Best To Reject Annuities That Feature An Inflation Rider

by Lynn O'Shaughnessy

Inflation has spooked Wall Street. Fearful of inflation, the stock market has lost its traction and is behaving like a kid careening down a slip and slide. These inflation worries have prompted plenty of 60-somethings to wonder if a box of Raisin Bran will someday cost them $49.99.

Not everyone, however, is perspiring at the prospects of price spikes. The inflation willies have opened up a new marketing opportunity for investment firms and insurers that would like retirees to embrace a type of annuity that until now has been relegated to corporate sub-basements. Insurers are eager to introduce retirees to an immediate annuity that offers peace-of-mind inflation protection.

These inflation-protected annuities aren't new. In fact, they've been around, but widely ignored, for at least two decades. For many years, the percentage of customers who bought the immediate annuities with an inflation rider never inched up higher than 2 or 3 percent. Their unpopularity is actually a good thing because these inflation-fighting annuities deserve to remain in the cellar. While insurers will tell you that they combat inflation, what they may really do is fight your ability to pay your bills in retirement.

Before you can understand why these inflation-adjusted annuities should be avoided, you need to appreciate why purchasing a plain vanilla immediate annuity could make you feel like a member of Mensa. Immediate annuities can be a godsend for anybody with iffy financial skills. Not sure if you fit into this category? Ask yourself this question: Can you round up the money in your 401(k), your Individual Retirement Accounts and any other cash stashed away for retirement and invest it in a way that will provide a reliable source of income for 30 or more years - without ever running dry? If mastering Mandarin would be an easier task, you might want to make some inquiries.

Fortunately for novice investors, immediate annuities are refreshingly straightforward. You sink money into one and, in return, you start receiving monthly income for the rest of your life. Even if the money you originally invest runs out, the insurance company is obligated to keep mailing you checks.

One of these annuities can be especially helpful for those who retire without a pension and will only have Social Security checks for dependable income. If Social Security will cover only half your monthly expenditures, for example, you might want to consider buying an immediate annuity that will take care of the rest.

Typically, the interest rates that insurers use to calculate immediate annuity payments are higher than certificate of deposit rates. What's more, because each annuity check includes a return of a portion of the principal, the payments will be greater than if a retiree was only pocketing the interest.

How much you receive depends upon your age, your gender and the investment amount. The older you are, the bigger your payments. To provide you with some idea what kind of money you can expect for your investment, I pulled some quotes off the Web site www.AnnuityShopper.com, which is an excellent resource for annuity investors.

Currently, a 70-year-old man could buy a $100,000 annuity that would spin off monthly checks of $754. If a couple shared the immediate annuity, the checks can be smaller because the annuity will keep chugging along until both customers die. For instance, if a 70-year-old man and his 68-year-old wife bought the $100,000 annuity, the payments would dip to $667 a month. Curiously enough, however, if both spouses were 70 years old, in this example, the payments would be the same as the husband's quote.Immediate annuities have never been popular for a number of reasons.

Many people aren't aware of them because stockbrokers and commissioned financial planners are too busy pushing deferred variable annuities, which are dreadful investment choices for nearly everyone and they certainly don't make sense for retirees. Seniors, however, must endure tsunami-strength marketing pushes because variable annuities generate fat commissions, while immediate annuities do not.

Retirees, who do somehow learn about immediate annuities, tend to reject them because they are terrified of buying one and the next day getting a diagnosis of colon cancer. Why, they ask themselves, take the risk of sinking a ton of cash into an immediate annuity when the benefit would vanish with a premature death? What many people don't realize is that they can protect against this financial Armageddon by choosing an annuity that will last a set number of years, such as 10, 15 or even 20. If you die 12 months after purchasing an annuity with 15 years of guaranteed income, your heirs will pocket the checks for 14 more years.

One of the legitimate knocks against immediate annuities is this: Inflation can be the boogeyman. With a level-income immediate annuity, your checks don't waver, regardless of whether inflation is flat-lining or throwing a party. You might assume that the annuities with a cost-of-living adjustment would resolve this nagging problem, but it doesn't because of the ridiculous way they are rigged against consumers, according to Hersh Stern, who is publisher of www.AnnuityShopper.com. "Adding a cost-of-living rider to an immediate annuity," he says, "doesn't make economic or actuarial sense the way the numbers crunch out."

When you buy an annuity with inflation protection, the monthly payments start far below those of the regular variety. Suppose, for example, that a 65-year-old decided to buy an annuity with 3 percent inflation protection. If he invested $100,000 into an annuity, his monthly payments the first year would be $518. In contrast, a regular immediate annuity would generate $687 a month.

If you added up all the payments generated by the inflation annuity, they wouldn't surpass the string of regular annuity payments during the customer's expected lifetime. With the pricing gap, it would take more than two decades before the inflation annuity generated more income.

A better way to address the inflation fear is to avoid putting all your money into an immediate annuity. Instead, invest some money in a diversified, low-cost portfolio of stock and bond index funds. A portion of your nest egg could also be invested in mutual funds or exchange-traded funds that thrive during inflationary times, such as commodities, precious metals and inflation-indexed Treasuries. Copley News Service

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