

# A Basic Introduction To Annuities

## A Basic Introduction To Annuities

As a consumer, you may or may not be familiar with the concept of annuities. Those who understand the value of annuities may use them for their tax benefits or to create a guaranteed revenue stream to draw upon after retirement. For others, the word annuities may be familiar but the details of what annuities are and how they work is not. If this is the case for you, the following information will provide a basic overview of the types of annuities that exist and some of the most common uses of annuities.

In the simplest terms, annuities are an agreement between a consumer and another company (most often an insurance company). Annuities possess both characteristics of life insurance and characteristics of an investment as well. The consumer pays in money to the annuity either all at once or over a period of time; when the consumer reaches retirement age, the company then pays the consumer a specified amount of money over time. Different types of annuities serve different purposes and each type of annuity may have different advantages and disadvantages.

One important thing to remember about purchasing annuities is that you need to verify the quality of the company from which you are purchasing your annuities. Your money may be guaranteed, but if the company is not a strong, well-rated company, you could be out of luck if the company were to fail.

## Three Types Of Annuities

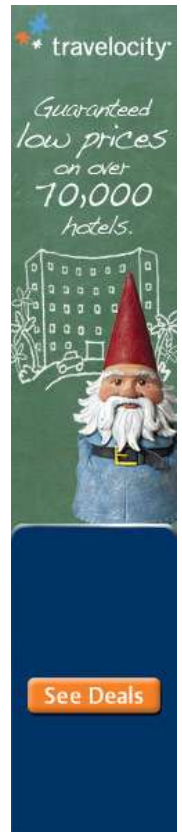
Generally, there are three different basic types of annuities. Each type of annuity has a different configuration and each operates differently. The three basic types of annuities are:

- Fixed annuities
- Variable annuities
- Indexed annuities

## Fixed Annuities

Fixed annuities have a guaranteed principal, a guaranteed minimum interest rate, and other features, such as a benefit paid out to a beneficiary in the event of your untimely passing. The money you pay into fixed annuities is allowed to grow tax-deferred—meaning you do not have to pay taxes on the money until you begin taking it out. Generally, fixed annuities are the most conservative, safest type of annuities.

Some drawbacks to fixed annuities include a lack of liquidity—it is not easy to free up funds from this investment if you need them. You also must pay a penalty if you decide to withdraw funds from your fixed annuities before you reach age 59-and-a-half.



## **Variable Annuities**

Variable annuities differ from fixed annuities in that the payments you make are invested into a choice of investment products, such as mutual funds. Because mutual funds vary with their performance in the stock market, the return from variable annuities is based on the performance of these funds. In essence, investing in variable annuities is similar to investing in mutual funds with some added benefits that function more conservatively, like life insurance, such as guarantees of living benefits and death benefits. Variable annuities also offer the benefit of tax-deferred growth of your investment.

Similarly to fixed annuities, variable annuities do not keep your funds very liquid—it is not easy to get your cash out of variable annuities quickly. Also similarly, there is an early withdrawal penalty.

## **Indexed Annuities**

Indexed annuities are essentially a hybrid of fixed annuities and variable annuities. They offer many of the conservatively structured guarantees of traditional fixed annuities, while they also offer the possibility of higher returns based on the performance of stock market indices, by investing a small portion of your funds in “index options.” Because of the guarantees built into indexed annuities, you cannot lose money if the market index related to your annuity goes down. Indexed annuities also allow funds to grow tax-deferred.

Although indexed annuities sound like the best of both worlds, they do have some potential drawbacks as well. For example, the returns from indexed annuities (despite their guarantee) may feel unpredictable. Indexed annuities are also extremely complex in the way they function—it may be hard to understand or predict the return on your investment. A lack of liquidity and early withdrawal penalties are characteristic of indexed annuities as well.

## **Is There More To Learn About Annuities? Definitely.**

The overview of annuities provided here is only a very basic introduction to get you started thinking about how annuities might work for you. Each type—fixed annuities, variable annuities, and indexed annuities—has a large number of features, options, and complexities beyond the information provided here.

If you are interested in purchasing annuities, finding a knowledgeable salesperson that will help you determine the best options for your needs is important. Annuities can be purchased from licensed insurance agents, stockbrokers, accountants, or financial planners. Your annuities broker or agent should be willing to take the time to explain the details and features of their annuities—they can be complicated. Remember to only purchase annuities from a well-rated company to ensure your investment will remain financially secure. Annuities may offer you tax benefits, financial security, or a guaranteed revenue stream for retirement. A qualified annuities salesperson can help you with this decision.

## **Back to**

[Popular Life Insurance Articles](#)

[Contact Us](#)

[Back](#)