Insured Retirement Institute
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TIPS FOR CONSUMERS

Six Important Questions to Ask when Purchasing an Annuity

As a growing number of Americans take charge of planning for and managing their retirement finances, an increasing number will consider investing a portion of their retirement assets in an annuity. According to IRI, the first step in determining if an annuity is right for you is to begin by answering a series of important questions:

Am I investing in an annuity to save for retirement or generate guaranteed retirement income, or both?

Answering this question forces the prospective annuity investor to examine his or her retirement objectives. Many people saving for retirement have not taken the time, on their own or with a financial advisor, to realistically project the costs of their envisioned lifestyle and to forecast the possible number of years that they will be living in retirement. Envisioning how you want to live in retirement is essential to understanding the role that an annuity can play.

When do I plan on using the money invested in the annuity?

Annuities are designed to be long-term retirement investments; a contract between you and an insurance company to provide you with lifetime guaranteed income payments. Payout annuities (a.k.a. "immediate" or "income" annuities) provide income payments that begin shortly after purchase. Deferred annuities allow you to accumulate assets for retirement and also offer the option to provide income payments sometime in the future. Therefore, if there is a good chance that within 10 years you will need to withdraw the money you plan to invest, a deferred annuity may not be the best investment for you. This is particularly the case if you expect to withdraw the money before age 59 ½ because tax penalties may apply.

What percentage of my assets is appropriate for an annuity given my retirement objectives?

It is generally not advisable to invest 100 percent of your retirement assets in an annuity or any other single investment vehicle. IRI estimates that the average deferred annuity contract should account for approximately one-third of the assets of an individual saving for retirement. In order to determine the most appropriate percentage of your assets to invest in an annuity, talk with a qualified financial advisor to help determine what makes sense for you.

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What does the annuity guarantee?

Annuities can provide a wide range of guarantees that are unavailable in other financial instruments, making them a very advantageous part of a retirement income strategy. Since annuities from different providers vary, it is important that you clearly understand the guarantees in your particular contract, as well as the financial strength and claims paying ability of the insurance company issuing the annuity contract. Deferred variable annuities include the following guarantees:

- ✓ Guaranteed lifetime income payments – an important component of a secure retirement plan given increasing life expectancies.
- ✓ Guaranteed death benefit – generally the greater of the purchase payment or the value of the annuity at the time of death; in addition, many variable annuity contracts allow you to lock in investment gains at periodic intervals.
- ✓ Guaranteed minimum accumulation benefits and guaranteed minimum withdrawal benefits – both provide principle protection against downside market risk.

What fees are associated with variable annuities?

All financial products have fees, including all "no-load" investments. While fee structures vary, it is essential that the prospective investor understand what they will be charged and when. Common variable annuity fees include:

<u>Investment Management Fee</u> – Similar to fees charged by retail mutual funds, these fees are charged for the management of the different funds in a variable annuity's investment portfolio. According to 2008 Morningstar data, investment management fees on the average variable annuity are .24% lower than that of the average retail mutual fund.

<u>Insurance Charge</u> – Insurance charges include mortality and expense risk charges (M&E fees), which are around 1.25 percent of the average value of the investment, and support the annuity's payout option, the death benefit and the guarantee that the annual insurance charges will not increase. Other elected insurance benefits will have additional fees (e.g., guaranteed minimum income benefit, guaranteed minimum withdrawal benefit, guaranteed minimum accumulation benefit, etc.). In addition to the insurance charges, most contracts impose administrative fees, which are typically around $30 per year, and pay for administration of the contract. However, administrative fees are typically waved for larger contracts.

<u>Surrender Charge</u> – A surrender charge is typically applied to the annuity investor who decides to cancel the annuity within an initial set number of years. Surrender charges generally range from five to seven percent of the annuity value and usually decline to zero over a period of time. Other sales charge structures exist; therefore you should consult with a financial advisor to determine which type of contract is best for you.

<u>Commission</u> – The fee paid to the broker for his or her expertise and professional guidance in helping determine which product is best suited for you. In the typical situation, the commission is paid to the broker by the company issuing the annuity, and does not reduce the annuity's contract value. The company recoups the commission costs over time through the various contract fees and charges listed above.

What is my risk tolerance?

Your individual risk tolerance will depend on a number of factors, including your age, time horizon and retirement goals. Annuities offer a range of investment portfolios from which you can choose based on your risk tolerance. Variable annuities offer a wide selection of options, from aggressive growth funds to more conservative investments, such as money market funds and fixed-rate instruments. They can also offer features that provide protection of the investment against downside market risk. Fixed annuities can minimize risk by locking in a fixed rate of return. Your financial professional and, in most cases your insurance company, can provide asset allocation tools and support to help you identify and manage your personal risk tolerance.

Financial Industry Regulatory Authority

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REVIEW LETTER

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Attention: Karen Alvarado

The material submitted appears consistent with applicable standards. However, we have the following comment:

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