Letter to the Editor - GLWBs

January 17, 2012

This is in response to Wade Pfau's article, GLWBs: Retiree Protection or Money Illusion?, which appeared on December 13, 2011:

Dear Editor,

Dr. Pfau makes some great point in his article regarding variable annuity guarantees. He is correct that much of the perceived value of annuity guarantees is an illusion.

But the model is flawed, as he compares GLWBs against market indices and not investor behavior. As the DALBAR studies have shown, investor returns are usually a fraction of the indices. As DALBAR reported, during the 20-years ending 12/31/2010, when the S&P 500 returned 9.14%, the average investor earned only 3.83%. If all a GLWB could do was prevent investors from cashing out during bear markets, it would be worth every penny of fees. In the event people still cash out *or* don't need the peace of mind offered by the GLWB to stay invested, then Pfau is correct, GLWBs are a rip-off.

From Pfau's academic standpoint, he is correct; GLWBs offer very little benefit when compared to the indices. However, as observed by legendary investment advisor, Nick Murray, annuities are ridiculously expensive, but their cost may be the only way to keep people from panicking out of a bear market.

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Wade Pfau responds: I responded to a similar concern here, in regard to a previous article I wrote. I am indeed interested in anyone who has data showing that GLWB users were better able to maintain their asset allocations after recent market drops.