YOUR MONEY

Annuities Bounce Back

With the Stock Market In a Downward Drift, Fixed Annuities Are Back in a Big Way

By Lynn O'Shaughnessy

Back when the stock market was still defying gravity, fixed annuities were a tough sell. But with the market's depressing slide, sales of fixed annuities have skyrocketed, with Americans pouring more than $50 billion into them in the first half of 2002 alone.

"The stock market hasn't bounced back, and people have lost their nerve and are running to safety," says John Wesley of TIAA-CREF, the nation's top seller of annuities. After looking at the interest rates on certificates of deposit (CDs) and money market accounts, he says, they're turning to fixed annuities.

Annuities are investment contracts with insurance companies that many buyers use for retirement income. Two types of annuities offer fixed interest rates: deferred fixed annuities and immediate fixed annuities. [See box.] Both can be appropriate for older, conservative investors. It's important, though, to understand how they differ from CDs.

Issuers of fixed annuities guarantee an interest rate for a specified period. The interest grows tax deferred—you don't pay taxes on it until you start drawing from the annuity. CDs don't enjoy this tax perk.

The penalties for an early withdrawal from a fixed annuity can be more painful than an early exit from a CD. Almost all fixed annuities carry surrender charges that typically start at 6 or 7 percent and decline by a percentage point a year. Making a withdrawal from a fixed annuity if you are under age 59½ can trigger a federal penalty of 10 percent.

Because fixed annuities are insurance products, Joseph Rosanswank, publisher of Comparative Annuity Reports, suggests sticking with issuers that have at least an "A" rating from A.M. Best Co.

If a fixed annuity sounds attractive, Glenn Daily, a fee-only insurance consultant in New York City, suggests that you zero in on CD-type fixed annuities, which, he says, are a great improvement over traditional fixed annuities. Like CDs, these annuities offer a guaranteed fixed interest rate for a specified period. If a five-year CD-type annuity offers an interest rate of 5.1 percent, for example, you'll receive that rate for five years. What's more, once the five years are over, the annuity's surrender charge expires.

In contrast, traditional fixed annuities typically guarantee an interest rate for only one year. Some offer tantalizingly high rates for the first year, but then the rates drop—sometimes sharply. Worse yet, surrender charges can keep buyers chained to them.

"I tell people to stay away from fixed annuities that have a guarantee period that ends before the surrender charge period does," Daily says. "It's not wise to put yourself at the mercy of insurance companies."

Shopping for fixed annuities is relatively simple. There's no need to worry about comparing expenses, because costs have already been deducted from an annuity's quoted interest rate. Daily recommends using TIAA-CREF's Personal Annuity Select Fixed Account as a benchmark when comparing quotes. (This annuity is unusual in that it has no surrender charge.)

IMMEDIATE ANNUITIES

Traditionally, immediate annuities have been about as popular as a blaring car alarm. But with the prolonged bear market, sales of these annuities have also surged upward. There are