Why Ken Fisher Is Wrong on Annuities: Milevsky, Finke

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Tarnishing all annuities over some bad sales practices is "ridiculous," Milevsky says.
Ken Fisher hates annuities, and annuity experts aren’t exactly in love with what the famed money manager said about those retirement products in an interview with ThinkAdvisor last week.

The chairman and CEO of Fisher Investments, who runs a three-year-old annuity conversion program, likened annuity sales approaches to the too-good-to-be-true promises of Ponzi schemes and charged that annuity salespeople often lie to make high commissions.

He insisted they “rattle off whatever it is that they know is a lie” and that other salespeople say what “they believe to be true but isn’t.” Attacking variable annuities, he thinks they should not be legal in their current form and marketing mode.

For the most part, the experts vehemently object to Fisher’s take on annuities.
“A lot of advisors don’t quite understand what it is they’re selling when they’re selling annuities — but to tarnish the entire industry is ridiculous,” says Moshe Milevsky, associate professor of finance at York University in Toronto and executive director of the IFID Centre at the Fields Institute for Research in Mathematical Sciences, in an interview.

The Fisher Investments founder tells ThinkAdvisor about what he calls the “lies” annuity salespeople tell and how he buys clients...Fisher declined to comment for this article.

Other interviews with ThinkAdvisor found experts taking umbrage, in particular, at what they called Fisher’s over-generalization of annuity products. There is a variety of annuities, with differing characteristics, and several are unique, they say.

“Lumping immediate annuities with all the other types is rather disingenuous,” says Wade Pfau, professor of retirement income at The American College of Financial Services and director of retirement research at McLean Asset Management in McLean, Virginia. Fisher “is trying to act like he’s doing his clients a service by paying their annuity surrender fees when he’s really just taking it out of the investment management fees he collects,” he says.

Fisher’s enmity was directed sharply at variable annuities, whose salespeople, he says, take advantage of consumers’ annuity naivete. Moreover, customers don’t understand VAs’ complicated contracts, a situation that works against their getting clarity about what they’re buying.

“Yes, as soon as you slap a living benefit onto an annuity, it becomes even more complex; but complexity doesn’t equal bad,” says Scott Stolz, senior vice president of private client group investment products at Raymond James, who is responsible for insurance and annuities, among other products. “Ken Fisher took a pretty drastic position.”

Annuity experts say that now, more than ever, Americans in retirement need the protection and income that annuities afford partly because of fast-disappearing private pensions and the planned elimination next year of some Social Security claiming strategies that can be used to boost retirees’ monthly checks.

“There is a magical, secret ingredient, a secret sauce, inside an annuity that can’t be replicated in any conventional financial product or synthesized by traditional money managers,” says Milevsky. “I’m a big fan of annuities that behave like pensions.”

Variable annuities can substantially benefit consumers, according to the experts. “Dismissing variable annuities is like dismissing ETFs or mutual funds,” says Michael Finke, a professor and coordinator of the doctoral program in personal financial planning at Texas Tech University.

In fact, Finke says, “VAs could serve as an ideal default for most Americans rolling their defined contribution assets into an IRA. A competitively priced variable annuity product is hard to beat compared to an unprotected investment portfolio, as long as the fees between the two are similar.”

New low-cost deferred variable annuities “deserve to get more respect,” insists Pfau. But he singles out the immediate annuity – also called an income annuity or a life annuity — as packed with the most potential because it offers “a ton of benefits to consumers.”

“This is a very important retirement tool,” Pfau says. “It’s very straightforward: a simple lump-sum payment, and you get income for life. It pools longevity risk across a large [group] of individuals; and because of its mortality credits, those who don’t live long subsidize those who live longer. The mortality credits are part of a [retiree’s] spending power. An income annuity can help preserve the remaining portfolio when someone lives a long time in retirement.”

In last week’s interview, Fisher said that salespeople mislead annuity buyers into thinking they’ll get a high return on their investment when actually what they receive is a return of their capital. “That’s blatantly wrong,” Milevsky says. “It’s not true. As soon as the account hits zero, you’re getting money for as long as you live – and that’s the insurance company’s money.”

Most portfolios can benefit from a mix: stocks and an annuity, academics say. “By combining an income annuity and stocks, you get the most efficient outcome,” Pfau says. “Annuities are [better] suited [than stocks] for protecting against longevity risk and investment volatility. Partial annuitization of a portfolio stabilizes the legacy value of the assets.”

To build an efficient retirement strategy, Pfau says, “you need to integrate both stocks and [an annuity] into the plan. For essential spending, you don’t want to be exposed [just] to the stock market; you want to have something more secure in place. For discretionary expenses, that’s where you can be invested in stocks and be more aggressive.”

In lauding annuities, Stolz stresses that “a longevity annuity or a deferred income annuity is like buying insurance against living too long. An immediate annuity from an insurance company is the only means out there that will guarantee you payment for life. If you live to 130, they’re still sending you checks. People buy immediate annuities for the certainty of knowing that they don’t have to worry about what the market did yesterday. It’s a way of providing peace of mind – basically you’re funding your own pension.”

Milevsky proposes “a reasonable allocation” on the annuity side of “20% to 40%.” “The portfolio should be balanced,” he emphasizes. Further, he points to the value of annuities as long-documented by academia, as well as more recently by the U.S. government.

“There is almost a consensus in the ‘ivory tower’ that annuities make sense for the consumer,” Milevksy says. “There have been 2,000 articles about annuities written by card-carrying professors since the 1960s, and 99.9% of them are pro-annuities.”

Moreover, the U.S. Department of the Treasury last year issued a statement “encouraging 401(k) plans to offerannuities,” Milevksy says. “But people are still saying that annuities are horrible.” However, Milevsky points out that for about 40% of the U.S. population, an annuity makes no sense: that is, those who are receiving most of their income from Social Security and have only a small amount of savings. “They’re already annuitized,” he says. As for the future of the annuities market, Finke, in calling for “better automatic decumulation products,” holds that a variable annuity is “ideal because it allows a retiree to accept a certain amount of investment risk while providing that pooling and longevity protection.”

Finke continues. “I don’t think paying 100 basis points per year for an investment portfolio that provides no mortality credits and exposes retirees to longevity risk is better than a competitively priced variable annuity.” And, as he writes in this month’s Research magazine, “income from a VA can provide a paycheck in retirement that lasts forever.”

Milevsky believes that annuities could be ready for rebranding. “Maybe a new category of product needs to be created that does essentially what a pension does but isn’t called an annuity. We may have to stop using that word,” he says. Milevsky believes that the introduction of tontines — group funds with increasing benefits to the longest survivors— will likely be part of the solution. A tontine, whose concept dates from the 17th century, is a way to annuitize without using an insurance company.

“The pool is sharing the risk amongst themselves, which means that traditional money managers can get into this business, and that is important regarding compensation,” says Milevsky, author of the book “King William’s Tontine” (April 2015). “If financial companies can manufacture a tontine scheme, they may be able to beat the insurance companies at their own game.”
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The author of the article is Jane Wollman Rusoff, she is a contributing editor to Research Magazine. She is also the founder of Family Star Productions.