INVESTING FOR RETIREMENT WITH ANNUITIES

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What is an Annuity?

On a basic level, annuities are insurance products, purchased from an insurance carrier, that are designed to help protect your retirement income from risks like market exposure or outliving your money. Annuities are tax-deferred investment products offered by insurance carriers and are typically used during retirement years. The main advantages of annuities are their tax-deferred feature, which allows an annuity owner to accumulate more money as compared to fully taxed investments. Also, annuities give the owner the benefit of growing their investment in a safe and secure investment instrument that will guarantee the gains accumulated cannot be lost.

An Annuity is a sum of money payable yearly or at other regular intervals. The actual amount of money is based upon a contractual relationship between the person covered called the Contract Owner, and the annuity insurance company called the Insurer, through which the investment is made. Annuities have been around for a long time. They have been available in the United States for more than 100 years, and several hundred years in some other countries.

Although annuities are sold only through the insurance industry (i.e., insurance agencies, brokerage firms, investment advisors, financial planners, banks, savings, and loan institutions), they have nothing to do with life insurance or insurance coverage.

Investing with Annuities

Anyone can sell you an annuity; however, it takes a truly qualified and experienced advisor to know how to structure them for income, inflation, growth, return of principal, and tax advantage. Typically, a person buying one annuity will not fix all of their income and retirement needs; rather, it will take a financial plan including an income source, life insurance, emergency funds accounts, possibly an annuity, and other financial tools to build a robust financial portfolio. It may take multiple types of other financial tools, including possibly multiple types and differently structured annuities, to balance your portfolio and achieve your financial objectives.

Annuity Protection/Guaranty

Similar to a bank account in the United States having FDIC Insurance backing, if an individual purchases an annuity, he/she is protected by a state guaranty association in the unlikely event the insurance company has financial trouble. Guaranty associations are created by state law, to assure that the claims of an insolvent insurance company's policyholders, who live in the state, will be paid, subject to the limits of the law. All insurers authorized to write life insurance, health insurance, and annuities in the state are required to be members of the association.

Types of Annuities

There is a wide range of annuities with varying options and features. All annuities are divided into two basic types: Fixed or Variable. However, there is also a hybrid type called a Fixed Indexed Annuity, which has the characteristics of both a fixed and variable annuity.

Immediate Annuity (Sold by Licensed Insurance Agents)
If a set rate of return is desired, the contract owner should choose the Fixed Annuity. This type of annuity guarantees that the money will accumulate at a minimum specified rate of interest. However, the insurance company will pay a higher rate of interest if its investment experience is better than the minimum guarantee.

Fixed Indexed Annuity (Sold by Licensed Insurance Agents)
This type of annuity is a hybrid called a Fixed Indexed Annuity. It is a tax-deferred long-term savings option that provides principal protection in a down market and opportunity for growth in an up market. It gives you more growth potential than a fixed annuity along with less risk, but less potential return than a variable annuity. Returns are based on the performance of an underlying index, such as the S&P 500® Composite Stock Price Index, a collection of 500 stocks intended to provide an opportunity for diversification and represent a broad segment of the market. While the benchmark index does follow the market, even being an investor, your money is never directly exposed to the stock market; consequently, there is no loss of the gains you have accumulated.

Variable Annuity (Sold by Certified Financial Planners CFI)*
If a more conservative to aggressive investment is desired, the contract owner can choose the Variable Annuity. In this way, the owner can decide where the money should be invested. These annuities also have death benefit provisions, including the attractive element of providing an insurance company guarantee that an annuity holder is entitled to the face amount of his or her annuity contract, regardless of what happens to the contract's investments.

*(Not offered by Retire American)

Income Features of Annuities

The two major applications for the Contract Owner are the need for income and options for investment. The application required is dependent upon when the need for income occurs.

An Immediate Annuity

An immediate annuity can provide income, in some cases, in as little as 31 days after the purchase of the annuity. For example, if the contract calls for monthly installment payments, they will begin one month after the date of purchase. These annuities are specifically designed for those customers who need to receive a specific amount of money each month. These can be used as the sole source of income or as an income supplement. Payments may be made depending upon the need, on a monthly, quarterly, or annual basis. The amount of the check the client receives will not fluctuate, and the actual dollar amount of the checks is in direct relationship to the total annuity investment.

An important note to remember is if the insurance company is going to begin paying the annuitant shortly after the purchase of the contract, then the immediate annuity must have been paid by a single payment.

The market for annuities and large investments is very competitive. Several insurance companies should be contacted. Check rates and specific payout intervals (Example: five, ten, fifteen, and twenty years) on the intended annuity investment amount. Then compare the differences in the returns on the investment.

A Deferred Annuity

A deferred annuity is used to receive income payments at some further point in the future. It offers growth and flexibility for growth either over a long or short time. A deferred annuity can be paid for by a single premium, annually, semi-annually, quarterly, or in monthly installments over some time.

Unlike the “immediate annuity,” the deferred annuity payments to the annuitant begin after a designated period has elapsed from the purchase date.

The contract owner can receive a specific dollar amount of income each year and can direct how the balance is to be reinvested. This deferral process gives the contract owner the flexibility of automatic reinvesting, withdrawal of a portion of the principal, or termination of the investment.

Different Ways to Invest Money?

Both the fixed-rate and variable annuity have an accumulation period (effective the moment investments are selected) and a payout period.

Investment Options

A Fixed Indexed Annuity offers a wide range of investment options. The value of the investment varies by the value of the total investment performance. If fixed annuities guarantee fixed monthly amounts, monthly annuity payments vary, and will depend on the performance of the investment options, an annuity holder chooses. The fluctuation of the cash value is the main difference between Fixed Indexed Annuities and Fixed Annuities.

Fixed-Rate Annuity

Premiums paid for fixed-rate annuities are invested with the insurance company's general funds, chiefly in fixed-income types of securities, with the ultimate purpose of providing a level annuity income.

Though the fixed-rate annuity affords the contract owner a guaranteed rate of return, that rate is dependent upon the length of time the funds will be invested. Though the most common maturity periods for annuities are three and five years, the longer the commitment, the higher the guaranteed rate of return for the contracted period.

With a fixed annuity, the contract owner is protected against rising or declining interest rates, stock market gains or losses, and insurance company profits or losses by assuring the safety of the principal and the exact interest the money will earn. This assurance is very appealing to the conservative investor, allowing the knowledge of specific projections.

However, the moderate to aggressive investor can utilize this type of annuity as a stabilizing factor in his overall portfolio. Using the guarantee that a fixed annuity allows, the diversified investor, along with other investments made (i.e., real estate, stocks, bonds, gold, mutual funds), is made to feel secure in his overall investment program.

Fixed Indexed Annuity

A Fixed Indexed Annuity is a fixed annuity, either immediate or deferred, that earns interest or provides benefits that are linked to an external equity reference or an equity index. The value of the index might be tied to a stock or other equity index. One of the most commonly used indexes is the Standard & Poor's 500 Composite Stock Price Index (the S&P 500), which is an equity index. The money can be placed in a credited fund account that is based on the index chosen in the stock market, such as the S&P 500.

When you buy a Fixed Indexed Annuity, you own an insurance contract. You are not buying shares of any stock or index. While the growth depends on the growth of the index stock market fund chosen, the money is not invested in the stock market, and can never fall below the amount gained, which was accumulated in the fund account. Other fixed annuities also credit interest at rates set from time to time by the insurance company. Fixed index annuity's credit interest using a formula based on changes in the index to which the annuity is linked. The method decides how the additional interest, if any, is calculated and credited. How much additional interest you receive depends on the features of your particular annuity contract.

Fixed-indexed annuities, like other fixed annuities, promise to pay a minimum interest rate. The rate that will be applied will not be less than the minimum guaranteed rate, even if the index-linked interest rate is lower. The value of your annuity also will not drop below a guaranteed minimum. Fixed indexed annuities cannot lose the accumulated gains, but can lose value based on how much income is taken out of the annuity. While the funds are being depleted because of the income taken, the remaining funds left in the annuity continue to grow. While the remaining funds will not add to the income value, they will add to the death benefit or accumulated value.

This type of annuity also offers riders that can be added, such as riders for a disability, nursing home stay, long-term care, and terminal illness. Most annuities allow for withdrawal without surrender penalties up to a certain amount per year, and death benefit to survivor or beneficiary if funds remain. Fixed-indexed annuities can grow tax-deferred without risking any of the accumulated gains.

Benefits of Investing in a Properly Structured Annuity

Financial Planning

Investing in a properly structured annuity can be a fruitful investment tool, which can help you take control of your financial future, and ensure you have a promising and successful retirement. With a properly designed annuity, you can prepare for your retirement years, and ensure you never run out of money. Annuities can be structured in a way that can ensure you never lose a dime in principle and still have guaranteed growth according to stock market performance. You can even structure your annuity to offer a guaranteed income for as long as you need it. Annuities can ensure growth without taking any market risks, and if properly structured, annuities can have zero market risks, and can even offer guaranteed growth.

Annuities grow in a tax-deferred status, which means you can entirely take full advantage of compounding interest. Annuities are designed to offer safety and security for your investment, and are insured by the State Guarantee Association. Investing in an annuity is a great way to secure a financial future, and ensure you never run out of money in your retirement years.

Annuity Income

Annuities can offer a guaranteed income for a specified period. This period can last as long as you choose, and can even last for the rest of your life. Annuities can be a second Social Security check that can pay you for the rest of your life, and can even be passed on to a spouse or loved one. Depending on the type of annuity purchased, and the annuity structure you choose, you can ensure a guaranteed income payment for the period you choose.

This income payment period can last for a specified amount of time or can be structured to last for the rest of your lifetime. Depending on the annuity structure, this income can potentially be passed on to a spouse or loved one as well. In addition, most annuity structures allow for any remaining funds after death, to be passed on to a beneficiary. This ensures that there is never a loss in principle for the annuity consumer.

Annuity Growth without Risk

Fixed Indexed Annuities are a tool that helps grow your money without any market risk. This is because your funds are not invested directly in the stock market, but instead are invested in an index that bases growth according to the growth of an index. You can choose which index fund(s) you want to invest your annuity assets within. The index reflects growth based on the stock market stocks that the index is invested within and will grow according to how the funds in the index grow, according to market gains. This is done as more of a reflection of the performance of the stock market and does not have any loss potential, as the funds are not invested inside the stock market itself, but are instead within an index fund, which will mirror the gains of the stock market's performance. This means that you will never lose your principal or interest accumulation. If your money has grown, it will never go below the amount it has grown to. This accumulation happens according to the investment strategy chosen and the success of the index fund(s) you choose to invest in.

Annuity Safety and Security

Annuity insurance companies are required to be part of the State Guarantee Association. This state-sanctioned non-profit organization is a fund that is created in each state and has a requirement for insurance companies offering financial products in that state to join. The insurance organizations required to join the association include companies that offer products such as annuity policies, life insurance policies, long-term care policies, and disability income policies. This association is funded by all the insurance companies offering these types of products within the state. The association is put in place in each state to create a fund, just in case an insurance company becomes insolvent. This is rare in general, as what would typically happen if an insurance company was having financial trouble, is a different insurance company would typically purchase the insolvent company's contracts. The state guarantee association is a backup that works similarly to FDIC insurance, but on a state level, to ensure the contract holder (the insured) does not lose their insurance product, in the event an insurance company becomes insolvent.

Annuities and Taxes

Annuities grow in a tax-deferred status. This means that you will only have to pay taxes when you withdraw your funds from the annuity. This structure helps with investment growth, as you are able to grow your principal and interest without reducing growth based on taxes that you might owe. This differs from other investments such as bank CDs or other non-tax deferred type accounts, since you don't have to take accumulated interest out from your interest payments, to pay the taxes that would be owed in these other types of accounts. This will help with faster growth of the annuity investment account, and ensures you can take full advantage of compounding interest.

Annuities and Compounding Interest

Annuities grow according to your principle, but will also grow based on your interest accumulation. This is referred to as compound interest. Albert Einstein described compound interest as the “eighth wonder of the world”. What does this mean for your investment? This means that if you put in your investment principle, and it accumulates interest, the next year your principle will be as much as your total principle and accumulated interest. These accumulations take place year after year, and while invested in an annuity, take place at a tax-deferred status, which means that there is no limit to the potential growth of your investment.

Annuity Bullet Points

Investing in an annuity has many benefits that can include:

- Unlimited growth potential
- Safety and security knowing there is no loss potential, as annuity investments are backed by the State Guarantee fund, which has a similar correlation to FDIC insurance.
- No loss in principle and accumulated growth
- Guaranteed growth when structured correctly
- Guaranteed income for the specified term, which can potentially last a lifetime.
- Tax-deferred growth
- Compounding interest to the max
- For more information about investing in an annuity, please contact us today! We want our customers to have all the knowledge and resources they need to make informed financial decisions.

Understanding Immediate Annuities

Immediate annuities are the simplest type of annuities. You give the insurance company a sum of money, this is called the premium, and they give you a payout each month for the rest of your life. The insurance company calculates the amount of the payout based on your age, your life expectancy, and the amount of the premium. It is also common to select a fixed payout period of say 10 to 15 years. It could be said that the insurance company is betting that you will die sooner since, at that time, the payouts stop. While you, on the other hand, are betting, you will receive payments over the entire payout period or live out a very long life if you have purchased a lifetime policy.

These annuities are mostly sold to retired people who will have sufficient assets remaining after purchasing the annuity to cover unexpected emergencies. Immediate annuities provide a guaranteed lifetime income stream, and there is no provision for a lump-sum payout to cover emergencies. Immediate annuities do offer income for those at any age but are typically used during retirement years. (This is only an example, and does not represent an actual scenario). To see how they work and to determine if they are a good option, look at a real-life example. If you are a male, 65 years old in 2013 living in Texas, then for a $100,000 premium, you can purchase an immediate annuity providing a lifetime monthly income payment of $585. The payout of 7.02% is determined by the yearly payout of $7020 for the $100000 premium.

Therefore, what interest rate are you earning on your investment? Well, that depends on when you die. If you live about 14 more years until you are 79, then you will have just received back your entire $100000 premium, that is to say, you will have realized a 0% interest rate. Your life expectancy, if you are 65, is about 19 years, so on average, you should live until you are 84 if you make it that far you will have received $133,380, which is equivalent to having received an annual interest rate of 3.182% on your investment for the 19 years.

You can think about this return in more familiar terms. Assume you borrowed $100000 and had to pay back $585 per month. If the contract called for 14 years of payment, then you would pay back the original amount so that the loan would have had zero annual interest. If it took longer to pay off the loan, then that would mean interest was applied. If the yearly interest rate were 3.182%, then it would take 19 years to pay off the loan, and the total payments would be $133,380. Now reverse the thinking and realize that the insurance company has effectively borrowed the $100000 from you and is paying it back with an effective interest based on how long you live.

To get the 7.02% annual interest advertised you have to live a very long time, more than another 100 years. However, let us say you made it to your life expectancy of 84 years old and realized an annual return of 3.2%. Some plans can continue payments if you die early. One example is a policy that pays for 20 years either to you if alive or to a beneficiary after you die. The payments, instead of being $585, would be reduced to $508 per month. At the end of the 20 years when payments stop, the effective annual interest rate would be 2.0% instead of 3.6% (from the table).

Understanding Fixed Indexed Annuities

A Fixed Indexed Annuity is a contract between you and an insurance company designed to help you achieve your longer-term retirement goals. In exchange for your premium payment, the insurance company provides you with income starting at a specified time in the future. The significant benefits of a Fixed Indexed Annuity are that the principal and credited interest accumulate by benefiting from stock market gains, but are protected against any market losses. Earnings are tax-deferred and can provide a guaranteed lifetime income to you or your policy's beneficiaries. The issuing insurance company backs these guarantees.

There are two phases to the Fixed Indexed Annuity: the accumulation phase and the payout or distribution phase. The accumulation phase, perhaps ten years, begins when you purchase the annuity. During this phase, your account value earns interest based partly on a fixed interest guarantee and partly on the gains in a stock market index such as the S&P 500. The interest credited to your account is not taxed until the distribution phase when you receive a payout, so the full benefit from compounding interest is achieved.

If a financial emergency occurs during this phase, some fraction, usually about 10%, of the total premiums can be withdrawn without penalty. Still, a more significant or full withdrawal will usually incur surrender charges. The amount of the charges decreases the longer the annuity is held.

The distribution phase begins when you decide to receive income from the annuity. There are several payout plans available, including fixed guaranteed monthly payouts during your lifetime, a lump-sum payout, payouts to beneficiaries after your death, and nursing home benefits. You decide the best method for distribution based on your needs now and in the future. Regardless of your choice of payment plans and your life expectancy, you or your beneficiary can be guaranteed a total payout at least equal to the total of your premiums and earnings gained during the lifetime of the annuity. An important optional feature for you may be the death benefit. This benefit states that should you pass away before you begin receiving payouts from your account, your beneficiary can receive either fixed payments from your account or the value in a lump sum payment. Keep in mind that all guarantees are based on the claims-paying ability of the issuing company.

The benefit of having credited interest based partly on stock market gains can be substantial. In other types of annuities, credited interest is based on a predetermined fixed interest rate, the profit or loss associated with mutual fund-type investments, or variable interest rates. In a Fixed Indexed Annuity, part of the return is based on a stock index of your choosing, typically the S&P 500. It works like this. If the index you have chosen increases by some percentage during the year, a portion of that increase is applied to your account. The portion used is determined by one and, in some cases, two factors. Some Fixed Indexed Annuities have a cap interest rate that can be applied. For example, if the index rose to say 12% for a year, but you had a cap of 8%, then you would receive the 8% credited interest. If the index rose only 5%, then you would receive the 5%. Some Fixed Indexed annuities have a participation rate that defines what percentage of the index gain is applied to your account. In the case of a 10% gain in the index, if the participation rate was 80%, then a credited interest of 8% would be applied to your account. It is possible to have both a cap and a participation rate that would be applied after the cap rate was applied.
A third-rate determining option called a spread is available for some Fixed Indexed annuities, where a fixed interest rate amount is subtracted from the index gain before applying interest to the account.

If the spread was 3% and the gain for the index was 10%, then 7% would be applied to your account. The primary reason Fixed Indexed Annuities are far outselling other annuity types is that customers purchasing these types of annuities benefit from gains in the stock market index, but protect against any losses. Also, all gains applied during previous years and in future years are locked-in and preserved and will not be affected by single or multiple yearly losses in the stock market.

The Annuity Structure and Process

A client investing in an annuity must complete an application. Once the application has been submitted to the insurer, the contract owner receives the contract, which contains a summary of the application, the rate of expected return on the investment(s), and type(s) of investments selected.

Annuity Premium Amounts

A Single Premium Immediate Annuity can be bought with a lump sum and start payouts at once. It is the most common type of annuity. It affords the contract owner a single premium, wherein the insurance company promises to pay the annuitant an amount each period (monthly, quarterly, semiannually, or annually).

The second method is “level premium.” Here, the premiums are paid in periodic payments over the years before the date upon which annuity income begins. The premiums can be paid yearly, semi-annually, quarterly, or monthly. The next premium payment option is a “flexible premium.” This is where the purchaser has the option to vary the amount of each premium payment, as long as it falls between a minimum and maximum amount.

Premium Computation and Annuity Payout Factors

Insurance companies use multiple factors to determine premiums and annuity payout amounts. These factors have been accumulated by the insurance industry using data on industry standards and identifying factors that have been found in specific groups of people. These factors can include:

- The annuitant's age will determine how long the insurance company will have to make income payments to the annuitant. These determinations are made using data that explained how long an individual would typically live and base it on when the annuitant will begin taking the annuity payments.
- Statistics say that the annuitant's sex plays a role. Statistics will show that women live longer than men do. Therefore, a woman would receive more income payments than a man would of her age.
- The insurance companies calculate the assumed interest rate. This rate is an assumption using data from the history of the success of the market, and the insurance industry offering annuities.
- The next factor is the annuitant's amount of periodic income and the guarantees the insurance company made to the annuitant concerning the total number of payments the annuitant will receive.
- The last factor is the "loading" for the insurance company operating expenses. The insurance company takes into consideration its operating costs and gives a value bases on the assumption it makes for how much it will need to continue successfully.

Lifetime Guaranteed Rate

The minimum interest rate that is guaranteed for the life of the annuity is known as the lifetime guaranteed rate. Each state's Department of Insurance, through its jurisdiction, mandates that annuities provide a lifetime guaranteed interest rate; therefore, most insurance companies offer rates of one to three percent on this type of annuity. The contract owner can opt for receipt of guaranteed income payouts on a monthly, quarterly, semi-annual, or annual basis.

Money-Back Guarantee

This is a significant selling feature in many annuity contracts due to no market risk for the contract owner. The contract owner is protected, and the insurer assumes the risks involved.

Contract owner satisfaction is guaranteed, depending upon the insurer's principal language. If the contract owner is not satisfied with his annuity within the insurer's allotted timeframe, he can get all of his money back. The insurer may also provide a guarantee on surrender charges that will not affect the principal, thereby allowing the contract owner to get back his entire initial premium.

Surrender Charges

Insurance companies vary in principal language to protect the insurer just as the guarantee of principal protects the contract owner. In most annuities, surrender charges are dissolved over a five to ten year period (ten percent free partial withdrawal not included). There may be an annual percentile decrease in surrender penalties, or the annuity may have a fixed surrender charge, such as the first six-months' interest.

The Bailout Clause or Escape Clause

The Bailout Clause or Escape Clause is another protection for the contract owner. Some insurers will waive surrender charges under certain circumstances (i.e., nursing home confinement, terminal illness diagnoses, and death of the annuitant). Also, the agreement between the insurer and the contract owner can allow for utilization of the Bailout Clause if the interest rate decreases below a certain level.

Advantages and Disadvantages of Annuity Investing

Advantages of Annuity Investing

An annuity provides more capabilities than any other type of investment available.

- An annuity is a safe vehicle for investment and can be easily monitored
- An annuity offers tax-deferred growth on earnings
- An annuity provides resources that can last as long as needed; and
- An annuity can offer a money-back guarantee.

Client Investment Protection

The fixed-rate annuity investment is unmatched by all investment standards. The annuitant cannot suffer a loss of principal, the interest rate is guaranteed, every dollar invested is guaranteed, there is no investment risk, and interest earned is guaranteed. The only time that the policy's value can go down is if there's a withdrawal.

Insurance Company Financial Power

Due to the sheer volume of insurance companies, they collectively own, manage or control more assets than all of the oil companies in the world combined and more assets than all the banks in the world combined.

It was the insurance companies that came to the rescue of the banking industry during the Great Depression, not the federal government.

Vital Performance

Though the interest rate guarantee depends on the annuity, fixed-rate annuities offer a specific and fully guaranteed rate of return for a specified period.

Insurance Company Reserves

By law, insurance companies are required to set aside reserves when a fixed-rate annuity is purchased. These reserves can be used for settling withdrawals and redeeming annuities, but cannot be used to pay any other unrelated annuity items (i.e., bad debts, overhead, claims). Since the insurance company's annuity portion of business represents their smallest source of revenue, other profit centers' money is used for this reserve fund.

The investor is protected by a legal reserve pool, which has mandatory membership for insurance companies in most states. The reserve pool's purpose is to carry out the liabilities and obligations due to the investor, should the primary insurer go out of business.

Insurance Company Ratings

As with any business, insurance companies have independent ratings. Even though annuities may have a perfect record of accomplishment, the Insurer's rating should also be taken into consideration. For a fixed-rate annuity, investors prefer an "A" or "A+" rating. For variable annuities, since earnings are not dependent upon the Insurer's solvency, the ratings are not so disconcerting. A.M. Best, the oldest rating company in the United States, rates companies in much the same manner as our public school system.

- A+ Superior rating
- A Excellent rating
- A- Excellent rating also
- B+ Very good
- B Good
- C+ Fairly good
- C Fair
- C- Fair

Other rating sources you should look at are Standard & Poor's and Moody's. In their review of the annuities market, Standard & Poor's maintains the belief that the life insurance industry, which offers annuity products, remains the strongest in the financial services sector. This view is based on the fact that the industry as a whole has a solid balance sheet.

Professional Management

The professional management team plays a vital role in the annuity field. Each member is a specialist in his or her field. These specialists are licensed, regulated by the federal government, and state insurance departments, highly skilled, and trained to focus on a specific segment of the marketplace. As with overall ratings, independent sources track the performance of annuities. Specialized publications such as The Wall Street Journal can provide excellent articles on annuities and annuity performances.

Options for Withdrawal

Both fixed-rate and Fixed Indexed Annuities provide withdrawal options; however, any withdrawal may be subject to a penalty or surrender charge. Most insurance companies permit annuity withdrawals of up to ten percent (usually based on the principal) per year without cost, penalty, or fees. When considering withdrawal options, consider that the restrictions applying to withdrawals will eventually disappear and that there is an estimated 75 percent of all people investing in annuities who never remove any money.

Guaranteed Death Benefit

Upon the death of the annuitant, the Fixed Indexed Annuity provides that the beneficiary will receive the greater of the principal plus any ongoing additions or the value of the account on the date of death. An older person desiring a high-income stream will find the Fixed Indexed Annuity guaranteed death benefit an ideal investment. It is based on the sum of all investments made by the owner or value on the date of death, whichever is greater.

The guaranteed death benefit will last until either:

- The annuitant terminates the contract;
- The annuitant annuitizes the investment;
- The annuitant dies; or
- The annuitant reaches a certain age, usually 75 or 80.

Decedent Probate

The value of an annuity will not be included when the gross estate is valued for probate purposes; therefore, all annuities avoid probate.

Disadvantages of Annuity Investing

What are the risks? The potential for long-term growth in an annuity is exceptional; however, as with any investment, caution and scrutiny should be utilized. The investment's potential is dependent upon the market.

IRS Penalties

Although there are very few disadvantages to investing in annuities, and most of them will never affect the client, there are a few to take note of:

- All annuities are subject to the IRS penalty, regardless of annuity type. Withdrawals made before the annuitant attaining the age of 59½ years are subject to a ten percent penalty. The exceptions to this rule are if the annuitant dies or becomes disabled, or takes a portion of the annuity's assets paid out as income regularly (annuitization).
- Monies accumulated are not tax-free; however, they can be deferred and can be indefinitely postponed. Taxes can be further deferred if:
- The surviving spouse remarries, or the surviving spouse is named as the annuitant, and their new spouse is a beneficiary.
- When both spouses die, the beneficiary would be able to postpone taxes for up to an additional five years.
- The tax liability will be the value of the annuity at the time of death minus the amount invested and then multiplied by the beneficiary's tax bracket percentage. The contract owner is wise to withdraw money from the annuity when in the lowest tax bracket.

IRS Penalties

Withdrawn funds of up to ten percent per year, after the first year, are not subject to penalty. The surrender charge applies only when amounts are withdrawn more than the free withdrawal privilege. The Insurer's penalty schedule should be investigated before purchasing an annuity, as terms vary.

Surrender charges are not applicable if the annuitant dies or becomes disabled, withdrawals are limited to those allowed under the free withdrawal privilege, systematic withdrawals of ten percent per year are made, or the penalty period has lapsed.

Rising Interest Rates

If an investor is "locked-in" to a fixed interest rate and the economy is experiencing a period of rising interest rates.

Inflation

Inflation may be the biggest threat to long-term investments. While a stock market crash may cause some temporary losses in stock investments, the market always fluctuates. If stocks are kept long enough, it is possible not only to regain the loss but also to make an eventual profit. Therefore, in the long term, the investment must keep pace with inflation.

Surrender Charges

Deposits to the contract are not subject to a "load" or "front-end fee." However, withdrawals may be subject to a contingent deferred sales charge (CDSC) and are assessed on a sliding scale. Charges are based on either the date of deposit or the date of the contract.

Fees for other options are charges imposed for some additional provisions in the annuity contract, such as a stepped-up death benefit, a guaranteed minimum income benefit, or long-term care insurance.

Annuitization/ AGE 59 ½

At age 59½, annuitization can be utilized, so that portions of the annuity's assets are paid out as income regularly. Only a portion of the amount withdrawn is subject to taxation; however, when a lump sum is taken, the entire growth and interest become subject to income taxes.

Annuities and Taxation

The Basics

A personal tax advisor should always be consulted, as insurance agents are not trained or qualified to provide tax advice. The understanding of basic annuity taxation only allows an agent to help people accumulate more money, not provide tax advice.

10% Excise Tax Penalty

Tax advantages are extended for retirement purposes by the government. Tax advantages are also extended to taxpayers who do not use the annuity for retirement. All interest withdrawn before the owner attains the age of 59½ is subject to a 10 percent excise tax penalty. However, the 10 percent excise penalty can be avoided under certain circumstances.

Taxpayer disability

- Distribution from a pre-8/14/82 annuity
- Death of owner (but the death of annuitant for annuities issued before 4/23/87)
- Payment from an immediate annuity where benefits commence within one year of purchase
- Payment from a structured settlement
- Substantially equal payments over the taxpayer's life expectancy

Exclusion

The annuitant will receive equal payments when and if the owner annuities (applies their annuity value toward a settlement option). Unlike withdrawals, the contract owner does not pay full taxes on the payments. An exclusion ratio is applied to each payment received, which stipulates that a percentage of each payment is considered a return of the owner's cost basis, and is tax-free. The balance, however, is taxable.

The exclusion ratio can be calculated by dividing the expected return by the total of all premiums paid into the contract.

Effective with all annuities-starting dates after 12/31/86, payments become fully taxable after the owner recovers the total of all premiums paid into a contract (determined by adding all dollars excluded from taxes). After the contract owner has lived beyond his life expectancy (as calculated when payments began), payments then become fully taxable.

Withdrawal

Depending upon the annuity purchased, withdrawals can be taxed in one of two ways. Before 8/14/82, annuities were structured with FIFO accounting (first in, first out), which allowed the principle to remain tax-free. On 8/14/82 and after that, annuity taxation changed to LIFO (last in, first out), which allowed for taxation on withdrawals since interest is withdrawn early. This is appealing to the customer since most are now paying taxes on interest even if they do not withdraw it.

Section 1035 (A) of the Internal Revenue Code (IRC)

Section 1035(a) of the Internal Revenue Code provides the ability to transfer money from one annuity to another annuity income tax-free. Note that such transfers should be reviewed carefully.

The Contract Owner may elect to perform any of the following:

- Assign the old annuity contract (if premiums are non-qualified) to the new insurance company;
- Exchange the entire annuity (cannot transfer some of the money);
- If loans are outstanding, repay loans before exchanging;
- Parties designated in the old contract as the owner, annuitant, and/or the beneficiary should again be identified in the new contract; and
- Customers should consult with their tax advisers before the exchange.

Annuity Taxation Basics

- Taxes are only paid when interest is withdrawn
- Just like the IRA, the 10% excise tax penalty exists under certain circumstances, such as when an individual is under 59½ years old
- The exclusion ratio allows clients to receive income partially income tax-free
- Section 1035(a) exchanges are a way to move annuity money income tax-free

For more information about annuity taxation, please contact Retire American today!

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