

Do you know the difference between "formal" and "informal" annuity payout options? Many producers and insurance company executives do not, or they know about it but they forget, when, how, and why to apply the options. We need to do a better job of understanding—and explaining—these options to our clients.

Let me explain by telling you what happened to my friends, Boyce and Randy. Randy recently converted one of his deferred annuities to a 60-month fixed period option by contacting the home office directly. He and his wife were going in partners with their son to build a lake cabin and needed money to help make the payments.

There were several advantages for Randy to "formally" annuitize (i.e., to elect a settlement option that's locked in permanently). He and his wife would know exactly how much each payment would be, gain a little tax relief, and know the income would keep coming for 60 months, no matter what. All in all, sound reasons and a practical decision—at the time.

A few days later Boyce (his friend and mine) came to my office to discuss Randy's decision. He pointed out to me that he and Randy were such good friends "we don't even water our lawns unless we talk it over." So, he said, if Randy is having his money paid out to him in a regular monthly stream, "well maybe I should do that, too."

What, he wanted to know, did I think about that? I asked him if he needed more income. He said, "Not now, but we may need some next year. I just want to know what my options are."

I explained there are essentially four different options—two of them "formal" (locked-in payout plans) and the other two "informal"

(flexible payout plans). Randy had taken one of the formal options, but Boyce might want to know about the others, before deciding. Here they are:

1. Boyce could "formally" decide to receive an income over his and/or his wife's life. But once this option was elected, he could never change his mind. And the insurer would be the ultimate beneficiary, not their children.
2. Boyce could "formally" annuitize for a set period of time, as his friend Randy had done. But once this was done, he must abide by the contract and could not make any changes.
3. Boyce could annuitize "informally", by requesting a systematic withdrawal. The insurer will send him a monthly check for whatever amount desired, and, because he hadn't formally annuitized, the insurer will continue to credit a higher interest rate to the policy rather than to pay a lower "settlement" rate. His actual results may be better or worse than a "formal" annuitization. (At this point, Boyce said: "We only need more monthly income every other year, because I have some money coming in from other sources at odd times." I told him that was the beauty of a flexible, "informal" annuity decision. Although he would lose some tax advantage, he could start, stop, increase, or decrease income as needed; he could even add more money to the annuity without extending the penalty period.)
4. Boyce could elect the second "informal" option, which is to receive a monthly interest check, thereby leaving the principal in tact for his family.

When I said that, he started telling me what was really on his mind. It concerned his 95-year old mother-in-law, who is in a nursing home.

After the woman's husband had died, he said, Boyce had spent over three months completing the ownership change on some Treasury Bonds. "That's a nightmare I don't ever want to go through again," he said. To make a long story short, with a Power of Attorney, he opened up a new annuity for his mother-in-law, selecting the second "informal" income option. He instructed the insurer to start sending monthly interest checks 30 days later.

The key deciding factor was that, when the mother-in-law dies, it will be much simpler for his wife to process an annuity death claim than dealing with Treasury Bonds. They would also know the exact value of the annuity as compared to the uncertain value of the Treasury Bonds.

When I reflect on my friends' experience with annuitization, I can't help but regret how confusing it can be for consumers to make good choices. Unfortunately, for those of us in the insurance business, we have a tendency to talk in sterile, technical terms, and give text book answers to client questions about annuitization. And, generally speaking, agents and home office service personnel don't fully understand the advantage and disadvantages of most income options. We need to learn, then, do a better job of explaining those differences to our clients, in order to help them make better decisions.

Randy called me a few days after he received his first "formal" income check and said, "Boyce told me what you said about income options. Wish that gal at the home office had told me about taking an informal payout—because my son backed out of the lake cabin deal. Do you have another annuity where I can put this money each month?"