Is an Annuity Right for You?

When it comes to your retirement, there are three factors that you may want to take into account when planning for your retirement income needs.

First, the deductibility of **Individual Retirement Account (IRA)** contributions is restricted if you or your spouse are active participants in an employer-sponsored retirement plan. Second, most new company pension plans have shifted from traditional **defined benefit plans** to **defined *contribution* plans**. In the former, the *employer* generally funds the plan and retirement benefits are based on salary and length of service. In the latter, the *employee* may fund part or all of the plan and retirement benefits are based on total contributions and investment performance. The third factor is the uncertainty surrounding the future of Social Security.

These three forces have converged to make it acutely apparent to many that planning for retirement now rests squarely on their own shoulders. Is purchasing an annuity compatible with the increasing trend toward self-direction in retirement planning?

Attractive Features of Annuities

Perhaps the most attractive feature of annuities is the lack of annual contribution limits such as those applying to IRAs and **401(k) plans**. Although the money deposited into an annuity is not tax deductible, all of the earnings accumulate tax deferred until they are withdrawn. (There may be a 10% federal income tax penalty for withdrawals prior to age 59½ and fees and surrender charges may apply.)

Annuities can be purchased with a single lump sum, with periodic fixed sums, or with variable sums at irregular intervals. This flexibility allows you to tailor purchases to the availability of funds for investment.

Furthermore, as an investor, you can choose between either a **fixed** or **variable annuity**. A ***fixed* annuity** earns a guaranteed interest rate and provides a specific payout when withdrawals commence. It may be more appropriate for conservative investors whose risk tolerance is low and who require safety of principal and predictable investment results. However, if greater growth potential is desired, then you might consider a ***variable* annuity** whose values and premiums fluctuate with that of an underlying securities portfolio.

Most annuities also have a **death benefit** provision (there are some differences between fixed and variable annuities), which can guarantee the passing of at least your original investment (minus any loans or withdrawals you have already received) to a named **beneficiary**.

An annuity may either be **immediate** or **deferred**. In an ***immediate*** **annuity,** the purchaser converts a lump-sum payment into a current income stream. In a ***deferred*** **annuity,** the investor makes either lump sum or periodic purchases that accumulate tax-deferred earnings until some point in the future when a payout program begins.

At the point of payout, several options are available for structuring withdrawals. Most payout arrangements are based on the age and gender of the annuitant. The payout options include: 1) for the life of the annuitant only; 2) to a survivor in the event of the death of the annuitant; 3) for a specified period of time.

While the “life-only” option provides a larger monthly benefit, the survivor option would help ensure an income stream for both the annuitant and a designated beneficiary. Of course, any guarantees such as a minimum death benefit, a schedule of annuity payments, or a fixed return on an investment account all depend on the claims-paying ability of the issuing insurance company.

Given the increasing shift toward self-financing of retirement, annuities can be a powerful tool to supplement IRAs and 401(k) plans. The flexibility in plan options means that you have the potential to design a strategy which best suits your needs.

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