Annuities for retirement: Good or bad idea?

By Sharon Epperson
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Jittery investors who are fearful about outliving their savings may have another investment option to consider in their workplace retirement plans. The Treasury Department has issued new guidelines designed to expand the use of annuities inside 401(k) plans. Annuities are attractive to some investors because they offer the ability to build tax-deferred savings, can help to protect the money that you've already saved, and generate a steady stream of income in retirement. ...

...An annuity is basically an insurance contract in which you pay a financial institution a specific amount of money—either in a lump sum or a series of payments—and the company then invests your money and promises to pay you a regular income right away or in the future.

With an "immediate" annuity, you can generally start receiving payments in about 30 days. A "deferred" annuity enables you to receive payments at some point down the road. You put in a lump sum or build up funds over time (by contributing a monthly amount) then you convert that amount, or "annuitize" it, into a income stream. ...

...It's also important to keep in mind that annuities can have varying degrees of risk.

A "fixed" annuity offers a fixed, guaranteed rate of return for a certain number of years. ...

...An "indexed" annuity is designed to give an upside from investment returns tied to an index, like the S&P 500. ...

...While many financial advisors and retirement experts say annuities might be a great options for some investors, they are certainly not appropriate for all.

If you haven't already maxed out your savings contributions in other tax-advantaged plans, 401(k)s and IRAs, it may not make sense to purchase an annuity...

...Annuities have had a bad reputation among individual investors, in part, because of their hefty fees, which can run as much as 3 percent a year or more. Financial advisors suggest that before you buy an annuity, you understand the expenses, management fees and surrender charges that you'll pay if you try to get out of the contract. There also may be fees for additional features like a living benefit income rider.

Participants should also be aware of costs related to their specific 401(k) plan for annuities, said David Kudla, CEO and chief investment strategist at Mainstay Capital Management in Grand Blanc, Mich. "An alternative may be available by simply rolling over your 401(k) to an IRA, where you would have several options for doing this, and potentially less expensive options," he added. ...