Annuity Options

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Special Interest Articles

Individual Highlights

Is an annuity right for you? Annuities are financial contracts between you and an insurance company. You give the company money now and the company pays you an income at a later time. Annuities can be useful retirement tools.

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Fixed vs. Variable Annuities

In a **fixed annuity**, an insurance company guarantees the principal and a minimum rate of interest. As long as the insurance company is financially sound, the money you have in a fixed annuity will grow and will not drop in value. The growth of the annuity's value and/or the benefits paid may be fixed at a dollar amount or by an interest rate, or by a specified formula. The growth of the annuity's value and/or the benefits paid does not depend directly on the performance of the investments the insurance company makes. Some fixed annuities credit a higher interest rate than the minimum, via a policy dividend that may be declared by the company's board of directors, if the company's financials are more favorable than was expected. Fixed annuities are regulated by state insurance departments.

Money in a **variable annuity** is invested in a fund—like a mutual fund. The fund has an investment objective, and the value of your money in a variable annuity—and the amount of money to be paid out to you—is determined by the investment performance of the fund. Most variable annuities offer investors many different fund alternatives. Variable annuities are regulated by state insurance departments and the federal Securities and Exchange Commission.

Types of Fixed; Deferred or Immediate

An **equity-indexed** annuity is a type of fixed annuity, but looks like a hybrid. It credits a minimum rate of interest, just as a fixed annuity does, but its value is also based on the performance of a specified stock index—usually computed as a fraction of that index's total return.

A **market-value-adjusted** annuity is one that combines two desirable features—the ability to select and fix the time period and interest rate over which your annuity will grow, and the flexibility to withdraw money from the annuity before the end of the time period selected. This withdrawal flexibility is achieved by adjusting the annuity's value, up or down, to reflect the change in the interest rate "market" (that is, the general level of interest rates) from the start of the selected time period to the time of withdrawal.

A **deferred annuity** receives premiums and investment changes for payout at a later time. The payout might be a very long time; deferred annuities for retirement can remain in the deferred stage for decades.

An **immediate annuity** is designed to pay an income one time-period after the immediate annuity is bought. The time period depends on how often the income is to be paid. For example, if the income is monthly, the first payment comes one month after the immediate annuity is bought.

Annuities have a special tax advantage under which you won't pay income taxes on gains in the contract until you begin to withdraw money. Withdrawals may be subject to surrender charges and, if made prior to age 59 1/2, may be subject to a 10 percent federal tax penalty. Although it may sound complex, the concept is fairly simple.

Is it Qualified?; and Types of Premiums

A **qualified annuity** is one used to invest and disburse money in a tax-favored retirement plan, such as an IRA or Keogh plan or plans governed by Internal Revenue Code sections, 401(k), 403(b), or 457. Under the terms of the plan, money paid into the annuity (called "premiums" or "contributions") is not included in taxable income for the year in which it is paid in. All other tax provisions that apply to nonqualified annuities also apply to qualified annuities.

A **non-qualified annuity** is one purchased separately from, or "outside of," a tax-favored retirement plan. Investment earnings of all annuities, qualified and non-qualified, are tax-deferred until they are withdrawn; at that point they are treated as taxable income (regardless of whether they came from selling capital at a gain or from dividends).

A **single premium** annuity is an annuity funded by a single payment. The payment might be invested for growth for a long period of time—a single premium deferred annuity—or invested for a short time, - after which payout begins—a single premium immediate annuity. Single premium annuities are often funded by rollovers or from the sale of an appreciated asset.

A **flexible premium** annuity is an annuity that is intended to be funded by a series of payments. Flexible premium annuities are only deferred annuities; that is, they are designed to have a significant period of payments into the annuity plus investment growth before any money is withdrawn from them.

Payout Options

There are a variety of payout options available for annuities:
- The annuitant can receive all of the funds at once in a **lump sum payment**.
- A **life annuity** makes payments of regular income for as long as the annuitant lives.
- **Joint and survivor** annuities make payments for the life of the annuitant and a beneficiary, such as a spouse or child.
- **Period certain** annuities make regular payments for a set term, whether or not the annuitant dies.

- The **life annuity with refund option** provides the annuitant with a guaranteed income for life and continues the payments to the beneficiaries according to the refund provision. With the refund provision, upon the death of the annuitant the beneficiaries receive an amount equal to the difference between the annuity's accumulated value prior to annuitization (payout) and the total of benefits received by the annuitant.
- A final payout option to be discussed is the **fixed amount option**. For the previous options, a period determines the size of benefits. With the fixed amount option, the annuity holder selects the size of the benefit payments, which then determines the length of time over which the benefits are received. This option is less commonly used.
- **Interest-only annuities** pay the interest on the account value to the annuitant, who can then withdraw all the funds from the account as a lump sum when he or she chooses.