7 ANNUITY BASICS

Over the past several decades, the responsibility for providing retirement income has shifted from employers and government programs, such as Social Security, to individuals. Because of this shift, many retirees and pre-retirees now use a fixed income product, like annuities, to help ensure a part of their income will be guaranteed.

Below are seven annuity basics that can give you a better understanding of annuities and whether this type of product may be suitable for a portion of your retirement assets within your overall financial strategy.

If you are considering an annuity, it is a good idea to work with a financial professional who can help you see a complete view of your financial picture, including how your retirement assets are integrated and work with one another.

1 ANNUITY DEFINED

An annuity is a contract between you and an insurance company where you pay a premium in exchange for guaranteed income for a set period of time or for the remainder of your life. The guarantees of an annuity are backed by the financial strength and claims-paying ability of the issuing insurer.

There are two phases of annuities: the accumulation phase, where your contract value accumulates interest earnings, and the distribution phase, where you receive income payments.

2 DIFFERENT TYPES OF ANNUITIES

Immediate annuities: An immediate annuity is purchased with a lump sum payment to the insurance company. In return, the insurance company provides a guaranteed series of payments that begin right away. The amount of income you receive depends on a number of factors. The payouts may be level, or they may increase over a fixed number of years or until the end of your life, whichever is longer. Once you decide to receive payments for life, the transaction is irreversible, and you no longer have access to your assets in a lump sum. When you die, any remaining contract value is forfeited to the insurance company.

Deferred annuities: With a deferred annuity, you make one or multiple payments over a longer period of time. You can begin drawing regular income payments according to the terms of your contract. Taxes on your interest are deferred until you receive money from the contract.

Below are three different types of deferred annuities:

- **Traditional fixed annuities:** When you purchase a fixed annuity, you'll receive a guaranteed interest rate for a predetermined number of years that can help you conservatively accumulate assets for retirement. Fixed annuities provide stable, guaranteed income and often appeal to those who favor protection over growth.
- **Fixed index annuities:** Like a traditional fixed annuity, a fixed index annuity provides guaranteed income with protection of principal from market losses, but it also has the potential to provide higher interest earnings. Interest earnings from a fixed index annuity are linked to the performance of an external market index, like the Standard & Poor's 500. This means you are earning interest without actually participating in the stock market. The amount of interest you receive from a fixed index annuity can vary, and there is a limit on how much interest you could earn.
- **Variable annuities:** Those willing to assume a higher degree of risk in exchange for the potential for greater returns may consider a variable annuity. In this type of annuity, your premium is invested in professionally managed portfolios, therefore offering greater growth potential. Like fixed annuities, taxes are deferred on your interest until you begin receiving money from the contract, but unlike fixed annuities, variable annuities are invested in the market and have the potential to lose money as a result of market declines.

3 COSTS ASSOCIATED WITH ANNUITIES

Annuities contain certain costs, and, because they are long-term contracts, there may be charges or penalties for taking money out early. If you're under the age of 59 ½, there may also be a 10 percent federal tax penalty. Fees, expenses and charges for annuities may include, but are not limited to:

- **Surrender charges:** These are penalties levied against withdrawals made during the early years of contract ownership, known as the surrender charge period. Usually, you can withdraw 10 percent a year with no penalty, but if you withdraw more than the amount specified in the annuity contract, there will be a surrender charge.
- **Commissions:** The financial professional who sells you the annuity earns a commission. Commissions are built into the cost of the product and are paid by the insurance company directly to the financial professional.
- **Load fees:** These fees are generally associated with variable annuities in order to cover the cost of the marketing and management of funds of the annuity. Examples include management fees based on a percentage of premium or a percentage of net assets; contract fees charged annually or at a flat rate; or transaction fees that may be charged when money is moved from one investment to another.
- **Rider fees:** There are various optional riders that you can purchase with an annuity that provide additional benefits, but they may come at additional costs.

Consider consulting with a financial professional to help ensure you understand all of the costs associated with the annuity you are considering.

4 ANNUITY DEATH BENEFITS

If you pass away before you begin to receive scheduled income payments, your beneficiary(ies) will receive a death benefit. Even if you pass away after income payouts have begun, it's still possible your beneficiary will receive a death benefit. The value and the manner in which your beneficiaries can receive the death benefit may vary based on the product selected and insurance company that issues it.

5 ACCESSING THE PRINCIPAL OF AN ANNUITY

While annuities are designed to be long-term income products, most offer options that allow you to withdraw a percentage of your contract value each year up to a certain limit.

However, withdrawals will reduce the contract's accumulation value, death benefit and income account value, if applicable. In addition to any possible surrender charges, all withdrawals are subject to ordinary income tax, and if taken prior to age 59 ½ may be subject to an additional 10 percent federal tax. A financial professional can help you understand your options with regard to early withdrawals.

6 LENGTH OF INCOME RECEIVED FROM AN ANNUITY

Annuities pay income in a variety of ways. Sometimes the income amount is guaranteed for life and can even cover a spouse's life. Others pay only until the account value is depleted, or through a specific time period.

7 RESEARCHING THE STABILITY OF INSURANCE COMPANIES

Because annuities are backed by the financial strength and claims-paying ability of the issuing insurance company, some buyers wish to do some research about the insurance company that is providing the annuity before making a purchase.

To inquire about the insurance company, you may contact the insurance company, or your state insurance department.

Annuities are designed to meet long-term needs for retirement income. Interest on annuities is earned on a tax-deferred basis, which means no taxes are paid on interest credited until payments are received or withdrawals are taken.

We are an independent financial services firm helping individuals create retirement strategies using a variety of insurance and investment products to custom suit their needs and objectives.

This is provided for informational purposes only and is not intended to provide specific tax or legal advice or serve as the basis for any financial decisions. Be sure to speak with qualified professionals before making any decisions about your personal situation.

Content prepared by Advisors Excel.

AE06179236C