

Annuities: Friend or Foe?

Dawn Litchfield Brown explores the multitude of options in building an annuity to suit your needs.

Annuities are like a Build-a-Bear®. This company allows children or adults to build a teddy bear that meets their exact needs, selecting the size, type of fur, clothes, message, color and other features.

Like teddy bears, not everyone needs an annuity. Some people, because of bad press and lack of understanding, don't want an annuity even though they would benefit from one. An annuity can be built to meet an individual's specific needs, but the problem is that most people don't know what they need.

Here are several questions to help determine what you need and if an annuity has a place in your financial future.

WHAT IS AN ANNUITY?

An annuity is designed to create a *stream of dependable income* that will last the rest of your life. It is even said that people live longer when they have an annuity's predictable income.

Social Security is really an annuity. You and your employer contribute money during your working years and when you retire the government promises to pay you X dollars for the rest of your life. A Defined Benefit plan through your employer is also a type of annuity.

There are two basic types of annuities — remember annuity means *stream of income*. If you understand the words deferred and immediate, this should not be difficult to understand.

- **Immediate Annuity** — Income starts *immediately* and cannot be stopped or changed, nor can you access your principal.

- **Deferred Annuity** — Income is *deferred* until a later date. You have access to your principal at various times. Your money is designed to grow with some predictability and limitations until you are ready to start taking income.

A variation of a Deferred Annuity is a Variable Deferred Annuity. This means that the rate of growth is not limited on either the up or downside. A Deferred Annuity can be changed to an Immediate Annuity at any time, but generally very few investors will choose that option. A Deferred Annuity can generally start a predictable stream of income without turning it into an Immediate Annuity.



BUILDING YOUR OWN ANNUITY

Not every annuity can meet all these needs, but these questions will allow you to "Build Your Own Annuity" to meet as many as possible.

- A. Do I need guaranteed income NOW?
- B. Do I want to defer taxes?
- C. Do I want guaranteed income later?
- D. Do I want predictable growth?
- E. Do I want growth with a safety net?
- F. Do I want auto-pilot investment management or active investment management?
- G. Do I have a reserve fund (money you can get to without any penalties) for emergencies?
- H. Do I want the flexibility to stop and start income?
- I. Do I want to have my income increase to stay ahead of inflation?
- J. Do I want the flexibility to take out some or all of my investment without a penalty?
- K. Do I want the flexibility to change companies if I am not satisfied?
- L. Do I want the flexibility change the investments inside the annuity to reflect economic conditions?
- M. For the peace of mind and some of the benefits above, am I willing to accept fees that average 3 percent (which includes the annuity company fee, the selling representative fee, the investment management fee) and the extra fee for any riders I add to the policy, such as a guarantee of principal or income?
- N. Can I wait until after I am 59½ before I start the stream of income?
- O. Can I find a solid company that offers the best investment options, multiple riders and lowest fees?
- P. Will I be in a higher tax bracket when I retire?
- Q. Do I worry about my future income?
- R. Am I comfortable taking risks without a safety net?

Each of the two primary types of annuities has many variables, meaning you will have many decisions to make as you "build your own annuity." There is no way you can look at either option and say for sure that one of them is for you, but the questions to the left will help guide you.

SPEND A LITTLE, PROTECT A LOT

Any investment you may be considering must be tailored to your personal financial situation as well as your tolerance for risk. Try this analogy: most people have homeowners insurance, even if they don't have to. Why? The answer is that they don't want to absorb the risk of the house burning or blowing down. They will never get the money spent on the policy back and don't expect to. It's considered a small price to pay for peace of mind in the unlikely chance that a disaster occurs. Flood riders are an example of an even smaller cost that protects a lot.

An annuity holding a part of your life savings works the same way. You can buy a rider specific to your financial needs. You may not be willing to risk losing your life savings, but need the growth. In this case, you will need a rider.

It's important to remember that no investment is right for everyone and that there are many different types of annuities out there, so when you "build your own annuity," work with someone you trust.

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