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Kiplinger’s Personal Finance

Kiplinger's Personal Finance: Ask lots of questions before buying an annuity

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Annuities can provide a valuable income stream in retirement.

Dreamstime

After years of declining sales, annuities are hot again.

Part of the reason for the resurgence is that rising interest rates are increasing annuity payouts.

But much of the credit for the rebound goes to the demise last year of the fiduciary rule — the U.S. Department of Labor rule that would have required brokers and others to put clients' financial interests ahead of their own when giving retirement-account advice.

Annuities can provide a valuable income stream in retirement, especially for those without a traditional pension.

Kiplinger's often recommends the plain-vanilla type to retirees: an immediate income annuity that can generate enough income along with Social Security and, perhaps, a pension to cover basic living expenses.

But other types — namely, variable and indexed annuities — are complicated and often carry high fees or commissions.

Some planners recommend variable annuities to high-income savers who have maxed out their 401(k)s and IRAs and want another tax-deferred investment. Indexed annuities are often pitched as a way for older investors to potentially enjoy some of the upside of the market without losing principal.

"Variable and fixed indexed annuities are the most complex, opaque and conflict-ridden, because they pay the people recommending the annuities the highest commissions and give them other types of perks," said Micah Hauptman, counsel with the Consumer Federation of America.

The more complex flavors of annuities are often on the menu at free dinners staged by financial professionals to attract new clients. A free-dinner seminar can be a legitimate way for companies to prospect for clients and for consumers to learn about a new product or strategy, said Gerri Walsh, senior vice president of investor education at the Financial Industry Regulatory Authority. "If you go to one of these pitches, go with an open mind. But don't go with your checkbook open," she said.

Anyone offering you an annuity should review your finances and goals first, and only then determine if an annuity would work for you. Kashif Ahmed, a certified financial planner in Bedford, Mass., says you should be asking, "What hole in my plan is this going to solve?"

Before investing in an annuity, ask about fees and the penalties for pulling out of the contract early. Ask how the adviser is being compensated by the insurer, including any sales incentives, because that could be a big driver behind the annuity recommendation.

A salesperson might receive 5 percent or 6 percent of the sale, or opt for a slightly smaller percentage up front and get a trailing commission of, say, 0.25 percent annually for the life of the annuity, says Ashley Foster, a certified financial planner in Houston.

Also, check out the background of the adviser selling the annuity. At https://brokercheck.finra.org, you can review the record of brokers selling variable annuities.

Go to www.naic.org for links to state insurance departments, where you can check on agents selling other types of annuities.

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