The Ten Biggest Misconceptions About Annuities

" Everything you've heard about annuities is probably wrong or from a biased source"

BY: TONY WALKER

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ABOUT TONY WALKER…

For nearly three decades, Retirement Specialist Tony Walker has made it his life's ambition to help hard-working Americans be *WorryFree*! A gifted communicator and listener, Tony has that unique gift of making complex financial issues seem simple. His many appearances on television, numerous books and articles he has authored, and producing and directing a documentary on retirement establishes Tony as one of the country's foremost retirement specialists.

Tony's WorryFree Retirement® Process provides his clients with a safe and secure game plan that allows them to use, enjoy and protect their retirement money.

Tony holds numerous financial licenses, as well as educational degrees from the American College CLU program and The College for Financial Planning.

A resident of Bowling Green, Kentucky, Tony is married to his high school sweetheart, Susan. Together, they enjoy three children and four dogs.

I began my financial services career (my first “real” job) in June of 1984. I quickly embarked on educating myself in taxes, estate planning, life insurance and annuities. In 1987, besides having my insurance license, I completed the necessary requirements to sell certain securities; namely, mutual funds, variable annuities and variable life insurance.

In 1988, I left the family business to establish my own practice: a financial and estate planning company. After a couple of years of slugging it out on my own, and upon a little reflection, I realized there was a lot to learn about investments and retirement planning. So I did the only logical thing a struggling financial advisor should do - get better educated about this new field. So at the ripe old age of 28, I earned my CLU (Chartered Life Underwriter) designation, becoming at that time, one of the youngest in the country to have such a credential. Besides my new found CLU credential, I also offered an array of financial products ranging from permanent life insurance to limited partnerships in gas wells. I was trying to be all things to all people – something I learned later in life that a “specialist” should never attempt. I had all the products a person could have in their financial quiver, save one: I refused to offer fixed annuities. I did like "variable" annuities and sold quite a few of those. There's a difference… just keep reading.

During the go-go 90's, many of my clients were experiencing double digit returns from my money management practice of stocks, bonds, variable annuities and mutual funds. I guess at the time, compared to all the exciting products like variable annuities and mutual funds, earning 4% to 5% in some fixed annuities didn't sound so hot. Add to that the fact that they seemed complicated to me. That's because a fixed annuity is a "contract" not an investment. To understand a fixed annuity, one has to actually take time to read and study a contract; something most insurance agents, financial planners and other "advisors" (including myself back then) will generally not take the time to do.

September 11, 2001: Two planes, flown by extreme terrorists and loaded with innocent passengers, fly directly into the twin World Trade Center towers in New York City.

Up until the time of this tragic incident, I spent a good deal of my time and efforts as a “money manager”. As a money manager, my job involved investing my client’s money into a variety of stocks, bonds and mutual funds for the sole purpose of creating as much growth and income as possible. Risking their principal was never a concern since, for the most part, I had never experienced any significant losses in the stock market.

However, within minutes of the 9/11 tragedy, not only did the stock market plunge, but much to my surprise, the market CLOSED! Talk about feeling out of control…

Realizing the dire ramifications of the market, my only thought was how could I, as a trusted advisor, get my clients’ money out of harm’s way and into safer territory? Immediately, my thoughts flashed back to my roots of “protecting” other people’s money, rather than worrying about trying to grow it at all costs. Seeing the true instability of the stock market, and how it could quickly erase one’s retirement money, I made a commitment to create a process that would allow my clients and future clients to be “WorryFree”.

After extensive research, here's what I discovered: in terms of "safety", I believe that there are only THREE safe places to save your money. Notice I didn't say "invest"… I said "save" because savings should be safe, not placed at risk. That's what my Granddad taught me, and that's what I've come to learn after working with thousands of folks over the past 25 years. A safe place to put your money also means that your original principal plus earnings on that principal are guaranteed!

- **Safe Alternative #1: government bonds held until maturity**

- **Safe Alternative #2: bank deposits & CDs backed by the FDIC**

- **Safe Alternative #3: fixed annuities**

In what follows, I will deal only with fixed annuities.

Make no mistake, much of my living comes from the sale of fixed annuities. I get a one time commission from the insurance company issuing the contract. I like to say "when you purchase an annuity contract, the insurance company pays the agent, you don't." One could say that since I am an agent, I'm biased toward fixed annuities.

Guess what?

I am!

That's because my experience in working in both the "World of Risk & Uncertainty" (the securities world) and the "World of Safety" (fixed annuities) has taught me that it's better to be safe than sorry. I truly believe that the majority of Americans want to play it safe. Problem is they aren't sure "where" the safe places are located. Sure, everyone knows about bank CD's and government bonds, but annuities?

Exploring both worlds has proven to me that "savers" – defined as people who are more concerned with the return OF their money than the return ON their money – don't enjoy the prospect of losing overnight what took a lifetime to create! The world of Wall Street is not for savers, but for investors and speculators. Their goal is to grow money - not be overly concerned with how much risk you might incur. In my practice, I am more concerned with minimizing costs and protecting principal. I have no interest in reliving the “good ole’ days” of risk and uncertainty.

So how does a fixed annuity differ from other investments? Mainly, fixed annuities are not “transaction” products. Unlike investments that are constantly being shuffled around by Wall Street, the fixed annuity is designed to put your money in and leave it alone until such time (usually years down the road) as you need it. No day trading or checking out the nightly news to see what the market did. Rather, a fixed annuity is designed for retirement - or at least the retirement-minded. It’s a savings vehicle (or vessel) issued by insurance companies that is designed to eventually provide a steady stream of guaranteed income. The person selling the annuity makes a one-time commission and that’s it. He or she is called an agent but can also be a Certified Financial Planner, Registered Investment Advisor, Registered Representative and more, but they must hold a valid insurance license.

Unlike variable annuities, which usually carry hefty annual fees, the fixed annuity generally charges no explicit fees; however, over the holding period of the annuity, the insurance company will recover their costs of manufacturing and distributing as well as make a reasonable profit – just like a bank does on the deposits you leave with them. The lack of recurring fees is the primary reason Wall Street doesn't care much for fixed annuities. That's because the majority of their products contain annual fees, and old habits are hard to break. Annual income, fees and bonuses are what drive Wall Street, and fixed annuities just don't fit their needs so they don't offer them.

So let's get to it: what are the "ten biggest misconceptions about fixed annuities", and what is the real truth behind these products? What follows is based on my three decades of experience that has involved working both "sides of Wall Street" and finally seeing the light.

<u>Misconception #1</u>: Fixed annuities come with huge surrender penalties.

Let's back up a minute: ALL financial institutions must make a profit: if they don't, they'll go belly-up. The only way any financial institution – bank, brokerage firm, credit union, insurance company or others -- makes money is on "other people's money". It's that simple and a universal truism. They make commissions and/or fees for handling the money of others, and they get paid in a variety of ways. Regardless of the product or the institution, a profit is built in; a fee is charged when sold or is recurring annually. You and I would do the same thing if we were in their shoes. It is so common, we've even given it a name: ***Capitalism***.

So what is a surrender penalty, and why do some annuities carry such high penalties? The main reason: to protect them and you (assuming you own an annuity). Insurance companies invest most fixed annuities money in long-term corporate and/or government bonds, and if they "cash in" early there is a penalty… so they charge the annuity holder a penalty if they "cash in" early. (Again, we aren't talking about variable annuities that are usually invested only in securities traded on the stock markets). To understand a fixed annuity, we need to understand the bonds backing the annuity and how a bond works.

Let's say you buy a bond. When you purchase a bond, you're essentially "loaning" your money to someone else like the government or a business. The borrower could range from the federal government to your local school district or a big corporation. They then pay you interest on your money for a specified period of time until the maturity date. The maturity date can range from a few months to 30 years or more, and is the time in the future that you will receive all of your original principal back.

Insurance companies have a multitude of bonds with various entities. This affords them (and you) the opportunity to diversify their portfolio of bonds so as not to have all their eggs in one basket. If one bond defaults, the insurance company can rely on other bonds to cover (guarantee) the contractual obligations of the annuity contract.

On average -- as of the date this is being written -- insurance companies are paying about 3½% - 4% interest rates annually on fixed annuity contracts. Generally the longer you are willing to “tie-up” your money (note: this is where surrender charges/penalties come into play) with the insurance company, the higher the interest rate they will pay you. This is no different than any other bond: everything else equal, the longer the maturity, the higher the rate.

So, let’s think about this a minute; if you were the insurance company, and “promised in writing” to pay someone a higher than normal interest rate, you’d have to find long-term bonds to cover that obligation, right? So, if you did this, wouldn’t you want some protection in case the bondholder decided he/she wanted all of his/her money back? This is why the insurance company charges a fee (surrender penalty) if the bond (annuity) is redeemed ahead of schedule. That just makes good business sense! Because if they didn’t, the insurance company would be taking higher risks and would not be as safe a place to keep your retirement money. If they lose, we all lose!

So, in the correct light, a surrender penalty can actually be viewed as a positive… not a negative. It is actually good for you and good for the insurance company, because it allows both parties to know “for certain” what will happen.

In my over 25 years in the financial trenches, I’ve only had a few of my clients incur surrender penalties. For two simple reasons: 1) I take a great deal of time explaining surrender charges until I’m convinced the prospective client understands them; 2) I always try to build a game plan that allows my client to avoid surrender penalties by planning ahead for their cash needs – emergency as well as just plain old contingency needs. Unfortunately, this takes time, patience and expertise that financial advisors gain through study and experience.

So why all the negative press about these wonderful products?

Let me respond with what I “see” in my practice with “existing” holders of annuities.

Whenever I meet someone who is upset over an annuity, or over some issue regarding an annuity, it usually relates back to the original sale of the annuity.

Basically, it boils down to the agent/broker not taking the time to explain (it's called disclosure) the mechanics of the annuity and how best to access the money without penalty. Or, in some other instances, I've visited with folks who had relatives that were taking monthly income from a fixed annuity (the relative had "annuitized" the annuity and was drawing a lifetime income) and upon the annuitant/relative's death, the annuity payment ended. The income does die with a "life only immediate" annuity, but that is not the case with other fixed annuities unless they are "annuitized" for a lifetime income.

Therein lies the problem; some insurance agents and financial advisors who only occasionally sell annuities do not understand these contracts. So instead of blaming the annuity for these misconceptions, blame the advisor for either not knowing enough about annuities or misrepresenting them.

<u>Misconception #2</u>: All annuities charge high fees.

Virtually all of the articles dealing with annuities refer to the "high fees" charged by the insurance company that administer them.

Nothing could be further from the truth!

Of course, if you are talking about variable annuities (as explained above, these are not fixed annuities) they do sometimes come with very high fees.

The reason a variable annuity charges high fees is because multiple parties are involved in their manufacture and distribution. The underlying assets (called sub-accounts) are generally mutual funds. Mutual funds require expensive management by a money manager. Their fee, along with the involvement of an insurance company, adds up to several parties with their hands in your till. The assets backing variable annuities are usually not invested in high-grade corporate bonds or government bonds (like a fixed annuity) but rather, directly invested into the stock market. Of course, constantly buying and selling stocks, pestering investors with an endless stream of paper from proxies to prospectuses, and charging for extras (like guaranteed death benefits and highest anniversary values) means more fees and charges. Again, this report is not talking about variable annuities, but I wanted to make it clear that variable annuities and fixed annuities are quite different from one another.

Fact: the majority of fixed annuities charge no fees or very minimal fees. End of story.

***Misconception #3*: Annuities are difficult to understand.**

Amen! I agree! But what contract isn't difficult to understand?

That's all the more reason the person selling you the annuity knows what they are talking about. As an agent, the only reason I should make a commission from the sale of a fixed annuity is that I know what I'm talking about and that I've done the best I can to be sure the client is comfortable with the annuity before purchasing it.

So knowing I and all these other folks get paid commissions for our work – make us earn it! Don't be afraid to ask questions. And for goodness sake, if you don't understand what they are telling you, don't give them your money.

I am often amused at the various articles I read about annuities (obviously written by people who have little understanding of annuities) as they go on-and-on about how complex annuities are. Here's what I'd like to ask these writers and pundits: if you don't understand annuities, why are you writing about them? Go write about something you actually understand so that people can learn the truth.

Can you imagine a minister telling you not to read (or believe in) the Good Book because it is too complex? I confess that my knowledge of how a TV works is pretty limited, but that doesn't keep me from watching my favorite programs. Moral to the story: just because something appears complex, doesn't mean it's not good for you!

If folks would simply take the time and interest to read and study annuities, they might become "believers", just like me. When you drill down to the basics, fixed annuities are not that complicated: you give your money to an insurance company, and they in return pay you interest, via a contract, for a certain period of time. If you break that contract, they spell out exactly what they are willing to pay you. Doesn't sound real complicated to me.

<u>Misconception #4</u>: The money I put in an annuity is all tied up.

Again, with the proper type of annuity, nothing could be further from the truth.

Let's face it, unless you put your money under a mattress or possibly in a checking/money market account in a bank, your money is "tied up". There are always some strings attached to getting 100% of your money back. For instance, you might invest in a stock. Is it tied up? Most people would say no… I can get my money out at any time. That's true, but what if you go to get the money out and the market is down 30%? Is this money "tied up?" My experience tells me that when people have lost money, they have a tendency "not" to take the loss. They instead take a "wait and see" attitude, which means, it's tied up! Let's say the person "does" take the loss… they sell the loser and walk away with 70% of their original investment. Now, the 30% loss is really tied up. It's gone forever. What a deal!

Either way, with most investments, remember your money is always tied up.

Almost all of the annuities I work with give you the following options:

1. Beginning after the first month of the contract, you can request the insurance company send you the interest earned;

2. After the first full contract year, you can request 10% -- without penalty – of the entire contract value, each and every year. In some annuities if you skip taking the 10% one year, you can take 20% the following year;

3. If you are diagnosed with a terminal illness or have to go into a nursing home, most will allow you to take out more than 10% penalty free each year;

4. Upon your death, the full value of the annuity will be paid to anyone you chose, with no penalty whatsoever;

5. At the end of the surrender term (usually 5 to 16 years) you can cash out the entire annuity value and do something else with it at no penalty whatsoever;

6. You can elect to receive a monthly income for the rest of your life or for a specified number of years by annuitizing, but once started it generally cannot be cashed out for a lump-sum;

7. If your annuity contract has a "guaranteed lifetime income rider", you can start the monthly income feature when you choose and even change your mind later and take the remaining annuity value in a lump-sum cash payment. This feature allows you to convert your retirement nest egg to a guaranteed lifetime income that you cannot outlive. How neat is that?

8. And finally, you can "cash out" your annuity at any time but unless the surrender period is over, you'll probably have to pay a penalty. But, you'll know exactly how much the penalty is,

because it is stipulated in the contract. This sure beats not knowing how much you'll get as is the case if you're playing the market. With a fixed annuity, the worst case is account value less a surrender charge. And, the interest you've already earned could be greater than the early surrender penalty. I like knowing "how much" with certainty rather than the "uncertainty" of how much!

So, as we can see, the right type of annuity is very, very flexible and accessible at any time as long as you use it appropriately. Sure makes planning your retirement a lot easier.

<u>Misconception #5</u>: Nothing is left for my family when I die.

Again, with most annuities this is **<u>NOT</u>** the case. The only time that an annuity will not pass to the beneficiaries you select is: 1) you spend it all during your lifetime or 2) you convert it to a lifetime monthly income (annuitize it) without specifying a minimum number of years.

Converting an annuity to an income is called "annuitization". Let me try to explain annuitization like this…

My Granddad worked for the same company for 43 years. For years of his loyal service, Granddad received a lifetime income (his employer called it a pension plan - Granddad called it ***Mailbox Money***SM). This pension income lasted for his life and his wife's life. Upon their deaths, nothing went to my mother or my uncle (their daughter and son). That's just how the annuity was structured: for maximum income for their lives. Nothing was left to their children, because that's the way they wanted it.

You can do the same thing with most annuities… and only an annuity -- not a stock, bond, mutual fund or other non-annuity investment. Only annuities offer the option of converting your money to a guaranteed lifetime income you cannot outlive.

So with an annuity, unless you annuitize that annuity into a pension-like lifetime income, the full annuity will pass to your named beneficiaries without going through the legal hassle of probate.

<u>Misconception #6</u>: The different types of annuities are confusing.

Again, if you know nothing about annuities or you're listening to someone who is willing to tell you more than they know about annuities, this is true. Annuities come in four basic types. Each is easy to understand if you keep them separate. Here's the breakdown of the four annuity types.

<u>Fixed Interest Rate Annuity</u> is a contract whereby you give your money to an insurance company and are guaranteed a fixed, set rate of interest for one or more years. What they pay you is generally based on the return of the insurance company's investment portfolio, but you get the guaranteed rate regardless of their profitability or loss. Does this sound similar to the way a bank CD works?

Let's say you give the insurance company $100,000, and they promise you 4% interest the first year of the annuity contract. That means that at the end of the year they would pay you, or add to your account, $4,000, or 4%, as interest on your $100,000. The $104,000 is the new floor on your account. If in year two they agreed to pay you 3% (this assumed the annuity's interest rate adjusts every year, but some annuities offer multiple-year rate guarantees) it would be applied to this new floor of $104,000. This process is repeated annually until your annuity contract ends and you either withdraw your annuity money or select a new annuity contract from the same insurance company.

Variable Annuity: Again, as described earlier, a variable annuity means your money is invested in mutual funds or some other type of security. While you have unlimited upside potential and can make a lot of money in a variable annuity, you also have unlimited downside and can lose a lot of money. In fact, over the past several years, you might have experienced or seen market losses. I have personally witnessed variable annuity losses of up to 50%! Such losses were no doubt by some people who, in many cases, could ill afford to lose that much of their retirement savings. Just another reason I left the world of risk and uncertainty. Give me the safety and security of no downside possibilities thank you!

<u>Fixed Indexed Annuity</u>: These types of annuities were first offered in the go-go 90s. I remember insurance companies calling on me to sell these products. At that time, with many of my clients making huge returns in the stock market, I had no interest in selling these products. Why? Because they limit or cap the rate of return!

For instance: say you purchase a fixed indexed annuity with a 40% participation rate. While you are not taking a “position in the market”, the earnings you will make are “linked” to the market. The insurance company is not investing your money in the stock market but rather using your money for their normal investments, including buying bonds. But, since you are being paid earnings based on the “market”, they “hedge” the risk they take by offering you “market-linked” returns. Hedging can get rather technical, so suffice it to say that they are buying “risk insurance” to assure that they can pay you the promised return regardless if the market goes up, down or sideways.

Let's say your fixed indexed annuity contract offers a 40% participation rate and during the year the actual stock market index you have selected, e.g., the S&P 500, goes up 20%. You would receive credit for only 40% of this 20% gain in the market. This would be equal to 8% -- 40% of 20%. So, if you placed $100,000 with the insurance company, you would make $8,000, or 8%, during the year, and this amount would be added to your account. Obviously, not as good as a variable annuity that would earn the full 20%, or $20,000, less fees. But wait, let's say the market lost 20% instead of making 20%, what now? What is the return on the variable annuity? Unfortunately, you'd be down the full amount plus whatever fees were assessed to your account. No doubt you'd be a bit unhappy about losing your hard earned money, but a reading of the variable annuity's prospectus would tell you the variable annuity has no floor and you can lose big time in a bad market. What about the fixed indexed annuity? In this case, if the market nosedived, your $108,000 is locked in. That's right, you would not lose a penny and not only that, next year when the market could possibly go back up, you would get to ride back up with it, starting from $108,000, and add to your previous year's gain.

It is a really good deal when you think about it; especially if you're a risk adverse saver like me who doesn't like losing money. This comparison of the variable annuity and the fixed indexed annuity is like the tale of the tortoise and the hare – fast starts and abrupt stops may not be as good as always moving forward at a steady pace.

Immediate Annuity: As illustrated earlier, an immediate annuity is like a pension. You basically pay money to an insurance company in exchange for a lifetime income for a set number of years or even for the life of a beneficiary. All insurance companies employ actuaries and underwriters whose job it is to estimate the life expectancy of an individual or the median life expectancy of a group of like people, e.g., those of the same age or gender. Once the actuaries and underwriters have determined the remaining life expectancy, they determine the amount of income you can be paid. Of course, the income you'll receive will depend on how much money you paid the insurance company, the general level of interest rates at the time, your age and gender and rarely your medical history if you choose the lifetime income. Based on these factors, they pay you a monthly income for the rest of your life. I love immediate annuities. The problem with immediate annuities is once they are set up they generally cannot be changed. It is possible to change any annuity – fixed, variable or indexed – into an immediate annuity by “annuitizing”, or taking your balance over a number of years or lifetime as periodic payments. When you win the lottery or maybe get a legal settlement for a major injury, the paying party (state for lottery and defendant for lawsuit) will purchase an annuity and “annuitize” it to pay you the money they owe. Bear in mind that an annuity with a “lifetime income benefit rider” can be turned into a lifetime income, BUT this type of annuity has a lot more flexibility than an Immediate Annuity with respect to changing your mind and taking a lump sum partial withdrawal or giving up the income and taking all your money out in a lump sum.

<u>Misconception #7</u>: Annuities are not good for older folks.

Quite the contrary! In fact, I think the older someone is, the more an annuity makes sense.

Face it, as people grow older, most of them want to protect their money, not throw it into the market or someplace risky. That's why I think fixed annuities can be excellent for older folks. What types of annuities should they be looking at? In my opinion, only fixed interest, fixed indexed or immediate annuities should be used for people who don't want to gamble with their retirement money.

People who are at or near retirement should think carefully before investing in variable annuities; mainly due to the unnecessary risks and fees they'll have to consider. Of course, if you are okay taking risks and you are shooting for high returns, a variable annuity or another market investment could be a good option for you. Just remember to always make sure you're clear on the fees and the possibility of losing some of your money. It is a good idea to have the person selling the variable annuity put the “exact” fees in writing. I have seen variable annuities with fees as high as 2 ½% - 3% a year!

By the way, all the fees of a variable annuity are in the prospectus you’ll receive, just don’t expect all the fees to be in one place and neatly summarized so they’re easy to find and understand. You’ll be provided the prospectus as a condition of the variable annuity sale and you must sign a document stating you’ve read and understand it. In my opinion, this is legal cover for the selling representative, because a prospectus can run 50 to 100 pages and is written in legalese that will make your eyes glaze over. And one more thing, in case you later have a dispute, you have to settle it by binding arbitration because this, too, is a condition of the sale.

Some folks feel the cards are stacked against them because (a) they don’t understand the prospectus, (b) cannot later in arbitration dispute the facts contained in this document and (c) the official conducting the arbitration oftentimes has a history in the brokerage industry.

***Misconception #8*: Annuities are not safe.**

Now if you are talking about comparing them to FDIC insured bank products, annuities are not FDIC insured and are not backed by the federal government. They are backed by the same insurance companies that protect your house, car, life, health and virtually everything else of value. A review of the factual history of fixed annuities shows that they are very safe. I have worked with insurance companies for over twenty-five years and have never had a problem with any annuity contract. In fact, during the great depression, there is no history or record of any insurance companies failing to pay claims on their contracts. This period was the most turbulent time of our country's history. Pretty good track record, wouldn't you say?

Still, it would be good for you to check with your State Department of Insurance (the government agency that regulates insurance companies) to confirm something called the State Guarantee Association Fund. Your state's guaranty fund was established to protect citizens holding annuities and other insurance policies. Of course, just like

FDIC dollar limits, these funds do have limits that vary by state. Rather than going into detail here, I would simply suggest that you contact your State Department of Insurance to clarify how this insurance program works in your state.

<u>Misconception #9</u>: Annuities pay huge commissions to agents.

I have worked on both sides of the compensation aisle: the fee for service side and the commission side. Here's the bottom line: for consumers, there is no way to avoid paying someone to help them with their money and make good decisions for their circumstances. You even pay banks for the privilege of keeping money on deposit. You get a rate of return, but the bank will price their products and services so they make a profit. By my way of thinking, a "profit" is simply another name for a "fee" or "commission" because it is money you don't get.

Think about it this way: when you go to a bank and give them your money, do you actually pay them a commission? Well, no, it's not called a commission but yes, they do make money on your money, correct? For example, let's say you deposit $20,000 in a certificate of deposit paying 2% interest. What does the bank do with your $20,000? Lock it up in the vault? Of course not! They loan it out to others so they can make money on the money you deposited with them. Now while it doesn't cost you anything out of pocket, it does cost you because some of the earnings on your money went into someone else's pocket. In my book, this is equal to a commission or fee – just not as obvious.

Let's look at another example. Mutual funds can be purchased without paying a commission. Of course, you'll still have to pay other fees associated with mutual funds. I used to sell no-commission (they're called no-load) mutual funds and then charge my clients a fee for my services. Basically, with this type of mutual fund, the consumer doesn't pay a commission up front, but pays an annual fee to the mutual fund company AND to the money manager. Bad news: these fees are charged regardless of whether your account goes up or down. Added to these annual fees could also be a management fee of 1% or 2% annually charged by the "for-fee" broker that sold you the mutual funds and is providing you investment advice and guidance. These fees, even on no-commission mutual funds, drag down the return you'll earn. It's a fact.

The reason I like fixed annuities is because, in most cases, the insurance company issuing the annuity pays me a "one-time" commission up front. That means that 100% of your money is working from day one. After the initial commission, I'm paid nothing but am expected to continue servicing my clients. That's good for you since you are now out of the fee game and your annual returns are not constantly being dragged down. Personally, I think commissions paid by the annuity company are the best way to go for everyone. You'll notice this looks just like the method used by your bank when selling CDs, the commission is built into the profit margin.

Let's face it, we're all human. If a money manager handles $50,000,000 of other people's money and only uses no-commission (no load) mutual funds, and the manager gets a 1% annual fee for keeping an eye on the market and mutual funds, the fund manager doesn't have to work too hard – does he? All he or she needs to do is keep the money there and try to keep people happy - or at least tell them to hang in there when the accounts are going down. This is exactly how I designed my practice during the go-go 90’s. Good and profitable business model for me, not so sure it was best for my clients.

So now, knowing what I know, I prefer working hard to earn a one time commission and then continue to service the client and take care of them. This way they are more likely to come back with more money to invest with me and/or refer me to their friends and family so I can then help more and more people worry less and less about their money.

<u>Misconception #10</u>: Annuities are good replacements for life insurance.

Just because annuities and life insurance are both contracts issued by insurance companies, doesn't mean they are created equal. While the primary purpose of an annuity is income, life insurance is meant to provide "tax-free, cold-hard cash" upon death. In fact, the ideal scenario is to have a retirement game plan that includes both annuities AND life insurance. Let me explain…

Let's say you're getting ready to retire with a 401(k) of $300,000. You wish to "rollover" your money into a self-directed IRA/fixed annuity. Assuming the agent representing the fixed annuity properly handles the paperwork, the entire $300,000 can be rolled over – without any taxes paid at the time -- into the annuity. That's why they call it a "tax-free" rollover. Problem is, whenever this person takes money out of the IRA/annuity, Uncle Sam is going to have his hand out for his fair share. In other words, all those taxes buried in the IRA have to be paid at some point.

So when you think about it, the current money in your IRA/annuity is not "all" yours; because some percent (based on your tax rate) belongs to the taxman. Your IRA/annuity has a tax lien attached to it. And as you begin to plan accordingly, you realize that you only have one of two choices: 1) take less income now and continue to defer the taxes as long as you can, or 2) take more income now and pay Uncle Sam his share now rather than putting off the pain!

Of course, you cannot postpone taxes forever, because the tax laws dictate that you've got to start taking money from your IRA/annuity no later than age 70½ - whether you need it or not. There are a couple ways to maneuver to "maybe" lessen the tax bite, but that's another discussion altogether.

So now what? You now realize that you're "darned if you do, darned if you don't!" It seems the lawyers who wrote the tax laws took special care to make sure they blocked all the tax-free exits. And, given the current outsized federal deficit resulting from wars, stimulus checks, entitlement programs, pork barrel political spending and more, taxes are not about to go down in the foreseeable future.

But what if you had both the $300,000 IRA/annuity and a life insurance policy that pays your beneficiaries $300,000 at your death? Better yet, what if the $300,000 death benefit was paid lump-sum and was not subject to taxes? Would that be good planning? If so… why?

Because now the $300,000 tax-free death benefit that WILL be paid to your family, favorite charity or other beneficiary (remember, it's not IF you die, but WHEN) gives you permission to spend and enjoy all of your retirement money instead of worrying about leaving it to the government (which is who'll have their hands out if you don't).

The moral of the story: while annuities may provide a cash balance to your heirs upon your death, or even have what is termed a "death benefit", the money is not passed tax-free. This is not the same as individually owned life insurance that pays your beneficiaries tax-free money at your death.

<u>In conclusion,</u> I hope that this report has helped you understand that I, too, had many misconceptions about annuities. I sometimes feel like I must apologize to people back in the 90's, because I was so turned off by fixed annuities and did not suggest them to people who could have benefited greatly. But now, I know better. Hopefully, you are better informed as well.

My advice: work with an agent or advisor who specializes in fixed annuities; preferably someone who has worked with these products for a number of years. If you run into someone who is still caught up in the above misconceptions, just smile and hand them a copy of this report. Remember, a lot of brokers and so-called financial advisors are biased about fixed annuities. They are willing to tell you more than they know or understand about fixed annuities.

One more word of caution: even when you are working with someone who understands fixed annuities and presents them correctly (does their best to make sure they are suitable for you) do not just look at a brochure and buy. Make sure you get a clear understanding of how they work and whether or not they can deliver what you want and need. Used correctly, fixed annuities can protect the hard-earned retirement money of people who are more interested in a return <u>of</u> their money than the return <u>on</u> their money. Fixed annuities will not deliver skyrocket growth – you're not going to get filthy rich with these products -- but with a fixed annuity, you can sleep at night knowing that you're not going to The Poor House.

It is really too bad that the fixed annuity has gotten such a bum rap, because they truly are wonderful for folks looking to enjoy their golden years free of risk, earning a competitive return and saving taxes.

I sincerely hope your walk through retirement is
WorryFree!

Tony Walker, Author & Creator
The WorryFree Retirement®

Other books by Tony Walker

1. The WorryFree Retirement® - An Exciting New Way of Thinking
2. Perfecting Your Walk® in Retirement – book and workbook
3. Don't Follow the Herd®: The 7 Costly Mistakes People Make with Their Money and How to Avoid Them

Tony Walker is a licensed insurance agent and Registered Investments Advisor. Tony resides in Bowling Green, Kentucky.

Review

"Tony Walker's straight-shooting about annuities is a must read for anyone who is retirement-minded, afraid of losses or tired of the market's uncertainty. The bum rap received by index annuities has been debunked head-on by Tony in an honest and understandable way."

Shelby J. Smith, Ph.D.
Economist
Houston, Texas

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