A lot of naysayers caution against the use of annuities as a store of value. Here are 8 of their false beliefs along with the reasons why you should ignore them.

You can get a serious case of intellectual whiplash listening to the arguments against owning an annuity. Most of them insult our intelligence and the perception that people can't walk and chew gum at the same time. If you have voiced or heard these false beliefs, you are not alone.
There are two basic categories of annuities – fixed and variable. Variable annuities require the consumer to assume the risk, while Fixed and Fixed Indexed Annuities will never suffer loss of principal due to a market decline. The following are rational thoughts on why these misconceptions about Fixed and Fixed Indexed Annuities give people the wrong impression.

1) "Annuities have surrender charges. My money is locked up & I can't get to it"

What are surrender charges and why do insurance companies impose them? Surrender charges are an early-withdrawal penalty in a deferred annuity contract. They are assessed for withdrawing an amount above a certain penalty-free percentage and decline over a specified period. Typically, the surrender charge is waived if the contract owner is confined to a nursing home or at death. Just as banks pay a higher interest rate on longer term CDs, insurance companies credit higher rates on longer term annuities. They can do this because they invest a substantial portion of their capital in long term bonds, which pay higher rates, and pass along higher rates to the policyholders. Banks impose an interest penalty in the event that a CD customer withdraws their money early and similarly, insurance companies charge customers a surrender fee for withdrawing money early, since the insurance company incurs costs in the implementation of the contract, has statutorily required reserves that must be set aside to ensure redemption and penalties for liquidating those securities before they mature.

Without having surrender charges on contracts surrendered early, the insurance company would have to recoup their losses another way. It could impose a front-end sales charge, impose annual fees or credit interest at a less than competitive rate. Realizing that these options are unattractive to buyers, the insurance company instead recovers it's losses only from those contracts surrendered early, and rewards those who don't by investing for the long term at higher rates.
Unlike CDs, annuities do provide for partial liquidity, usually 5% to 10% of the accumulation value per year without a penalty. Some annuities allow for up to 50% penalty-free withdrawals under certain conditions. Thus, surrender charges may be seen as *benefits* to the buyer, resulting in a higher rate of interest than would be possible without those surrender charges, plus providing some liquidity.

2) "An annuity is a long-term commitment"

Retirement is a long-term commitment. Aren't IRAs and 401(k)s and other retirement accounts meant for long term accessibility to those funds? Surrender charges can vary between 3 years and 15 years, yet some annuities have a return of premium feature allowing the return of deposited funds at any time with no surrender fees. Most people are in retirement for the long term anyway and for them, it's a perfect fit.

3) "Index annuities have caps that limit upside potential"

The trade-off for having zero downside market risk is some form of limitation on upside potential. It's called sleep insurance or aggravation insurance. Some annuities have caps on growth of an index, some have a margin or spread with no cap and unlimited upside of an index beyond the spread. Others have unlimited upside subject to a participation rate but with no cap. The question is: would you rather have 100% of the market ups and 100% of the market downs, or would you rather have a limitation of the ups and none of the downs? Over the long term, policyholders should expect an average annual return of 4% to 7%.

4) "The retirement income is modest with annuities"

There is a conventional 4% rule devised more than 20 years ago in the financial services industry. Financial planners propose withdrawing not more than 4% from your stock and bond portfolio plus a little extra for inflation, each year, in the hope that it will provide 30 years of income without running out of money. In contrast, annuities that have a lifetime income benefit can provide a withdrawal rate of 5% up to 6.25% depending on what age the income starts. And that's guaranteed – no guessing.

5) "Turning on income payments is irreversible and access to principal is lost"

That's the old-fashioned and outdated method of "annuitization" for income payments. Today's annuities that have guaranteed income either built in to the contract at no charge or with an added rider with a fee allow policyholders the option of receiving a guaranteed stream of income or accessing the accumulation value for withdrawals or liquidating the annuity entirely.

6) "Fees are too high in annuities"

You're most likely thinking about variable annuities, not fixed or fixed indexed annuities. Most variable annuity fees average 4% or more per year whereas most fixed annuities only have a fee if an optional rider is added to the annuity at inception. Rider fees can vary from .75% to 1.75%, depending on the insurance company and type of rider, still less than the fees imposed on most variable annuities and mutual funds.

7) "Commissions to agent are high"

Another myth. An average commission on a 10 year annuity is 7%. That's providing service at 0.7% per year during the 10 year surrender period or less than ¼ of 1% per year over a 30 year income phase, which includes service obligations for statements, adjusting annual allocation of premiums, helping with withdrawals and income planning. When compared to the commissions paid on a managed mutual fund portfolio, typically 1% per year, they are moderate and very fair.

8) "Annuities are too complicated"

How many of you have a savings account or CDs?
How many of you know how a CD works?
Congratulations, you have a basic understanding of an annuity.
When explained properly, annuities are easy to understand. Simply put, annuities are savings accounts with insurance companies. Interest is credited either at a fixed rate or a rate that is linked to the performance of a financial index. At the end of every index crediting period, any gains are locked in and compound with principal and previous years interest.
Compare that with studying and absorbing all the terminology, instructions and risk disclosures contained in a securities prospectus.

There you have it – the debunking of eight of the most common arguments against owning an annuity. Let's review the pros and cons of owning an annuity:

Advantages of Tax Deferred Annuities

1) <u>Tax Deferred Growth and Triple Compounding</u>.

The interest earned is not taxed until withdrawn. The premium in the annuity earns triple compound interest: interest is earned on the principal, interest is earned on the deferred interest and interest is earned on the taxes that are being deferred.

2) <u>Safety and Satisfaction.</u>

Annuities provide safety, guarantees and Peace of Mind.

3) <u>Guaranteed Interest or Interest tied to an Index</u>.

Fixed annuities credit an interest rate that is guaranteed for the duration of the surrender period. Fixed Indexed annuities credit interest based on how the chosen underlying stock or bond or other financial index performs, with the added benefit of a guaranteed no-risk-to-principal in the event of a negative index outcome for any crediting period.

4) <u>Income</u>.

At any time, an owner can convert a savings or accumulation vehicle to an interest income vehicle. Annuities can also provide guaranteed retirement income

to supplement Social Security or a pension and help to cover basic living expenses. Survivors may continue receiving income, if already initiated, with a spousal continuance provision.

5) Estate Planning.
Annuities help protect assets in the event of a long-term care need.

6) Death Benefit Avoids Probate.
Beneficiaries always receive the full account value from the annuity immediately without a court mandated probate.

7) Fees.
No contract fees or sales commissions are deducted from the accumulation value. Optional benefits or riders, if elected, may have fees.

8) Comparison to other Savings Instruments.
Interest rate credits on annuities are superior to bank CD's or other fully-guaranteed products.

9) Access to Money.
Unlike bank CD's, access to your funds is granted using penalty-free withdrawals during the surrender time period.

Limitations of Tax Deferred Annuities

1. Penalty for Early Withdrawal.
During the surrender period, withdrawing more than the contract allows annually results in a penalty. This penalty may be avoided by withdrawing less than the maximum penalty-free amount each year, selecting an income producing option or receiving the death benefit.

2. Overall Performance.
Fixed Indexed annuities will not match equity market gains in bull market performing years, however, they will also not participate in nonperforming bear market years.

3. Early Access to Money.
Access to funds in a tax deferred annuity before age 59 ½ can be subject to a tax penalty of 10%, but there are several exceptions. A few of the 10% penalty exceptions that apply if the distributions are either:

- Part of a series of substantially equal periodic payments ("SEPPs")
- Made after separation from service if separation occurred during or after the calendar year in which taxpayer attained age 55
- Paid to alternate payees under a qualified domestic relations order (QDROs)

- Paid to taxpayer to the extent there are deductible expenses for medical care (the amount that exceed 7½% of AGI), whether or not deductions are itemized
- Paid on account of death or total and permanent disability

When one weighs the advantages versus the limitations of owning an annuity, the obvious conclusion is that the annuity wins hands-down.