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The Problem With Annuities

Annuities aren't the only choice for addressing worries about outliving your money. In fact, they're often the wrong choice.

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I have a confession to make: I used to sell annuities. It was a long time ago—I was young and believed the hype. I thought annuities were can't-miss ways to guarantee income for life. Since then, however, I've learned the truth about annuities. They're often too expensive, too complicated and not in the client's best interest. And now it's time to say I'm sorry—and to suggest alternate ways to tackle the issues annuities promise to solve.

A dream meets reality

Let me tell you how I got from there to here. In my early 20s—fresh from college with a degree in finance—I found myself behind the wheel of a giant water truck on the highway near Long Beach, Calif., at three o'clock in the morning. I was working in construction, bringing water to resupply the heavy equipment that road crews used to rebuild the highway. As I sat behind the wheel of that truck, I asked myself a question common among people in their early 20s: "What am I doing?"

Soon after that middle-of-the-night moment of reckoning, I quit the road crew and decided to put my finance degree to good use. I wanted to become a financial advisor and help people make smart decisions about their money. I wanted to help regular people make sense of the tricky world of Wall Street, and take advantage of the power of investing to meet their goals, from giving their kids the best education possible to affording a comfortable retirement.

I got my foot in the door at a large financial services firm and thought I was on my way. In time, however, I learned the company had its own way of "helping" clients—which often included looking out for the client only *after* looking out for the company. We were expected to sell the company's products, including annuities. If we didn't, we'd quickly lose support of the top brass.

The trouble was, the products we were selling didn't always make sense for our clients; some carried high fees, others locked up too much of the clients' money in retirement. This fact was often lost on them, though, because we weren't describing the products in clear, simple language. The financial industry is chock full of jargon, particularly when it comes to annuities: For many clients, terms like surrender charge, guaranteed minimum withdrawal benefit and drawdown rate just went in one ear and out the other.

Then there's the part I now find so frustrating: With annuities, insurance companies effectively begin by paying clients back with their own money. Unfortunately, I've seen clients miss out on the full benefits of the annuity

by, for example, liquidating the contract early. In these cases, the insurance company again ends up with the winning hand.

Then there are the bells and whistles that dazzle prospective investors. Annuity salespeople tout the guarantees and riders that promise to enhance the value of the annuity. However, these add-ons often are expensive but useless adornments. The truth can be devastating to a client banking on these additions pumping up the value of the annuity.

But even when clients took pains to really understand the ins and outs of the annuity they were buying, they would forget much of that knowledge within a few months. Now imagine having to stay on top of an annuity's byzantine set of rules for two or more decades after retirement. The fact is, I regularly have clients and prospective clients ask me about annuities, and they often have their facts wrong. They hear about an annuity that provides guaranteed withdrawals of 4% to 5% a year, but think that means the annuity promises a 4% to 5% *annual return* on their investment.

What's the *real* problem?

For many people, an annuity's promise of guaranteed income appears to solve a major retirement riddle: making sure their savings last through their lifetimes. When Blake Street and I founded Warren Street Wealth Advisors in 2013, our goal was to help clients build their financial lives. In the process, I've learned that there often are better ways to address the problem of outliving your money if we just ask the right questions.

Consider this: A patient goes to the doctor complaining of back pain and says, "I need surgery!" As a doctor, I'd want to explore every option before scheduling the surgery. I'd ask the patient where the back pain might be coming from. Are they exercising, or have they tried yoga? Does the pain come and go, or is it always there? The point is, there's usually something that's causing the back pain, and identifying and addressing that issue may keep the patient from the operating table.

It's the same with the problem of outliving retirement savings: If you're worried about running out of money, a good advisor should be able to help you identify *why* that's such a big concern. Perhaps you're carrying more debt than you're comfortable with, or are afraid that a massive market downturn will wipe out your savings just when you need them the most.

No client ever has asked to buy an annuity. Instead, clients tell me they're scared about the news, or the health of the economy. They're worried their account balance will drop to zero. In these cases, we believe there are better solutions than locking up your savings in an annuity. Instead, let's work on budgeting, and let's build a portfolio with investments that zig when the market zags. Let's not pay any more than we have to pay to own those investments, and let's make sure that portfolio is as liquid as possible—so you can get to your money when you need it. Let's explore the entire investment landscape, from stodgy Treasury bonds to emerging markets stocks, and let's buy them when they're cheap and out of favor.

This is the approach that's helping our clients address their concerns about outliving their money in retirement. I still work with many of the clients that I sold annuities to many years ago. Most have since dumped them, with my help. Some haven't, and I'll keep working with them to address the worries they thought annuities would solve, and will continue to explore other more cost-efficient options to help ensure that the money they've worked so hard to save will be there when they need it most. After all, that's why I quit construction and became an advisor: to help the clients sitting next to me.

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