A Simple Guide to Understanding Annuities

What is an Annuity & why should I use it in my financial planning?

An annuity is an insurance product that operates long-term, providing regular payments at set intervals. It's a way to gain guaranteed income and is often a supplement to retirement funds.

When you have an annuity set up, you have money growing tax-free. Combining an annuity with a 401k or an IRA can create a buffer to meet short-term expenses.

An annuity will allow you to let the money grow, preparing for years in advance like retirement, and you won't have to pay taxes until you take the funds out. Alternatively, all annuities can also pass on to your beneficiary if you aren't able to enjoy the full benefits.

Setting up an annuity can provide added security or extra income to make your retirement years comfortable. Data shows us that people live longer, and thus, more resources are needed to fill the gap left by other retirement funds. Another source of money can help pay for essential expenses.

Unlike other retirement products, annuities come with more flexibility. There are no annual contribution limits to it compared to the IRA. You also have the freedom to structure it depending on your preferences. All in all, it's a great addition that can further enhance your financial preparations.

What are the benefits of Annuities?

One of the advantages of annuities is that they are treated more favorably in regards to taxes. If you use the money you've paid taxes on to buy it, only earnings have tax during the withdrawal.

Apart from that, annuities have different customizations attached to them through riders. These are provisions that change a contract, adding a more personal touch.

These do come with additional fees if you opt for them, but most of them will provide benefits that can transform the annuity to match your needs.

The annuity is a predictable long-term income stream that can help during the retirement years. You won't have to worry about outliving the money you've saved, giving you more freedom and peace during your later years.

Choosing one will depend on your desired outcome and your current financial situation.

There are many other benefits that contribute to the reasons people buy annuities. The most notable are outlined on the next page:

- **Tax-deferred**: The annuity will grow with interest, and you don't have to pay taxes until later.
- **No limits**: Unlike the 401k or IRA, you can build your annuity without limiting the contribution.
- **Alternative retirement fund**: The annuity can act as a primary source of income for retirement. It can also supplement or become part of a portfolio that aims to provide during retirement years.

Free Look Period

Most states require insurance companies to provide free look periods. It is a set time where a buyer can test the annuity to see if it works for them or not. If they do not want to continue with it, they can cancel it without paying extra fees. Normally, insurance companies have a surrender charge and a fee you need to pay to get out of the annuity.

Death Benefit

The death benefit is another reason why people opt for annuities. If a person defers it and accumulates money, they can enjoy it later. However, if they aren't able to reach that point or they pass away without withdrawing the amount, it's not the end.
The annuity passes on to the family, allowing them to continue gaining the benefits.

You can set up the annuity to transfer in the event of death. Choosing which family member inherits the benefit will be up to the buyer.

What are the different types of Annuities?

There are four main types of annuities:

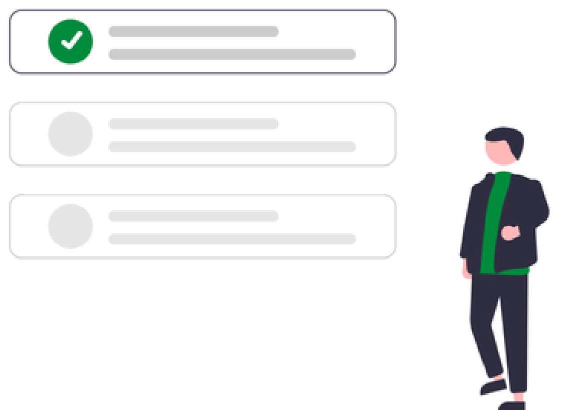
- Variable
- Fixed
- Fixed Indexed
- MYGA

There are different classifications for them, but they fall under these four categories.

Each differs depending on what growth plan you want it to have and your desired timeframe for payments.

You can get returns right away, use interest rates to grow it, etc.

Let's take a look at each type...



Variable

A variable annuity is considered the investment that has the highest upside. You can place the money you invested into an account that can grow. For example, you can put it in a sub-account that can act similar to a 401k. The upside of market growth plus the annuity contract guarantee appeals to many investors.

Over time, your accounts will grow in value faster, and some can even outperform inflation. It all depends on how the market performs during your investment. There is risk involved, as a volatile market can go up and down. The good news is that income can be guaranteed, and you can pass that guarantee to the next generation.

The only caveat is that you can only invest the variable annuity in a preselected group of mutual funds. The insurance company will provide you with the details, and you'll select one, which you feel is best for your goals.

Most people want to go into a variable annuity if they've already maxed out similar options. For example, if you've maxed your contributions to your Roth IRA, it can be an alternative to place your extra money.

The unique thing about variable annuities is that no other product comes close to its offering. It's a combination of several products that balance risk and safety. However, you'll need to be careful with decisions before entering into one. Most of those who blindly get a variable annuity without prior knowledge regret their decision in the long run.

Fixed

Unlike the variable annuity, the fixed annuity has a simple structure. You get a fixed interest rate, which guarantees that your investment will yield many returns over its contract period. It can vary, as some rates will last throughout the length of the contract while others will only accrue for a set number of years. There is less risk with a fixed annuity as you won't have to deal with the market's ups and downs.

You'll know what you'll get each month, no more and no less. While you will not be able to get the upside of market swings, it protects you from the downturns.

When you finish the contract, you can renew it, transfer the money elsewhere, or set up an annuity that begins to pay its returns to you. Many people use it to grow their money as they continue to accumulate funds for their eventual retirement. That means that many opt for fixed annuities when they have more time to grow.

Fixed annuities are commonplace among those close to retirement. At that age, they want most of their money in more conservative vehicles to avoid the risk of a market downturn.

Since there is little time available before they start using the money, it's ideal to have it grow a bit with as little risk as possible. Another option is to have a fixed annuity mixed with other financial vehicles fulfilling specific goals.

Speak to an Agent

Fixed Indexed

A fixed indexed annuity provides more growth potential than a fixed one while also having little to no risk than a variable annuity. It's because the annuity ties to the performance of a specific index. For example, you can set your plan to invest in the S&P 500 or the Nasdaq. These indexes mitigate risk by design because you invest in multiple companies instead of one.

While your money is in the annuity, it is never directly exposed to the stock market, so you'll never receive anything lower than the original deposit in a negative performance. It is your potential earnings that could be affected by a negative performance.

The only downside of this protection is that there is likely a cap on the upswing. You cannot maximize your returns during the big market moves as an offset to the premium protection. It's more of a middle ground for those who are averse to risk but still want a bit of upside.

Again, it all depends on what the insurance company offers. It is possible to mix a fixed interest rate with index performance to find a middle ground that works best in the returns you seek.

Like other annuities, it is tax-deferred and a plan that can provide income during your lifetime. You can also pass it to beneficiaries. For example, it may reward you at the end of a year. Some carriers also allow you to get earnings during index highs.

MYGA

MYGA is short for multi-year guaranteed annuities. Other annuity types depend on the performance of a specific instrument. The MYGA provides a guarantee of accumulating interest in a set period. Once you get a plan like this, the contract will determine how much you'll gain each year.

Many people opt for this as it has more potential than lower-risk investments like a certificate of deposit (CD).

These types of annuities require that you pay a lump-sum premium. You have a guaranteed fixed interest rate that lasts anywhere from 3-10 years. The difference between this and the CD is that it comes from an insurance company rather than a bank.

A common reason why some people choose the MYGA over the fixed annuity is that there can be contract changes that could lower the returns you get later. You might get into a 10-year plan in a fixed annuity at a high percentage of 4%.

However, the conditions of the fixed annuity describe how interest may change five years into the plan. It could go down to 2 or 3%.

With a MYGA, the rate will not rise or fall for any reason. It does not matter if rates change in different industries or markets crash. This assurance is one of the reasons MYGA plans are popular. Instead of getting a 4% interest plan that fluctuates every four years, a MYGA can guarantee that rate for the entire duration.

Optional and extra Annuity benefits

While it isn't a standard part of annuity contracts, it is possible to add extra benefits, aligning it closer to your preferences. Some insurance companies may also offer them as add-ons to your initial agreement.

Remember that these additions may mean extra charges or fees that affect your earnings.

Optional Riders:

The common term for these add-ons is annuity riders. They are provisions added to ensure the annuity meets your needs. The most common added riders are the death benefits and guarantees.

Some companies include them as part of the plan, while you may have to ask them to be for others. Here are some of the most popular optional riders:

Speak to an Agent

LIBR/GILR

The LIBR or Lifetime Income Benefit Rider is a way for you to enhance the annuity by lengthening the contract period to a lifetime. With this rider, you have more control over your money and can choose a rate that works best. You can also share the annuity with your spouse for their additional income.

Rather than annuitized payments, the LIBR takes income from the annuity without letting go of the retirement assets. The insurance company will make the computations and let you know how much you'll get at each cycle.

For example, you can get a compounding rate of 6% as a part of LIBR, which lasts from 10 years. You can renew the contract and increase it for another 20 years. Most of these riders allow you to continuously refresh the agreement until it passes to the next generation.

Remember that the insurance company still controls what you get from the LIBR. They may charge a rider fee and place restrictions on the agreement as they see fit. Read the fine print before finalizing your decision.

Also, note that some companies may term this rider as GILR or Guaranteed Income Lifetime Rider. Both operate in the same manner.

Nursing Home Rider

The nursing home rider or long-term care rider is a benefit that helps you with any expenses you'll need later in life. It takes money directly from the death benefit monthly to pay for a nursing home, or medical care.

However, these riders are only allowed if
the one with the annuity has trouble performing at least two of their daily tasks. A medical professional will verify this before the insurance company allows it.

You'll often see this rider attached due to terminal illnesses or long-term diseases. Cognitive impairment issues like Alzheimer's count for the benefit. It is an expensive add-on compared to the others but maybe worth it if you foresee some medical expenses later in life.

Some use these long-term care riders to act as a supplement to other health insurance they may have. For example, you can use it in conjunction with Medicare and Medicaid. Some people only have the annuity as an option because of health insurance troubles.

Remember that it takes from the death benefit. Beneficiaries may receive less than what you're getting because part of the money is going into long-term care. The insurance company may also place a cap on it as they see fit.

Rate Boosters

A rate booster increases the earning potential of your annuity. As the name implies, it can improve the return rates, meaning you get more from growth (an increase in interest). It also allows you to move funds or relocate them. These rate boosters often connect to a fixed index annuity.

For example, you may have several annuities, and some do not have any increase in return rates. You can move funds in and out of them. Those with boosted rates may experience higher volatility but more potential. You can then keep some of your investment in a safer environment if you're looking for short-term returns.

The additional fee for getting a booster will depend on the company. Some will charge a 1% deduction of your accumulated value.

Rates also tend to change throughout the year. It depends on the market performance and what the company set during that period.

Annuity Niche-Inherited IRAs

Inherited IRAs can occur from all types of plans. It can come from the deceased's 401k, Roth, Simple, and even SEP-IRA. In the provision, the assets held within passes on to a beneficiary. You can set up this agreement with a bank, though the fastest option is to use the firm that also created the IRA of the deceased.

The designation is vital, and details of the deceased plus the beneficiary should be present. The document will only honor what's written on the paper even if the previous owner suddenly chooses someone else before their passing.

Once someone receives an IRA, there are several options to take. You can take the inheritance as a lump sum though this might incur significant taxes. Another option is to withdraw in portions until you get everything. Here are some other ways a person may set up their payouts from annuities:

- **Stretch distribution**: Stretching the payments over the remaining duration of the annuity
- **Five-year payments**: Instead of an expensive lump sum, the inheritor can withdraw a lump sum, five years' worth of returns. That way, they can avoid the high taxes on the benefit.
- **Annuitized Payments**: You set the schedule on how payment should come to you. However, once you set this, you cannot change it.

As an inheritor, they must take distributions from the account and cannot withhold them. The amount you get will either be similar to the deceased or a new computation based on current life expectancy.

The 10-Year Rule

Inherited IRAs do not have a lifetime guarantee like the previous owner had. The IRA imposes a strict 10-year limit for all inheritors. When they get the IRA, they must withdraw all the amount within the limit. If not, they could incur significant penalties.

The penalty imposed by the IRA is a penalty equal to 50% of the amount still left in the account. The fee ensures that the person with the inheritance is still withdrawing payments. Since most of these accounts are tax-deferred, it makes sense that the IRA would push for withdrawals to pay taxes.

One strategy to take with the 10-year limit, is to defer the account until the limit. Let it grow and gain more money and withdraw it before any penalty incurs. By doing this, the extra money can offset the taxes that the inheritor must pay. Again, it's all dependent on their preference for withdrawing the money.

There are a few exceptions to the 10-year rule for disabled or chronically ill patients, those who are only a decade younger (or less) than the deceased, or for children. For children specifically, the 10-year rule will apply when they reach the age of majority.

Spouses also have some exceptions to the 10-year rule, as they can roll over the IRA into their own IRA so long as they do so within 60 days of inheriting the IRA account.

Who can help me select the right annuity for my goals?

Most of the discussion in previous pages cover the basics of annuities. However, it can still get confusing and complicated if you try to deal with them yourself. Instead of risking a mistake that could set you back, use professionals to help you. A team from How Annuities Work can help you select the right plan that fits your financial goals.

With experts on your side, you have professional advice that can help you throughout all stages of the annuity. You'll know what to do during accumulation and withdrawal. If you inherited one, we'll help you strategize payment, so you maximize your returns.

Law requires that all professionals who deal with annuities have certifications. The documents verify that we understand all the legalities involved in these contracts. Not only can we help you make the best decision, but our skills also provide the following benefits:

- Manage your portfolio to tune it to the risk and exposure you desire
- Research the best plans and opportunities that aligns with your financial goals
- Create an investment strategy that can set you up from the short-term to your retirement
- Analyze risk in all your investments and manage them
- Be a reliable consultant when deciding between the different financial vehicles available

Remember that annuities are only a part of a larger financial plan. They act as a supplement to your retirement income. We can help you decide on where to use the payments you get. It can be for that extra income or to cover short-term expenses.

Annuities will affect you for the rest of your life, so you have to be sure you are choosing the right one. Gain confidence and analyze the outcome of your decisions with the help of our team. We've helped thousands of people find the right plan they'll enjoy later in life.

Speak to an Agent

Visit our website