FPA FINANCIAL PLANNING PERSPECTIVES

As Annuities Get Attention in Washington, It's Worth Reviewing the Basics

Recent research from the Financial Planning Association® (FPA®) shows that planners are embracing annuity products to help a more conservative generation of clients protect assets and reach their retirement goals. Apparently the White House is getting in on the annuity bandwagon as well.

The question is, should you? First, start with the definition. An annuity is a financial product that accepts funds from an individual with a plan to grow them, and then at a specific time begins a stream of regular payments to guarantee a steady flow of inflation-protected cash to that individual until they die. Annuities come with various features, which will be detailed below.

The whole notion of guaranteed payments after an economic crisis seems to be more attractive these days.

A report in the April FPA *Journal of Financial Planning* stated that 35 percent of advisers surveyed said the recent financial crisis had changed the way they viewed annuities and as a result, they were more likely to use or recommend them than they were before the crisis. Washington also appears to be getting friendly with annuities as a conservative solution for those in retirement. In January, the Obama Administration released a report from its Middle Class Task Force favoring annuities as one of a series of tools that might offer guaranteed life income to millions of Americans.

Annuities have plenty of promoters and detractors, and it's best to start by reading as much about them as possible first, and then discussing your retirement savings choices with your tax professional and an experienced financial adviser. Some basics:

Annuities come in two flavors – fixed and variable: Fixed annuities offer a return that are tied to interest rates or a particular index, meaning these are "fixed" investments your money will always be tied to. Variable annuities are invested in a series of investments -- including mutual funds -- that allow the investor to change their investment allocations. If you are willing to pay heftier fees, you may be able to receive a guarantee that your variable annuity will not dip below the value of the initial principal.

Tax-deferred growth, but payments are taxed as ordinary income: Just like a 401(k) or IRA, the contributions and earnings within an annuity grow tax-deferred until the funds start coming out. But also like a 401(k) or IRA, you pay a 10 percent penalty for early withdrawals if you are younger than age 59 ½. Yet there's a tradeoff for a lifetime guaranteed payment, and that's the taxman. All withdrawals are treated as ordinary income and don't qualify for more favorable long-term capital gains treatment.

Money for life, but check the company thoroughly: The number one selling point of any annuity is that the issuer – typically an insurance company that writes up an annuity contract – guarantees that you will receive money for as long as you live. Of course, you need to make sure the insurance company behind the annuity contract is financially healthy. Check its Comdex ranking, which is an average percentile ranking of credit ratings provided for life and

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health insurance companies by firms such as Moody's Investors Service, A.M. Best Company and Standard & Poor's Corporation.

Fees and commissions can be steep: Always ask how much commission an agent makes – and planners can be agents if they are properly licensed – when they sell you an annuity. And be sure to compare commissions and ongoing fees on any annuity products you consider. Also keep in mind that some annuities can charge a surrender fee if you withdraw your money before age 59 ½ in addition to the 10 percent penalty.

Compare promised returns: We're still in a low interest-rate environment. Understand how any annuity you're considering will react in various interest rate scenarios.

Check out consequences of transferring an annuity: Find out what the tax and economic ramifications might be for transferring an annuity to spouses or other family members when you die. This effort should be part of an overall review of your personal finances and the creation of an estate plan.

Stay diversified: Keep in mind that putting everything you have into an annuity is not good financial planning. Discuss how you should allocate all your assets as you head into your retirement years.

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