Financial Wellness
& Education

Understanding annuities

Thinking ahead

There's no mystery to providing for a comfortable retirement—it begins with careful preparation. And the sooner you begin, the better. This is particularly true when one considers realities such as inflation, taxes and potential cuts in Social Security benefits. To deal with these issues, many investors are making annuities a part of their retirement strategy. To develop a better understanding of annuities and how they work, it's necessary to begin with the basics.

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What is an Annuity?

An annuity is a contract issued by an insurance company that guarantees a steady stream of payments at some point in the future. Traditionally, annuities safeguard against the risk of an investor outliving his or her assets by providing periodic income payments that can be guaranteed for life. When used judiciously, as long-term investment vehicles that grow tax-deferred, annuities can be a powerful financial product. There are many types of annuities to consider, including: Immediate, Deferred, Fixed, Variable, Bonus, Single Pay and Flexible Pay.

Immediate versus Deferred Annuities

An immediate annuity is purchased with a single payment and is designed to generate an immediate stream of income. Payments to the annuitant typically begin within 60 days after the contract has been annuitized (converted into income). A deferred annuity, on the other hand, is characterized by an accumulation period. The contract owner funds a deferred annuity by making periodic premium payments or by making a single, lump-sum payment. The assets accumulate tax-deferred and payments are put off until a later date, at which time the contract owner may select a payout option.

Fixed versus Variable Annuities

Annuities that offer a guaranteed rate of return for a set period of time are called fixed annuities. This rate is determined and guaranteed by the life insurance company that issues the contract. In a variable annuity, you are offered investment choices through a selection of "subaccounts" whose values will fluctuate over time. Consequently, the return on a variable annuity is a direct reflection of the investment performance of the subaccounts. The choice of a fixed or variable annuity usually depends on the contract owner's specific needs and goals, as well as risk tolerance.

Single Payment versus Flexible Payment Annuities

A single payment annuity is purchased with a single lump-sum payment at the inception of the contract. This means that the funding of this annuity is achieved with one payment. Conversely, flexible payment annuities are purchased with periodic payments, payable on a flexible schedule.

Benefits of diversification

With variable annuities, your money is pooled with that of other variable annuity and variable life insurance owners with similar objectives and is invested in professionally managed portfolios. Most variable annuities allow you to choose among portfolios of stocks, bonds and money market instruments. This affords you the advantage of greater diversification. In addition, you may adjust your allocations among the available subaccounts to rebalance for your risk tolerance and circumstances without incurring a current tax liability.

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Tax-deferred advantage

One of the primary advantages of annuities is that they are tax-deferred, which means that you pay no current income taxes on the gains your annuity earns until you withdraw your money. Due to the power of compounding, the value of a tax-deferred annuity will potentially grow faster than a taxable investment earning the same return. Because the government established the rules for tax deferral in an effort to encourage Americans to save for retirement, withdrawals made before age 59½ may be subject to a 10 percent federal tax penalty on the amount of earnings withdrawn, in addition to any income taxes due on that amount. The following chart shows the general advantage of tax deferral:

Guaranteed death benefit

The death benefit guarantees that your beneficiary will never receive less than the amount you contribute to your contract (less any withdrawals you make) even if the balance declines because of market fluctuations. Any assets remaining in your annuity (minus withdrawals and fees) can be paid directly to your named beneficiaries without the cost and delays of probate.

Benefit from our experience

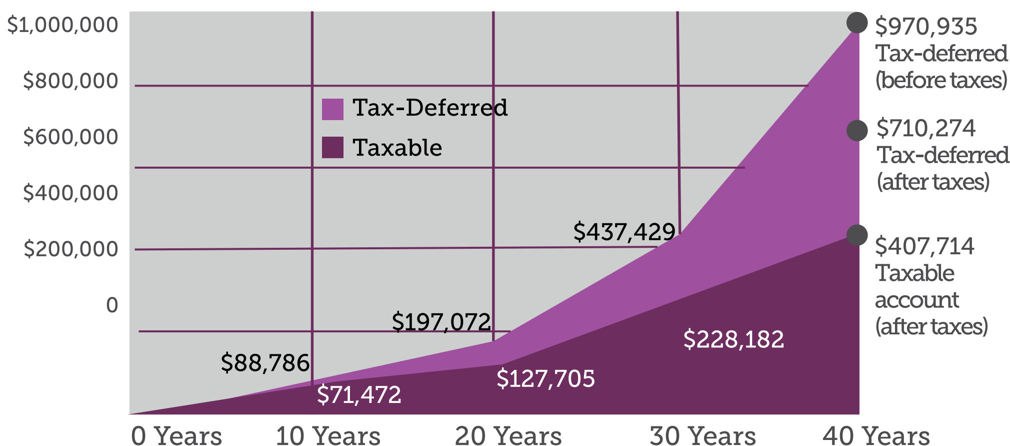
Foresters Financial Services, Inc. provides everyday families and individuals with financial solutions, guidance and tools, to meet their needs across all life stages. Our Financial Representatives offer personalized service combined with a solid, long-term approach and fresh thinking to help you:

- Save and invest for retirement, education and other life events
- Create retirement income strategies
- Protect the ones you love
- Plan your legacy

Together, we can help you achieve financial and family well-being—now and tomorrow, this generation and the next.

Neither Foresters Financial nor its Representatives offer tax, legal or estate planning services. Clients should contact their personal tax and legal advisers for any advice about tax-related investment decisions, estate planning or gifting.

Hypothetical example—the power of tax deferral



The hypothetical assumes a net investment of $40,000 and a constant annual growth rate of 8 percent compounded monthly. It assumes that an effective federal income tax rate of 28 percent applies. In the case of the taxable investment, it is assumed that taxes are paid on gains as earned each year. In the case of the tax-deferred investment, it is assumed that no taxes are paid until the investment is liquidated at which time the taxes are paid on the entire amount of the gain at an effective rate of 28 percent. No reference to any specific product is intended. This illustration does not reflect mortality and expense charges, sales charges and other administrative fees typically found with annuities. Lower maximum tax rates on capital gains and dividends would make the return of the taxable investment more favorable, thereby reducing the difference in performance between the accounts shown. Changes in tax rates and tax treatment of investment earnings may impact comparative results so investors should consider their personal investment horizon and income tax bracket (both current and anticipated) when making investment decisions. This example is hypothetical and does not represent an investment in or performance of any annuity from Foresters Life Insurance and Annuity Company.

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