

Annuities (Simply) Explained

One of the most common complaints about annuities is that they are difficult to understand. Annuities are one of the safest forms of investments, and they don't have to be complicated.

What is an annuity?

In plain English, an annuity is a long-term contract between you and your insurance company. When you think about annuities, think security. An annuity enables you to grow funds on a tax-deferred basis for a later payout in the form of guaranteed income that you cannot outlive.

How do annuities work?

Insurance companies sell annuities. You either make one large or several smaller payments, and your funds grow tax-deferred at a fixed or variable rate, this is what's called the annuitization phase. An annuity also entitles your beneficiary to a death benefit which is either the value of your annuity or a guaranteed minimum, whichever is greater.

What type of annuities are there?

There are several annuity categories:

Deferred annuity: A deferred annuity grows, tax-deferred, until the contract is put into a payment stream or paid out as a lump sum. All deferred annuities have one common characteristic: they offer tax-deferred growth. You will not pay taxes until you withdraw money from your contract.

A deferred annuity will earn interest on:

- Principal
- Interest
- Unpaid taxes

Immediate annuity: If you want payments right away, you should consider an immediate annuity. An immediate annuity can guarantee payments for a lifetime or a specified time period. The primary differentiator of an immediate annuity is its ability to distribute savings with a tax-deferred growth factor. Immediate annuities are routinely used to convert accumulated savings into an income stream during retirement.

Fixed annuity: A fixed annuity guarantees returns for periods ranging from one year to ten years. For example, a fixed annuity might guarantee that the interest rate on your investment accumulating in your policy will be at least 4.25%.

A fixed annuity is designed to protect you from market fluctuations. The drawback is that they don't offer substantial growth potential. If you want growth with the stability of a fixed annuity, you might consider a fixed index annuity.

Variable annuity: Unlike a fixed annuity, a variable annuity includes fluctuating interest rates. As a result, your income payments will be variable. There is a possibility for growth and loss with a variable annuity. Both fixed and variable annuities are tax-deferred on your interest until you begin to draw money from the contract. The most significant weakness of a variable annuity is that it can lose money as a result of market declines.

Is an annuity a safe investment?

History shows that annuities have been an extremely safe investment. Annuities are designed by insurance companies to be guaranteed income streams for retirees. An annuity is an investment vehicle to protect your life-savings from volatility. The closer you are to retirement, needing the money, the less tolerance you have for the inherent market ups and downs of equity investing. Even conservative investments in the stock market are highly volatile.

Before you invest in an annuity take the following steps:

- Go with the large well-organized insurance companies. Small insurance companies are more likely to run into problems than big ones.
- Even though there are hundreds of insurance companies to choose from, you should focus on those with a long history. National Life Group, for example, has been in business for 168 years.
- Research ratings - Only consider the highest rated large insurance companies.

These financial rating services rank insurance companies based on financial strength and stability, consult them before you make a decision:

Standard & Poor's (www.standardandpoors.com)
800-523-4534

Fitch Ratings (www.fitchratings.com)
800-893-4824

Moody's Investor Service, Inc. (www.moodys.com)
212-553-0377

Weiss Ratings (www.weissratings.com)
877-934-7778

A.M. Best Co. (www.ambest.com)
908-439-2200

If you are looking for a product to provide you with income for as long as you live, an annuity is a reliable investment option.

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