

New Academic Research Finds Deferred Income Annuities Reduce Overall Cost of Funding Retirement

DIAs avoid market risk giving individuals the flexibility to increase equity allocation without changing overall risk profile

MILWAUKEE, April 16, 2015 /PRNewswire/ -- Including a deferred income annuity (DIA) in a retirement portfolio helps reduce the cost of funding retirement while also offsetting risk and providing asset allocation flexibility, according to a new academic paper authored by Michael Finke, Professor and Director of Retirement Planning and Living, Texas Tech University and Wade Pfau, Professor of Retirement Income, American College.

Northwestern Mutual partnered with the professors on the paper - "[*The Retirement Income Challenge: Deferred Income Annuities Before Retirement*](#)" - being presented tomorrow by Finke and Pfau at the 2015 Retirement Industry Conference, "[New Retirement Realities - Strategies for Success](#)" jointly hosted by the LIMRA LOMA Secure Retirement Institute and the Society of Actuaries.

"Market volatility and longevity are two big question marks in retirement. We can't predict how the market will perform leading into and continuing through retirement, or how many years we will live in retirement, so it's important that retirement planning uses both offensive and defensive strategies to position individuals for financial security," said David Simbro, senior vice president, life and annuity products, Northwestern Mutual.

Simbro added: "This paper demonstrates that annuities give individuals the confidence of knowing they have a guaranteed lifetime income, while also providing the flexibility to leverage other parts of their investment portfolios to achieve additional growth and income."

To conduct the research, Finke and Pfau used Monte Carlo analyses to simulate how an investment portfolio designed to provide \$100,000 of real lifetime income behaves, both with and without the use of a DIA. They ran more than 50,000 simulations and adjusted for longevity, stock and bond market performance and inflation.

The research found that DIA's:

Help to mitigate uncertainty and reduce the cost of retirement – The cost of retirement includes the actual cost of generating a given income in retirement in the face of unknown variables such as longevity and asset returns. When a retirement plan allocates a portion of assets to a DIA, the average cost of retirement is reduced by softening the financial blow of a long lifetime or poor market returns by guaranteeing a portion of retirement income.

Allow investors to take on more equity risk – Setting aside assets before retirement to buy a DIA places a portion of the retirement portfolio into a bond-like asset. With a level of income guaranteed, individuals can then invest the rest of their assets more aggressively while maintaining the same risk profile.

The research also found that innovative new DIA products provide additional value given the low-interest rate environment as they may allow for potential payout increases over time via dividends, while providing protection against inflation and longevity.

"There are no silver bullets solutions for retirement planning—that's why it's so important to work with an experienced financial professional who can tailor a plan to meet an individual's unique circumstances," noted Simbro. "The ultimate goal is to build a lifetime income, and DIA's can be one of the financial tools to help do just that."

About the Authors

Michael Finke, PhD, CFP is Professor and Director of Retirement Planning and Living in the department of Personal Financial Planning at Texas Tech University. He served as President of the American Council on Consumer Interests, and is the editor of the Journal of Personal Finance and a contributing editor to Research Magazine. He holds a doctorate in consumer economics from Ohio State University and in finance from the University of Missouri.

Wade D. Pfau, PhD, CFA, is a Professor of Retirement Income in the new PhD program for Financial and Retirement Planning at The American College in Bryn Mawr, PA. He holds a doctorate in economics from Princeton University and has published research on retirement planning in a wide variety of academic and practitioner research journals.

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