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Annuities and their many versions

An annuity is nothing new. They have been available for many years and are complex. An annuity is a contract between you and an insurance company. They are designed to meet long-term goals, such as retirement.

You buy or obtain an annuity by making either a single payment or a series of payments called the accumulation phase. Payout may come either as one lump sum payment or a series of payments over time, called the payout or income phase.

The annuity is only as good as the claims-paying ability of the insurance company to honor the contract that may run for many years.

It usually has three parts: the owner of the contract, the annuitant, and the beneficiary in case the annuitant dies.

Depending on the account of the owner, annuities can be held in accounts such as an IRA, individual name, joint name, trust, etc.

Annuities can handle a broad range of financial needs. They are not one-size-fits-all. You should establish your goals and then select the strategies that best fit those goals.

The following is a brief and incomplete look at the overall concept of annuities. They have many moving parts and can become complex and complicated. The basic contract may have riders attached. Let’s begin.

Fixed annuities. Fixed annuities are designed as savings vehicles, similar to a CD, and are built for safety of principal and a consistent, guaranteed return, rather than assuming risk to obtain a possible higher rate of return.

Fixed annuities offer a guaranteed minimum interest rate and tax-deferred accumulation. They can also be annuitized or converted into a series of periodic income payments for a specified period of time or for life.

Income annuities. Income annuities offer a way to generate reliable income to fund your needs. They can convert an asset that is subject to market risk into reliable income. In doing so, you transfer market risk and the risk of outliving retirement income to the issuing insurance company.

The income annuity concept can frequently be added as a rider that is attached to other annuity contracts, usually for a fee.

Variable annuities. Variable annuities are tax-deferred investment vehicles that may have the option of an income rider provided by the issuing insurance company.

The variable annuity returns are based on the performance of the underlying securities, usually mutual funds. They offer an array of securities and strategies that the annuity holder can choose from and make adjustments to, within the limitations of the contract. In exchange for potentially higher returns, variable annuities do not typically offer downside protection.

Index annuities. Index annuities are principal-protected contracts that do not offer a predetermined rate of growth or income. Instead, the growth rate is determined by the performance of an underlying index, such as the S&P 500 Index, EAFE Index, Real Estate Index, etc over a period of time.

Generally, if the index is positive for the time period, such as one year, the account value will be credited. The amount it grows could be based on a participation percentage, such as 50%, or a predetermined maximum amount, such as 5%, called the cap. If the index is negative, the account value simply stays flat for that time period.

Any growth is tax-deferred and additional riders can usually be purchased to help owners meet their goals.

Structured annuities. Structured annuities are designed to provide potentially higher returns in exchange for potential principal loss tied to an Index. For example, if the index declines 10%, the contract provides for no loss. If the loss is greater than 10%, it is the owner's loss.

Investors can select from a variety of "segments" within each contract. Each segment provides a unique combination of market exposure and downside protection. At the end of the segment, the account value will increase or decrease depending on the index performance and the level of protection.

Specialty annuities. Many annuities are used for retirement income, but specialty annuities are used for other needs. They include Medicaid planning, pension plan termination, selling a business, providing compensation for an injury or wrongful death claim, and other situations.

Riders. There are many riders available that can be added to an annuity, usually for a fee. You may want an income rider, long-term-care rider, a death benefit rider, etc. Check with your financial advisor who can guide you through the many rider options.

Bonuses. You deposit money and the insurance company adds their money, such as 5%. They frequently lengthen the surrender time, may increase the surrender percentage, or add other charges. If you liquidate, normally you do not get their bonus money.

Fees and charges. Depending on the contract, there may be fees and charges. For instance, there may be fees for mortality and expense, administrative, underlying fund expense, fee for a rider, a surrender charge, annual charge, and more.

As you can see, this is a complicated topic. Carefully study the many options. Once you buy the annuity, you have a short time to review the contract. Later on, you may be able to surrender all or part of the contract or even exchange it for another, but there may be surrender and other charges.

Ask your financial advisor for the rating of the insurance company you may be considering. Get help and buy it right the first time.

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