

Kiplinger

Annuities: 10 Things You Must Know

Not all annuities are alike, and some may not be appropriate for you. How much do you know about these investment products?

by: the editors of Kiplinger's Personal Finance
July 17, 2020



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Annuities aren't new. **The annuity concept dates back to early Rome**, when citizens would make a lump-sum payment to a contract called an annua in exchange for income payments received once a year for the rest of their lives.

As traditional sources of guaranteed retirement income -- such as pensions -- disappear, many retirees are wondering where to turn. An annuity may be the answer, but not all annuities are alike, and some may not be appropriate for you. **Learn about these products and whether you should invest in them.**

Immediate Annuities vs. Deferred Annuities



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There are two types of annuities: immediate annuities and deferred annuities. **Immediate annuities are best for retirees who want to receive payouts right away.**

If you invest money in an immediate annuity, **an insurance company guarantees that you will receive a fixed payment every month for as long as you live** (or as long as you or a beneficiary are alive). But, in most cases, your money is locked up after you hand it over to the insurance company, although some insurance companies allow one-time withdrawals for certain emergencies. So you don't want to tie up *all* of your money in an annuity.

Deferred annuities are better for people who are still saving for a future retirement. The money they invest grows tax-deferred until it is withdrawn later.

A deferred annuity, also known as a longevity annuity, requires a smaller outlay of cash. With this annuity, you get guaranteed payments when you reach a certain age.

How Much Do Annuities Pay?



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Even in today's low-rate environment, a 65-year-old man can buy an annuity that pays more than 6% of his initial investment annually for the rest of his life. That's because **your payouts are both from earnings and a return of your principal**, and you pool your risk with other policyholders. You'll receive the highest payout with an annuity that stops paying when you die.

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Annuity Payouts: Single Life vs. Joint Life



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If you buy an immediate annuity, you'll get the highest annual payout if you buy a single-life version—one that stops payouts when you die, even if your spouse is still alive.

But if your spouse is counting on that income, it may be better to take a lower payout that will continue for his or her lifetime, too. (Some annuities are guaranteed to pay for a certain number of years, even if you and your spouse die during that period.) The annual payouts for a 65-year-old man who invests \$100,000 in an immediate annuity would shrink from \$5,928 for a life-only annuity to about \$5,004 per year if he buys a joint life annuity that continues payouts as long as either he or his 65-year-old wife is alive.

You can compare how much you'll receive for different types of payouts at [immediateannuities.com](https://www.immediateannuities.com).

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Annuity Payouts: Men vs. Women



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In general, **annual immediate annuity payments are higher for men** because men usually have a shorter life expectancy. Now a 65-year-old man who invests \$100,000 in an immediate annuity can receive about \$5,928 per year, while a 65-year-old woman could receive about \$5,628 per year.

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Annuity Payouts: Older Buyers vs. Younger Buyers



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The **older you are when you buy the annuity, the higher your annual payout** because your life expectancy is shorter. Currently, a 65-year-old man who invests \$100,000 in an immediate annuity can receive about \$6,700 per year, while a 75-year-old man can receive about \$9,350 per year. For this reason, some people ladder their annuities -- investing some money early in retirement to cover expenses, then adding more when they get older to boost payouts.

Consider an Inflation-Adjusted Annuity



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Standard immediate annuities guarantee that you'll receive an annual fixed payout that will never decrease for the rest of your life, but **inflation could erode the value of your payments over time**. Some companies offer cost-of-living adjustments that boost the payouts to keep up with inflation—3% a year, for example—but that will lower your initial payouts by up to 28%.

Low Interest Rates Will Sink Your Annuity Payout



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When [interest rates](#) are low, payouts from annuities are depressed, too. Payouts are usually tied to rates for 10-year Treasuries, and that rate is historically low. If you're worried that interest rates could go lower—or you'd like to start receiving at least some guaranteed income now—**consider building an annuity ladder**. With this strategy, you spread the amount you want to invest in an immediate annuity over several years. For example, if you want to invest \$200,000, you would buy an annuity for \$50,000 this year and another \$50,000 every two years until you have spent the entire amount. If rates rise, you'll be able to capture them, and if they fall, you'll have locked in payments at the higher rate.

You'll Pay Fees for Cashing Out Your Annuity



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Although deferred annuities let you cash out at any time, you may not get all your money back. **You generally have to pay a surrender charge that starts at about 7% to 10% of the account balance in the first year, and gradually decreases every year until it disappears after seven to ten years.** Also, if you take the money before age 59½, you generally have to pay an early-withdrawal penalty of 10%. However, this year, because of the CARES act that penalty is waived for annuities held in IRAs if the money is needed to cover a coronavirus-related health emergency or hardship. If your employer allows COVID-related distributions from an annuity in a savings plan like a 401(k), the penalty is waived then, too.

Deferred Annuities: Fixed vs. Variable



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Most deferred annuities allow you to invest your money in mutual-fund-like subaccounts. **Many of these products, known as deferred variable annuities, allow you to add, for an extra fee, guarantees that you won't lose money** even if the underlying investments decline in value. If the market tanks, you can still withdraw about 5% of the guaranteed balance each year. And you can withdraw the actual account value at any time (after the surrender period expires) if your investments increase in value.

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Your Annuity Is Protected Even If the Insurer Goes Bankrupt



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If you have a fixed deferred annuity or are receiving fixed immediate annuity payouts, then your payouts are protected by the state guaranty association. The level of protection varies by state. Find your state limits at nolhga.com.

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