

## A CLOSER LOOK

# Is an Annuity Right for You?

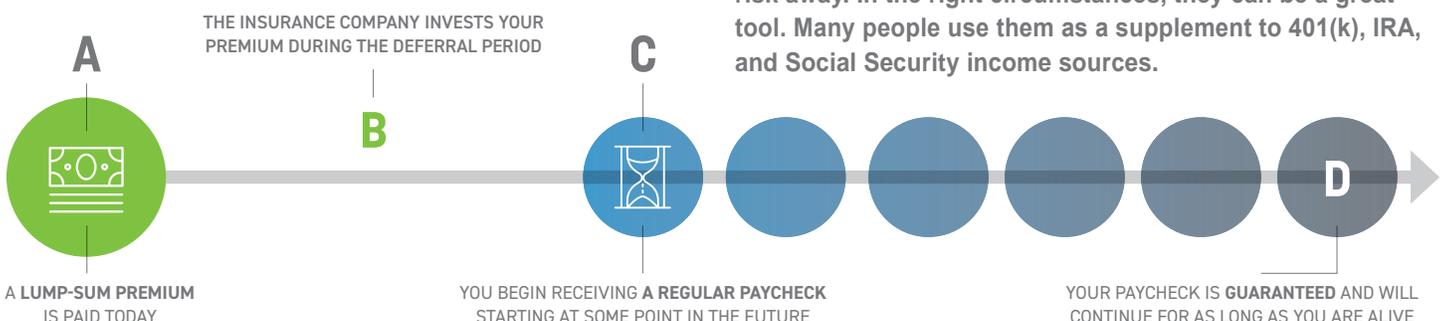
**If you've spent any time thinking about your retirement income, you may have wondered about annuities. Who are they for? Why do people get them? What, exactly, do they do?**

It's actually a simple concept: an annuity is a contract between you and an insurance company. You pay for the contract (the premium), and in return, they send you regular payments every year or quarter or month as income. It's a way to convert a lump sum of money into a stream of future payments.

The insurance company is taking your premium payment, investing it, and disbursing it back to you later. The effective rate of return you get for your investment is generally lower than if you invested it in a low-cost diversified portfolio yourself. But for many investors, the tradeoff is worth it because you're offloading certain risks onto the insurance company—investment risk, longevity risk, tax risk, or some other dimension of uncertainty. That's the real business that insurers are in: bearing risk.

There are many different flavors of annuity. You can receive fixed, variable, or indexed payments. Premiums can be paid in a lump sum or over time. The income can start right away or be delayed until a later date. You can structure the contract to guarantee that if you die before you have received back the value of your premium, the difference will go to your beneficiaries.

## HOW A TYPICAL ANNUITY WORKS



Here are some of the most common reasons why investors choose annuities:

### SCENARIO 1: You want guaranteed income in retirement.

Annuities are often structured with a fixed payment—a guaranteed income. Many investors like to have that certainty in their retirement cash flow.

### SCENARIO 2: You could benefit from deferring taxes on investment returns.

Imagine that instead of buying an annuity, you invested the same amount in a regular taxable investment account in bonds. You'll pay yearly taxes on the interest income and realized gains in that account. By directing the money to an annuity contract, the insurer is investing it for you but the gains don't create a tax liability for you. In this way, annuities are a useful tax-deferring tool for some investors.

### SCENARIO 3: You worry about outliving your other retirement income sources.

The modern retirement system of 401(k)s, IRAs, and similar accounts offers control and a lot of upside depending on how savings are invested. But many still worry about the drawdown phase—that they'll outlive their savings. Annuities can be structured to pay out over a set window ("certain period") or for as long as you live ("lifetime income").

**Annuities are not for everyone. Remember that they're insurance contracts; you're paying to transfer some kind of risk away. In the right circumstances, they can be a great tool. Many people use them as a supplement to 401(k), IRA, and Social Security income sources.**

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