SAVINGS GAME

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Annuities Not As Complex as You May Think

In the more than eight years I have been writing this column, I must have said it at least 100 times: Never, ever, put your money into something you don't understand.

That's why it bothers me - it angers me - when I came across surveys such as a recent one from Fidelity Investments that found 13 percent of annuity owners "don't understand them at all" And another 33 percent, according to the survey, understand them "only somewhat."

I was bothered and angry, but not surprised.

Not when I routinely get letters from annuity owners who tell me, "I do not know anything about variable annuities" or ask, "Do you know which kind of annuity I have?"

The Fidelity survey, which consisted of telephone interviews with 1,000 adults by the firm Bruskin-Goldring Research, found that the phrase Americans most often associate with annuities is "confusing or complex."

And one third of those surveyed did not even know enough about annuities to venture a response.

Granted, annuities can be made to look awfully complicated.

But the basic idea behind them is not.

An annuity is simply an investment with some insurance features and tax benefits.

Because of the insurance part, the only way to buy an annuity is by signing a contract with an insurance company. But annuities are mostly investments, not insurance policies.

There are two basic types of annuities, fixed and variable. In a fixed annuity, the insurance company promises to pay you a set rate of interest for a set length of you sell your fund shares for a profit.

But if you withdraw money from an annuity before you are age 59½, you will typically owe not only income tax but also a 10 percent penalty on your earnings.

And whenever you take your money out, regardless of age, your gains will be taxed at the higher rate for ordinary income. In a taxable mutual fund account, long-term capital gains are taxed at the lower capital-gains rate. Most annuities also impose at least a partial "surrender charge" if you take your money out before a certain time.

What's the insurance part, you may be asking? Annuities guarantee two things:

• First, that if you die before starting to take your money out, your beneficiary will get at least what you put in.

If you invest $50,000, the market crashes and your account balance goes down to $30,000, your beneficiary still gets at least $50,000 if you die.

This insurance, however, does not protect *you* against an investment loss. If it is you who takes the money out, you only get the $30,000.

• Second, annuities guarantee that, if that is your choice, you may withdraw your account balance as a series of monthly payments for life - your life and that of a beneficiary. The insurance company is assuming the risk that you or your beneficiary will "live too long" and eventually get back far more than you put in.

These insurance features, of course do not come for free. Annuities'impose "mortality and expense risk charges" that often reach or exceed 1.40 percent a year.

That means your investment return is reduced by 1.40 percent, or whatever the number is, year in and year out.

If your investment otherwise would have made 10 percent a particular year, you would be left with 8.6 percent.

Debate has raged for years among financial professionals as to whether these insurance benefits are worth it and, if they are, whether annuities are charging too much for them. Peter Katt, a nationally known certified financial planner and life insurance adviser calls annuities "the most oversold fmancial asset in America" and claims that "at least 90 of the people buying variable annuities should not be," because of the annual expenses and the tax conseauences on with-time.

For example, you may get 5.5 percent a year for the next five years.

. In a variable annuity, you decIde where to invest the money, and return will "vary," dependmg on how well or poorly your investments perform. Typically, you choose from a pool of "subaccounts" or "separate accounts" that are basically the same as mutual funds but go by another name.

One big plus of all annuities is that you're not taxed on any of your gains until you take the out. If you invest directly m mutual funds in a taxable account, you're taxed any time you receive a dividend or capital gains distribution, 'lTld any time drawal.

Also, if you die before starting to take the money out of an annuity, your beneficiary will owe ordinary income tax on any gains. If you invest in a taxable mutual fund account, your heirs would not owe any tax on the gains.

On the other hand, the growth in the number of low-cost annuities and the addition of new features, such as bonuses on deposits, have made many annuities more attractive.

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