Of 100 70-year-old women alive today, 58 will live to be at least 85 years old. 14 will live to be at least 95. Three will live to be 100, and one will live to be 103 or older. For people without traditional pensions who are relying on their savings to support themselves in old age, living longer than your money is a big risk, but there are ways to reduce that risk.

Imagine that you and nine of your close friends turn 70 the same year. You all decide to pool money together to support those of you who live the longest in your old age. You each pitch in $100,000. The money is invested for 15 years, at which time five of you have died. The money is now use to support the five friends who are still alive at 85. Each of them gets about twice the income that they could have gotten from investing only their own money. This is basically how Deferred Income Annuities, or DIAs, work. Of course, you don't join our pool with nine of your best friends. Instead, you buy a deferred income annuity from an insurance company, often paying one single premium payment, but sometimes in installments. The insurance company guarantees you a fixed income, starting some date in the future until you die.

One strategy is to buy a series of smaller deferred income annuities over time. Deferred income annuities are also known as advanced life delayed annuities, and when held in traditional IRAs or 401(k) accounts, they are called Qualified Longevity Annuity Contracts, or QLACs. Deferred income annuities are sold by insurance companies. The agent who sells the annuity will be paid a commission, which is included in the price you are quoted. Mutual fund companies don't sell annuities directly, though many fund companies act as agents for insurance companies, and some may take lower than average commissions. As with any insurance product, before buying a deferred income annuity, always compare prices from different sources and make sure the annuities you compare have the same terms and features.

Deferred income annuities are not the same as variable annuities. Variable annuities are complicated products that function like mutual funds, with certain income guarantees and reoccurring annual fees. They are often sold to people who don't understand them, by agents and advisers who earn large commissions. I'm not going to discuss variable annuities in this video. Some of them may be good, some aren't. In general, I prefer simple financial products, because complexity makes it difficult to compare prices. Insurance companies that sell deferred income annuities are regulated by state agencies. If an insurance company fails, each state has a fund that covers losses to the annuity holders. The limit of what the fund will cover varies from state to state, but for most states it's $250,000 per person, not per policy. If an insurance company fails, oftentimes another insurance company will take over its annuities, and payments will continue uninterrupted. However, there's always a chance of disruption in payments, and always a chance that if your company does fail, you won't receive the entire promised payments.
So when buying a deferred income annuity, you want to pay attention to the credit rating of the insurance company. A.M. Best is the most comprehensive rating agency for insurance companies. The top ratings A.M. Best gives are A-plus-plus, A-plus, and A. I'd suggest not buying from a company with a rating lower than A. More highly rated companies may offer you a slightly lower annuity payment for the same initial cost, but these annuities will also be somewhat safer investments. So always shop for a good price, but also pay attention to the insurance company credit ratings. When you buy a deferred income annuity, there are a few options that you're going to be offered.

Option one. Do you want your spouse to continue to receive income from the annuity if you die before your spouse? If your spouse is going to need the annuity income after you die, survivorship benefits make sense. If he or she won't need the entire annuity income, you can choose survivorship benefits of 2/3 or one half the original benefit level. Do you want your income from the annuity to increase each year so as to adjust to increasing costs of living? Cost Of Living Adjustments, or COLAs, make sense. Companies offer fixed cost of living adjustments, such as 2% or 3% a year. Some companies offer adjustments based on the CPI-U, that is the Consumer Price Index for Urban Areas. CPI-U cost of living adjustments are the safest since they offer protection if inflation is much higher when you start collecting annuity payments than it is now. Quotes I recently looked up price the CPI-U cost of living adjustments between the 2% and 3% options. However, not all companies currently offer CPI-U cost of living adjustments for deferred income annuities sold in 401(k) plans. The cost of living adjustment option does not apply to the years between when you purchase a deferred income annuity and when the annuity begins to pay you an income.

Currently, you can't get deferred income annuities that adjust your starting income, based on changes in the Consumer Price Index, so you should consider inflation when you're deciding how much annuity income you will need when the policy starts to pay. In recent years, inflation has averaged between 2% and 3%. If inflation were to be 3% for the next 15 years, then $3 in 15 years would buy you roughly what $2 buys today. So if you think that you'll need $2,000 a month in today's dollars from annuity that starts paying in 15 years, you should consider buying a policy that will make initial payments of $3,000 a month.

Option three. If you die before you've collected as much money as you paid the insurance company, do you want the insurance company to pay the difference to your beneficiaries? For example, if you pay $100,000 for deferred income annuity and die before the income payments begin, do you want the insurance company to pay the $100,000 back to your heirs? Sounds great, but this is one popular option that you should not take. Why not? Because returning the purchase price of an annuity to the beneficiaries of people who die early ruins much of the risk sharing advantages of annuities. You end up paying too high of a premium for too little future income.

Think about the 10 friends who pooled their money. Let's say that their investment earns 3% a year, and that five of the friends die at age 75 and the rest live to be 85 or older. If no money is returned to the heirs of the five friends who die first, then when the surviving five friends turn 85, they're going to have about $1,558,000 to support themselves in their old age. However, if after each of the five friend dies at 75 their original payment of $100,000 is returned to their heirs, the surviving five friends will only have about $886,000 to support themselves in their old age. They're going to have less than 60% as much income in retirement, as they would have gotten without the refund to the heirs. So don't take the return
of premium options. By turning them down, you'll get more income in your old age for a smaller premium now.

As annuity expert, Moshe Milevsky, once pointed out to me, these are the sorts of guarantees that turn annuities into the equivalent of expensive bond funds. Deferred income annuities are a good option for people who have recently, or not yet, retired, and don't have a traditional pension. If you're one of the lucky few who has saved more money than you can possibly spend before you die, you don't need a deferred income annuity. If you do buy a deferred income annuity, be sure to keep enough money outside of the annuity to support yourself until the annuity starts paying, and to provide extra funds if you have an emergency. Consider investing 20% to 25% of your retirement savings in a deferred income annuity, no more. Finally, insurance companies assume that most annuity buyers are in good health, and likely to live longer than the average person. Thus, the pricing of deferred income annuities is not that attractive for those who are less healthy.

Since 2014, deferred income annuities can be purchased in traditional IRAs and 401(k) plans as Qualified Longevity Annuity Contracts, or QLACs. Of course not every 401(k) plan may offer qualified longevity annuity contracts as one of its choices, and a few rules apply. The most you can spend on qualified longevity annuity contracts is 25% of the balance in each of your traditional IRA and 401(k) accounts, with the total not exceeding $125,000. The annuity payments must start by age 85, and some insurance companies require that you buy these annuities before you turn 69. The regulations regarding qualified longevity annuity contracts do not apply to deferred income annuities purchased in Roth IRAs. Cancer, car crashes, and cholesterol. We spend much of our life worrying about dying too soon, but what about the risk of living too long, living longer than your savings? Deferred income annuities are one strategy for guaranteeing you won't outlive your income.