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# WHAT ARE ANNUITIES?

An annuity is an insurance product that offers a stream of deferred fixed income to individuals seeking the security of guaranteed income for life. Although annuities generate income — and some annuities offer growth potential — they are not suitable for short-term investment strategies. These products appeal to people whose goals include long-term financial security, retirement income, diversification, and bottom line preservation.

Annuities can be optimized for long-term income or growth, but they are not short-term investment strategies. People seeking long-term financial security, retirement income, diversification, and preservation of capital find these products attractive.

## How do annuities work?

* Annuities turn a one-time payment into a stream of income that you will earn until the day you die. Many retirees require extra than Social Security and investment funds to live comfortably. Meet their daily needs.
* Annuities are intended to provide. This income is obtained through a process of accumulation and annuitization, or, in the case of immediate annuities, by the insurance company guaranteeing lifelong payments. Beginning the month of purchase, without the need for an accumulation phase.
* Basically, when you buy a deferred annuity, you pay a premium to the insurance company. That initial investment will grow tax-deferred during the accumulation phase, typically between ten and thirty years, depending on the terms of your contract. Once the annuitization or distribution phase begins—again, depending on the terms of your contract—you will begin to receive on a regular basis.
* Annuity contracts transmit all the risk of a falling market to the insurance company. This means that you, the annuity owner, are protected against market and longevity risk—the risk that your life will outlast your money.
* Insurance businesses price expenses for funding management, settlement riders, and different administrative offerings to offset this risk. Also, most annuity contracts include surrender periods during which the contract holder cannot withdraw money from the annuity without incurring a surrender charge.

## Features of annuities

In general, annuities have the subsequent features:

* Tax deferral on funding earnings: Many investments are taxed 12 months through 12 months; however, the funding earnings—capitals profits and funding income—in annuities are not taxable till the investor withdraws cash. This tax deferral is likewise real to 401(k) s and IRAs; however, not like those products, there aren't any limits on the quantity possible placed into an annuity. Moreover, the minimal withdrawal necessities for annuities are a great deal extra liberal than they may be for 401(k)s and IRAs.
* Protection from lenders People who very own a direct annuity (that is, who're receiving cash from a coverage agency) are afforded a few safety from lenders. Generally, the maximum that lenders can get entry to is the bills as they may be made because the cash the annuity proprietor gave the coverage agency now belongs to the agency. Some country statutes and courtroom docket selections additionally defend a few or all the bills from one's annuities.
* An array of funding options. Many annuity businesses provide a number of funding options. For example, people can spend money on a hard and fast annuity that credits an exact hobby rate, much like a financial institution's Certificate of Deposit (CD). If they purchase a variable annuity, their cash may be invested in stocks, bonds, or mutual price range. In latest years, annuity businesses have created numerous kinds of "floors" that restrict the volume of funding decline from a growing reference point.
* Tax-free transfers amongst funding options. In the assessment of mutual price range and different investments made with after-tax cash, with annuities, there aren't any tax outcomes if proprietors alternate how their price range is invested. This may be especially precious if they may use an approach called "rebalancing," which is suggested by many monetary advisors. Under rebalancing, traders shift their investments periodically to go back to the proportions that constitute the risk/go back mixture maximum suitable for the investor's situation.
* Lifetime income. An on-the-spot lifetime annuity converts funding right into a move of bills that are closing till the annuity proprietor dies. In concept, the bills come from three "pockets": The unique funding, funding earnings, and cash from a pool of human beings with inside the investor's organization who do now no longer stay so long as actuarial tables forecast. The pooling is precise to annuities, and it is what permits annuity businesses in order to ensure an entire life income.
* Benefits to heirs. There is a not unusual place apprehension that if a character begins offevolved a direct lifetime annuity and dies quickly after that, the coverage agency maintains all the funding with inside the annuity. To save you this situation, people should buy an "assured length" with a direct annuity. An assured length commits the coverage agency to maintain bills after the proprietor dies to 1 or certain extra beneficiaries; the bills maintain to the stop of the said assured length—typically 10 or 20 years (measured from while the proprietor commenced receiving the annuity bills). Moreover, annuity advantages that skip to beneficiaries do not undergo probate and are not ruled through the annuity proprietor's will.

## Reasons to buy an annuity.

By purchasing annuities, you intend to earn long-term income. Although most often considered financial solutions for seniors nearing retirement, annuities can benefit investors of any age with a variety of financial goals.

***Reasons to buy an annuity include:***

* Long-term security
* Tax-deferred growth
* Capital protection
* Asset distribution without inheritance
* Inflation adjustments
* Death benefits for heirs

Income annuities are often suitable for people who will retire in less than a year and want the security of their guaranteed income. Remember, Single Premium Immediate Annuities (SPIAs) start paying within one year from the date of purchase. This means that there's no accumulation length as there's with deferred annuities.

For this reason, SPIAs also are useful for young people who have inherited a large sum of money and want to protect unexpected money from financial mismanagement.

By contrast, deferred annuities are not typically recommended for people with short-term financial needs or younger people with more aggressive investment strategies.

## Benefits of Annuities

* One of the important thing advantages of an annuity is that it lets the investor shop cash without paying taxes on the hobby till a later date. Annuities do not have contribution limits, unlike 401(k)s and individual retirement accounts (IRAs).
* Another important benefit of annuities is the creation of a predictable stream of income to fund retirement. With an annuity, you ought not to fear your savings not lasting your entire life. This is a great advantage for the years after retirement.
* The reasons for investing in an annuity should match your particular lifestyle and financial situation.

## Disadvantages of Annuities

Some purchasers see it as a disadvantage to sacrifice liquidity in exchange for lifetime financial security. In fact, if your financial status or short-term goals limit the amount of cash you have on hand, an annuity probably isn't the right solution for you. It will not make financial sense to buy a valuable and viable product if it is not valuable and viable for you.

***Other common concerns about annuity structure and design include:***

* Commissions and fees
* Complexity
* Conservative returns (compared to investment products)
* Loss of potential returns from other investments

The loss of possible returns is what is known as "opportunity cost." People often cite opportunity cost as a drawback. This objection is valid for people with a higher tolerance for risk. For instance, younger investors with longer time horizons would probably advantage from an extra competitive funding approach due to the fact they have got time for their cash to develop and will get over transient marketplace losses.

Older buyers and retirees, on the alternative hand, want to evaluate possible prices relative to their particular circumstances. People in this age institution are much less probably to view the possibility of prices as a downside of an annuity.

## Types of Annuities

Types of annuities to suit the different desires of the market. Your private desires and goals will decide the kind of annuity that is proper for you.

1. Fixed Annuities
2. Indexed Annuity
3. Variable Annuity
4. **Fixed annuities**

A fixed annuity is a coverage agreement that ensures that the insurer pays the purchaser a guaranteed, fixed rate of interest on their contributions to the annuity for a specified period. Fixed annuities are a decreased chance than variable annuities and can provide a steady stream of income in retirement.

Fixed annuities are the most effective and maximum honest kind of annuity. They additionally offer the maximum predictable and dependable flow of income, regularly with the bottom fees.

A constant annuity may be instant or deferred. That is, relying upon your contract, you can start receiving annuity payments within a year of purchasing your fixed annuity, or you can have payments start at a later time. Deferred annuities typically begin making payments at retirement.

When deciding if a fixed annuity is right for you, you should consider how it works and the way it compares to different kinds of annuities.

## How does a fixed annuity work?

* How your fixed annuity money grows will be explained in your contract. It can be for a fixed dollar amount, an interest rate, or every other method specific with inside the contract. Unlike variable annuities and listed annuities, constant annuities aren't tied to the overall performance of a portfolio of different investments.
* Income bills from a hard and fast annuity may be assured for lifestyles or for a fixed range of years, relying on the phrases of the contract that specify the annuity's payment options.
* You can also choose to receive it in a lump sum. This is known as a multi-year guaranteed annuity.

## Advantages and Disadvantages of Fixed Annuities

With any investment, it's wise to weigh the pros and cons before deciding which option is right for you.

**Advantages**

* **Simple**: Unlike variable and index annuities, fixed annuities don't have complicated formulas to determine the amount of money you'll receive in income payments. The fees and any changes are specified in the annuity contract.
* **Predictable**: Since everything is agreed upon in the contract, you know what to expect. There is no need to worry about whether an investment portfolio or the stock market is doing well. The interest rate is specified and guaranteed in the contract.
* **Lowest risk:** Since interest is not tied to the performance of investments or stocks, there's no want to fear approximately dropping cash whilst shares and different investments underperform. This is particularly essential for retirees, who cannot come up with the money to lose the cash they want to pay for living expenses.

**Disadvantages**

* **The Basics:** The main drawback is that fixed annuities don't have the potential of riskier annuities to yield higher interest rates if an investment portfolio or stock index does well.
* **No inflation protection:** Growth is fixed and may not keep pace with inflation. That means its real value can decrease over time.
* **No capital gains tax rates:** Money withdrawn from annuities are taxed as ordinary income. You do not benefit from the lower capital gains rates.
* **Early Withdrawal Penalties:** Because annuities are designed to help people save for retirement, in case you withdraw cash from an annuity earlier than age 59½, you'll be subject to a 10 percent penalty.
* **Possible Surrender Fees:** If you don't like interest rates when they Reset and need to withdraw your cash early, you could incur penalties.

## Are fixed annuities guaranteed?

Your fixed annuity contract will include a guaranteed minimum rate. The annuity company's guarantee is that the interest on your fixed annuity will not drop below that rate. The company also guarantees the principal investment.

In general, annuity funds are not guaranteed by the Federal Deposit Insurance Corporation or any other federal insurance Agency. They are regulated and assured via way of means nation coverage commissions.

## Differences between Fixed and Variable Annuities

Fixed annuities differ from variable annuities in the way interest rates are determined. With fixed annuities, the interest rates are clearly defined with inside the contract. The increased fee of variable annuities relies upon the overall performance of a funding portfolio.

**The 3 foremost variations are:**

**Fixed Variable**

1. Interest is decided at the contract date Interest depends on return on investments

2. Low risk highest risk

3. Predictable, easy Complicated, harder to understand

## Differences between Fixed and Indexed Annuities

Indexed Annuities integrate the capabilities of constant and variable annuities. Here are the primary variations among fixed and indexed annuities:

**Fixed Indexed**

1. Interest is determined on the contract date Interest linked to index performance, such as the S&P 500 Guaranteed not to drop below a certain level.

2. Lower rates higher rates

3. Predictable, easy complex

Indexed Annuity is listed annuity, additionally referred to as a set-index or equity-listed annuity, capabilities earnings bills tied to an inventory index, along with the S&P 500. Indexed annuities carry out properly, while the monetary markets carry out properly. People regularly discuss it listed annuities as hybrids of constant and variable annuities. An Indexed annuity is a monetary agreement between you and a coverage organization. It capabilities traits of each constant and variable annuities. Indexed annuities provide a minimal assured hobby fee mixed with a hobby fee tied to a vast inventory marketplace index, along with the S&P 500 or the Dow Jones Industrial Average. This specific hybrid layout can provide safety in opposition to inventory marketplace losses, in addition to the capacity to take advantage of the marketplace's profits. Indexed annuities have been created at some stage in the inventory increase of the mid-Nineties, while buyers have been extra inquisitive about the probably better profits of shares and much less inquisitive about strong, decreased returns from investments like bonds. They have been mainly designed to compete with a certificate of deposit. Index Annuity Pros and Cons Like any funding, index annuities have their advantages and costs. Since they're basically a hybrid of constant and variable annuities, they have a combination of professionals and cons. They have the capacity for better returns without the danger of dropping your cash. Because those annuities are complicated, they may be hard to understand.

**Pros**

* As with all annuity types, indexed annuities are tax-deferred products.
* When shares for your index, along with the S&P 500, grow in price, the price of your agreement increases.
* The brought growth in yields might also additionally function as a hedge in opposition to inflation. If the inventory marketplace underperforms, you do not lose cash.
* Index profits are locked in.
* They regularly offer higher quotes than a certificate of deposit.

**Cons**

* The profits of your agreement may be capped and may not mirror the whole growth with inside the price of shares.
* Lack of rate transparency. Fees might not be simply disclosed.
* High-income commissions.
* The cap with inside the growing price can be decreased with inside the later years of your agreement. In addition, the share of the advantage you could obtain with inside the index price might also additionally decrease.
* As with different kinds of annuities, you face steep give-up expenses for early withdrawal.
* With a set annuity, the quantities of the earnings bills are gifted with inside the agreement. They do now no longer change, while the agreement requires them to be reset.

## Differentiating Indexed Annuities to Fixed and Variable Annuities.

Indexed annuities are simply one of the 3 most important annuity types. The differences are fixed annuities and variable annuities.

1. Fixed annuities aren't tied to the overall performance of the inventory marketplace. The hobby fee is about for your agreement at the time of buy and does now no longer fluctuate. The finances, therefore, are assured to develop on the identical fee for a distinctive time.
2. Variable Annuity: A variable annuity is a form of annuity whose price is tied to the overall performance of a funding portfolio. Payments from variable annuities can stimulate growth if the portfolio plays properly and reduce if it loses cash. Although variable annuities bring the capacity of better returns than constant annuities, they do not provide an assured payout.

## Variable Annuity and How Does It Work?

A variable annuity is an agreement between you and an annuity provider — typically a coverage organization — in that you buy the cap potential to obtain a move of earnings in your existence or a fixed period. When you buy a variable annuity, the cash you pay is allotted to a funding portfolio. You can have numerous alternatives for making an investment in the finances of your portfolio. These alternatives, or subaccounts, can encompass shares, bonds, cash marketplace finances; strong earnings price mutual finances, and different investments. The number of earnings you obtain will upward push or fall, relying on the overall performance of the portfolio. Along with mutual finances and different investments, you will be capable of making investments a part of your cash into a set account, which earns a set fee for hobby and is not tied to the inventory marketplace. Usually, the annuity organization ensures the go back of premium (ROP), and because of this, you may not lose your preliminary funding. But in case your portfolio does not carry out properly, you could now no longer earn any growth. On the alternative hand, in case your portfolio plays properly, you've got the capacity for extra profits. This situation differs from a set annuity, which capabilities a pre-set hobby fee that does not depend upon the overall performance of investments.

## Variable Annuity advantages and disadvantages

As with any funding, the advantages and dangers of variable annuities ought to be weighed while thinking about whether or not to make investments. These annuities bring the promise of better returns than fixed annuities. But, consistent with the Financial Industry Regulatory Authority, in addition, they include dangers that warrant caution.

**Pros**

1. **Possible Inflation hedge –** If your funding portfolio plays properly, you've got the capacity to look at growth for your bills, allowing you to higher maintain up with inflation.
2. **Tax deferral –** You do not pay taxes on income till you're taking the cash out of the annuity.
3. **Initial funding safety –** Usually, the annuity organization will assure you may have to get admission to the cash you invested, even in case you make no hobby in case your portfolio does poorly.
4. **Death benefit –** If you die earlier than you begin receiving bills, your beneficiary will obtain a payout from the annuity organization.
5. **Payments for existence –** You have the choice of receiving bills for the relaxation of your existence, even in case your portfolio plays poorly, and also you exhaust your important funding. You might also additionally pay greater for this option.

**Cons**

1. **No assurance to go back –** Unlike fixed and indexed annuities, there's no assurance that you may earn a hobby in your funding. If your funding portfolio plays poorly, it'll have an effect on the price of your annuity.
2. **Taxed as earnings –** When you withdraw your cash, the income is taxed as earnings, now no longer on the extra favorable capital-profits fee.
3. **Complexity –** Because they may be complicated, a few buyers might also additionally turn out to be pressured approximately the provisions of variable annuities. This has brought about what regulators say are questionable income practices making variable annuities the main supply of investor lawsuits to the (FINRA).
4. **Surrender fee –** If you're taking a few or all your cash from your annuity in advance than the agreement allows, you may pay a give up or withdrawal fee. This fee may be as excessive as 10 percent (10%) early with inside the agreement. Some annuities can help you withdraw small quantities – generally 10 percent (10%) or much less – annually.
5. **Mortality and rate danger fee –** This is the fee to cowl assured loss of life advantages, assured earnings for existence, or assured caps on administrative expenses. These charges may be 1.2 percent (1.2%) or extra a year.
6. **Administrative Fees –** These cowl record-retaining and different administrative costs.
7. **Sales commission –** The agent who bought you the annuity might also additionally obtain repayment for sale.
8. **Underlying fund charges –** These cowl charges of the subaccounts wherein your cash is invested. This may be extra than 1 percent (1%) a year.

## Death Benefits

All variable annuities include a death benefit.

* If the settlement has now no longer been annuitized, the insurer will make a dying gain fee to the beneficiary named at the settlement after the annuity proprietor or annuitant dies.
* The dying gain beneficiary is assured of getting hold of the top rate or modern-day price of the settlement, whichever is greater, minus any withdrawals and fees.
* The well-known dying gain is to be had free of charge above the settlement's mortality and price charge. It lets your beneficiary get hold of the modern-day price of the settlement.
* Many insurers have created new dying blessings with extra guarantees. These alternatives can consist of locking in funding overall performance at a particular time or making certain a minimal periodic growth with inside the dying gain.
* According to a purchaser bulletin from the U.S. Securities and Exchange Commission: "The cause of a stepped-up dying gain is to **'lock in'** your overall funding performance and save you a later decline with inside the price of your account from eroding the quantity which you anticipate to depart for your heirs."
* Keep in thought that the beneficiary of your annuity may also inherit your duty to pay profits tax at the distinction among what you paid in your annuity and what it is really well worth whilst you by skipping away.

## Comparing Variable and Fixed Annuities

* Predictability and risk are the biggest differences between variable and fixed annuities.
* Fixed annuities percentage similarities with financial institution certificate of deposit (CDs). You deposit a sum of cash, and the insurer has the same opinion to pay a sure hobby charge over a distinctive period. Because of their predictable nature, constant annuities are taken into consideration much less volatile than variable annuities.
* Unlike variable annuities, cash in a conventional constant annuity grows at a hobby charge set through the coverage company. It doesn't divulge an investor to the inventory marketplace.
* Fixed index annuities — which songs a vast marketplace index just like the S&P 500 — provide a little marketplace exposure.
* In contrast, variable annuity capabilities are greater than a mutual fund. You put money into one or greater subaccounts, which preserve stocks, bonds, or an aggregate of both.
* Variable annuities include more short-time period volatility. Your cash fluctuates with the wider markets, and your returns can vary.
* Unlike a hard and fast annuity, variable annuities do not provide any assured go back in your important investment. But a few traders are inclined to take in this danger for more capability returns.
* A variable annuity can be an awesome choice when you have an extended time horizon and better danger tolerance.
* Keep in thought that variable annuities frequently include better costs and prices than fixed annuities. Make positive you apprehend the restrictions and consequences of any annuity earlier than signing a contract.