

UNDERSTANDING ANNUITIES: Myths, Facts, and How They Work



Annuities are one of the most widely discussed and often misunderstood financial tools used in retirement preparation. Some people view them as a powerful way to create reliable income, while others have concerns about costs, flexibility, or complexity.

The truth is that annuities are neither universally good nor universally bad. Like any financial tool, they serve a specific purpose and may make sense in certain situations but not in others.

Understanding how annuities work, the different types available, and the common misconceptions surrounding them can help you make more informed decisions about whether they may have a place in your retirement strategy.

Why Annuities Exist

One of the biggest challenges retirees face is turning their savings into income that can last for decades. During your working years, income typically comes from a paycheck. In retirement, that paycheck must be replaced using savings, investments, Social Security, and other income sources. Annuities were designed to address one specific concern many retirees share: The risk of outliving their savings.

In simple terms, an annuity is a contract with an insurance company. In exchange for a lump sum or series of payments, the insurer agrees to provide income either immediately or at a future date.

Depending on the structure of the contract, that income may last for a set number of years or even for the rest of your life.

Common Myths About Annuities

If you've researched annuities, you've probably encountered a wide range of opinions. Much of this debate and confusion comes from misunderstandings about how different annuities work. Here are a few of the most common myths and the facts behind them.

Myth: All annuities are expensive

Fact: Some annuities include fees, particularly those with investment management or additional features. Others, such as many fixed annuities, may not have ongoing management fees at all. The cost structure depends on the type of annuity and the options selected.

Myth: Once you buy an annuity, your money is locked up forever

Fact: While annuities often include surrender periods, many allow limited withdrawals each year without penalty. Some also include income features or liquidity options designed to provide access to funds when needed.

Myth: Annuities replace investing

Fact: For many retirees, annuities are not intended to replace investments. Instead, they may be used alongside investment accounts to help balance growth potential with income stability.

Myth: Annuities are only for people who dislike market risk

Fact: Different annuities address different goals. Some prioritize stability, while others allow for growth linked to market performance.



Types of Annuities

Annuities are not a single product category. Several types exist, each designed to serve different retirement needs.

Fixed Annuities

Fixed annuities offer a predetermined interest rate for a specified period. They are often used by those who want stability and predictable growth without exposure to market volatility.

Example scenario: Susan is five years away from retirement and wants to protect a portion of her savings from market swings. She allocates some of her retirement funds to a fixed annuity to help preserve principal while earning a predictable rate of return.

Indexed Annuities

Indexed annuities link potential growth to a market index, such as the S&P 500, while typically providing protection from market losses. These contracts often include limits on gains, but they are designed to offer a balance between growth potential and protection.

Example scenario: Mark plans to retire in the next decade but is concerned about market volatility. He places a portion of his savings into an indexed annuity that allows for growth tied to a market index while protecting against market downturns.

Immediate Annuities

Immediate annuities begin providing income shortly after purchase, often within a year. They are commonly used by retirees who want to convert a portion of their savings into predictable income right away.

Example scenario: John retires at age 67 and wants additional income to supplement Social Security. He allocates a portion of his savings to an immediate annuity that provides monthly payments for life.

Where Annuities May Fit in a Retirement Strategy

No financial tool should be evaluated in isolation. Annuities are most useful when considered within the context of a broader retirement income strategy. For some, they may provide stability and income confidence. For others, different strategies may better align with their goals.

Understanding the tradeoffs, benefits, and limitations of annuities can help you determine whether they deserve consideration as part of your long-term financial strategy. If you'd like to learn more about how annuities work and whether they may fit into your retirement strategy, consider scheduling a complimentary, no-obligation visit with our office.

Together, we can review your goals, discuss available income strategies, and help you determine whether an annuity may play a role in supporting your retirement income needs.