Wall Street Journal

When to Surrender an Annuity

Your insurer may be trying to persuade you to sell your contract back.

By Kelly Greene

Feb. 14, 2014

Retirement-minded investors have snapped up hundreds of billions of dollars of variable annuities with benefit guarantees. Now some insurers are trying to persuade owners to walk away from their policies.

Variable annuities combine a 401(k)-like investment account with the equivalent of an insurance policy. They appeal to investors approaching retirement with a promise of guaranteed regular payouts that could reset higher if the policy's underlying investments fare well.

Yet the products usually have higher fees than plain-vanilla "immediate" annuities, which deliver an annual payout in return for a lump-sum payment. (Variable annuities are complicated enough—and consumers are confused enough about them—that the Securities and Exchange Commission issued an investor bulletin this month explaining how they work.)

Some insurers that sold products with rich guarantees are trying to dissuade longtime customers from holding on to their contracts. In addition to offering to buy back variable annuities with benefit guarantees, insurers are limiting investment choices, raising fees and blocking additional account contributions.

The goal is to limit future payouts on accounts whose balances have tumbled at the same time ultralow interest rates hurt insurers' own investment returns.

Insurers have sent out a flurry of letters in the past year informing annuity owners that their accounts are being shifted into more-conservative investment options—unless the owners opt out.

Michael Manon, a retired lawyer and entrepreneur who in March 2009 invested $120,000 in a variable annuity with a guaranteed-income rider, turned down an offer this month to sell the contract back to his insurer. His account is now worth more than $250,000.

"I still want the protection," Mr. Manon says, pointing to the stock market's January downturn as a reason why he values the guaranteed payout.

He decided to turn down the buyout offer after consulting a financial planner with a specialty in counseling investors and advisers on the pros and cons of such annuities.

When should you consider getting out of an annuity with a guarantee? If you aren't seeking income as the main goal, if you have been diagnosed with a medical condition that severely shortens your life expectancy or if you have a dire need for a lump sum of cash, experts say.

Otherwise, consider holding on—as long as the contract still offers a broad range of stock investments, the income guarantees are higher than what you could get for such a product if you bought it now, and you still want a steady income stream in retirement.

If you—or your parents—are holding an annuity and having second thoughts, here are some strategies to consider.

Stay aggressive.

Some insurers, including AXA's AXAHY +0.95% AXA Equitable Life Insurance, have sent letters to investors informing them that their assets would be shifted automatically from the growth funds they originally selected into lower-cost index funds, unless the investors opt out of the change.

"We were very clear that the offer was voluntary and that it may not make sense for everyone," an AXA spokeswoman said. "But for some customers, their circumstances may have changed and it may make sense."

There is no reason to invest conservatively with assets for which you are paying an income guarantee, says Mark Cortazzo, a certified financial planner in Parsippany, N.J., who two years ago started Annuity Review, a service that charges about $200 to analyze an annuity contract.

Roger Rose, an 82-year-old retired doctor in South Salem, N.Y., bought a variable annuity about six years ago with a lifetime guarantee of a 6% annual return. After a financial adviser shifted his annuity investments last fall to money-market funds from stock mutual funds, Dr. Rose worked with Mr. Cortazzo to shift back to equities.

"Insurers are mapping people automatically to these new options, but they still may have options available that are more consistent" with their original investment plan, Mr. Cortazzo says.

Cut a deal before you get out.

In cases where investors decide to dump their annuity and the insurer isn't offering a buyback, they may have to pay surrender charges to get their money back. At least one investment-advisory firm, Fisher Investments of Camas, Wash., is offering to cover that charge in lieu of its annual fee to new clients who, in turn, invest with the firm.

Pam Brehm, a 59-year-old state-health-department investigator in Denver, bought a variable annuity with a benefit guarantee six years ago after her husband, a banker, was forced into retirement following a merger. He had beaten cancer five years earlier, so the death benefit appealed to them as well.

Fisher Investments is paying back $14,400 of the couple's $17,000 surrender charge, the firm says.

Nathan Fisher, who oversees the firm's annuities evaluation business, says the firm has reviewed more than 4,500 annuity contracts since September 2011. Among 520 contracts it analyzed from February through August 2013, the average annual fee was 3.4%—compared with the roughly 1% to 1.5% that investors typically pay other professionals to manage their investments.

Focus on the death benefit.

With some older annuity contracts, you can withdraw nearly all the assets to invest elsewhere, but be sure to keep a minimal amount in the contract to preserve the death benefit for your heirs.

For example, if you had a $200,000 guaranteed income amount and an actual account value of $100,000, you might be able to take out $99,000, leave $1,000 in the account and still preserve a $101,000 death benefit, Mr. Cortazzo says.

"I've got people with hundreds of thousands of dollars' worth of death benefits, and only a couple grand sitting in their accounts," he says.

About those heirs, he adds: Don't name a trust as a beneficiary. Doing so could disqualify your surviving spouse from your income benefit.