

Before You Commit: Annuities in Perspective

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Annuities promise steady income in retirement, but what's the real story behind the sales pitch? This newsletter explains how annuities work, so you can better understand what you're getting into before putting your signature in ink.



(Stevenson, 2024)

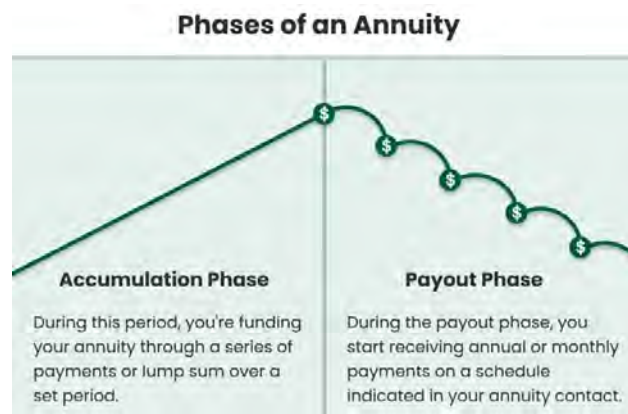
What is an Annuity?

An annuity is an insurance contract; you pay in, and the insurance company pays you a steady income for a set period. Annuities are a form of insurance because they help protect against outliving your retirement funds through regulated spending.

An annuity has two phases. The first is the accumulation period, which begins with funding through a lump sum or a series of payments. These funds can grow at different rates depending on the type of annuity:

1. **Fixed Annuity** - The annuity sets a payout based on a guaranteed low fixed interest rate.
2. **Variable Annuity** - Functions as an investment account; payout is based on investment performance.
3. **Indexed Annuity** - An annuity that tracks a major stock index, such as the S&P 500.

The second phase is annuitization. You exchange your rights to your funds for a guaranteed income stream from the insurer for a set period.



(Ambrose, Borelli, 2025)

What to Consider Before Signing

Guaranteed income sounds appealing, but annuities are complex and come with trade-offs.

Illiquidity: When you invest in an annuity, your funds are locked in for a specified period known as the surrender period, which typically ranges from 2 to 10 years. Withdrawing money in surrender incurs an additional fee (ranging from 2% to 10% on withdrawals).¹ Evaluating your liquidity needs before committing is crucial, as unexpected withdrawals can lead to unnecessary financial setbacks.

Complexity: Annuity contracts are often filled with financial jargon, making it difficult to understand how they work and what they will ultimately cost. This complexity can obscure important details, such as the frequency and amount of fees you can expect.

Cost: Annuities often come with various fees that can impact your returns: commissions, administrative fees, mortality fees, and optional riders. Riders can provide increased protection, but they come at an added cost. Variable annuities also include investment management costs and optional downside protections, which can further erode already variable returns.

Annuitization: When annuitizing a contract, you relinquish control of your money to the insurance company. In doing so, the risk of outliving your savings falls to the insurer. This agreement is only as reliable as the financial strength of the issuing company. Failing to assess the insurer's credit rating could put your income stream at risk (insurers' credit ratings can be found on credit agency sites like [Standard & Poor's](#)).² Carefully weigh whether giving up control of your assets is worth the benefit of a predictable income stream.

Closing Thoughts

Annuities are not inherently good or bad insurance products; they are merely a financial tool like many other investment products. The key is to clarify whether this financial tool is an actual investment or a risk transfer mechanism. Retirement planning is too important to leave to a sales pitch. Before entering any annuity contract, consult a fiduciary advisor (like McIlrath & Eck) who can decide if annuities can be a valuable part of a well-rounded financial plan.

References

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4. Stevenson J. Cash Refund Annuity... How Does It Work? John Stevenson | Annuities, Not Incentives. Published June 8, 2024. Accessed November 14, 2025. <https://johnstevenson.com/cash-refund-annuity/>

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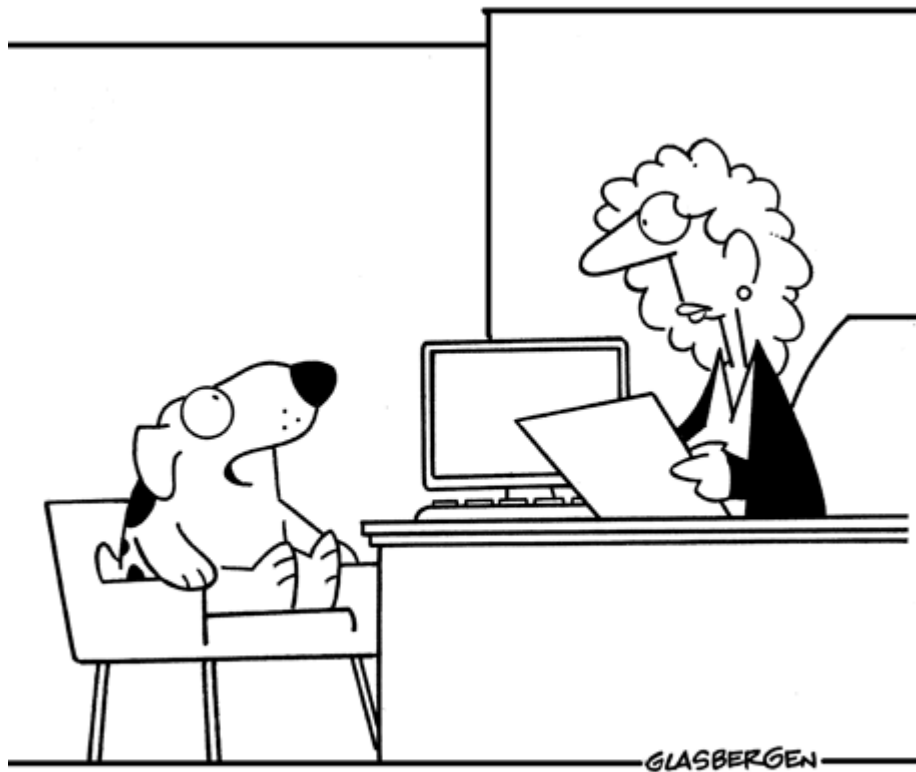
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