RETIREMENT INCOME EDUCATION SERIES

Annuities 101

A plain-English guide to how annuities work, the questions to ask, and how to tell if guaranteed lifetime income belongs in your retirement plan.

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0%
Market-loss floor on a fixed indexed annuity; principal is protected from downturns

Lifetime
Income that continues no matter how long you live — you cannot outlive payments

40+
A & A+ rated top carriers an independent advisor can shop to compare options

If you're within a few years of retirement — or already there — you've probably asked yourself two critical questions: *"What happens to my savings if the market drops right when I need to start using it?"* and *"How do I turn a lump sum into a paycheck that lasts as long as I do?"* Annuities were built to answer exactly those two questions. This guide walks through what they are, how the most common type works, what protections they offer, and the honest trade-offs so that if you ever explore one, you're doing it from an informed position.

What This Guide Covers:

- **01** **What an annuity actually is** — The core mechanism & fundamental problem solved
- **02** **The 3 types, in plain terms** — Fixed, Fixed Indexed, and Variable annuities compared
- **03** **How growth & income work** — Account Value vs. Income Base & index crediting
- **04** **Protections, fees & safety** — LTC multipliers, withdrawal rules, and rider costs
- **05** **Is it right for you? + FAQ** — Fit analysis, tax treatment, and top questions

PART 01: What Is an Annuity, Really?

Strip away the industry jargon and an annuity is simple: it's a contract with an insurance company. You give them a lump sum (or a series of payments), and in exchange they guarantee to pay you an income often for the rest of your life, no matter how long that is. People sometimes call it a "private pension" because it works the same way pensions used to: predictable money, on a predictable schedule, regardless of what the stock market is doing.

The short version: a fixed indexed annuity is built to do three things at the same time: **protect your principal**, **provide guaranteed lifetime income**, and **still let you participate in market upside**.

1. The Problem It Solves

Two fears dominate retirement planning: running out of money, and a market downturn hitting right as you start withdrawing. Traditional portfolios don't have a built-in answer to either. An annuity is a tool specifically designed to remove both fears from a portion of your savings.

2. The Trade You're Making

In exchange for the guarantee, your money typically moves into a contract with the insurance company for a set number of years (the surrender period), with limited access above a certain amount each year. You're trading some flexibility for certainty of income.

There are only three sources of truly guaranteed lifetime income:

- **Social Security:** A government-backed benefit based on your work history. For most people, this is the foundation but rarely covers the full retirement lifestyle on its own.
- **A Pension:** An employer-funded guarantee. Once common, now increasingly rare outside government and union jobs — most workers today don't have one.
- **An Annuity:** A guarantee you build yourself, from your own savings, on your own terms and timeline — the one source of the three that you control.

Why this matters: If Social Security and a pension won't fully cover your monthly needs, the gap has traditionally been filled by withdrawing from a stock/bond portfolio and hoping it lasts. An annuity lets you close that gap with a guarantee instead of a hope — using a portion of the savings you already have.

Key Benchmark Comparison:
• **4% Rule:** Traditional "safe withdrawal rate" from a market portfolio designed so a lump sum statistically lasts 25–30 years.
• **7–8%+ Guaranteed Payout:** Typical payout rate insurers offer on an annuity income rider at common retirement ages.

PART 02: The Three Main Types of Annuities

Not all annuities work the same way. The word gets used as a catch-all, but the differences between these three types are significant — especially when it comes to risk.

TYPE	HOW IT GROWS	DOWNSIDE RISK	BEST FOR
Fixed Annuity / MYGA *(Multi-Year Guaranteed)*	A set, guaranteed interest rate for the term; works like a CD, issued by an insurer.	**None.** Rate is locked for the full contract term.	Simple, guaranteed growth without lifetime income rider needs.
Fixed Indexed Annuity (FIA)	Linked to an index (e.g. S&P 500), credited up to a cap or participation rate.	**Zero market risk.** If index drops, credited rate is 0% — not a loss.	Market-linked growth & guaranteed lifetime income option with no principal loss.
Variable Annuity	Invested directly in market sub-accounts (similar to mutual funds).	**Real market risk.** Principal can lose value in downturns.	Growth seeking; carries market risk many retirees prefer to avoid.

A note on variable annuities: A lot of the negative reputation annuities carry traces back to variable annuities sold in the late 1990s and 2000s, many of which lost significant value in the dot-com crash and the 2008 financial crisis because they were still fully exposed to the market. That's a fundamentally different product from a fixed indexed annuity, which has a built-in floor. When comparing options, always confirm in writing which category a product falls into.

Why Fixed Indexed Annuities Are the Most Common Recommendation

They're the only category built to do two things at once: protect principal from market drops (a 0% floor, not a loss), and still offer upside participation when markets do well. That combination is why FIAs are typically the product used when the goal is turning savings into guaranteed retirement income.

Every Carrier is Different

Across roughly 40 A- and A+ rated carriers, there are hundreds of individual annuity products, each with its own cap rates, participation rates, income payout percentages, and bonus structures. Two FIAs can behave very differently — product selection matters as much as the decision to use an annuity at all.

PART 03: How Growth & Guaranteed Income Work

A fixed indexed annuity actually tracks two separate numbers. Understanding the difference between them is the key to understanding the whole product.

1. Account Value

The real cash value of your contract. It's what you'd receive (minus any surrender charge) if you cashed out early, and it's what passes to your beneficiaries as a death benefit. It grows with index-linked interest crediting, subject to a cap or participation rate, with a 0% floor in down years.

2. Income Base

A separate, larger number used only to calculate your guaranteed lifetime payment. It often grows with a guaranteed annual "roll-up" or deferral bonus (commonly in the 4–7%+ range, compounding) for every year you wait before turning income on. It is not a cash value you can withdraw in a lump sum.

Illustration: How Market-Linked Crediting Works

Consider a 3-year hypothetical market sequence:

- **Year 1 (Down Market):** Market Index drops ***-18%*** → **Your Credited Growth: 0%** *(0% Floor Protects Principal)*
- **Year 2 (Up Market):** Market Index gains ***+22%*** → **Your Credited Growth: +22%*** *(100% Participation Applied)*
- **Year 3 (Down Market):** Market Index drops ***-5%*** → **Your Credited Growth: 0%** *(0% Floor Protects Principal)*

*Hypothetical example assuming illustrative 100% participation with no cap. Actual caps, participation rates, and index options vary by carrier and product.

Why Deferring Increases Your Income

Just like waiting past age 62 increases a Social Security benefit, waiting to switch on annuity income lets the income base compound. Turning income on immediately versus waiting five to seven years can meaningfully change the size of the lifetime paycheck — which is why timing is a real planning decision, not an afterthought.

Turning the Income On

Once you activate lifetime income, the payment amount is locked in by contract for as long as you (or you and a spouse, under a joint payout option) are alive. It does not shrink if the market drops, and a joint option continues paying the survivor at the same level.

PART 04: Protections, Access & Fees

Annuities come with real contractual features worth understanding before you commit — both the ones that work in your favor and the costs that fund them.

- **Impairment / Long-Term-Care Multiplier:** Many income riders include a feature that doubles (or increases by 1.5x) your guaranteed monthly payment if you're unable to perform 2 of 6 activities of daily living (eating, bathing, dressing, toileting, transferring, continence). It helps offset in-home or nursing care costs when needed most.
- **Penalty-Free Withdrawals:** Most contracts allow you to withdraw up to 10% of the account value each year, in addition to any guaranteed income payments, without a surrender charge.
- **Surrender Schedule:** Annuities are issued with a surrender period (commonly 5–10 years), during which early full withdrawal comes with a declining charge (starting around 7–10% and stepping down to 0%). Your guaranteed income payments continue on schedule regardless.
- **Rider & Fee Structure:** A guaranteed lifetime income rider typically carries an annual fee (commonly 0.95%–1.5%), deducted from the account value. There are no upfront commissions or advisory fees charged directly to you — independent advisors are compensated by the carrier.

> **Ask to see this in writing:** Before moving forward with any annuity, you're entitled to a full product illustration showing guaranteed values, historical backtested performance, exact rider fees, and the surrender schedule year by year.

PART 05: Safety, Taxes & Is It Right for You?

How Safe Is the Guarantee?

Annuities are not FDIC insured like bank deposits. Instead, safety relies on three strong layers: (1) Carriers hold 3–10x cash reserves relative to obligations to maintain A/A+ ratings, (2) Regular independent agency audits, and (3) State guaranty association backstops. Partnering with 75–100+ year old solvent carriers is paramount.

How Income Is Taxed

Qualified funds (Traditional IRA/401k) rolled into an annuity stay tax-deferred, and income is taxed as ordinary income upon payout. Guaranteed payouts often satisfy Required Minimum Distributions (RMDs) at age 73. Roth dollars grow completely tax-free.

OFTEN A GOOD FIT	WORTH A CLOSER LOOK FIRST
• Want guaranteed income floor for essentials • Concerned about market drops early in retirement • Comfortable committing portion of savings 5–10 yrs • Have qualified funds facing future RMDs	• Need full, immediate liquidity on all savings • Social Security/pension already covers all expenses • Very short time horizon before needing lump sum back • Primary goal is aggressive growth, not income certainty

Frequently Asked Questions

Do I have to put all my savings into an annuity?
No. Most people allocate a portion — often between 25% and 75% of investable retirement assets — and keep the remainder liquid and invested.

Can I lose money in a fixed indexed annuity?

Your principal is protected by the 0% floor. Surrender charges apply only if you exceed free withdrawal limits early.

What happens to the money when I pass away?

Any remaining account value passes directly to your named beneficiaries as a death benefit, outside of probate in most cases.

Want to see what this looks like with your numbers?

A conversation is educational and no-pressure. We shop 40+ carriers to bring you clear, custom illustrations.

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