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Why People Buy Annuities

With so many advisers recommending annuities these days its difficult to know which one is right for you. Like any investment there are pros and cons.

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BOCA RATON , FLORIDA, USA , January 24, 2017 /EINPresswire.com/ -- The word annuity for some can be the end of the conversation drawing upon a perceived Idea of what an annuity is usually based on a lot of misinformation and bad publicity. But yet billions of dollars are put into annuities every year and for good reason. Annuities offer something that other investments just don't and that is a peace of mind knowing that you won't out live your money.

With any investment there are always pro's and con's so let us explore some basics on what an annuity is and is not. There are basically two types of annuity classes: deferred and immediate. Under the deferred class you have several categories such as fixed, fixed indexed, variable. The annuities are called deferred because you're deferring your income and any growth inside the annuity is growing tax deferred to be taxed on withdrawals on a last in first out (LIFO) basis.

So let's take a look at some deferred fixed annuities.

> Create your own personal pension by using an annuity"
> *Stuart Chamberlin*

Fixed annuity or just a straight fixed also called a multi-year guaranteed annuity (MYGA)
In this annuity you get a simple interest rate like a CD but issued and backed by an insurance company with usually a higher interest rate than a CD. The durations can be anywhere from 3-10 years and you can take the interest annually if you wish. If inflation is an issue then the fixed annuity might not be the best recommendation since interest rates are so low at this time. But if you're comparing CD rates with MYGA's then you're on the same page.

Fixed Indexed annuities or (FIA's)

A fixed indexed annuity offers safety of principal like a traditional fixed annuity but linked to an index like the S&P 500. Your typical FIA has two values one is the contract value which is also the death benefit and the other is the income account value (IAV) which is only used to calculate your income. As an example let's use 100k with a premium bonus of 8% since many companies offer an upfront bonus. In this case we are using a premium bonus meaning the 8% bonus is actually added to your contract value or death benefit from day one. This is important to remember since many insurance companies only add the bonus to the income account value which is a value only used to calculate your income. So using 100k as your initial premium your contract value and your income account value both start at $108,000.00.
The contract value is linked to the index and all gains based on the indexing strategy you choose are locked in on the contract anniversary date each year. All the gains are locked in so once locked in they can't go back down.

The income account value if you choose a rider moves up based on an interest rate. So for example using 100k plus the 8% bonus= $108,000 and using a rider that compound's the IAV at 6% by year 5 you would have $144,536.39 in your income account value. Now if your contract value by year 5 was worth 125k then your income if turned on would be based on the income account value which is the higher of the two values.

The pro about this contract is safety of principle, being linked to an index that out performs inflation, income for life (can cover two lives) and grows tax deferred, gains are locked in annually. The con on this contract is limited access usually 10% of the contract value without a surrender charge during the surrender period. If you're buying this annuity for income then the surrender period means nothing since you are taking income and not looking for a lump sum. The income is fixed once turned on though there are FIA's out there where the income actually moves up with the index after turned on. Remember that the contract value is also the death benefit which bypasses probate like a trust does.

Single Premium Immediate Annuity or (SPIA)

If you're someone who needs income immediately then this type of annuity might make sense. A SPIA uses a payout percentage not an interest rate. So basically its payout of your own money with a very small interest rate built in. There are many ways of taking income from a SPIA for example, Life Only, Life with Period Certain, and Cash Refund.

Life only option is usually the highest payout for a reason. With this option if the annuitant dies the insurance company keeps whatever the balance is left no matter how long into the contract. If there are no intentions of leaving anything for a beneficiary and there is an income need that must be met or if there is already a life insurance policy in place covering the value of the annuity then this might make sense.

Life with Period Certain means that during the period certain if the annuitant dies whatever has not been paid out to the annuitant gets paid to a beneficiary.

For example if you choose a SPIA with life with 10 years period certain during the 10 year period certain if you passed away the remaining balance would be paid to a beneficiary. The income would continue for life if you live pass the 10 year period certain but there would be nothing left in the contract after the 10 years for a beneficiary.

Cash refund option just means whatever has not yet been paid out to the annuitant upon death will be paid to the beneficiary.

Variable annuities or (VA's) are actually considered a security unlike a fixed indexed annuity which are considered an insurance contract. With a VA your income is based on the original investment or greater but your death benefit is the contract value which can go up or down. The con's on this type of contract are, very high fee's which can be a drag on performance, and risk to principal.

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