WHAT IS AN ANNUITY?

An annuity is a financial product designed to provide a stream of payments for a specified amount of time at stated intervals. There are many types of annuity contracts. Annuity contracts can present many different options to the consumer, including the amount of the purchase price or premium; how money is invested within the annuity; at what point the annuity begins to make payments; for how long, in what amount and to whom payments will be made; and when an annuity can be liquidated without a penalty. Typically, money invested in an annuity grows tax-deferred, with payouts being taxed when received as income on the return of principal.

WHAT TYPES OF ANNUITIES ARE AVAILABLE?

Annuities may be fixed, variable, or indexed, with immediate or deferred payments. A <u>fixed</u> income annuity generally means that the insurance company makes payments in a guaranteed amount for the duration of the contract. With a <u>variable</u> annuity, the amount the owner receives can fluctuate depending on the success of the investments the company makes with purchase money. The return on an <u>indexed</u> annuity is based on a portfolio of investments that mirror one of several stock market indices such as the Standard & Poor's 500. With an <u>immediate</u> annuity, payments start immediately; with a <u>deferred</u> annuity, payments—or disbursements--start at some time in the future. Deferred annuities can provide for payment streams to occur many years after the issuance of the original annuity contract. This is a critical point to understand when purchasing an annuity.

Payouts may be made for a set number of years, or during the owner's lifetime, or for the lifetime of a spouse or other beneficiary. At additional cost, extra benefits such as a guaranteed minimum death benefit or a guaranteed minimum withdrawal benefit can be purchased. A guaranteed minimum death benefit, or GM<u>D</u>B rider, means that your beneficiaries or your estate will receive a set amount as defined in the contract if you die before the annuity begins paying benefits. A guaranteed minimum withdrawal benefit, or GM<u>W</u>B rider, means that while you are alive you will receive a fixed percentage of your investment each year.

A WORD OF CAUTION IS IN ORDER

Because annuities necessarily result in the loss of liquidity for the account owner to the extent a lump sum is used to purchase the annuity in favor of a payment stream (which may not start for years to come), it is vital that a financial professional determine that any particular annuity is suitable to the financial situation of the owner. Some annuities are considered to be insurance products while others may be considered securities. Different bodies of law, therefore, can govern the sales of each of these products.

Annuities are very complex investment options which may offer strong commissions for the person selling the product. As a result, high-pressured marketing of these financial products can occur. It is important that marketing materials, the strength of the issuing company and the terms of the annuity be studied carefully. The more complex investment schemes with lots of bells and whistles could be smoke and mirrors to make money for the company at the owner's expense. A good test is whether the owner can cogently explain how the investment works and what value he or she is getting for the purchase price. Most importantly, the owner must understand how the annuity fits into his or her overall financial and estate plan, including whether there is a penalty for surrendering the annuity. Maintaining liquidity for foreseeable living expenses is a critical factor to consider when deciding whether to invest in an annuity. Periodic review of an annuity contract is important to confirm that it continues to fit the owner's needs. Many annuity contracts let the owner change some of the options. Before making a change, the owner should understand the tax consequences of that decision.