



**BlackRock**<sup>®</sup>

# **Annuities 101**

How to add security and stability to  
your retirement income

If you are nearing retirement age, you may worry about outliving your savings. You're not alone: The [BlackRock Read on Retirement report](#) found that 1 in 4 plan participants are less confident in how much they might be able to spend in retirement due to volatility and inflation.<sup>1</sup> Fortunately, annuities might be able to help. These are insurance products designed specifically to help tame some of the uncertainties of retirement planning. Better yet, we believe annuities align with individuals' natural risk preferences.

<sup>1</sup> Blackrock. (n.d.). 2023 read on retirement survey – [See the moment.](#)



# Annuities: A sophisticated but compelling purchase

Between rising costs and market volatility, it's not an easy time to plan for retirement. That's where annuities come into the picture; they can help promote financial security. In recent years, there have been a number of meaningful enhancements and innovations made to annuities. As a result, a new lens is required when comparing annuities to traditional investment options such as mutual funds or stocks and bonds. It is essential to understand these tools thoroughly before you decide if they are right for you. This guide will provide an overview and answer some frequently asked questions.

## What is an annuity?

An annuity is an investment product offered by insurance companies to help create a reliable retirement income stream or build retirement savings. These unique products allow you to create something similar to a pension plan, where you can arrange a monthly paycheck.

Annuities are a contract between you and an insurance company, where you pay a set amount either today or over time in exchange for specific future payments. In most annuities, you purchase what is referred to as a guaranteed income, which can make retirement planning easier.

In today's evolving financial world, annuities can play a critical role. They are the only commercially available financial product that can provide a lifetime guaranteed income to ensure you don't outlive your money.

## Why consider annuities?

Because these products were designed for retirement planning, annuities offer features that other investments like mutual funds or target date funds do not. Here are some of the main benefits:

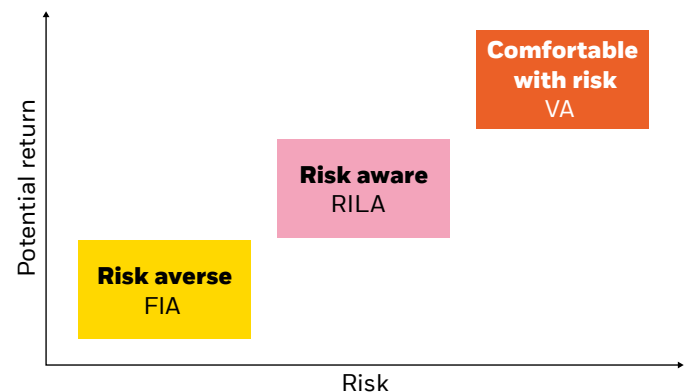
- **Income protection:** A dependable income stream can mean the difference between enjoying your retirement and constant financial uncertainty. Annuities can provide a guaranteed source of income.
- **Market volatility:** Certain types of annuities can help protect you against stock market ups and downs.
- **Tax deferral:** With annuities, you can defer taxes on your interest and investment earnings until you start taking withdrawals. That helps keep more of your money working for you.

- **No annual contribution limits:** Unlike retirement accounts, there is no limit to the amount you can put into an annuity to take advantage of the tax deferral features.
- **Legacy planning:** Many annuities offer the option to add a guaranteed death benefit so you can pass assets or income down to heirs.
- **Flexibility and customization:** Annuities are flexible. You can choose a specific combination of options that meet your needs and goals, whether you are looking for growth, income, or a combination of the two.

## Different annuities for different goals

There is not just one type of annuity. Instead, there are several varieties, each with its own unique features. Because of these differences, it is critical that you understand precisely what you are purchasing and how the annuity's specific characteristics align with your goals.

### Different products fit different clients' needs



## When do you want your annuity payments to start?

Most annuities differ primarily in how your contract has the opportunity to grow. They fall into two primary groups:

1. **Immediate:** If you want to start your annuity payments now or very soon, unsurprisingly, an Immediate Annuity may be best for you.
2. **Deferred:** If you have time to keep the money growing before you start taking payments, a Deferred Annuity might be a better fit.

## What specific annuities can you choose from?

Within the big categories of Immediate or Deferred Annuities, insurers have created a variety of products to fit varying goals and needs. Here are the most common Immediate Annuities out there today:<sup>2</sup> **Income Annuities** or **SPIAs (Single Premium Immediate Annuities)**. By converting a lump sum into a retirement income stream, you can use these tools to create a pension-like monthly payment. And they usually start right away.

## Deferred Annuities

But if you are still some years away from retiring, a Deferred Annuity might be a better fit. With these annuities, your income stream begins after the money has had some time to grow. There are several types of these products, which can help you build a future stream of guaranteed income that will be there when you need it:

- **Qualified Longevity Annuity Contracts (QLACs)** can be used to convert funds from a 401(k) or other retirement accounts directly into a Deferred Annuity. In other words, QLACs help you turn your retirement account into a fixed income stream with guaranteed future payments and are specifically designed to address the longevity aspect of the retirement challenge. You also benefit from a delay in the Requirement Minimum Distributions, allowing you to further compound your money while deferring income taxes.
- **Fixed Deferred Annuities** typically provide you with a guaranteed interest rate. These annuity contracts include protection of your principal, making it more suitable if you want to avoid stock market risks.
- **Fixed Indexed Annuities** offer you the benefits of potential growth as well as monthly payments and protection of your initial investment. Instead of guaranteeing a fixed interest rate, these annuities credit interest based on the stock market's performance.
- **Variable Annuities** offer you upside growth but do not protect your initial investment, so they involve more risk. However, many Variable Annuities offer optional add-on benefits for an additional cost that can provide a lifetime income option or mitigation of market volatility.

- **Registered Index Linked Annuities (RILAs)**, also known as Hybrid Annuities, combine the features of Indexed and Variable Annuities. You can enjoy the returns of the stock market but with the protection of a floor or buffer to limit your potential losses.

## What are the risks?

Every investment carries both benefits and risks. While annuities offer numerous advantages for retirement investors, it's also essential to be aware of potential drawbacks.

- **Fees and expenses:** Annuities are contracts with an insurer, so it is essential to carefully review the costs associated with them before purchasing. Fees and expenses will include costs such as administrative fees, investment management fees, and mortality and expense charges. It's important to factor all of the contract's costs into your overall return.
- **Tying up your money:** Annuities are designed for long-term retirement planning. They are not appropriate for any short-term use. Withdrawing money before you reach a certain age or within a specified timeframe (which will be outlined in your contract) may result in you incurring penalties and a surrender charge.
- **Market risk:** Some annuity products are subject to market fluctuations, especially those linked to investment performance. That means that if the underlying investments perform poorly, the value of your annuity may decrease, impacting your income and/or growth.
- **Annuitization:** Annuitization is the process of converting your investment into a series of periodic income payments. Once you agree to annuitize your investment, you will permanently forego access to that initial lump sum.
- **Surrender charges:** Because annuities shift some or all of your risk to the insurance company, a cost is associated with that. That's why annuity contracts usually impose surrender charges if you withdraw a portion of your funds within a specified period. These charges can vary widely and reduce the amount you receive, so it is vital to understand the provisions of the specific annuity before purchasing.

### Types of annuities

Type of annuity	Tax deferral	Market participation	Guaranteed income	Principal protection	Potential to leave a legacy	Access to your funds up to a certain limit	Purpose
IOVA	✓	✓			✓	✓	Accumulation
Variable Annuity with guaranteed lifetime withdrawal	✓	✓	✓		✓	✓	Guaranteed income
RILA	✓	✓		Partial	✓	✓	Accumulation
Fixed Index Annuity	✓	Linked to an index		✓	✓	✓	Accumulation and income
Fixed Index Annuity with guaranteed lifetime withdrawal	✓	Linked to an index	✓	✓	✓	✓	Accumulation and income
Fixed	✓	Set return		✓	✓	✓	Accumulation

<sup>2</sup> Unless otherwise noted, source for all data is BlackRock, as of March 2024.

## Annuity FAQ

### Q. What happens to an annuity after I die?

A. That depends upon the features you choose when you purchase the annuity. By default, most annuity payments will end after your death. However, if you select a death benefit when you set up the annuity contract, you can specify that a beneficiary gets either the remaining money or a guaranteed minimum. If the beneficiary is your spouse, estate and tax laws give them more control over the annuity than other heirs, such as children or nonprofits, would receive.

### Q. Do all annuities charge high fees?

A. No, not all annuities charge high fees. Annuity fees can vary significantly based on several factors: The type of annuity, the company offering the annuity, and the specific benefits and features. While some annuities have higher fees and expenses, many products are available with lower costs. For example, Fixed Annuities, Fixed Indexed Annuities and Investment-Only Variable Annuities (IOVAs) tend to have lower fees. Variable Annuities with a lifetime income benefit will usually have higher costs.

### Q. What investment options do annuities have?

A. This will depend upon which type of annuity you choose. With Fixed-Rate Annuities, you do not choose the investments. Instead, the insurance company accepts that responsibility and agrees to pay you a

fixed return. However, you will have investment choices if you select a variable annuity. You will decide how to invest that money by choosing specific funds from the investment company's lineup. Then, the value of your investment will fluctuate with the funds' performance.

### Q. Are the payouts taxed if I use pre-tax dollars from an IRA or a 401k to purchase an annuity?

A. If you use pre-tax money to purchase an annuity, all payouts will be fully taxed. On the other hand, if you buy the annuity with after-tax dollars, a portion of the payouts will be classified as a tax-free return of principal. In both cases, you will pay taxes you owe on the annuity at your ordinary income tax rate, not the capital gains rate.

### Q. If I purchase an immediate annuity with after-tax dollars, are the payouts taxed?

A. Since you already paid tax on the amount invested, you'll only be taxed on the annuity's earnings.

### Q. Am I taxed when I withdraw money from an annuity?

A. Some types of annuities allow withdrawals; many do not. With regard to taxes, the IRS allows you to withdraw up to 10% per year from an annuity without penalty after age 59½. Withdrawals over that amount or before age 59½ may be subject to a 10% penalty tax. (Please note that your withdrawal may also be subject to charges or fees from the annuity company if applicable.)

## Key takeaways

Annuities can be a valuable tool in retirement planning, offering you a way to create an income stream, potentially mitigate your losses from market downturns and enjoy some tax deferral benefits. However, this is a significant purchase, so it's wise to carefully consider it. Take your time, do your research and carefully compare your options. While it can mean a bit of extra work, doing it right may help add significant stability to your retirement.

## Can an annuity help you achieve your retirement goals?

Reach out to a financial advisor to learn more today!

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A Guaranteed Lifetime Withdrawal Benefit is an optional living benefit rider that provides an income stream in the form of annual withdrawals of a specified minimum percentage for life, regardless of market performance. A GLWB typically must be elected at issue if the owner(s)/annuitant(s) are within the age specifications as set forth in the contract/rider. GLWB riders require an additional charge (could be applied to the contract value or income benefit base) and may be irrevocable once elected. Withdrawals that exceed the annual withdrawal limit may have a negative impact on the benefits of the GLWB rider. Typically any portion of the annual withdrawal limit not withdrawn during a contract year may not be carried over to the next contract year. The cap rates and spread rates associated with fixed indexed annuities may significantly limit the opportunity for step-ups under a GLWB rider. Income taxes may apply to annuity distributions to the extent of gain. Carriers typically reserve the right to increase the charges associated with a living benefit, subject to a defined maximum rider charge that is stated at the time of purchase. In addition, carriers typically reserve the right to reject or limit additional premiums after contract issue. Read your contract carefully to determine what changes the insurance company may make to these features.

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