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The Case for Annuities in Today's Market

By Robert Huebscher
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Financial Professionals and their clients need to manage pressures they have not seen for 20 years: market volatility, inflation, rising interest rates and potentially higher taxes. With fixed income potentially not holding up as a low-risk part of the portfolio, it may be time to look at other strategies to help clients protect their portfolios.

Steve Scanlon is head of individual retirement for Equitable and a member of the operating committee. In this role, he drives the strategy for the individual retirement business, including distribution, product, in-force portfolio, M&A, capital and strategic relationships.

I spoke with Steve on September 29, 2022. To listen to this as a podcast, click here.

Steve Scanlon
Head of Individual Retirement

Bob: What strategies can financial professionals use to invest through this period of higher volatility, rising inflation and interest rates, and potentially higher taxes?

Steve: Even an experienced financial professional, somebody who has 10 to 15 years in the profession, has never seen this. In a 60/40 portfolio, the 40 was there to protect the 60. That may not be working as well in this current environment. We're seeing people looking in the alternative space for protection and for income. I place annuities as an asset class of its own in the alternative space. If your clients are looking to address taxes, inflation, rising interest rates, volatile markets — certain annuities may be something for them to consider. We're seeing a lot of financial professionals say, "Maybe my clients are retired, but their money can't retire. I've got to make sure to help them as they look to participate in the upside potential but with the opportunity for partial downside protection."

Bob: Annuities are sometimes thought of as "one size fits all" products. To what degree is that still the case or in what ways have they evolved?

Steve: It's not the case at all anymore industry wide. Equitable Financial Life Insurance Company (Equitable Financial) invented a big part of the variable annuity space: the Registered Index-Linked Annuity (RILA) category, which is a buffered equity-participation annuity product. It was true 15 years ago. Even if you didn't want a death benefit, the only way you could get the living benefit was by having a death benefit. Now, for the most part, it is bifurcated. If you just want tax-deferred growth potential, that's the investment-only variable annuity space, which we participate in. If you want partial protection on the downside, you can do that through the RILA category. If you just want income, we created a product, Structured Capital Strategies® Income, last November where you can get a buffer strategy on the upside and get guaranteed income if that's the only thing that you want.

I think about our business and how we work with financial professionals in a very similar fashion to how they work with their clients. We sit down and talk about the individual client's needs, and then we can help as the financial professional customizes a strategy around that. It's one of the biggest "aha" moments for financial professionals who haven't looked at annuities in years. I've seen this myself several times. They'll say, "I wish you could just do this, or could you do that." I explain that we've been able to do that for 10 years. They just haven't looked at annuities in that long. Then we encourage them to come back and take a second look, because the annuity business has evolved considerably in the past 10 to 15 years.

Bob: What types of clients benefit the most from the

partial downside protection that certain variable annuities can offer?

Steve: It varies. For the first time in a while, it includes younger people who typically had not looked at annuities in a long time. But they just funded their 401(k) or IRA, and they've got other money ear-marked for retirement. They're putting money away in something that's affordable and provides tax-deferred growth. I think about it as a private retirement account. People in retirement have always benefited from the guarantees that annuities offer. But we're seeing high net-worth investors coming in and saying, "I've still got to protect my income." They ask, "Can I just buy something where I've got a guaranteed income stream?" They used to not want the death benefit, and they wanted the living benefit. Now we are able to say, "What is it that you're looking for?"

It is anywhere from younger people, which is a newer one for us, all the way up to high net-worth clients that need to make sure they take steps to protect their income on some level and most everything in between.

You're seeing people starting to understand that bonds can go down. It seems like a long time since some people have understood that they can lose money in bonds. It's been fascinating. In my observation, many didn't know or understand that you could lose money in bonds and that their income could be affected. A lot of fixed-income investors are coming here. Elderly people are worried about the market. One of the biggest tools that certain annuities can provide for financial professionals and by proxy, their clients, is enabling them to invest appropriately with some level of protection. Clients appear to want to be invested a lot less in equities because they are scared, but they can face longevity risk. Financial professionals can offer annuities to clients as a way to help them become appropriately allocated to equities, but also help them feel good.

Bob: You mentioned bonds can go down, and we've certainly seen that this year. We've got a stock market that is flirting with bear market territory. Rates are headed up. Given that climate, could it be an advantageous time to buy an annuity?

Steve: This is the perfect storm. If you go back to when I started in this business, annuities were all about striving to outpace inflation, not having to pay taxes until you were ready and a death benefit.

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They've come all the way to offer a very critical part of asset allocation. We haven't talked about inflation or rates going up in some time. That's coming back into the fold. What's old is new again. All these things that we used to talk about in the 1990s have come back with a vengeance. You have bonds recently underperforming and stock market volatility, while people are living a lot longer. People are retiring, and they have to make sure that they have the opportunity for some level of protection through retirement. This is as good of an environment for what we offer as any I've ever seen.

Bob: The other concern that financial professionals and clients have around rising rates is that they're going to eat away from the income that a variable annuity provides. What's your response to that?

Steve: Variable annuities are obviously subject to market moves, but the guarantees within the variable annuities are not. It is like you have two ledgers. You've got your account value that's moving up and down as it does, but you also have your guarantee that you can rely on. In that sense, an annuity — and no other product — can tell you in a worst-case scenario what you are going to get. People know going in exactly what they're going to get.

It won't erode the guarantee. It can certainly nip away at the account value. And even while past performance never guarantees future results, we know that over time, staying in the market has generally provided long-term positive results for clients. The guarantee gives people the willpower to stay invested knowing that they're at least going to get a certain amount with that guarantee. That guarantee is very attractive.

Bob: Aside from that guarantee, what else should financial professionals and their clients consider when they think about adding an annuity to a portfolio?

Steve: If you think about an asset allocation model, financial professionals consider the needs and wants of their clients. Think about all the things that we've talked about: taxes, inflation, rising rates, and volatility. There is uncertainty. If there is one financial product that helps address those things, it is an annuity.

Our strong feeling is that what we are providing is based on and may help address whatever the customer is most worried about. It could be from paying taxes every year or from volatility. That's why we recommend considering annuities as a sleeve, like an exposure to international stocks can complement S&P participation, depending on the particular investor's circumstances, needs, goals, time horizon and risk tolerance. That's what people need to be looking at in terms of variable annuities.

Bob: What other allocation changes should clients be thinking about in the context of making a commitment to an annuity within a portfolio?

Steve: Some people look at it as wanting exposure to international, for example. But they are worried about international markets. Their financial professional wants them to have a global portfolio. Within certain variable annuities, clients can "globalize" their allocations among the available investment options and still know that they have some level of partial downside protection, for example. And they can clearly do that with the S&P as well.

We see a lot of people who are moving into our guaranteed-income annuity products because they're not getting the income. Bonds, as we've talked about, are exposed. They need to protect their income. Some people are using annuities because they had a 60/40 portfolio, and are now going to go 60% equities, 20% bonds, and 20% annuities with a guarantee.

The beauty of that is clients can change their allocations. I spent a lot of years in the asset management business. From a financial professional's perspective, they can help clients consider and reconsider what they need the annuity for.

That is lost on a lot of financial professionals and certainly clients. An annuity can be bought for something now, but you can change your mind and still have that sleeve to provide a different level of partial downside protection.

Bob: If there's one key takeaway that you would like to leave with our audience of financial professionals about how they should position annuities to clients in this market environment, what would that be?

Steve: There are things that we have not seen in decades, like inflation and rising rates. There are also things that we haven't seen since the credit crisis, which is significant volatility in the markets. All those things combined are concerning to all of us and concerning to clients, particularly those who are relying on a certain amount of income in retirement.

Certain annuities can give clients partial protection on the downside to make sure that they're going to be protected to a certain level, but they get some of the upside. Annuities can give them guaranteed income that they can't get even in fixed income. Certain annuities can offer the potential to outpace inflation by giving them opportunities to invest in equities with also the understanding that they're going to be partially protected on the downside.

My overall message to the financial professional community is if you haven't looked at annuities in a long time as a possible portfolio sleeve, there's never been a better time. You will be shocked at how far we've come if you haven't looked at an annuity in a decade.

A registered index-linked annuity is a variable and index-linked deferred annuity contract that offers guaranteed lifetime income and an innovative strategy combining structured growth potential, up to a cap, with tax deferral. The product includes a partial protection feature that eliminates a portion of the contract holder's downside risk, while still giving the contract holder the opportunity to invest for growth up to a Performance Cap Rate. However, there is risk of substantial loss of principal because the investor agrees to absorb all losses that exceed the protection provided by the buffer. An annuity is a long-term financial product designed for retirement purposes. Simply stated, an annuity is a contract between the contract holder and an insurance company that lets the contract holder pursue the accumulation of assets through equities and other investment options. There are fees and charges associated with variable annuities, and they contain certain restrictions and limitations and are subject to market risk including loss of principal. Withdrawals are subject to ordinary income tax treatment, and if taken prior to age 59½, may be subject to an additional 10% federal tax. All contract and rider guarantees are backed by the claims-paying ability of the issuing life insurance company.

Variable annuities are offered by prospectus, which contains detailed information about the contract and its charges, risks, expenses, and investment objectives. Prospective contract holders should read the prospectus and consider this information carefully before purchasing a contract or sending money.

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