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FINANCIAL PLANNING ALERT

Annuities – "The Good, the Bad & the Ugly"

A *Google* search of the word "annuity" produces a staggering 19.5 million results! With so many variations of annuities and hundreds of companies selling them it is difficult to know if purchasing one makes sense. Annuities are appropriate for only a small group of individuals. **For anyone considering an annuity, it is important to understand the concept of an annuity and to be aware of their many shortcomings.**

An annuity is not an investment product, it is an insurance product and the risk is actuarially determined. **To ensure themselves a profit, the odds are stacked in favor of the insurance company.** The revenue comes from fees charged to the annuitant as well as the forfeiture of benefits when an annuitant dies. The earlier an annuitant dies (*or second-to-die, if survivor policy*), the greater the benefit to the insurance company. In some cases, the annuitant may live beyond the actuarial break-even point and end up receiving the greatest benefit.

The table below summarizes "the good, the bad and the ugly" features of 3 common types of annuities:

TYPE	DESCRIPTION	THE GOOD	THE BAD	THE UGLY
Variable Annuity	Premiums are invested into stock funds, called separate accounts. The value of the annuity tends to follow the stock market. The earnings grow tax-deferred and at retirement you can choose among different income options.	**Higher Returns**- Over time you can expect the value to increase faster than a traditional annuity because it is invested in the stock market.	**More Risk**- The stock market is volatile and the annuity can experience dramatic increases and decreases in its value.	**Fees & More Fees**- The fees come in 3 varieties – Sales Charges, Mortality and Expense Charges, and Investment Account Charges. These can quickly add up to 2-3% of the account value annually. If you change annuities or cash out before 8 years you may face substantial surrender charges.
Fixed Annuity	Premiums are invested in the company's "general account" and a minimum return is guaranteed. The earnings grow tax-deferred and at retirement you can choose among different income options.	**Less Risk**- The fixed annuity provides a predictable level of growth and the terms of the contract are fairly easy to understand.	**Lower Returns**- The general account is invested in assets that provide a low return, often just above inflation rates.	**Opportunity Cost**- With the low returns, your account may not grow fast enough to make an impact at retirement. The annual return net of inflation and fees may only be 1% per year.
Equity-Indexed Annuity	Premiums are invested in an account that promises to match the "adjusted" performance of a stock index but with limited down-side risk. The earnings grow tax-deferred and at retirement you can choose among different income options.	**Performance Floors**- This annuity is structured like a fixed, with some downside safety, but has the potential to provide faster growth than a fixed annuity.	**Limited Upside**- The returns do not actually match the chosen index. The complex formula excludes dividends and imposes monthly performance caps. In the end, your return may only be a fraction of that of the index.	**Complex, Confusing and often Misleading-** The slogan is "Stock market returns with none of the risk." In reality, you are not investing in stocks and over time the annuity will probably fall well short of the market because of the performance speed bumps that are installed. If you change annuities or cash out before 8 years you may face substantial surrender charges.

This information is provided as a general summary. For detailed information about a specific annuity refer to the annuity prospectus.

Maneuvering your way through the smoke and mirrors that is often found in annuity sales material can be a challenge. Here are three common pitfalls to watch out for:

> ***Investing Your IRA in an Annuity*** – Individuals should avoid investing money from their IRA into an annuity product. One of the primary reasons that annuities were created was to allow individuals to invest and have the earnings grow tax-deferred. But an IRA *already* provides

this tax-deferred benefit. It is therefore redundant and impractical to invest money from a tax-deferred account, such as an IRA into an annuity.

Exchanging One Annuity for Another – Annuities have been described as "…the same pig in a different dress." While this is not exactly true, most annuities do have very similar features. If considering an exchange, it is wise to compare elements that are easily understood such as fees, surrender charges, and the guaranteed minimum death benefit. For full disclosure, ask the salesperson what they stand to receive in the way of commission if you were to exchange annuities.

Adding Unnecessary Features – During most annuity presentations there is a sales pitch about the extra features available. These features may promise "safer investment returns" or "alternative payment options". Individuals should be weary of purchasing extra features as many are not worth the additional cost.

Traditional investments such as mutual funds can provide many advantages in saving for retirement compared to annuity products. The average mutual fund cost is less than half of the 2-3% combined annual fee that most annuities charge. A savings of 1% annually can make a substantial difference in the long term value of an investment. In addition, when an annuitant dies (*or second-to-die, if survivor policy*) the income from the annuity ceases and there is typically no cash value to pass on to loved ones. However, assets held in an investment account, including mutual funds, can be passed on to loved ones at death according to their Will or the designated beneficiary.

The most important thing to consider when evaluating an annuity product is whether or not it is suitable. Though there are hundreds of companies selling a variety of annuity products, the reality is that annuities are appropriate for only a narrow group of individuals. Sadly, there are many bright individuals who are persuaded to purchase an annuity product when it is not suitable for them.

If you are considering purchasing an annuity and would like to learn more about it, please contact our office. We can sit down and evaluate the annuity product with you. As a fee-only provider we do not receive a commission on any product or service. This allows us to provide financial planning and investment recommendations that are objective.