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A Quick-and-Easy Guide to Annuity Terminology

Understanding the different types of annuities and related terms you may hear in conversations with your financial professional or see in annuity brochures or contracts.

Annuities can be an important part of a retirement plan, offering diversification benefits, protection for existing savings, and a source of steady retirement income. There are different types of annuities, each with special features. Here's a look at the main types of annuities and definitions for unique terminology related to these financial tools.

Q: What are the different types of annuities?

All annuities are financial products sold by an insurance company through a financial advisor. There are four major categories of annuities, each with unique sets of characteristics and protections that can vary by insurance company:

Income Annuities

Income annuities turn a portion of someone's assets into a guaranteed stream of regular income payments, which can begin immediately (using a Single Premium Immediate Annuity) or at a future date (using a Deferred Income Annuity). These payments are not affected by market movements, meaning the investment in both types of income annuities do not carry market risk.

Fixed Annuities

Fixed annuities protect a portion of someone's assets from market losses, but provide guaranteed growth at a fixed interest rate over the term of the annuity. That growth is tax-deferred, meaning that annuity owners don't owe taxes on those interest payments until they begin making withdrawals.[1]

Index-Linked Annuities

Index-linked annuities allow someone to use a portion of their assets to take advantage of market growth while receiving a level of downside protection. Investments in an index-linked annuity can be partially protected from market losses in exchange for a cap or other limits on growth. Growth opportunities are based, in part, on the performance of a selected market index, such as the S&P 500® Index. Index-linked annuities don't invest directly in the market, but track their performance instead.

For example, an index-linked annuity might achieve growth equal to a portion of the market's return during a specific period of time, such as 80% over six years. This upper limit of growth potential is called the annuity's **cap rate**. If the market performs well, the account value rises proportionally, up to the cap rate. If the market experiences a loss over the selected period of time, the investment in an index-linked annuity is partially cushioned, with the annuity's value declining only to a limit offered by the insurer, such as the first 10% of the market's loss.

Variable Annuities

Variable annuities offer the highest growth potential for building long-term retirement savings, but they also carry more risk than other types of annuities because the underlying funds are directly exposed to the market. The money saved in a variable annuity is invested in subaccounts of the owner's choosing that offer exposure to stocks, bonds, or money market accounts. As a result, the annuity's value will increase or decrease in relation to market fluctuations. However, optional benefits can offer additional protections, such as guaranteeing future income payments regardless of declines in the annuity's account value or, in the event of the owner's death, guaranteeing a minimum payment to the beneficiary equal to the value of the purchase payments minus any withdrawals.

[1] If you're buying an annuity to fund a qualified retirement plan or IRA, you should do so for the annuity's features and benefits other than tax deferral. That's because tax deferral is not an additional benefit of the annuity. References throughout this material to tax advantages, such as tax deferral and tax-free transfers, are subject to this consideration. In addition, non-qualified annuity contracts owned by corporations do not receive tax deferral on earnings. If your annuity funds an IRA, there are amounts you may be required to withdraw from this account after age 70½ under the IRS required minimum distribution rules (which include free withdrawals already taken in the current contract year).

Q: What terms should I know to better understand annuities?

Annuities come with a range of special terms related to their features, benefits, and fees. Here are important terms to understand:

Account Value	For most annuity types, the account value is the sum of all purchase payments increased by accumulated interest, minus any withdrawals. The account value does not necessarily represent the value available for immediate withdrawal.[2]
Accumulation Period	The time between the first purchase payment toward an annuity and the date upon which annuity payments begin. Interest credits or other growth that occurs during the accumulation period is tax-deferred.
Administration Charge	A fee charged by an insurance company to cover the costs of administering the annuity. The administration charge is typically deducted on a daily basis based on the daily net asset value of the annuity's investment portfolios.
Annuitant	The natural person (not a company or trust) on whose life annuity payments are based – the annuitant's life expectancy and age are used to calculate the annuity payments. The annuitant collects the benefits of the annuity.
Annuitization	The process of converting the annuity's account value into a schedule of regular annuity payments. Annuitization is based on a number of factors, including the account value and the annuity option elected.
Annuity	An annuity is a contract between the annuity owner and the issuing company that requires the company to make payments to the annuitant, either immediately or in the future.
Annuity Payments	The series of regular payments made to an annuity owner during the distribution period as outlined in the annuity contract. Annuity payments are made up of a proportional return of principal and growth from earnings or interest over time.
Benefit Base	A hypothetical amount (not actual cash value) used to calculate the annuity owner's optional benefits within a variable annuity. A benefit base cannot be withdrawn for cash, and is used solely to calculate the variable annuity's optional guarantees.
Cash Surrender Value	The amount an annuity owner would receive if they cashed out the annuity, minus any surrender charge outlined in the annuity contract.

[2] Withdrawal charges may apply. Withdrawals of taxable amounts are subject to ordinary income tax and, if made before age 59½, a federal income tax penalty of 10% may apply. Distributions of taxable amounts from a non-qualified annuity may also be subject to the 3.8% Unearned Income Medicare Contribution Tax on Net Investment Income if your modified adjusted gross income exceeds the applicable threshold amount.

Death Benefit

A feature that provides a cash payment to a named beneficiary if the annuity owner dies before annuity payments begin. The death benefit typically is an amount equal to the total purchase payments, minus any withdrawals (including any applicable withdrawal charge) at the time of the owner's death. Death benefits are standard with many types of annuities. There are optional death benefits available with many annuities, as well.

Deferred Annuity

An annuity that delays income payments until sometime in the future. Deferred annuities can be purchased with either a lump-sum payment or with regular payments over time.

Distribution Period

Also called the payout phase or income phase, this is the contractually established period during which an annuity distributes principal and accumulated interest to the annuity owner. The distribution period can be for a specific time period or for the annuitant's lifetime.

Dollar Cost Averaging

Strategy that allows for the investment of a fixed amount on a regular schedule versus investing the total amount at one time. Doing so may result in an increased number of shares purchased and a decreased average share price, and may make annuity owners less susceptible to the impact of market fluctuations.

Financial Strength Ratings

A measure of an insurance company's ability to make promised income payments over a specific time period based on ratings provided by agencies such as Moody's and Standard & Poor's. Because an annuity's guarantees are only as strong as the financial security of the insurance company that issued it, financial strength ratings are an important part of the annuity selection process.

Immediate Annuity

An annuity that is purchased with a single, lump-sum payment and that begins paying income immediately.

Investment Management Fees

These may be assessed depending on the investment options within the annuity, and are similar to management fees on mutual funds.

Joint Life and Survivorship

An annuity option that provides annuity payments as long as the annuitant and a second person (the joint annuitant) are both alive. When either annuitant dies, annuity payments continue, as long as the survivor continues to live. Annuity payments end after the last survivor's death.

Mortality and Expense Charges

These charges pay for insurance guarantees in the annuity, including a death benefit, guaranteed lifetime income options, and the selling and administrative expenses of the contract.

Non-Qualified Annuity

An annuity purchased with after-tax dollars that is not part of a tax-qualified retirement plan (e.g., 401(k) plan). Purchase payments made to a non-qualified annuity are not tax-deductible.

Optional Death Benefit	A benefit that can be added to a variable annuity policy for an additional cost to lock in periodic investment gains (e.g., annually) and/or to pay a minimum interest rate on purchase payments to the beneficiary. It can result in a death benefit that is potentially greater than the standard death benefit.
Purchase Payment(s)	Money the annuity owner puts into the annuity (in a single or series of payments) in exchange for regular income payments.
Qualified Annuity	An annuity purchased with pre-tax dollars as part of a tax-qualified retirement plan, such as a traditional Individual Retirement Annuity/Account (IRA).
Riders	An optional contract provision that changes or adds to an annuity's features or rules in exchange for a fee. For example, a guaranteed lifetime withdrawal benefit rider offers guaranteed lifetime income, while an optional death benefit rider can provide enhanced death benefit guarantees.
Rider Charges	These charges compensate for the risk assumed in providing the benefit of the rider. This may include contractual annual increases to living or death benefit guaranteed amounts and/or guaranteeing minimum income amounts for life.
Surrender Charge	See Withdrawal Charge
Withdrawal Charge (also known as a back-end load or contingent deferred sales charge)	Fee charged when a variable annuity contract is redeemed within a set period of time after purchase. It is a percentage of the contract's value and decreases each year during the holding period (usually 5-10 years) until it reaches zero.

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