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A Question of Risk

After collapse of stocks, safety of annuities, life insurance a new concern

By Janet Kidd Stewart

Dean Gackstetter and his wife, Ardyce, moved a portion of their nest egg into an immediate, fixed annuity. Their financial planner estimates the move saved the couple hundreds of thousands of dollars. **DOUG DREYER/FOR THE TRIBUNE**

Scorned by stocks, investors are flocking to products that promise guarantees.

But will those guarantees become the next house of cards to topple? Even troubled U.S. insurers are still paying claims to policyholders, but some experts fear that the industry isn't adequately protected for the level of guarantees it is providing. Fixed-annuity and whole-life insurance sales are surging, while products that depend on financial market performance are suffering, thanks largely to 2008's dismal markets. And while sales of variable annuities are declining, reversing years of growth, their most popular feature remains guaranteed withdrawal benefits, which came on the scene just a few years ago.

But just how solid are any of these promises? Signing a contract with a life insurer or annuity provider is typically a long-term decision, and it's important to examine the company's strength before taking the plunge.

Recent events in the credit market have proved little comfort for prospective buyers.

"Insurers have had to take additional write-offs and provide reserves," said Darian Hala, senior financial analyst with credit-rating agency A.M. Best.

Meanwhile, many customers are fleeing any investments that involve risk.

"People are worried about outliving their income," said Chris Blunt, senior vice president in charge of **New York Life Insurance Co.**'s retirement business.

But it's important for potential buyers to do their homework. Beyond checking credit ratings from the major agencies such as A.M. Best, Fitch, Moody's and Standard & Poor's, potential buyers can look at other factors in determining whether an annuity provider or insurer will be there for the long haul.

State insurance departments can tell you if a company is drowning in consumer complaints, said Noel Abkemeier, a former board member for the Society of Actuaries and a principal with Milliman Inc., a Chicago-based actuarial firm.

Beyond that, consider splitting policies among a few different carriers, Abkemeier said. This will help you stay under state caps on insurance protection and mitigate your risk that any one carrier will go belly up, he said.

Thinking about guaranteed living benefits in a variable annuity? Ask your financial adviser to do some checking on how much exposure to leverage your prospective company has.

And expect some price increases on those living-benefit riders in 2009 as companies scramble to cover their expected costs, said Moshe Milevsky, an annuity expert and finance professor at York University in Toronto, who has warned the industry that the products have been underpriced for their exposure.

"No state-regulated product has gone bust" in terms of paying clients, Milevsky said, noting that even troubled American International Group Inc. is paying claims.

But he also believes consumers should do business with more than one provider to lessen the impact of any failure.

He said putting all your assets into guaranteed products is dangerous, particularly after stock prices have reached such bargain levels that they have significant upside potential.

Finding the appropriate amount to lock up with guarantees depends on the overall size of your portfolio and how much of it you would need to put in an insured investment vehicle to cover basic spending needs. He suggests putting no more than 40 percent of your total nest egg into annuities.

"Never put all your investments in annuities, period," he said.

Dean Gackstetter shunned them altogether for years. Like a lot of entrepreneurs who thrive on risk and self-reliance, he was skeptical of products like life insurance and annuities.

Gackstetter, 79, had been chairman of a local bank in Watertown, S.D., and previously owned several card and drugstores. During his working years, he plowed a lot of his wealth back into his businesses. Over time, he began investing in individual stocks he chose himself.

Then, about three years ago, his financial adviser persuaded him to lock up a portion of his nest egg in an immediate, fixed annuity.

Gackstetter "was one of the toughest to convince," recalled John Schwan, founder of the Schwan Financial Group in Aberdeen, S.D.

Today, Schwan figures moving that money out of stocks and into the annuity saved Gackstetter and his wife, Ardyce, hundreds of thousands of dollars that would have evaporated if they'd left it in the stock market.

At the time the couple bought the annuity, though, the motivation had nothing to do with market timing or a changing risk tolerance as they aged.

"I just decided it was time for somebody else to manage all this," Gackstetter said. "I'm at the stage of the game where I want my wife to be taken care of if something happens to me."

So the couple tallied up their basic living expenses and started talking about how much they wanted to leave their four grown children and 10 grandchildren in an inheritance. Then they purchased a single-premium income annuity and a life insurance policy inside a trust.

The remainder of their money is divided among certificates of deposit, municipal bonds, a small variable annuity and stocks, Gackstetter said.

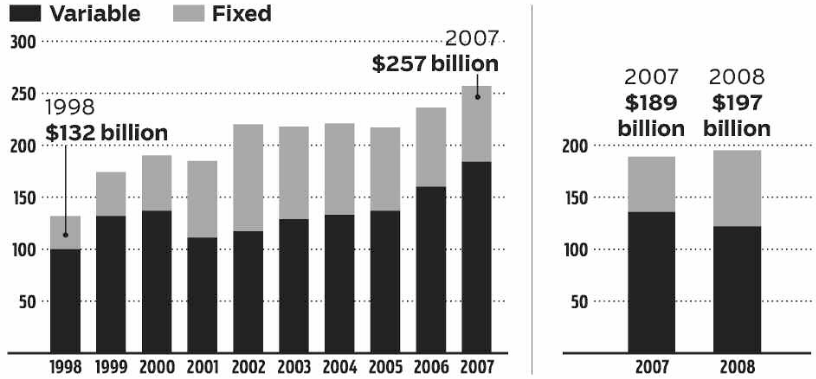
The annuity pays basic living expenses, and the other investments are supposed to cover more discretionary purchases. Whatever is left when they die is for heirs.

When Schwan and the couple started talking seriously about an annuity a few years ago, credit strength of the provider didn't carry as much importance as it is with clients now, Schwan said.

"Clients are asking about that more today," he said. "Now they want to know how the companies are owned, if they're obligated to stockholders, what the asset size is. It has become a huge issue."

Janet Kidd Stewart is a Your Money columnist.

ANNUITY SALES *In billions of dollars*



SOURCE: LIMRA International

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Key terms

Fixed annuity: A contract between an investor and an insurer that guarantees a stream of payments for the life of the contract in exchange for a lump sum or periodic investments. Payments can be deferred or begin immediately.

Variable annuity: Another contract with an insurer that can begin immediately or be deferred after an initial lump-sum deposit or periodic investments. The income stream varies with investment performance.

Guaranteed living benefits: Riders attached to variable annuities that lock in minimum withdrawals or income payments.

Term life insurance: Provides a death benefit if the insured dies within the term of the contract.

Whole life insurance: Permanent insurance that comes with a death benefit and an investment component. Premiums, death benefits and minimum cash values are guaranteed, as opposed to universal and variable policies that fluctuate with market performance.