Dow, S&P 500 or NASDAQ). The insurance guys, just like the bank guys, are in the business of making money on your money at no risk to them. If the stock index goes up 10% for the year, you would get about 70% of the gains, and they would pocket the difference. So your $1,000 investment would now have grown to $1,070. You give up a percentage of the upside in order to eliminate 100% of the downside.

If the market is down, you don't make anything, but you don't lose anything either. You then take your same account value and go on to the next year. The insurance companies are able to do this by buying one-year options on that index. You are never actually in the stock market. The insurance company uses its legion of Ph.Ds and super computers to accomplish this for you. If the markets gain, everyone wins. If the markets lose, the insurance company only loses the cost of the option. In either case, you don't lose any value from your account. This strategy is called indexing, and you will never lose money using it

The magnificence of indexing using the fixed indexed annuity is that your gains will be "locked-in" each year and sheltered from the declines in the stock market. As I mentioned, your principal of $1,000 and the $70 you will make on it the next year comes to a total of $1,070. This $1,070 balance will be locked-in going forward, and you will not lose it, even though you might not make any more money the year after due to a downturn in the markets. Your principal and the earnings on your principal are guaranteed. I'm sure you see the huge contrast between this lock-in feature in the fixed indexed annuity and the lack of this feature in mutual funds and other vehicles.

As an important disclaimer here: Fixed income annuities are an integral piece of the UPS, but must be tied together with other types of annuities and income generating investments. UPS is not a one-size-fits-all planning technique. Everyone's financial situation is slightly different and the UPS must be tailored by a professional team to guarantee results.

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