Annuities Explained: The Choices And Red Flags

by NPR STAFF

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Companies are licking their chops at the prospect of a wave of baby boomers leaving their jobs with trillions of dollars in 401(k)s and other savings accounts, so older Americans may find themselves bombarded with ads for annuities. And younger boomers, too, may be targeted, since many are helping their parents with investment decisions.

Annuities are a $200-billion-a-year business for life insurance companies and financial institutions that sell them. They are a sort of private pension that people can buy for themselves to create regular income for after they retire. They are tax-deferred mutual-fund-like investments, there are no annual contribution limits, contributions can be made in a lump sum or over time, and the payouts can be immediate or deferred.

"The older you are when you invest the money, the more your annual payouts are," Kiplinger's Kimberly Lankford tells Morning Edition's Renee Montagne. Payout amounts also depend on how long they go on for. For example, to get the highest amount, payments stop when you die. It's possible to extend payouts out, say, 10 years after death to go to your beneficiary, but that will lower the annual amount. "There are all these choices to make," Lankford says.

More from Kiplinger's Kimberly Lankford

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As with any financial product, annuities — or, rather, the salespeople who market them — promise benefits like guaranteed payouts. But salespeople can make big commissions on annuities contracts, and the insurance companies that issue the contracts earn hefty fees. There have been abuses, and in the past, state regulators have fined insurers for putting investors into unsuitable annuities.

Given the **mind-boggling math** involved with annuities, even a highly literate person will have trouble making a decision. Lankford has been writing about annuities for years, noting several red flags to watch out for:

Surrender fees. These are fees you pay to cancel an annuity contract or withdraw funds early. They are designed to encourage investors to stay in their contract. A typical surrender charge starts at 7 percent of the funds contributed to the contract or on withdrawals in the first year. The fee percentage could fall in subsequent years and can also remain for 10 years or more. If older seniors buy an annuity, these fees may still be in effect exactly when the investor needs to withdraw the money.

Churning. This is when an annuities salesperson convinces an investor to switch contracts. Moving money from one annuity to another earns the salesperson additional commission. Sometimes it's OK to switch to another annuity with lower fees or different guarantees, but you need to be careful that the salesperson is not trying to get you to switch just for the commission.

Buybacks. Currently, some insurance and financial companies are finding that the annuity contracts they sold many years ago have terms that are generous for investors but not good for the company's bottom line. So they are offering investors large sums to buy back contracts. Lankford warns investors in a recent article that "in most cases, the extra payments will be a bad deal for seniors who own older annuities."

"Free lunch" seminars. Investment seminars offering a free meal may be touted as educational, but they've been listed as a top threat to investors by the Securities and Exchange Commission and other regulatory groups. These seminars often target older adults and can include high-pressure tactics to buy products they may not need.