Annuities Draw New Look at Time of Uncertainty

Financial uncertainty fuels new push for guaranteed retirement income (shh, that's annuities)

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The controversy over annuities mystifies people like Dennis Defnet.

The semiretired businessman and his wife, Karen, have three annuities that pay a total of several thousand dollars a month. The Wisconsin couple take comfort in knowing they have an assured income for life. And those checks allow them to postpone taking Social Security until age 70, when they can get the maximum payments.

"I can't imagine what drawbacks there would be for anyone who is retiring," says Defnet, 62. "Who would not like to have guaranteed income for the rest of their life?"

More people like the Defnets are coming to appreciate annuities, an investment product which can help retirees meet their income needs once they get a handle on its complexities.

By buying an annuity, generally from an insurance company, investors exchange a sum of money for a stream of periodic payments. Those payments are guaranteed under a fixed annuity but are subject to market risk under a variable annuity, which ties returns to a portfolio of investments.

Not everyone is a fan. Annuities can be dauntingly complicated, and some financial advisers shun them because they can be loaded with traps and fees.

But interest is growing, reflecting a need for more financial self-reliance at a time when pensions are disappearing and there's increased anxiety about whether savings will survive a volatile stock market. Everyone from the Obama administration to AARP to a growing number of advisers is encouraging consumers to consider annuities as a way to lock in income in retirement.

"A lot of people just don't understand these products," says David Certner, legislative policy director for AARP, the group that represents 40 million Americans over age 50. "But it's something we want to encourage people to at least look at."

Many underestimate how long they may live, he notes. And their other sources of income can either run out or shrink significantly due to inflation.

Some big issues give pause when it comes to buying annuities.

The need to trust an insurer with a large chunk of money that you will no longer control dissuades many. So does the dizzying array of choices and fine-print terms, which should be reviewed with a financial adviser.

One straightforward option that makes sense for many approaching retirement is the immediate income annuity, which involves turning over a lump sum and immediately receiving monthly, quarterly or annual checks for a specified period or for life. Immediate annuities generally are fixed, meaning they deliver a set rate of return.

Income annuities are the most efficient way of providing income in retirement and can pay as much as 6 percent to 8 percent of the purchase amount per year for life, according to Drew Denning, a vice president in the retirement services division at Principal Financial Group.

How big a check you receive for an immediate annuity guaranteed to last your lifetime depends on your age and any conditions you attach. If you want to guarantee that your heirs receive money if you die before you've recouped the amount you paid, you will have to settle for a lower income.

Consumer websites such as AnnuityAdvantage.com and DirectAnnuities.com give rundowns of the various annuity types and rates available, and ImmediateAnnuities.com shows how much you might get based on your age and location. For example, a 65-year-old man buying a $100,000 annuity is likely to be paid $628 a month for life. If he is concerned about a premature death and wants to guarantee that the income goes to his beneficiaries through the 20th year of the policy, the payments drop to $552.

Many retirees who hold either immediate annuities or variable annuities with guarantees in them enjoyed welcome security during the stock market meltdown that began in 2008. More than 80 percent of all variable annuities are now sold with guaranteed minimum benefits that provide some form of protection against market drops for an extra cost, according to the Insured Retirement Institute.

"They didn't lose their savings — they continued to get their paychecks," says Cathy Weatherford, CEO of the annuities trade group.

Joan Donnelly, a widow in her 70s from Gainesville, Va., was leery of annuities for years. After losing faith in the stock market, she finally decided to invest $200,000 in a variable annuity with a guaranteed death benefit two years ago to ensure her heirs will get something.

"I thought, 'Gosh, this is my best shot at guaranteeing that money other than putting it in a mattress or leaving it in a non-interest-bearing account at a bank,'" says the retired business executive, who invested through Campbell Wealth Management.

Marlene Roth of New York City, who hopes to retire soon from her job with a telecommunications firm, bought a variable annuity two years ago that helps make up for the fact she doesn't have a pension. "It's nice to know that at least a percentage of my portfolio is secure," she says.

The Defnets, of Winneconne, Wis., who have an immediate annuity and two variable annuities through Principal Financial, say the fees they pay are worth it for the sense of security alone.

Careful analysis is still required to determine which annuity, if any, is appropriate for your situation.

Annuities probably don't make sense if you have a serious medical condition that limits your life expectancy or if the expense won't leave you with enough cash for big expenses like medical emergencies or home repairs.

Historically low interest rates also mean this may not be the best time to buy one, according to Laura Clark, an investment principal for private wealth management firm Lowry Hill in Chicago. That's because the spending power of your fixed payout is only going to be decreased by rising inflation going forward.

You also have to make sure you buy from a credible insurance company that's going to be around years from now to keep its promise.

"Annuities could be helpful, especially if your biggest concern is outliving your assets," Clark says. "But they're not a panacea. You still have to step back and make sure you have enough money overall to meet your retirement needs."