Annuities Made Simple

A 101 guide provided by Annuity.org

This guide helps you determine if an annuity may be right for you, and then choose annuity products, compare rates and understand their role in securing retirement income.

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What Is An Annuity?

An annuity is a financial product issued by an insurance company that allows you to grow your money tax-deferred and receive income in the future. You purchase an annuity with an initial premium or series of premium payments; in return, the insurance company provides interest credits to grow your value. The contract includes a surrender charge period and other provisions defining when and how to access your funds. Over time, you can take income payments through annuitization or optional income riders or withdraw funds as a lump sum, depending on your needs.

Key Benefits of Annuities

- Accumulation Potential: Growth via a fixed rate, potential indexed interest, or variable options.
- Tax Deferral Growth: Interest or gains can grow without immediate taxation.
- Guaranteed Lifetime Income: You won’t outlive your savings.
- Avoids Probate: Allows for direct beneficiary designation to bypass probate.
- Market Protection Opportunity: Some annuities protect all of your principal from market downturns, while others offer more significant potential in exchange for market risk.

Types of Annuities

For many Americans, securing a stable retirement means ensuring they won't outlive their savings. One way to help you achieve this is by using a portion of retirement assets to purchase an annuity. Unlike traditional investments, annuities provide a unique combination of protection, guaranteed income, and tax advantages that can help create financial stability throughout retirement.

With different types of annuities available, it's important to understand how they work and which may be best suited to your goals. Whether you're looking for immediate income, long-term growth, or market-linked potential with downside protection, annuities offer flexible solutions to help safeguard your financial future. Here's a quick breakdown of the most common types of annuities and how they can fit into your retirement plan.

Immediate Annuities: Start paying income within a year of purchase.
Fixed Annuities: Offer a guaranteed interest rate.
Fixed Index Annuities: Potential for interest linked to a financial index (subject to limits) with downside protection
Registered Index-Linked Annuity (RILA): Potential interest tied to a financial index (subject to limits) with limited downside risk and higher growth potential than fixed index annuities.
Variable Annuities: Returns depend on market performance with risk to principal.

Common Annuity Myths

Annuities Are Bad

Contrary to some media coverage, annuities are a viable option for many retirees to help save for and create income in retirement. They are issued by insurance carriers and are distributed by insurance agencies and licensed insurance agents within banks and brokerage firms. They are regulated by state insurance departments, and also by the Financial Industry Regulatory Authority (FINRA), for variable and RILA contracts.

Annuities Have Hidden Fees That Make Them a Bad Deal

As with all financial products, annuities do come with some costs and fees. Some of the common annuity fees include:

- Surrender charges: Surrender charges may apply if you withdraw funds before the surrender penalty period, usually between five to 10 years. The surrender charge period is determined at purchase, depending on the carrier and product selected.
- Administrative fees: These fees are usually a flat amount or a percentage of your account value and are charged for managing your annuity.
- Agent commissions: Annuities generally involve agent commissions that typically range from 1% to 8%. However, traditionally, these commissions are paid by the insurance carrier to the agent, and they do not come out of your account value.
- Investment fees: Variable annuities may be subject to investment fees between 0.6% and over 3% to help pay for managing the investments in your account.
- Mortality and expense (M&E) risk fees: These fees are typically about 1.25% each year and are intended to cover the insurance company's risk of you selling the annuity.
- Optional Rider Fees: Depending on the product purchased, optional riders may be available for a fee. Those could include a higher premium bonus, a lifetime income benefit rider (LIBR), or long-term care benefits for example. These fees could range from 0.50% to 1.50% per rider selected.

You Lose Access To Your Money Forever

Even though annuities are long-term vehicles, you may still access some of your funds. Fortunately, most annuities include a penalty-free withdrawal, typically 10% per year, allowing you to pull money from your account before the surrender penalty period ends without incurring any fees. As soon as your annuity is past the surrender period (usually five to 10 years), you may access the full value of your account and won't have to worry about any penalties. In addition, you may choose a payout option that allows you to collect income for life. Annuity withdrawals are taxed as ordinary income, and may incur an additional 10% IRS penalty if taken before age 59-1/2.

Annuity Payments Don't Keep Up With Inflation

Inflation is significant to consider when you plan for your retirement income. Often, as an electable feature on a contract for an additional fee, some annuities allow your income payments to increase to help keep up with inflation. This feature typically uses the Consumer Price Index (CPI) as a benchmark to establish increased income to help protect you from the rising prices for goods and services. Note that these features usually come with a cap, the maximum annual growth rate allowed.

Insurance Companies Can Go Bankrupt, and You Lose Everything

Insurance companies are highly regulated financial institutions, designed with safeguards to help ensure policyholder protection. They are required to maintain strong financial reserves and adhere to strict solvency regulations set by state insurance departments. Insurance companies must hold enough assets to cover future claims.

Annuities Are Only For Retirees

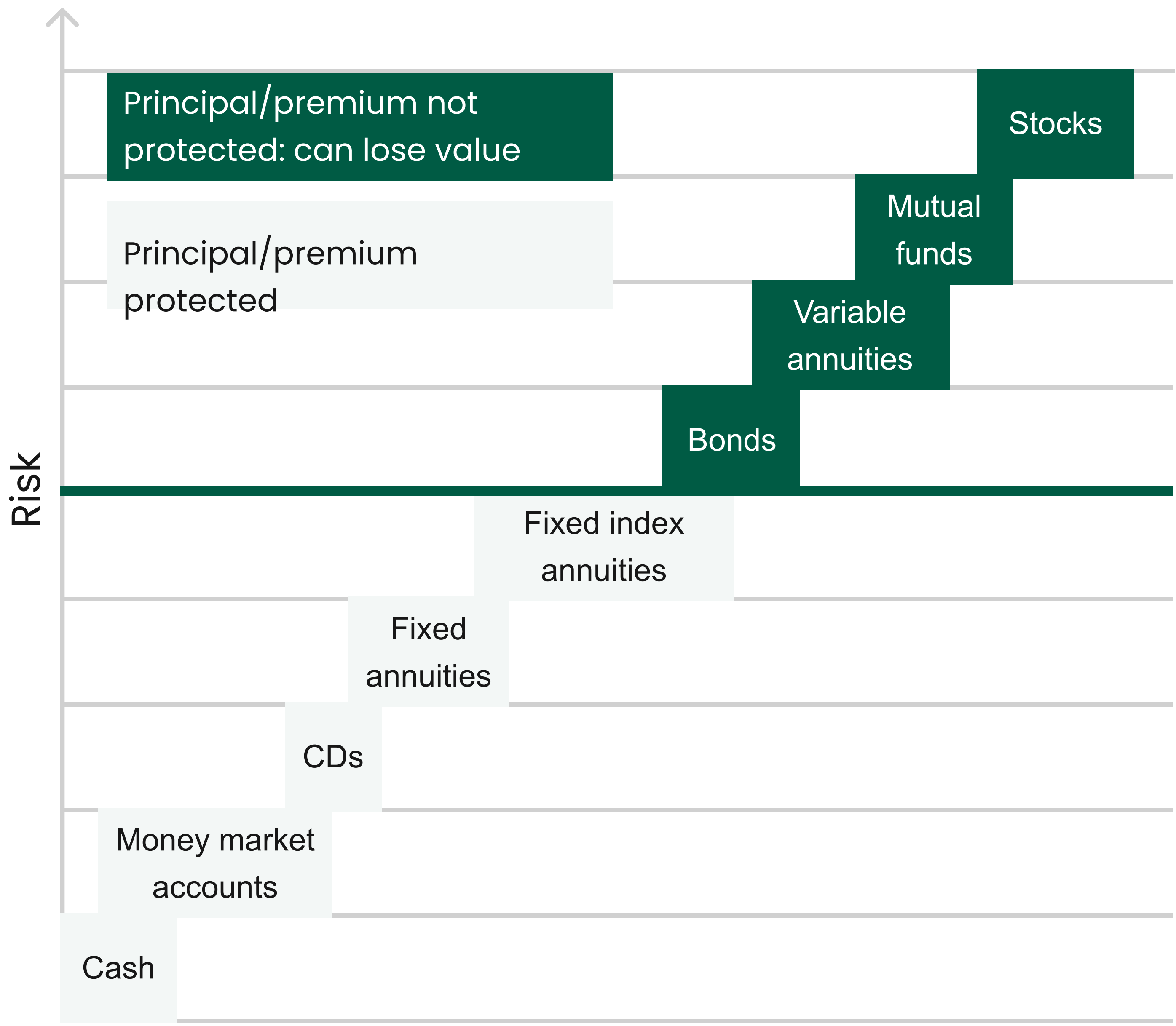
While many people associate annuities with retirees, these financial products can also be worthwhile for younger individuals and those still in their working years, as they may benefit from deferred payouts or the guarantees and protection they can provide to your principal. Also, remember that the earlier you open an annuity, the more you can take advantage of tax-deferred growth. Annuities may be a smart way to help diversify your retirement savings depending on your unique situation.

Comparing Annuity Products

Feature	Fixed Annuity	Fixed Index Annuity	Registered Index-Linked Annuity	Variable Annuity
Risk Level	Low	Low-Moderate	Moderate	High
Growth Potential	Fixed interest	Index-Linked interest potential	Index-Linked interest potential	Market-Dependent
Downside Protection	Yes	Yes	Partial	No
Tax-Deferred Growth	Yes	Yes	Yes	Yes
Guaranteed Income	Yes	Yes & Optional Riders	Yes & Optional Riders	Yes & Optional Riders

Fixed annuities offer lower-risk, guaranteed interest and income, making them a potentially appropriate choice for stability. Fixed index annuities offer the potential for interest tied to an external index, subject to limits, while never being invested in the market or exposed to market losses, while registered index-linked annuities (RILAs) offer higher growth potential but only partial protection. Variable annuities carry the highest risk, with returns tied to market performance and no downside protection. All annuities allow for tax-deferred growth, and guaranteed income options may be available through optional riders.

Annuity Risk Spectrum



The Annuity Risk Spectrum highlights the range of financial products from low-risk, principal-protected options like cash, CDs, and fixed annuities to higher-risk investments like variable annuities, mutual funds, and stocks, where principal is not protected. Fixed and fixed index annuities offer a balance between protection and growth potential, while variable annuities and stocks provide higher return potential but come with greater risk. Understanding this spectrum helps investors align their choices with their risk tolerance and financial goals.

Annuity Growth Options

Annuities can be an important part of a retirement plan, but understanding how they earn interest.

Fixed Annuities

- Provide a guaranteed interest rate for a set period of time. Typically, longer terms provide better rates.

To see the currently available fixed rates, check our live rates page, which is updated daily.

Fixed Index Annuities

- Interest is calculated (usually annually) based on changes to an external market index such as the S&P 500, subject to limits set by the issuing company. These annuities offer a guaranteed interest rate, usually 0%, in down market years, to ensure you don't lose principal due to market losses.
- Principal isn't lost if the index goes down, although caps and participation rates limit upside.
- Potentially yield more interest than fixed annuities but they are never invested in the market.
- Cap rates vary by the product and issuing company selected and may change at the issuing company's discretion.

Learn more about caps and participation rates, known as "indexing methods."

Past Performance Statistics One-Year Indexed Term 01/25/1965 - 12/26/2023

PERFORMANCE	INDEXED TERMS
Best	10.25%
Average	6.37%
Worst	0%

FREQUENCY OF RETURNS	INDEXED TERMS
Positive	73.6%
Zero	26.4%
Negative	0%

Source: iCapital, as of Dec. 26, 2023. Assumes a five-year surrender charge period and a minimal initial premium of $25,000. For illustrative purposes only. Past performance is not indicative of future results.

Comparisons to Other Investment Vehicles

- CDs: Offer guaranteed interest and FDIC insurance (up to limits), usually at lower rates than annuities of similar duration.
- Bonds: Provide income and return of principal if held to maturity, but can pay less than annuities, and market value may fluctuate with interest rate changes.
- Stock Market (Mutual Funds/ETFs): Historically higher returns but with greater risk and volatility. Annuities can't match peak equity gains but do protect against downside losses.

In short, fixed and fixed index annuities can deliver steadier, more predictable returns than many alternatives, particularly for those prioritizing capital preservation. However, carefully compare features, guarantees, potential returns, and liquidity before deciding which product best fits your financial goals.

Choosing the Right Annuity

Consider Your Goals

Are you looking for immediate income, future growth, or market-linked potential?

Choosing which annuity will best help you achieve your goals is a matter of determining those goals and then shopping around and doing research.

If your goal is to pay your retirement expenses and not run out of money, you may want to consider an annuity with an income rider. If you're concerned about keeping up with inflation, investigate adding an inflation rider or, perhaps, purchasing a fixed index annuity, which has more potential for growth.

Evaluate Fees & Features

People are often unaware of or confused about the fees associated with different annuities. An experienced financial professional can help you select the correct type of annuity for your particular needs and answer your questions about its features and fees. Some features may come built into the products, whereas others may be available as an optional rider for an additional cost.

Compare Insurers

Because insurance companies sell annuities, they're not backed by the FDIC like a CD or other bank accounts. Instead, they are supported by the companies' financial strength and claims-paying ability.

For this reason, checking the company's ratings from agencies such as AM Best, Moody's, Fitch, and S&P is important to ensure you're buying from a financially sound provider. Additionally, their ability to provide proper and timely service to their licensed agents and customers is also essential to consider. Various customer satisfaction surveys and research companies publish information like this.

Independent insurance agents work with many of the top companies in the industry, some familiar names and some you may not have heard of before. Remember that each insurance carrier's branding and marketing strategy may not make them a household name to some, but that doesn't mean they are not strong, financially credible, reputable companies.

Purchasing an Annuity: Working with a Licensed Annuity Agent

When you're ready to explore annuities more seriously, knowing how an experienced insurance professional should guide you is helpful. Here are some key steps and considerations:

1. Initial Conversation & Goal Setting: A good insurance agent starts by understanding your financial goals, retirement timeline, and risk tolerance. This helps ensure any recommendation aligns with your unique needs.
2. Education & Transparency: They'll explain annuity types (fixed, fixed index, variable, immediate, deferred) and key features like surrender charges, fees, and payout options. To avoid surprises, you're encouraged to ask about costs and the insurer's financial strength.

3. Best Interest: A licensed insurance agent must recommend annuity products that are in your best interest to help protect against generic "one-size-fits-all" pitches.
4. Product Recommendations & Options: Once you understand annuities, the agent should present tailored options, outlining benefits, potential rates, riders and drawbacks. Comparing options lets you make an informed decision.
5. Purchasing & Ongoing Support: If you choose an annuity, the agent handles paperwork and helps to ensure that the annuity is appropriate for you. Periodic reviews will help confirm your annuity continues to meet your evolving financial goals.

Buying an annuity should fit into your broader retirement plan—never feel rushed or hesitant to seek a second opinion. Annuity.org has a network of vetted, licensed annuity agents ready to guide you, to help insurance transparency and alignment with your long-term objectives.

Get a Free Quote

Visit Annuity.org to explore your annuity options and help secure guaranteed income for life.

Secure Your Future Today!