While I usually take Malcolm Berko's articles with a grain of salt, I feel his article of July 15th concerning annuities needs some clarification. I agree with Mr. Berko that there have been some abuses in the annuity marketplace and with some unscrupulous annuity salespeople. The problem of this negative reporting is that it is too easy to paint all annuities with the same brush. Annuities are effective investing and tax planning tools that have been around in different forms for many years.

Let's start out with a brief description of the three basic annuity types. And remember, all annuities are not created equal.

1. Fixed annuity - This type of annuity has guaranteed principle and a guaranteed interest rate. These annuities can have surrender charges within one to fifteen years. Be careful of long surrender charges with this type annuity. People looking for higher yields, but who don't want market fluctuations, pick this type of annuity. This annuity is guaranteed against losses by state law up to $100,000 in cash value per person per company.
2. Immediate annuity - This type of annuity pays a guaranteed check for the rest of a person's life or joint lives. A lump sum of cash is exchanged for a series of payments. This decision is irrevocable and cannot be changed. It provides the largest monthly check because it involves a repayment of both interest and principle. Immediate annuities are guaranteed by state law for a payout value of up to $300,000.
3. Variable annuities - This type of annuity uses different investment options called sub-accounts that work like mutual funds. These annuities have surrender charges within zero to ten years. Many variable annuities are offered without surrender charges--unfortunately, in most cases, you need to ask for them. Variable annuities have higher expenses than mutual funds but provide guarantees that mutual funds do not have, like guaranteed income riders, guaranteed death benefits and guaranteed return of premium riders. Just because a variable annuity has higher expenses does not mean that returns will be lower. There is no state law that guarantees variable sub-accounts. Guarantees are backed by the financial strength of the issuing company making financial ratings especially important.

In the last 10 years, different riders for annuity policies have become available. These riders have been developed due to recent stock and bond market volatility as a way to add some protections to investor funds. The negative part for consumers is that these riders are complex and can be hard to understand. Income riders guarantee an interest rate on a dollar amount that will be used to calculate a future income payment for life. This is not the same as earning that rate on your account on what is called "walk away money." You cannot cash out this money. It is just used to calculate the payment amount. It does provide a guaranteed payment amount option if your investment accounts do poorly. The guaranteed death benefit guarantees that your initial investment will be paid to your beneficiaries regardless of market losses. Some even guarantee an increasing death benefit. The guaranteed return of premium rider guarantees the return of your original investment at some point in the future regardless of potential market losses. Some even capture the annual increase in your account. These riders all come at a cost; but if it's a good idea to insure a large asset like your house, doesn't it make sense to insure your retirement funds?

Annuities are truly a suitable option if applied correctly. They avoid probate by going directly to your beneficiaries at death and offer guarantees not available on other investments. They also can defer taxes to a later date so you can keep more of your money working. Be careful when picking annuities by watching for excessive surrender charges and make sure you work with a trustworthy advisor. Always be careful to keep enough money liquid and don't put all your eggs in one basket. A well-diversified portfolio that addresses different forms of risk is the best plan. The same investment is not perfect for everybody, but annuities are a part of that plan for many people.

As disastrous as the scenario that Mr. Berko outlined in his article concerning the losses and withdrawal charges suffered by his reader, there are many happy annuity owners who can sleep at night knowing they have guarantees on their investments and the availability of their funds.

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