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Common Consumer Mistakes by Baby Boomers and Seniors When Buying Annuities

Annuities can be complex products and deciding to purchase one can have significant and long-lasting consequences, so properly understanding how annuity contracts work, and some of the more common mistakes that consumers make, are among the first steps toward putting yourself in the best position to make the right decision on whether or not an annuity is suitable for you.

In addition to the features and benefits, consumers should always know the disadvantages and negatives of any financial product or policy that they are considering purchasing.

The suitability and effectiveness of an annuity will be different for each individual and their personal situation, and the strengths and weaknesses of an annuity will vary greatly between the specific annuity product in question and the person who is considering it, but as a general overview, here are top mistakes that many consumers make during this process.

1. Not Being Aware of Annuity Fees *– Most, but not all, annuities have fees. Some annuities, like variable annuities, typically have substantial fees. Some of these fees include Mortality & Expense fees, Management fees, and Administrative fees. Also, you can add riders to variable annuities (and fixed index annuities) for an additional fee. You need to understand what these fees are paying for so you can determine whether or not you should buy an annuity.*

2. Not understanding Surrender Charges *– Almost all annuities, whether fixed or variable, will have surrender charges for early withdrawal of funds. Annuities are usually considered longer term contracts, some with early withdrawal charges of up to 10 years. You will not want to purchase an annuity if you are not comfortable with this aspect, since being hit with the surrender charges can be severe. In many cases, the surrender charges are a tradeoff that is very appropriate to take, but the relative benefits of the annuity contract must be worth it.*

3. Ignoring Interest Rate Risk *– Interest rate risk can play a large role when purchasing a bond, annuity, or even a bank CD. Essentially interest rate risk occurs when you commit your money for specified time period and lock in your interest rate for that entire period, and then interest rates rise during that period. If your money is locked away, you would* *not be able to access and achieve the higher rate since your funds are committed for that pre-determined time period. When you lock in an interest rate for a specified time period, you always run the risk that better interest rates may come along that you aren't ready to take advantage of since your funds have already been committed to another investment.*

4. Lack of Understanding of the Annuity's Primary Objective *– Too often consumers purchase financial products without fully understanding the purpose of the product. Before purchasing an annuity it is important to make sure you know what the main features of the product are as well as what your goals are. This clear view allows you to determine if an annuity can meet your personal goals. Annuities do some things very well and other things not so well- it is your personal situation that makes it a suitable product or not.*

5. Lacking a Coordinated Approach for Investment Options within the Annuity*– Variable and Fixed index annuities allow you to invest your funds across different investment options within the contract. In some cases you will also typically have a fixed rate option, such as a guaranteed interest rate for the year. It is important to have a clear understanding of the tradeoffs and risks of these options and then choose a coordinated strategy to take advantage of them.*