

# 7 worst annuity mistakes

(Story: Kimberly Lankford. Source: [Kiplinger](#)) InvestmentNews 6-28-13



As you shift your focus from saving for retirement to withdrawing money, an annuity can be a crucial part of your income strategy. An annuity can provide guaranteed income that lasts for your lifetime — no matter how long you live — and can be a good way to supplement income from Social Security and a pension. But annuities can be complicated and expensive, and it's easy to make mistakes. Here are seven annuity missteps to avoid.

## 7. Investing too much money



Annuities are a great source of lifetime income, but they can also be inflexible. Immediate annuities can pay out a lot more than interest on CDs and other fixed investments. But to get that extra income, you have to give up control over the money: After you give the insurer the lump sum for an immediate annuity, you can't take it back. And even with deferred annuities, which let you cash out or withdraw as much as you like after you invest, you will jeopardize your income guarantees if you withdraw more than a certain amount (often 5% or 6% of your guaranteed value) each year.

The best way to calculate how much to invest is to work backward: Add up your essential expenses in retirement, subtract money coming in from guaranteed sources such as Social Security and a pension, and invest enough money in an annuity to fill that gap.

## 6. Going for the wrong payout



If you buy an immediate annuity, you'll get the highest annual payout if you buy a single-life version — one that stops paying when you die, even if your spouse is still alive. But if your spouse is counting on that income, it may be better to take a lower payout that will continue for his or her lifetime, too. You can get current rates at [ImmediateAnnuities.com](#). Before you choose the type of annuity payout, review your financial plan and make sure your spouse will have enough income to live on after you die.

## 5. Going for the wrong payout guarantees

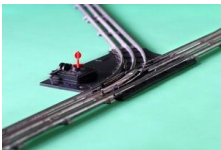


Instead of an immediate annuity, you can get a deferred variable annuity with payout guarantees. These annuities let you invest in mutual fund-like accounts that can increase in value, and they promise that you will receive at least a certain amount of income each year for your lifetime, even if the investments lose money.

One version of variable annuities with guarantees — called guaranteed minimum income benefits — requires you to annuitize the account in order to receive the promised lifetime income. That means you convert your account into an immediate annuity, which can provide higher payouts than the versions with more flexibility but requires you to give up control over the lump sum at that point.

If you don't want to sacrifice flexibility, then you should buy an annuity with guaranteed minimum withdrawal benefits. These annuities promise they will pay out income for life based on your initial investment or bump up your guaranteed payouts based on the highest point your investments have reached, even if they lose value after that.

## 4. Switching to another annuity



Older versions of variable annuities with payout guarantees that promise a certain amount of money every year for life, no matter what actually happens to your investments, often let you take 6% of your guaranteed amount every year. Newer versions often cap these guarantees at 5%. Your guaranteed value can be much higher than your actual account value, which can make these annuities valuable in a down market. But if you cash out the annuity or switch to another one, you'll only get to take the actual account value rather than the guaranteed value.

New annuities generally have higher fees and smaller guarantees than the versions sold in the late 1990s to mid 2000s. If your annuity's guarantee is worth more than its account value, be wary of any broker who wants you to switch (salespeople make a commission when you buy a new annuity). You may also have to pay a surrender charge of 7% or more if you switch out of the annuity within the first seven to ten years.

## 3. Overdoing the cash withdrawals



Variable annuities with guaranteed minimum withdrawal benefits usually let you take out 5% to 6% of the guaranteed value each year. But if you take more than that, you can jeopardize the guarantee. The consequence varies by annuity. Mark Cortazzo, a certified financial planner with Macro Consulting Group, in Parsippany, N.J., gives an example of how two annuities adjust your guarantee very differently if you withdraw more than the permitted amount in one year. Both annuities have a \$500,000 account value and \$1 million guaranteed value, and you can withdraw 6% of the guaranteed value each year, for a withdrawal of \$60,000. If you withdraw an extra \$5,000 just once, one of the annuities will reduce your guaranteed value to \$990,000, and your

annual withdrawal will fall slightly, to \$59,400. The other will slice the guaranteed value to \$500,000 — and your annual withdrawal will drop to \$30,000. That's one reason it's important to keep plenty of money outside of the annuity so that you aren't forced to withdraw more than the permitted amount.

## 2. Not making the most of the guarantee



(Photo: Bloomberg News)

If you're paying 0.95% to 1.75% a year in fees just for the guarantee, you should invest that money more aggressively than you do with your investments that don't have guarantees. The lifetime guarantee is often based on the highest value the investments reach. So even if your investments take a hit for a few years, you'll have a guaranteed floor. And when the market rebounds, your guaranteed value will rise as well.

## 1. Jumping at a buyback offer



Many insurers offered generous guarantees in the late 1990s and early 2000s, when the stock market was rising and interest rates were higher. Some of these older annuities based lifetime payouts and death benefits on the investor's original investment plus annual returns of 5% and 6%, no matter what happened in the stock market. Since the market downturn in 2008, some of these insurers have been looking to shed these guarantees from their books and are offering annuity holders a lump sum — often worth more than the account value — to cash out. But these older annuities can be much more valuable than newer versions; it's a mistake to take the buyback offer if you still have the lifetime-income or death-benefit needs you had when you originally purchased them.