BRK-A

Annuities:

Good, Not so Good, or Bad?

Are They For You?

"More often than not, it's clear that variable annuities always benefit the seller, and only infrequently benefit the buyer." -- Forbes

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Annuities—good & bad

"Annuities are controversial investments, even with the financial community."

"I hate variable annuities with a passion..."

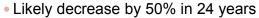
--Suze Orman

- How comfortable are you with market fluctuations?
- Annuities can help iron out market wrinkles



Some Background

- Most investment products designed to maximize return
- Annuity is designed to <u>hedge</u> against the risk of outliving your assets
 - A distribution rate can be locked in
 - DANGER: Payout not normally adjusted for inflation
 - Your <u>buying power</u> will decrease at the inflation rate—3% on average



Annuities—WHAT ARE THEY?

- Annuities are insurance contracts
 - You pay money in—
 - once -or- over time
 - Insurance company pays money out—
 - Once -or- over time
 - Payments can be:
 - Guaranteed for a minimum \$\$ amount
 - Guaranteed for a minimum period
 - Or rate of return for a set period of time

Annuities—WHAT ARE THEY?

- The types of annuities are almost endless
 - Can be very confusing and difficult to understand
- An annuity is kind of like a marriage
 - Except there is no real option for divorce
 - Or like a divorce—undoing it can be very expensive
 - It means choosing a partner for the rest of your life—an insurance company

Annuities—WHAT ARE THEY?

- When you invest in stocks, bonds, and mutual funds, you're focused on accumulating a nest egg.
- When you buy an annuity, focus shifts from building up a pile of cash to <u>establishing a foundation of</u> <u>security and certainty</u>, often in the form of a <u>guaranteed payout</u>.
- Annuities give you the opportunity to create your own income stream—but each option is at a cost
 - "Costs" will be explored later



Annuities—WHAT ARE THEY?

- Rather than taking portfolio withdrawals at ~4%
 - You could run out of money—worry, worry
- Lock in a potentially higher rate—but at a cost
 - You won't run out of payments (reduced)
 - You may run out of money—inflation
 - Buying power will be reduced
 - \$1,000 today isn't \$1,000 tomorrow

Annuities—DIFFERENT TYPES

- Immediate or Deferred -- Fixed or Variable
- Immediate and <u>Deferred</u> refer to <u>when</u> you get your money
- <u>Fixed</u> and <u>Variable</u> refer to the type of <u>payout</u>—a set payment or rate of return, or one based on underlying investment performance.
- Fixed annuities can be immediate or deferred
 - Same for <u>variables</u>, although they are usually deferred since unknown gains/losses are involved





Annuities—RIDERS

- Buyers can add a combination of other optional benefits—
 - A guaranteed payout
 - A guaranteed return of principal
- Of course, each rider will push up the cost or decrease the payout (Increases the sales commission paid too)

Annuities—FIXED

- The simplest annuity is perhaps the <u>fixed</u> <u>immediate</u> variety (Life Annuity)
- Pay a lump sum or over time
- Receive a stream of guaranteed payments—either for a <u>number of years</u>, the <u>rest of your life</u>, the rest of your life <u>and your spouse's life</u>, or a <u>set number of years</u> after you're gone. The longer the guaranteed period, the lower the payment.
- Explore how much income this type of annuity would generate at:

www.immediateannunities.com





Not Recommended

Annuities—VARIABLE

- Investor either pays a lump sum up front or can continue to add funds
- Money goes into investments, which act similar to mutual funds
- Contributions grow tax-deferred until withdrawals begin
 - Similar to a 401(k) or Individual Retirement Account
- Payout can <u>increase</u> if the investments do well
- Payout can <u>decrease</u> if the fund loses value
- Variable annuities can provide a guaranteed minimum income rider—at additional cost
- "I have demonstrated many times, the expenses of these annuities tend to defeat their purpose."



Annuities—DRAWBACKS

- Cost—Commissions and Annual Fees
 - More expensive than many mutual funds and exchangetraded funds –the price you pay for tax deferral and potential guaranteed income or returns
- Taxes also can be an issue annuities income can be taxed as regular income
 - Taxes on capital gains or dividends from an <u>investment account</u> may be lower
- Money is locked up
 - "Surrender fees" for the first several years
 - And unless you buy a death or survivor benefit rider, once you die, you can't necessarily pass on the annuity to heirs

Annuities—good & bad Oops—there's more

- Typically: During the first seven years, you will be charged a surrender fee of 2% to 7% of the account value each year that you make withdrawals beyond amount allowed. (Typically 15%) The fee declines as the years progress.
- Bottom line:
 - Money can be tied up for many years



More "oops"

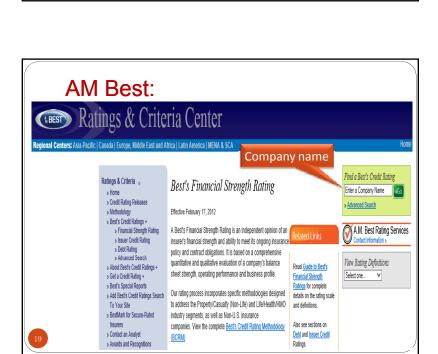
- Annuities cannot be passed on to heirs unless a rider is purchased
- Annuity payments taxed as regular income
- Inflation is an unseen risk in fixed annuities
- ETFs and index funds historically provide a better return

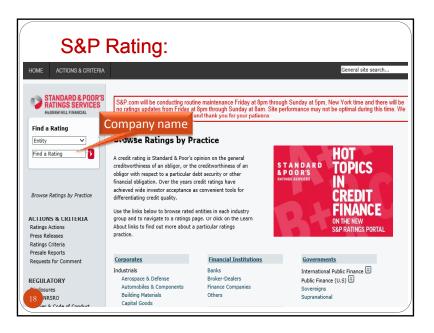
General Advice

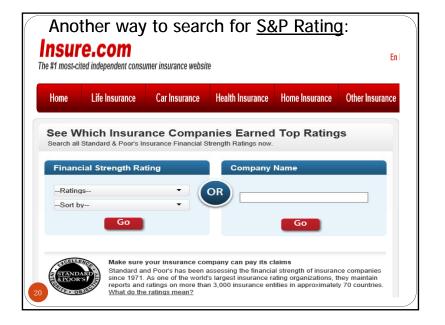
- Size of Annuity to Portfolio
 - No more than 30%--possibly 50%
 - How much stability do you require
 - Annuities lock up your cash
 - Always a danger



Annuities—FINANCIAL STRENGTH • Focus on carriers with financial strength • Require a minimum S&P credit rating of AA or better www.standardandpoors.com/ratings/en/us/ • Require a minimum A.M.Best credit rating of A or better www.ambest.com/ratings/guide.asp • Additional information: www.insure.com/articles/interactivetools/sandp/newtool1.jsp







Annuities—LOW COST

- Focus on carriers with low cost
 - No surrender charge
 - No load
 - No sales commission
 - (Vanguard Group)*
- No more than 30% to 50% (maximum) of assets should go into annuities
 - *No recommendation intended

Annuities—HIGH QUALITY

- Focus on carriers with high quality
 - Ask for ratings of <u>investment holdings</u>
 - (They may be listed in Annual Report)
- If 10% of total investment holdings are Junk Bonds—holding a <u>rating of BB or</u> <u>less</u>—be wary



Annuities—FINANCIAL CAUTION

- Annuities are an investment product
- Not FDIC Insured
- No Bank Guarantee
- May Lose Value
- Bankruptcy of insurance company is possible

Investors should carefully consider a variable annuity's <u>risks</u>, <u>charges</u>, <u>limitations</u>, <u>and expenses</u>, as well as the <u>risks</u>, <u>charges</u>, <u>expenses</u>, and investment objectives of the underlying investment options.

--Consumer Reports



Mortality and Expense Risk 1.30%

Risk and uncertainly increases costs

 Any time an insurance company offers an <u>annuity</u> to someone, it must make assumptions about uncertain factors (such as the <u>life expectancy</u> of the annuitant) and the <u>likelihood of uncertain events</u> actually occurring; it must also provide the annuitant with peace of mind via <u>lifetime payout</u> options for the future and fixed insurance premiums. The insurance company <u>prices these risks</u> inherent to the structure of an annuity as accurately as possible and <u>packages it into a dollar value charge</u> for the annuitant.



Mortality and Expense Risk – a surcharge of ~1.3%

- The mortality expense classification is based on the applicants gender and age at the time of application.
- Expense risk is based on several factors
 - Health
 - Weight
 - Profession
 - Tobacco use
- Risk % is adjusted depending on those factors

Annuities—RIDERS

- Annual cost breakdown of <u>least expensive</u> annuity options <u>of more than 50</u> available
- Option Fees (Riders)

Mortality and expense risk	1.30%
Administrative services	0.20
Death benefit	0.35
Spousal protection	0.20
5% lifetime income	1.00
Mutual Fund expense	0.80
Total annual fees	3.85%
PLUS a Commission of	<u>5-6%</u>
	~9%

Change an Annuity? (divorce)

Take advantage of a tax-free 1035 exchange

- How long to recover surrender fees
- Annuity Contract example:
 - 8% surrender fee
 - 2.6% total costs
 - Recover surrender fee in ~4 years

http://seattletimes.com/html/businesstechnology/2022013403_bizburns27xml.html

-- Scott Burns

Payout Options

- Your best pension-payout options
 - Lump sum
 - Monthly income
- They each have some advantages



Annuity Payout Options

- Lump sum: (Roll into an IRA)
 - You select investment for future growth
 - Taxes not paid until withdrawn
 - Maintain stash of cash for emergencies
 - Heirs can inherit what's left

More Annuity Payout Options

- Monthly income payment (annuity)
 - Longevity insurance
 - Check will arrive each month
 - Lose purchasing power to inflation
 - Three percent per year on average
 - Taxes may be due
 - Possible risk of bankruptcy of payer
 - Pension Benefit Guaranty Corp. can step in (Fed Gov.)
 - Guarantee is limited see www.pbgc.gov



Annuity – as a last resort

- Set one up through Vanguard
 - 0.5% annual cost
 - 70% below industry average
- Already have an annuity?
 - What are the surrender charges?
- Use this cost calculator:

https://personal.vanguard.com/us/whatweoffer/annuities/costcalculator

• Or call Vanguard 800-357-4720



Bottom line: the income options

- Social Security +
- Income from a portfolio
 - •401(k)
 - •IRA
 - Annuity
 - Retirement account
 - Other (Rich uncle/aunt, etc.)



Final Word:

 Given the plethora of options and the wide range of fees on annuities—as well as the pros and cons of locking up your cash for years to come—it's best to educate yourself about specific products. Not Easy!

"Although there are certain instances in which buying an annuity may make sense, in a majority of cases I believe that annuities cause more harm than good."

– Suze Orman

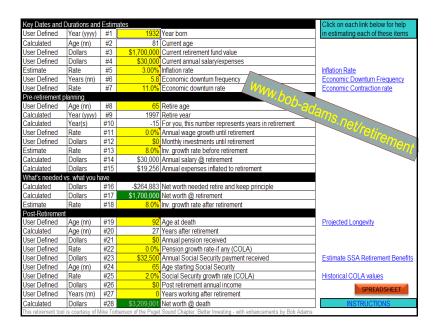


How long will I live? Fill in the fol "Calculate Life Expectancy". For values which you are ≅tion 'don't know': For zero values, enter "0", DO NO1 10-If you're in a hurry, try our Short life expectancy calculator I am 81 year old male v white v My height is 70 inches (NOTE!!! Only input inches: Eg. 5'8" = 68 inches) My weight is 160 pounds I expect to have more than 11 ∨ years of education My family's total income for the past 12 months is 1,000,000 dollars I expect that for most of my life I will be not married > Compared to other people of the same age and sex as me, I am in the 4th ✓ quintile of fitness(refer to Fitness Table) ✓ have at least one first degree relative (parents, sibling, children) who has a history of heart diseases I do not have at least one first degree relative (parents, sibling, children) who has a history of prostate cancer I do not have at least one first degree relative (parents, sibling, children) who has a history of breast cancer I do not have at least one first degree relative (parents, sibling, children) who has a history of colorectal cancer I do not value at least one first degree relative (parents, sibling, children) who has a history of stomach cancer I do not have at least one first degree relative (parents, sibling, children) who has a history of lung cancer of my first degree relative (parents, sibling, children) has a history of diabetes whave at least one first degree relative (parents, sibling, children) who has a history of stroke I reside in Washington I have not V been diagnosed with asthma I have not been diagnosed with diabetes My diastolic blood pressure (the smaller/bottom number- an average adult's is about 80) is 74 mmHg cigarettes per day ouse smokes 0 cigarettes per day

Final Word:

- Is there an Adult Care facility in your future?
 - · For most of us..."yes"
 - Money tied up in an annuity might disallow it
- Average inflation rate is ~3%
 - · Annuity is not normally inflation adjusted
- Sales people have a conflict of interest
 - Large sales fees are involved
- What is your historical family longevity?
 - Use this tool as a basis for how long you will live
 - http://gosset.wharton.upenn.edu/mortality/perl/CalcForm.html

	I travel thousand miles per year in an automobile	l
	The driver of the automobile which I most frequently travel in is a don't know ✓	ı
	The age of the driver of the automobile which I most frequently travel in is years	ı
	I don't know ✓ regularly wear seat belts when travelling in a automobile	ı
	The automobile which I most frequently travel in don't know ✓ regularly keep to speeds appropriate to road conditions	ı
	The driver of the automobile which I most frequently travel in is don't know ∨ drunk while driving	ı
	Of the 10 things listed in the Stress List, of them happened to me in the past 12 months	ı
	I am a don't know	l
	I work in the don't know ✓ industry	ı
	My father worked in a don't know ✓job	ı
	My first regular occupation is a don't know ✓job	ı
	My current occupation is a don't know ✓job	ı
	Of the 5 types of food in the Dietary Diversity List, on average I consume types	l
	don't know ∨ than 10% of my energy intake comes from fat	ı
	I don't know ✓among the 15% most depressed of the population	ı
	I have had sexual partners in the past 12 months	ı
	For most of my sexual encounters, I don't know ∨ use condoms	ı
	On average, I have hours of sleep a day	ı
		ı
	36 alculate Life Expectancy	l
/		ı



Final Word:

- Caution is advised
 - Learn about Annuities before taking the learn
- Caution is advised
 - Look at other options before taking the leap
- Caution is advised
 - You will likely do better by investing in equities
- You will likely do better by <u>waiting</u> until late in life if an annuity is for you
- It's a BIG decision—know your specific reasons for investing in an annuity

