



Annuity Income:

Behind the Smoke & Mirrors!

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Pay No Attention to that Man Behind the Curtain!

“Pay no attention to that man behind the curtain” was a famous quote from the Wizard of Oz.

When Dorothy first entered the Wizard’s great hall, she was greeted with an impressive sight – the face of the Wizard was enormous! Smoke and flames radiated around his image. The lion was so terrified, he jumped through a window. However, when the wizard was later unmasked,

Dorothy discovered that the Great and Powerful Wizard of Oz was an ordinary man. The creation of the wizard persona was nothing more than smoke and mirrors and special effects.

Regrettably, in the financial services industry, I see a lot of smoke and mirrors in the presentation of financial instruments. In my experience the most egregious examples come when advisors sell annuities – particularly those with income benefits.

There are generally three ways to withdraw money from an annuity.

Annuitize - This is where the insurance company makes payments for either a certain period of time or for a lifetime (or sometimes two lifetimes – in the case of married couples). When a lifetime annuity is selected the payments end with the death of the annuitant.

Withdrawals – In a deferred annuity, the account balance (referred to as the accumulation value) can be withdrawn just like any ordinary investment account. The accumulation value increases for earnings and decreases for losses, withdrawals and fees. When the accumulation value is zero, the contract is closed.

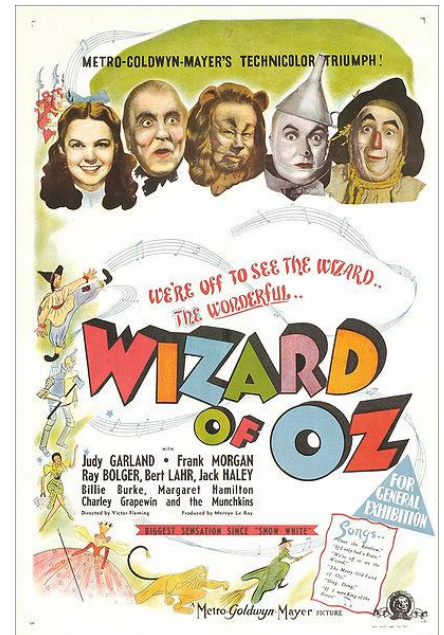
Income Benefit – An annuity with an income benefit takes the best features of the two withdrawal methods above. Like the annuitization option, an income benefit is paid to the annuitant(s) for as long as they live. However, if the annuitant dies before the accumulation value is exhausted, the remaining balance is paid to their heirs.

An annuity with an income rider is a terrific alternative for retirees who are concerned about outliving their money. However, with the dizzying array of contracts that are marketed to retirees, it is often difficult to truly find the best product to meet their particular needs.

The confusion often comes in with the way that these income benefits are marketed. You may see advertisements in the newspaper where an annuity is purported to provide 5%, 6%, 7% income benefits (with a lot of indecipherable fine print at the bottom).

Remember the old saying “If it sounds too good to be true, it probably is”. This credo holds true for these purported income claims. After all, with interest rates as low as they are, it’s hard to believe that any investment can pay you that high of a rate of return.

In reality, an income benefit (often referred to as a GLWB – or Guaranteed Lifetime Withdrawal Benefit) is really a cash flow benefit. When the “income” is paid out, the payouts will eventually begin to deplete your original investment. Also, the 5%-7% increase in the value of the GLWB account is not real money. It is what I refer to as “Monopoly™ money”.



When you pay Monopoly™, you know that the money inside the game cannot be spent somewhere else. Likewise, the increases of the GLWB base are generally not real money that you can cash out or pass on to your beneficiaries. It is merely a means to calculate the cash flow that will be paid to you for the rest of your life.

So are annuity income riders good or bad? If you are in a situation where you are concerned about running out of money, an annuity may be a wonderful solution to meeting your needs in retirement. However, I often see people who have adequate retirement income who are sold an annuity based on the increase in the GLWB base and only to find out later that this was Monopoly™ money.

When you are shopping for an income benefit annuity, ask the following questions:

- How much will my lifetime income be when I start withdrawals in ___ years.
- What is the amount of the rider charge? Are there other fees and expenses?
- Are there additional benefits if I become disabled?
- Do the income payouts increase?

Most importantly, find out what are the strings attached to the annuity that you are considering. There is no perfect investment. Find out about your potential investment's imperfections. This will allow you to cut through the smoke and mirrors and find out if an annuity (or any investment) is right for you.



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