Consider the Advantages of the Annuity

Long popular among the thrifty of Britain, the annuity is a form of insurance growing in popularity in the United States

G. W. Fitch, an insurance man of Wisconsin, discusses the annuity in the December *Mercury* under the heading *One Way to Security in Old Age.* When you see that phrase, *old age*, why is it so acrid in the mouth? It is because no one has ever found quite what to do with it, and because the hazards of earlier life usually deprive the aged of much choice in the matter. Usually? Even so. The Fitch piece begins with those somber data of every hundred Americans reaching sixty: one is wealthy, two in comfortable circumstances, fifteen have estates of $2,000 to $15,000, eighty-two have no estates at all, are destitute.

Here is the sad tale of ₱10,000 of hard-earned savings in Manila. More than ten years ago the first ₱5,000 was put into a residential lot in one of the suburbs with apparently good prospects. Possibly the lot could be sold today for ₱1,000, but it is not worth that much as bank collateral. The next ₱5,000 was risked, upon what seemed excellent advice, in securities that promised to keep earning despite the depression and are now reckoned a total loss. Maybe some people have better luck; of course they do, but they lose, too—no one can invest savings as securely as a life insurance company can invest them for him. That is why, during the depression, the insurance companies have gone prosperously ahead.

Now listen to Mr. Fitch a moment, about annuities:

Two sisters, school-teachers, who had saved enough to buy the home in which they lived but who had made no other saving for old age, each bought, at forty, an annuity of $50 a month to start at sixty. The investment for each was a trifle less than $250 a year. It was an amount within their means and gave them a combined income of $100 a month at retirement. Had they set the age at sixty-five instead of sixty the cost would have been less than $145 each.

A single man thirty-five years old wished to make some provision for his mother, aged sixty. At a cost of $75 a year he bought a contract that would, in the event of his death, pay his mother more than $215 a year. And if he outlived her it would pay him, beginning at sixty-five, a life income of $22.50 a month.

A prosperous farmer of forty bought at $125 a year an annuity of $50 a month to start at sixty-five. It matured three years ago and he is now getting along very nicely, although the rent he receives at present from his farm is little more than enough to pay the taxes.

A dentist who put his earnings into an annuity during the days when his income was the largest will begin next year at sixty to receive $200 a month for the rest of his life.

The superiority of annuity contracts to ordinary investments was never better illustrated than in an analysis of "Investment for a Widow" by Sherwin C. Badger, in a recent issue of *Barron's Financial Weekly.* In 1925 *Barron's* invited its readers to participate in a prize contest to determine the best way in which a widow with two children might invest an estate of $100,000. The primary emphasis was upon income, but it was required that "every investment plan be so drawn as to minimize, as far as possible, the hazards of individual judgment." Seven years of business extremes have intervened since the contest, and Mr. Badger now reviews the winning lists in the light of present conditions. As a whole, he concludes that the lists have stood up very well, but adds:

None of the fourteen winning lists was the best solution for the widow—that is, to date. As a practical matter, she would have fared better if she had placed her $100,000 in a savings bank and made up the deficiency in her income by withdrawing some principal each year. For there is no group of investments which would have protected her principal intact. United States government securities, and the highest grade rail and utility bonds, would have come nearest to so doing, but none of these would have provided sufficient income. [To have reached the needed income of $5,000 by bonds alone] it would have been necessary to include some issues of doubtful merit.

This careful study of investment plans submitted to a leading financial magazine by over 1100 readers confirms the belief that the prevailing business methods in the United States do not promise assured financial security either to the widow, the retired business man, or the frugal wage earner. If security is to be had it must be sought elsewhere. In Mr. Badger's article no suggestion is made that annuities might offer the best solution of the widow's problem, but it will be worth while to compare an annuity contract with the plan which won first prize.

By this plan the widow's money was placed three-fifths in bonds and two-fifths in common stocks, with a resulting income of $5,004. If we assume her to have been thirty-five years old an equivalent annuity would have brought her $5,448, a gain in income of $444. Objection might properly be made to this on the ground that it would leave the children without income in the event of the death of their mother. But there is an easy way around this difficulty. We can use the $100,000 for the purchase of three annuities, one for the mother at a cost of $50,000 and two for the children at a cost of $25,000 each. Such an arrangement will provide $2,724 annually for the mother, $1,163 for the boy, and $1,134 for the girl, if we assume the boy to be ten and the girl eight years old. The combined family income will now be $5,021, which is less than the income for the mother alone but it is still $17 more than the returns from the investment plan that won *Barron's* contest.

The first advantage of these three annuities over the stock and bond investment is the guarantee that the mother will receive slightly more than $225 a month, and each of the children nearly $100 a month, for the duration of their lives, regardless of changing financial conditions. Also, their incomes will be net, as there is no expense connected with their payment. They are not even subject to income tax until the total drawn exceeds the original investment, which will not happen in less than twenty years.

If the comparison is now brought down to the present, the annuity income will still be intact at the original amount of $5,021 a year. The investment plan does not fare nearly so well. The market value of the securities has decreased to $62,000 and the dividends on the common stocks have ceased. Though interest on the bonds continues, the widow's income is now but $3,741 a year, a decrease of $1,263, and there is no immediate prospect of the resumption of her stock dividends. The desired stability of income and the necessary 5% have been achieved only by the annuity. Mr. Badger's suggestion that the best plan might have been to put all the money in a savings bank and increase the income by using a portion of the principal each year is virtually an annuity proposition, but with the very great disadvantage that when the principal was finally exhausted there would be nothing further for either widow or children, while an annuity would leave each one with a fixed income for life.

Life insurance companies are not subject to runs. When money is placed with one of them the intention is to leave it there, and members surrender their policies for their cash values only with the greatest reluctance. Money deposited in a bank is put there in order to have it ready for immediate use, and it is drawn out as soon as needed. Heavy and persistent withdrawals can destroy in a few days the most solvent bank in the world. The position of a life company is very different. Money can be withdrawn only after certain formalities, the members are widely scattered, and most of them are far from the home office.

The income of a life insurance company is thus more steady than that of any other financial institution. This is due in a large measure to the persistence of the income from policy premiums. The average policy is for only about $3,000, and in consequence millions of small premium payments flow into the company treasuries from cities, villages and farms all over the land. They come in a steady stream regardless of prosperity or depression and in their total volume furnish a vast income of great stability. Similarly, the companies' loan investments, widely diversified and bearing moderate interest with ample security, have stood up satisfactorily despite the Depression.

During the past two years life insurance has been assailed by almost every possible peril, yet during 1931 the combined incomes of the American companies exceeded their disbursements by more than $1,396,000,000 and new business was written of over $14,000,000,000. The total assets of all the companies are in excess of twenty billion dollars. No human institution is infallible, but the position of the leading life companies is so impregnable that nothing would seem able to threaten them save only a universal catastrophe that would endanger the very government itself.

The safety of a life annuity is thus nearly absolute. It offers the easiest way to obtain old age security. It lasts until death without diminution. It protects the rich from the perils of their own recklessness and the poor from the perils of their poverty. Thousands are in want today who once had plenty. Other thousands are in want who never had property. All of them would find old age fuller and happier if they had purchased annuities, according to their means, in the days when earnings were best and want had not yet begun to threaten them.