

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

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Some Background

- Most investment products – designed to maximize return
- Annuity is designed to hedge against the risk of outliving your assets
 - A distribution rate can be locked in
 - **DANGER:** Payout not normally adjusted for inflation
 - Your buying power will decrease at the inflation rate—3% on average
 - Likely decrease by 50% in 24 years

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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

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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

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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 establishing a foundation of security and certainty, often in the form of a guaranteed payout.
- Annuities give you the opportunity to create your own income stream—but each option is at a cost
 - “Costs” will be explored later

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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

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Annuities—DIFFERENT TYPES

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

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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)

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Annuities—FIXED

- The simplest annuity is perhaps the fixed immediate variety (Life Annuity)
- Pay a lump sum or over time
- Receive a stream of guaranteed payments—either for a number of years, the rest of your life, the rest of your life and your spouse's life, or a set number of years 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.immediateannuities.com

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Visit: Annuity Quote Online

Annuities

- Annuities
- Annuity Rates
- What Is An Annuity
- What Is An Ira Annuity

Buying Annuities

- Buy Annuity
- Buyer Structured Settlement Annuity
- Annuities Retirement
- Best Annuity Rates

Structured Annuities

- **Fixed Annuities**
- Equity Index Annuities
- Retirement Annuities
- Structured Settlement Annuity

Private Annuities

- Retirement Annuity
- Private Annuity Trust
- Gift Annuities
- Charitable Gift Annuities

Top Sites

- Annuity Quote Online
- Immediate Annuities
- Annuities
- Annuity Rates
- Online Investing
- Fixed Annuities

Variable Annuities

- Variable Annuity
- Variable Rate Annuities
- Guaranteed Variable Annuities
- Flexible Premium Annuity

Investments

- Online Investing
- Retirement Investment
- Financial Investments
- Stock Investment Advice

Selling Annuities

- Cash For Annuity
- Selling Annuity
- Sell Annuity Payments
- Annuity Buyers

Insurance Annuities

- Annuity Quote Online
- Immediate Annuities
- Insurance Annuities
- Life Annuities
- Life Insurance Annuities

Tax Sheltered Annuities

- Tax-deferred Annuity
- Tax Free Annuity
- Tax Shelter Annuities
- Fixed Deferred Annuity

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Annuities—VARIABLE

Not Recommended

- 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 increase if the investments do well
- Payout can decrease 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.”**

Scott Burns – Syndicated financial columnist

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Annuities—DRAWBACKS

- **Cost—Commissions and Annual Fees**
 - More expensive than many mutual funds and exchange-traded 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 investment account 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

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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

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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*

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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

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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

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S&P Rating:

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AM Best:

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Another way to search for S&P Rating:

Insure.com

The #1 most-cited independent consumer insurance website

En

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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

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Annuities—HIGH QUALITY

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

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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 risks, charges, limitations, and expenses, as well as the risks, charges, expenses, and investment objectives of the underlying investment options.

--Consumer Reports

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Mortality and Expense Risk 1.30%

Risk and uncertainly increases costs

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

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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

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Annuities—RIDERS

- Annual cost breakdown of least expensive annuity options of more than 50 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%

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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/business/technology/2022013403_bizburns27.xml.html

-- Scott Burns

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Payout Options

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

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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

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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

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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

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Bottom line: the income options

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

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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

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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>

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How long will I live?

Fill in the following information to use the "Calculate Life Expectancy" tool.
 For values which you are unsure of, use the "don't know" option.
 For zero values, enter "0", DO NOT leave blank.

If you're in a hurry, try our [Short life expectancy calculator](#).

<http://gosset.wharton.upenn.edu/mortality/perl/CalcForm.html>

I am year old

My height is inches (NOTE!!! Only input inches: Eg. 5'8" = 68 inches)

My weight is pounds

I expect to have years of education

My family's total income for the past 12 months is dollars

I expect that for most of my life I will be

Compared to other people of the same age and sex as me, I am in the quintile of fitness (refer to [Fitness Table](#))

I 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 have 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

One of my first degree relative (parents, sibling, children) has a history of diabetes

I do have at least one first degree relative (parents, sibling, children) who has a history of stroke

I reside in

I have not 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 mmHg

I smoke cigarettes per day

My spouse smokes cigarettes per day

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I travel thousand miles per year in an automobile

The driver of the automobile which I most frequently travel in is a

The age of the driver of the automobile which I most frequently travel in is years

I do not regularly wear seat belts when travelling in a automobile

The automobile which I most frequently travel in regularly keep to speeds appropriate to road conditions

The driver of the automobile which I most frequently travel in is drunk while driving

Of the 10 things listed in the [Stress List](#), of them happened to me in the past 12 months

I am a

I work in the industry

My father worked in a job

My first regular occupation is a job

My current occupation is a job

Of the 5 types of food in the [Dietary Diversity List](#), on average I consume types

do not more than 10% of my energy intake comes from fat

I do not among the 15% most depressed of the population

I have had sexual partners in the past 12 months

For most of my sexual encounters, I use condoms

On average, I have hours of sleep a day

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Key Dates and Durations and Estimates			
User Defined	Year (yyyy)	#1	1932 Year born
Calculated	Age (nn)	#2	81 Current age
User Defined	Dollars	#3	\$1,700,000 Current retirement fund value
User Defined	Dollars	#4	\$30,000 Current annual salary/expenses
Estimate	Rate	#5	3.00% Inflation rate
User Defined	Years (nn)	#6	5.8 Economic downturn frequency
User Defined	Rate	#7	11.0% Economic downturn rate
Pre-retirement planning			
User Defined	Age (nn)	#8	85 Retire age
Calculated	Year (yyyy)	#9	1997 Retire year
Calculated	Year(s)	#10	-15 For you, this number represents years in retirement
User Defined	Rate	#11	0.0% Annual wage growth until retirement
User Defined	Dollars	#12	\$0 Monthly investments until retirement
Estimate	Rate	#13	8.0% Inv. growth rate before retirement
Calculated	Dollars	#14	\$30,000 Annual salary @ retirement
Calculated	Dollars	#15	\$19,256 Annual expenses inflated to retirement
What's needed vs. what you have			
Calculated	Dollars	#16	-\$264,883 Net worth needed retire and keep principle
Calculated	Dollars	#17	\$1,700,000 Net worth @ retirement
Estimate	Rate	#18	8.0% Inv. growth rate after retirement
Post-Retirement			
User Defined	Age (nn)	#19	92 Age at death
Calculated	Age (nn)	#20	27 Years after retirement
User Defined	Dollars	#21	\$0 Annual pension received
User Defined	Rate	#22	0.0% Pension growth rate-if any (COLA)
User Defined	Dollars	#23	\$32,500 Annual Social Security payment received
User Defined	Age (nn)	#24	65 Age starting Social Security
User Defined	Rate	#25	2.0% Social Security growth rate (COLA)
User Defined	Dollars	#26	\$0 Post retirement annual income
User Defined	Years (nn)	#27	0 Years working after retirement
Calculated	Dollars	#28	\$3,209,001 Net worth @ death

[Click on each link below for help in estimating each of these items](#)

[Inflation Rate](#)
[Economic Downturn Frequency](#)
[Economic Contraction rate](#)

[Projected Longevity](#)

[Estimate SSA Retirement Benefits](#)

[Historical COLA values](#)

[SPREADSHEET](#)

[INSTRUCTIONS](#)

www.bob-adams.net/retirement

This retirement tool is courtesy of Mike Tobenson of the Puget Sound Chapter, Better Investing - with enhancements by Bob Adams.

Final Word:

- **Caution** is advised
 - Learn about Annuities before taking the leap
- **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 waiting until late in life if an annuity is for you
- It's a BIG decision—know your specific reasons for investing in an annuity

The end is near
www.bob-adams.net