



WHY ARE THERE SO MANY KINDS OF ANNUITIES?

The answer lies in understanding how different types of annuities work and what they're designed to achieve for their owners.

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When it comes to pursuing retirement goals, people's thoughts often turn to maintaining their lifestyle in their post-work years and being prepared for unexpected expenses. For many, a key aspect of these goals is knowing their retirement income plan features a steady stream of protected lifetime income.

An annuity is a financial product designed specifically for retirement savings that can provide a regular flow of income for a period of time, usually during retirement. But one thing people quickly discover is that there are many types of annuities.

Why are there so many kinds of annuities? There are different types of annuities because they are designed to address different needs and objectives. To better

understand that, we must start at the highest level where there are really only two types of annuities: fixed and variable.

FIXED AND VARIABLE¹

A **fixed annuity** is a contract between you and an insurance company. It can provide a predictable and reliable rate of return because the owner is protected with a guaranteed minimum interest rate.

A **variable annuity**² is also a contract between you and an insurance company. Unlike a fixed annuity, the return the variable annuity produces will be based on the performance of its underlying investment accounts. It has the opportunity for growth over the long term, as well as the potential to lose value in a down market.

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An annuity can fit into your income plan and help you achieve your retirement goals in different ways. It's important to understand that both fixed and variable annuities can help provide you with a guaranteed lifetime income during retirement. Each person's retirement income needs and objectives are different.

For example, some people worry about living longer and wonder if their retirement income will cover their needs throughout retirement. Others know their needs can be met but they want to be sure they also have a level of comfort with a protected lifetime income stream. Some want to know how they can fulfill their wishes to help their families after they're gone.

OPTIONS FOR RECEIVING INCOME

A key aspect of a strong income strategy is knowing you'll have income that is paid in retirement every month without having to earn a paycheck. Both fixed annuities and variable annuities can support your income strategy. Let's take a closer look at three specific types of annuities: immediate, deferred, and longevity³.

IMMEDIATE ANNUITY

Every **immediate annuity** is designed to produce an income stream right away, though income may start as late as 13 months after its purchase. Unlike other annuity types, there is no accumulation period where you make payments over time before receiving income at a later date. Immediate annuities are always purchased with a single premium.

When you buy an immediate annuity, you are exchanging the single premium for an income stream. The amount of each income payment depends upon many factors, including the amount of the premium and the payout option chosen. There are two types of immediate annuities:

1. **The fixed immediate annuity** provides a regular, protected income stream in an amount that is either level over the payout period or one that increases each year by a set percentage.
2. **The variable immediate annuity** provides income, but the amount will vary according to the size of the single premium, the payout option selected, and the performance of the investment accounts chosen. The investment accounts are also called "sub-accounts" and have specified investment objectives. The value of each account varies each day based on the performance of its investments.

Those looking for an immediate stream of protected income in exchange for a portion of their savings may be interested in an immediate annuity.

DEFERRED ANNUITY

All deferred annuities have two phases: the *accumulation phase* and the *payout phase*. During the accumulation phase, the annuity may grow in value through interest (for fixed annuities) or through an increase based on market performance (for variable annuities).

During the payout phase, your income is paid according to the option you selected. You have the flexibility to withdraw funds if and when you need it. You don't have to choose to "annuitize" to get a systematic stream of protected income. Annuitizing requires you to give up control of the underlying assets in exchange for an income stream. A popular option is something called the Guaranteed Lifetime Withdrawal Benefit which provides for protected income and the ability to maintain a measure of control of the account value.

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The **fixed deferred annuity** guarantees, during the accumulation phase, both principal and a minimum rate of interest. During the payout phase, your income is received based on the payout selection you picked. There are two basic types of fixed deferred annuities:

1. With a **declared rate fixed deferred annuity**, you earn interest spelled out in the contract and based on a rate set by the insurance company and declared at the beginning of each period, often for one, two, or more years. That “current” interest may never be lower than the minimum rate set in the contract.
2. With an **index deferred annuity**, interest credited to your annuity is linked to the positive performance of an index, such as the S&P 500. Typically, some of the positive gain in the index is credited to the annuity at the end of the period. Of course, if the market goes down, there is no positive gain. Nearly all index annuities treat a period where the index has lost money as a “zero percent gain.”

The **variable deferred annuity** has two phases, like its fixed cousin. During the accumulation phase, the value of the contract is the sum of its various accumulation units. That value will almost always change daily because it is based on the performance of the chosen investment options.

When you begin to take income from a fixed deferred annuity or variable deferred annuity, known as “annuitizing,” you may elect to take the payout either on a “fixed” or “variable” basis. On a fixed basis, the payout option will produce a pre-determined amount of money during the period chosen. On a variable basis, the amount of each year’s income payment will vary based on the market performance of the annuity’s investment accounts.

Of course, as mentioned earlier, if you don’t want to give up control of the underlying

assets in exchange for an income stream, you don’t have to annuitize. You could choose a Guaranteed Lifetime Withdrawal Benefit that provides protected lifetime income, while leaving you in control of the assets.

One key benefit of deferred annuities is tax deferral. Even though you can’t deduct your contributions to a deferred annuity in the same way as an IRA or 401(k), earnings can grow without having to pay taxes until years later.

Those looking to build additional tax-deferred savings for retirement may be interested in deferred annuities. While everyone’s tax situation is different, those looking to build additional tax-deferred savings for retirement may be interested in deferred annuities.⁴



LONGEVITY ANNUITY

The decline of traditional pensions has created certain challenges for retirees. In the past, a guaranteed pension, coupled with Social Security, gave people confidence. They could pursue their retirement goals secure in knowing they would have steady income.

Now, you work hard and save money for retirement, but your traditional IRA or 401(k) is not an automatic source of protected lifetime income. It only gives you a sense of probable income, not protected income.

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Enter the longevity annuity, a relatively recent development. A longevity annuity turns a portion of your savings into a protected, reliable source of lifetime income. Some people think of it like buying a pension for yourself.

In this type of arrangement, you select a longevity annuity starting date well into the future (even decades) and can know, in advance, the exact amount of your future income. Although deferred annuities often *illustrate* future annuity payout rates, those illustrations are not a guarantee. A longevity annuity is like buying an immediate annuity well in advance, knowing the amount of income it will produce.

Those who are looking for protection against outliving their retirement savings late in life may be interested in a longevity annuity.

TAXES: QUALIFIED VS. NON-QUALIFIED⁴

When we talk about qualified versus non-qualified annuities, we are talking about their treatment under the tax code.

All three types of annuity contracts can be qualified or non-qualified. The tax rules for each are very different.

Qualified annuities are purchased with pre-tax money. It's "qualified" because you don't pay taxes on the funds used to purchase the annuity until after you withdraw them, a common tax feature of many retirement programs.

Additionally, your purchase amount or contribution is deductible from your taxable

income. You don't pay taxes on your gains while the money is invested, and when you withdraw your money, you owe ordinary income tax on those funds at your then-current tax rate. And your original contribution is returned to you tax-free. Most of the rules governing qualified annuities, including contribution limits, are the same as those for qualified retirement accounts such as a traditional IRA or a 401(k).

Non-qualified annuities are purchased with after-tax dollars. You can contribute nearly any amount you wish, subject to approval from the insurance company. It's "non-qualified" because you cannot deduct the purchase amount or contributions from your taxable income. Like a qualified annuity, you won't pay taxes on dividends, interest, or capital gains until you withdraw money from your non-qualified annuity. When you do, you'll pay ordinary income tax rates on those gains. But your original contribution is returned to you tax-free.

TAKING THE NEXT STEP

When you are planning your income in retirement, annuities can play an important role in helping you achieve your goals. A financial professional can help you determine if an annuity may fit your needs and which type of annuity may be best for you.

Once you've decided, there will be a few other things to consider such as costs, income options, and what portion of your portfolio will be used to provide you with protected income. The more you know about your financial future, the more confident you can be about your life in retirement.

¹ Investors should consider the features of the contract and the underlying portfolios' investment objectives, policies, management, risks, charges, and expenses carefully before investing. This and other important information is contained in the prospectus, which can be obtained from your financial professional. Please read the prospectus carefully before investing.

² A variable annuity is a long-term investment designed for retirement purposes. Investment returns and the principal value of an investment will fluctuate so that an investor's units, when redeemed, may be worth more or less than the original investment. Withdrawals or surrenders may be subject to contingent deferred sales charges. Withdrawals and distributions of taxable amounts are subject to ordinary income tax and, if made prior to age 59½, may be subject to an additional 10% federal income tax penalty, sometimes referred to as an additional income tax. Withdrawals reduce the account value and the living and death benefits.

³ Annuity contracts contain exclusions, limitations, reductions of benefits, and terms for keeping them in force. Your licensed financial professional can provide you with complete details. All references to guarantees, including optional benefits, are backed by the claims-paying ability of the issuing company and do not apply to the underlying investment options.

⁴ This article is not intended as tax, accounting, or legal advice. Please consult your own accountant or attorney.

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