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The Most Important Thing About Buying Annuities

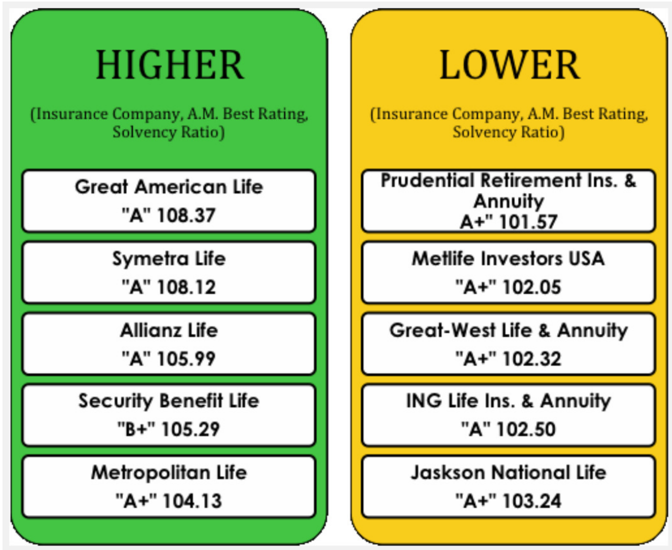
Annuities come in more flavors than Baskin-Robbins ice cream with all the add-on features (called "riders") and varieties of ways to earn interest within the annuity contract. Because of all the customizable options, annuities have been fiercely criticized for being too complex for the average investor to understand. While annuities are no more complex than understanding the mechanics of a mutual fund it can be easy for you to become confused without some expert guidance.

(Photo credit: LendingMemo)

While many advisors and consumers are trying to find the right match of benefits, expenses, and interest options within their annuity plan…they may be overlooking the single most important factor…the financial strength of the annuity company. Rating agencies like A.M. Best and S&P do their best to provide grades on insurance companies in an effort to help you gauge who's the strongest and weakest companies. A company that's rated "A" or "A+" are considered the strongest while "B" and below are considered less strong or weaker. While this grading system may aim to make it simple to understand, it may not be the most important factor when buying an annuity.

When the rubber meets the road what matters most is how likely you'll be to get your money back should the insurance company fail. In other words, how solvent is that company? Solvency simply is a measurement of how much you have in assets versus how much you owe. So, a high "solvency ratio" is the critical (probably the most crucial) component on what company to entrust a portion of your life savings with. For example, a company with a solvency ratio of 105 means that for every $1 dollar you put into an annuity they have $1.05 in assets to back that principal promise. In contrast, large banks only have to keep about .03 – .10 in reserves for every $1 dollar you deposit in the bank.

The higher the solvency ratio the stronger the promise. If you're thinking about buying an annuity or changing one that you already own, first check the list below of some of the more solvent and less solvent companies around.



Insurance Company Solvency Ratios & Ratings (source: A.M. Best data 12/2012)

It's interesting to see how there's very little correlation between ratings and solvency ratios. For instance, compare Prudential's rating of "A+" and solvency of 101.57 to Security Benefit's "B+" rating and solvency of 105.29 (note: S&P gives Security Benefit a rating of "A-"). It appears that Security Benefit, while it has a lower rating by A.M. Best, is actually in a stronger position to make good on their promise to their annuity owners.

If you're looking for principal protection and guaranteed income you can't outlive, then annuities may be your best choice (for some of your money), just be sure to choose the most solvent companies and work with an advisor who can decipher all the details and available options.

Disclosure: Rob Russell offers advisory services through Centum Capital Advisors, LLC an independent RIA

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