

## The World of Annuities - Transcript

**Tom Mullooly:** In episode 98 we cover the wide world of annuities.

Welcome to the Mullooly Asset Show. I'm your host Tom Mullooly and this is episode number 98 where we're going to talk about the wide, wide world of annuities. Not a specific question that came in this week but a topic that we're asked to discuss all the time so we wanted to put together a quick video to talk about the basics that you need to know about annuities. Because annuities as a term is just a general umbrella. There's a lot to peel away underneath the umbrella.

The first thing that you need to know when you're talking about an annuity is, is it an immediate annuity? Or is it deferred annuity? Deferred annuity has a couple of moving parts. They could be a fixed annuity. They could be a variable annuity. There's different types of these that you need to know about. When we talk about immediate annuities, what you need to think of is kind of like a pension.

You may work at a place of business that still offers a pension and you'll get a statement as you're working saying you've accumulated this much money in your pension account and that translates into \$4,000 a month. When you go to retire, that whole asset maybe it's a half a million dollars, maybe it's 700,000, whatever the number is, that goes away. You're really not entitled to that. What you do with a pension or an immediate annuity is you trade that lump sum in for, you trade that in and receive monthly income.

You're going to get a steady stream of monthly checks for the immediate annuity that you have. You want this thing to start paying you right away, same amount every month on the same day. The only risk that you've got with an immediate annuity is if something goes wrong with the insurance company. If the insurance company goes bust, you're going to have a problem. It does happen from time to time so it's important to read the fine print. That's immediate annuities.

Let's talk a little bit about deferred annuities. Now there's fixed annuities and then there's variable annuities. We'll do the easy ones first. The fixed annuity is something that it's going to pay you a fixed rate. Think about like when you go to the bank and take out a CD. Your rate is locked in for a year, maybe two years, maybe three years but after that initial rate, then it fluctuates. It's going to go up or down based on what the market is going to offer so understand with a fixed annuity you're going to get a fixed rate of interest for a period of time. A year, two, three, after that it's going to move around a little bit. But also understand that you're going to have surrender charges.

While you may have a rate that's guaranteed for two years, you may be locked into an annuity like this for seven, eight, nine years. You have to take that all into consideration. Insurance companies will sometimes offer a teaser rate or somewhat higher rate in that initial period, that first year or two to get you to invest. After the contract's over you're going to find that there was nothing special, they've just kind of fronted you some of the later returns and pushed them up front.

Let's talk about variable annuities. Think about investing like you would in a 401K or a retirement plan and also know that a variable annuity is probably one of the most expensive ways to invest. You're going to have a fund manager, someone who's going to manage the sub-accounts that are in the variable annuity. They're going to go up and down with interest rate changes or the stock market or some other maybe foreign place, you can really get into some crazy diversification with a variable annuity.

But understand that the expenses are going to be higher than average than what you'd see in a mutual fund. Also, what you're going to find is because it's an insurance product, there's going to be mortality and expenses built in to your contract. Again like I said, it's a very expensive way to invest for growth. But it is possible and a lot of people sign up for it every year.

There's a lot of different flavors of variable annuities. Keep that in mind so your returns are really going to be based on the terms of the contract. Sometimes they're capped based on an index. Sometimes they're uncapped based on some other crazy index. We saw one that was tied to the Euro stocks 50 index. They're out there. You got to read the prospectus carefully and understand that when you get involved in an annuity it's a contract so you have, and each state's a little different, but in most cases, you're going to have what they call a free look period. If there's something in there that you didn't know about or you're uncomfortable with, you can turn the contract back. You can rescind the contract, get all your money back and cancel the deal.

It's important that you understand that as you're entering a contract for an annuity. And like we tend to say around here in the office, "Understand that annuities are sold, they're never bought." People never call up and say, "Hey, I'd like to put money into an annuity." Someone put that idea in their head. Remember, the insurance company that's underwriting the annuity feels that they can make more of a return with your money than you can. They may pay you 3% for the first year in a fixed annuity.

They feel like they're going to get more over the lifetime of investing your money and then you're going to pay you a slice. They're getting the use of capital, think about that. Think about the surrender charges that are packed into your contract. Think about the fees that are being sliced off every year. It's a long term investment, it's really got to make sense for you.

Also understand that with withdrawals from annuities are taxed a little differently. They come out as ordinary income even though it may be in a variable annuity that's invested in the stock market, no capital gains, the money that comes out is going to be ordinary income. These are tax deferred investments, what that means is, you don't get a 1099 for as long as you're invested in this thing. It's only when you start taking money out, that's when you're going to see a 1099.

So explain to me, we'll end this video with a question, if you have a tax deferred investment, why are billions and billions of dollars of these products bought in individual retirement accounts?

***Why would you put a tax deferred investment inside a vehicle like an IRA that's already tax deferred?*** For 30 years I've been waiting for a good answer. Haven't heard one yet.

Thanks for watching episode 98, see you on the next one.

