Are annuities good or bad? readers ask

The topic of annuities generates much confusion – and passion.

In response to a recent column, one annuity seller said I had "seemingly been brainwashed" against index annuities.

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Another reader considered the column favorable to annuities and warned me to "not sell out to the insurance industry."

So what gives? Are annuities, as readers keep asking, good or bad?

First, let's define terms. An annuity is a contract with an insurance company that includes, immediately or in the future, the option to convert your principal into a guaranteed lifetime income stream. Within that broad definition, there are many types. Among them:

- Deferred fixed annuities pay interest and allow your money to grow tax-deferred until it is either withdrawn or "annuitized," that is, converted into an income stream.
- Deferred variable annuities allow you to invest in "subaccounts" similar to mutual funds. Gains accumulate tax-deferred until the money is withdrawn or annuitized. You can lose money with your investments. To soften the impact of potential losses, many variable annuities offer, for a fee, riders guaranteeing minimum withdrawal or income payments for life regardless of how the investments perform.
- Index annuities, a type of deferred fixed annuity, credit interest that's typically a portion of the gains of a market index while preserving principal if the index goes down. Again, gains grow tax-deferred.
- Immediate annuities turn a lump sum premium into a lifetime income stream. The income can be a set amount for life, increase by a set percentage or be adjusted for inflation each year. In the case of immediate variable annuities, the income will vary based on the performance of underlying investments.

No annuity is intrinsically good or bad. Any type can be appropriate if you understand how it works and the annuity fits into your financial plan. Any type can be inappropriate if you don't understand it or are not aware of potential drawbacks.

For many deferred variable annuities, these drawbacks include high annual expenses that cut into investment returns.

Most deferred annuities levy surrender charges if you withdraw more than a certain amount during a specified number of years.

Other drawbacks include no access or extremely limited access to principal for immediate annuities and highly complex formulas to compute the permitted withdrawals from variable annuities with guarantee riders and the interest credited in index annuities. Some index annuities allow the insurance company to change the terms of the formula after one year.

For the record, and since readers often ask, I own three immediate annuities, and my wife owns a deferred variable annuity with a minimum lifetime income rider. I've owned six deferred fixed annuities, all cashed in (not annuitized) at the end of the surrender-charge period. I've never bought an index annuity but don't rule out doing so.

For common sense advice on annuities, go to the websites of the National Association of Insurance Commissioners (**Naic.org**) and the Financial Industry Regulatory Authority (**Finra.org**) and do a search for annuities.