

About...Annuities

This Life Advice(r) pamphlet about Annuities was produced by the MetLife Consumer Education Center and reviewed by LOMA (Life Office Management Association), NAVA (National Association for Variable Annuities) and by selected educators of the USDA Cooperative Extension System. It is intended as general information only and does not describe and is not an offer to sell any MetLife products. Editorial services provided by Meredith Integrated Marketing.

Confused About Annuities?

You're not alone. Many people have difficulty understanding them. The main reason for all the confusion: Annuities may be single or flexible-payment; fixed or variable; deferred or immediate. No matter the type, annuities are financial contracts with an insurance company that are designed to be a source of retirement income. This pamphlet will help you decide if an annuity is right for you and help you to choose the type of annuity that best meets your needs.

Single vs. Flexible-Payment Annuities

You can purchase an annuity in two ways:

- ***Make one lump-sum payment to purchase a single-premium annuity.*** If you want to contribute more money at a later date, you will have to purchase another annuity.
- ***Make ongoing contributions to a flexible-payment annuity.*** You can contribute money at regular or even irregular intervals anytime you want.

Fixed vs. Variable Annuities

There are two basic types of annuities you can buy—fixed and variable.

Fixed Annuities

Fixed annuities earn a guaranteed rate of

Variable Annuities

Variable annuities typically offer a range of investment or funding options. These funding options may include stocks, bonds and money market instruments. The return on variable annuities can go up or down. Your principal and the return you earn are not guaranteed; they depend on the performance of the underlying investment options. If the funding options you choose for your annuity perform well, they may exceed the inflation rate or fixed annuity returns. If they don't, you may lose not only prior earnings, but even some of your principal.

Some variable annuities offer, in addition to a range of investment options, a fixed account option that guarantees both principal and interest, much like a fixed annuity. This gives you the option of dividing your money between the low-risk fixed option and higher-risk vehicles such as stocks, all under the umbrella of just one annuity. Many variable annuities offer asset allocation programs to help you decide where to invest your assets based on your circumstances.

Variable annuities also allow you to transfer money from one account to another without triggering a taxable event. In other words, if you transfer money to a different funding option within your variable annuity, you will not have to pay taxes on any earnings you have made. Tax-free switching lets you re-allocate money to suit changing market conditions, without

interest for a specific time period, such as one, three or five years. Once the guarantee period is over, a new interest rate is set for the next period. This guarantee of both interest and principal makes fixed annuities somewhat similar to Certificates of Deposit (CDs) purchased from a bank. Unlike a typical CD, however, an annuity is not backed by the Federal Deposit Insurance Corporation (FDIC); its security is directly related to the financial health of the insurance company that issues the annuity.

worrying about the taxes.

Fixed and Variable Annuity Expenses

Variable annuities usually have more features and higher fees than fixed annuities. With some fixed annuities, contract expenses – such as maintenance and contract fees – are taken into consideration when the company declares periodic interest rates or determines the payment amount. Surrender charges may also apply.

Variable annuity fees are more complicated. They may include an annual contract charge that covers administrative expenses and surrender fees, as well as a mortality and expense risk charge. Variable annuities charge this latter fee to guarantee the death benefit, the availability of payout options and the level of expenses.

In addition, a variable annuity has fees for the management and operating expenses of the funding options in which your money is invested. These charges pay for everything from the fund manager's salary to the costs of printing the fund prospectus.

For a variable annuity, all important information will be explained in the prospectus that describes the variable annuity contract. The prospectus must be given to you when you are considering the purchase of a contract with after-tax dollars. Read it carefully before you invest or send money and be sure you understand exactly what your expenses will be.

Deferred vs. Immediate Annuities

While you can put money into a deferred annuity with a single payment or flexible payments, immediate annuities are usually purchased with a single payment. When you receive payments also differs. Just as the names imply, you get money earlier from an immediate annuity and you delay getting money from a deferred annuity.

This easy quiz will help you determine whether you should consider an immediate or a

deferred annuity. Answer the following statements:

1. Saving for retirement is one of my main goals. Yes___ No___
2. I do not want to touch my principal or interest until I am at least 59½ years old. Yes___ No___
3. I contribute the maximum deductible amount to my IRA, 401(k) or 403(b). Yes___ No___
4. I need an investment that will earn tax-deferred interest for many years. Yes___ No___
5. I am retired or very near retirement now. Yes___ No___
6. I have a lump sum of money and I want to begin drawing an income from it. Yes___ No___
7. I want immediate return from my investment. Yes___ No___
8. I want to receive a steady monthly check for the rest of my life. Yes___ No___

If you answered yes to questions 1 through 4, a deferred annuity may be appropriate for you. If you answered yes to questions 5 through 8, you're more likely to need an immediate annuity. A financial advisor or qualified insurance agent can help you decide if an annuity is the right retirement savings vehicle for you.

Deferred Annuities

Deferred annuities can be a great way to accumulate money for retirement, if you want retirement income beyond what you will receive from Social Security or your pension plan. They are particularly effective if you have many years before retirement. Your money grows tax deferred, which means you pay no taxes on earnings until you begin to withdraw your money.*

*Note: Unlike a nonqualified deferred annuity purchased with after-tax-dollars, an IRA receives tax deferral under the provisions of the Internal Revenue Code. Therefore, there is no additional tax benefit in purchasing a deferred annuity.

If the tax-deferred aspect of a deferred annuity is important to you, make sure the expenses do not outweigh the tax benefits. This can be a tough judgment call, but a

If you switch annuities, you may also incur withdrawal charges from your current annuity. If a salesperson advises you to change annuities despite the fact that you will be penalized, make sure you know the reason. Do the benefits of the new annuity – such as a higher interest rate, better investment choices or greater flexibility – offset the withdrawal charges? Be sure the salesperson isn't benefiting from the switch at your expense. If you decide to exchange one annuity for another, be sure to request and complete the appropriate forms provided by your insurance company to ensure that the transaction will be treated as a tax-free exchange under the federal income tax law (Section 1035 of the Internal Revenue Code).

Withdrawing Money from a Deferred Annuity

When you're ready to start withdrawing

good guideline is that if the expense charges are more than 1.5% greater than a comparable financial vehicle and your time horizon is less than 10 years, a deferred annuity may not be the option for you. Consult a tax advisor for assistance in making this determination.

A deferred annuity is not a vehicle for money you may need for current expenses. If you withdraw income before age 59½, the IRS will usually apply a 10% penalty in addition to ordinary income tax, similar to the penalty for early IRA withdrawals. What's more, your insurer may impose its own early withdrawal penalty, also known as surrender fees, if you cash in your deferred annuity within a specified period. These fees, similar to withdrawal penalties on a CD, usually cease seven years after your date of purchase. Often there is a separate surrender fee for each payment. So, a new payment may have a 7% fee if you take the new payment out right away, while a 10-year-old payment may have no surrender fee. The fee will usually decrease and be eliminated over time. Keep in mind, however, you can often withdraw small amounts (e.g., 10%) annually without any penalty from your insurer, but the IRS penalty may still apply. The IRS views all withdrawals as income, which are taxable, until all income has been paid out.

money from your deferred annuity, you will need to choose how to receive your money. You can take it all out in a lump sum, take it as needed, or receive it in a steady stream of periodic payments – so-called "annuitizing." If you annuitize, you can receive a stream of income that is guaranteed to continue for the rest of your life, no matter how long you live. And, the tax liability can be spread out for the rest of your life too. Some of the earnings are included in each payment and are taxable, meanwhile, any earnings continue to accumulate tax-deferred on the remaining principal and earnings that have not yet been distributed. So, receiving distributions as periodic payments after retirement may further reduce your income tax liability, if you are in a lower tax bracket. Some annuities also provide you with an option to have a set amount, determined by you, automatically withdrawn and deposited directly in your bank account during a regularly scheduled period, such as monthly. You have many options on how you receive your money, each with its own tax ramifications. Consult your tax or financial advisor to tailor a plan for your particular needs.

Why Buy a Deferred Annuity?

There are a number of good reasons to consider a deferred annuity as part of your financial retirement plan:

- ***You postpone paying income taxes on any earnings until you withdraw money, typically during retirement, when you may be in a***

To purchase an immediate annuity, you make a one-time payment, and distributions typically begin within a month. Immediate annuities can be fixed or variable, just like deferred annuities. The income payments you receive from fixed immediate annuities are based on the amount you contribute, your age and the interest rate environment at the time of purchase. The payments to you will not

lower tax bracket. All earnings grow tax-deferred.

- ***You can put in as much money as you want. Unlike Individual Retirement Accounts (IRAs), there is no IRS restriction on the amount that can be contributed annually to deferred annuities with your after-tax money.*** You can, however, use a deferred annuity to fund your traditional or Roth IRA, in which case you would operate within IRA limitations.

You can provide death benefits to your heirs. If you die prematurely, your annuity can offer a death benefit to your beneficiaries without the costs and delays of probate. Your beneficiaries will never receive less than what you have contributed (less any withdrawals). In addition, a spouse who inherits an annuity before distribution has begun can step in as the new owner of the annuity and the tax deferral continues until amounts are withdrawn. If distribution payments had begun, the benefits would generally have to be distributed to the beneficiary at least as rapidly as through the method in effect at the time of the annuitant's death. Taxation will continue to apply to those proceeds. Generally, a beneficiary who inherits an annuity before distribution begins can request a lump sum distribution without penalty but will be subject to full taxation on the accrued interest or gain on the contract.

Immediate Annuities

Immediate annuities can provide dependable financial security: a stream of income payments guaranteed to continue for the rest of your life or for a period you

change. The payments from variable immediate annuities fluctuate based on the performance of the investment options you choose. Although payments may go up or down, variable annuities are designed to provide income that can rise over time to help you keep pace with inflation.

The principal in an immediate annuity is not readily accessible. If you need more money than the income provided by the immediate annuity, you can minimize this drawback by keeping some of your retirement funds in a liquid account, such as a savings account or money market fund. There also is a chance you may lose some of your principal. If you choose an income for life option with no refund guarantee, and you should die before your principal is all paid out, the balance of your principal and any earnings will go to the insurance company rather than to your heirs. Fortunately, annuities offer several guaranteed payout options. For more information see [Options with Guarantees](#).

When selecting the investment options for your immediate annuity, keep inflation in mind. You want investments that will keep pace with inflation. Variable annuities can let you participate in stock market growth, historically shown to be one of the best ways to combat inflation over the long term. However, the downside is that payments can drop if the market drops. Not only is this unnerving, but obviously it will make it harder for you to budget. If you still want the potential for higher payments, consider dividing your retirement savings between fixed and variable options to provide fixed payments, as well as growth potential.

select. If you are about to retire, an immediate annuity may be a good place to put a large lump sum of money accumulated for retirement through another savings or investment vehicle. You also can convert your deferred annuity into an immediate annuity to start receiving income.

Why Buy an Immediate Annuity?

Among the reasons to consider an immediate annuity are the following:

- ***An immediate annuity is a financial vehicle that can provide guaranteed income for life.***
- ***The income payments you receive can supplement your other income sources, such as Social Security and pension payments, which may not provide enough income by themselves.***
- ***You choose how often to receive your income payments. Whether monthly, quarterly, semi-annually or annually, there's a payout plan to fit your particular needs.***
- ***You pay income taxes only as you receive your payments.*** When you receive income payments, you will be taxed on the portion of the payments that is earnings. The portion that is principal, which represents your initial deposit made with money that had already been taxed, is not taxable.
- ***You may lessen your financial worries.*** Financial management can be a burden in your retirement

Options with Guarantees

You can choose from a number of options for receiving income from an annuity.

Lifetime Income for You. You can opt for income, guaranteed by the insurance company, for the rest of your life. Payments cease upon your death.

Lifetime Income with a Guaranteed Period. You will receive income for life. If you die before the guarantee period is over, your beneficiaries will receive the remaining number of payments.

Lifetime Income for Two. You can opt for income guaranteed for the rest of your life and the life of another person, such as your spouse. Guaranteed income for two people is known as a joint and survivor option, which guarantees that income payments will continue for the life of the primary owner and a second person. The guarantee is made by the insurance company issuing the annuity.

There are many other options which can be explained to you by a financial advisor or insurance representative. These options can usually be mixed and matched to provide an ideal income plan for your needs. For example, say you and your spouse retire at age 65 with 10 years left on your mortgage. You could choose the option to have income for two people with a 10-year

years. Because you don't know how long you'll live, it's hard to be sure your resources will last as long as you need them. If you withdraw too much of your nest egg, your future income can suffer or you may run out of money entirely. If you are too thrifty when it comes to spending your nest egg, your level of living may suffer. Immediate annuities can remove some of these burdens by providing you with a predictable fixed payment for life, so you can concentrate on enjoying your hard-earned retirement.

guaranteed period, so that if you both die before the guarantee expires, the payments would continue until the end of the 10-year period to pay the mortgage for your heirs.

Before You Buy an Annuity Consider the Following:

The money contributed to an annuity may be in post-tax dollars. When you contribute after-tax savings to an annuity, you can put in as much money as you like. Before you put after-tax savings into an annuity, it may be advisable for you to put the maximum pre-tax amount into a retirement plan such as your IRA, SEP, 401(k) or 403(b). Also note that annuities may fund an IRA, SEP, 401(k), 403(b). When an annuity is used to fund these vehicles there are contribution limits that apply, and federal tax laws generally require that you begin taking minimum distributions by April 1 of the calendar year following the year in which you reach age 70½. Failure to do so will result in a tax penalty of 50% of the amount of the shortfall. Additionally, once money is in your 401(k) or 403(b) plan, you generally cannot make withdrawals before age 59½ except for special circumstances, such as severance from employment, death or disability. If you meet an exception, withdrawals are

Expenses can vary. Make sure that the annuity contracts you consider have competitive fees. Independent rating services such as [Morningstar](#) and [Lipper](#) both publish reports that compare variable annuity fees. Your local library may have copies. While cheaper doesn't necessarily mean better, if a contract is too expensive it could offset gains from the tax-deferred status.

All earnings from annuities are taxed as ordinary income.* If your ordinary income rate at retirement is higher than the current capital gains rate for other investments, you would actually pay higher taxes. You do, however, have a tax deferral on any earnings. With some other investments, you could be subject to ordinary income as well as capital gains taxes annually, even if you have not cashed in the investment, which can reduce the value of your earnings.

* Tax regulations are subject to change.

generally subject to a 20% federal income tax withholding in addition to regular income tax and a 10% early withdrawal penalty for pre-59½ withdrawals.

Some Questions to Ask Before Buying

If you've decided that an annuity makes sense for you, here are a few key questions to ask yourself before signing up:

1. Have you done some comparison shopping and considered all of your options? Because annuities are long-term savings vehicles, you'll want to make sure the company you pick will be around at least as long as you will. And, as you learned in the previous discussion, different annuities offer a wide range of choices, prices, features and flexibility.

2. Does the rate on a fixed annuity look too good to be true? You want a competitive interest rate at renewal time. If the company is offering bonus rates (a higher interest rate for a set period of time) make sure the underlying interest rate and the company selling the annuity are financially viable. Once the bonus rate term expires, there is no guarantee going forward that renewal rates will be competitive. Be especially careful if you are exchanging annuities.

3. What are the annuity's surrender fees and how long are they in place? If the surrender fee is high (typical fees are around 6-7% and decline over a period of approximately five-to-seven years), you could feel locked into a contract from which it will be costly to escape.

4. What is the track record of the funding options offered in a variable annuity?

5. Does a variable annuity offer multiple funding options in case you change your investment strategy a few years down the road? Look for a range of funds to diversify your retirement savings as your needs change.

6. Will your ordinary income tax rate be greater than the current capital gains rate when you begin to take distributions (possibly at retirement)? If so, you may pay more in taxes by choosing annuities over another investment that would be taxed at the capital gains rate. Keep in mind, however, that your money in an annuity is accumulating on a tax-deferred basis. By selecting an annuity, you avoid paying yearly ordinary income tax on the earnings while your money compounds and grows.

7. What is the insurance company's rating? While anyone who is properly licensed to sell insurance products (e.g., banks, brokers, agents) can sell annuities, the annuity contract is issued by an insurance company. So, you'll want to consider the company's rating. Is it financially secure, with a good claims paying record? While this is most important for fixed annuities, it is relevant to any guarantees (e.g., death benefit) in a variable annuity as well. Checking up on an insurance company is easy at your local library, or you can contact [your state's Department of Insurance](#), [A.M. Best](#), [Standard & Poor's](#) and [Moody's](#) all rate the financial stability of insurance company general accounts. [Morningstar](#) and [VARDS](#)

Don't be swayed by last month's top performer. Look for strong returns over a three-to-five-year period or more. Newspapers such as [Barron's](#) and the [Wall Street Journal](#) – available in your local public library - publish rankings of various funding options on a regular basis. The history of various funding options also can be found in [Morningstar](#) and [Lipper](#) publications, available in larger libraries. Remember, past performance is not a guarantee of future results.

evaluate and report information on variable contracts only. Variable annuities are rated by independent sources such as [Lipper Analytical Services](#), [VARDS](#) and [Morningstar](#). It's a good idea to choose an annuity from a company that gets high marks from at least two independent rating sources.

Reference Materials

Getting Started in Annuities
(ISBN# 0471-283037)
Gordon Williamson, John
Wiley & Sons \$19.95

Creating Retirement Income
Virginia B. Morris, Lightbulb
Press Inc. and the National
Association for Variable
Annuities \$14.95

Pamphlets from the Federal Government

The quarterly Consumer Information Center Catalog lists more than 200 helpful federal publications. For your free copy write Consumer Information Catalog, Pueblo, CO 81009, call 1-888/8-PUEBLO, or find the catalog on the Net (<http://www.pueblo.gsa.gov/>).

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Additional Sources

Life Office Management Association (LOMA)
2300 Windy Ridge Parkway
Suite 600
Atlanta, GA 30339
1-800-ASK-LOMA (275-5662)
<http://www.loma.org/>

National Association for Variable Annuities (NAVA)
11710 Plaza America Drive
Suite 100
Reston, VA 20190
<http://www.navanet.org/>

The National Insurance Consumer Helpline can answer questions about annuities 4242. The helpline also will send you a free booklet called *A Consumer's Guide to Annuities* which lists basic terminology and outlines the difference between types of annuities.

Internet Information

If you're on the Net, check us out. We're part of MetLife Online. (<http://www.metlife.com/Applications/Corporate/WPS/CDA/PageGenerator>)

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