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Good Information for Good Decisions.®

FINANCIAL PLANNING

ANNUITIES



OUR MISSION

The mission of The USAA Educational Foundation is to help consumers make informed decisions by providing information on financial management, safety concerns and significant life events.



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2 WHAT YOU SHOULD KNOW

If one of your financial goals is to maintain your current standard of living after you retire, you should take steps now. Annuities are useful financial tools that can help you achieve your retirement saving and income goals.

This publication contains information to help you understand:

- How annuities work.
- How to select the right annuity features.
- How to purchase an annuity.

What Is An Annuity?

An annuity is a contract between you and an insurance company. It can be part of a long-range retirement plan. It has three stages: **start-up**, **accumulation** and **payout**. When you purchase an annuity (start up), you pay the insurance company an amount of money, either in a lump sum or series of payments. Your money has the potential to grow tax-deferred over time (accumulation). In the final stage (payout) you have options depending on how you want to receive the money in retirement. The options include lump-sum payment or an income stream that cannot be outlived.

What Are The Benefits Of An Annuity?

- An annuity can provide something no other planning tool offers — **the potential for lifetime income**. Annuities are designed to protect you from outliving your savings.
- When an annuity is owned by an individual, all **earnings are tax deferred** for current federal income taxes. In other words, earnings are taxed only when you take money out of the annuity. Over time, tax deferral, combined with the benefits of compounding, may help your money to grow faster.
- Annuities offer a **wide range of withdrawal and payment options**, so you can tailor a plan to fit your needs. You may choose a lump-sum withdrawal or a series of periodic payments, with payments beginning immediately or at a future date.

What Is The Financial Role Of An Annuity?

You may be concerned that financing your retirement will be more expensive than you imagined — and, like many individuals, you may be facing crucial investment decisions that will affect your future lifestyle. For example, some employers are eliminating or reducing their contributions to retirement plans. This means more Americans are responsible for supplementing their retirement income through careful planning, investing and money management.

Even if you have substantial net worth, not all of your investments may be income-generating. For example, some stocks do not pay dividends. Even stocks that pay regular dividends may not provide enough money to live on.

Many individuals' primary real estate investment is their home, but it generally will not produce regular retirement income, either. You might be able to arrange a reverse mortgage or secure a loan against your equity, but these options will reduce the value of your equity.

Many individuals find it useful to sell non-income producing assets and then use the money to purchase a financial product. Annuities can provide income guaranteed to last as long as you live. If you are planning for the future or already living in retirement, an annuity can help ensure your financial security in the years ahead.

Who Should Own An Annuity?

An annuity can fill the retirement income gap if you:

- Contribute the most you can to employer-sponsored retirement plans such as 401(k) or 403(b) plans and need to save more for retirement.
- Have already contributed the maximum to a Roth or Traditional IRA — or your adjusted gross income prohibits you from contributing to such accounts.
- Already have investment or savings accounts that can be quickly converted to cash.
- Need to generate a guaranteed, steady retirement income.
- Need to ensure a steady income for your spouse or another beneficiary after your death.
- Expect to be in a lower federal income tax bracket in the future.
- Want protection, safety and guarantees for your money.

MANY EXPERTS SUGGEST A RETIREE'S FIXED EXPENSES SHOULD BE COVERED BY A GUARANTEED SOURCE OF INCOME, SUCH AS SOCIAL SECURITY OR A DEFINED BENEFIT PENSION. AN ANNUITY CAN HELP FILL THE GAP.

4 ANNUITY BASICS

How Do Annuities Work?

There are two basic types of annuities: **fixed** and **variable**.

A **fixed annuity** income remains steady, even if returns on other investments slump due to a changing economy, declining interest rates or falling stock prices. A **variable annuity** income can rise and fall with your chosen portfolio performance. You may earn higher returns, but those returns are not guaranteed. Although the value of a variable annuity may fluctuate in the accumulation phase, it can be annuitized — begin a series of payments — as a fixed annuity. Thus, the payment only varies if you select a variable payout.

FIXED ANNUITY	VARIABLE ANNUITY
<ul style="list-style-type: none">• Earns a steady interest rate set by the insurance company.• Guarantees an unchanging income stream for your lifetime or another specific time period.• Appeals to people who want to ensure a steady, level, reliable income.	<ul style="list-style-type: none">• Lets you allocate your money among professionally managed stock, bond and cash equivalent portfolios.• Payouts may vary with portfolio performance.• Offers greater potential returns but are riskier than fixed annuities.

There are two basic types of annuity payouts: **immediate** and **deferred**.

IMMEDIATE ANNUITY	DEFERRED ANNUITY
<ul style="list-style-type: none">• You put in a lump sum and your insurance company begins monthly payments to you right away.	<ul style="list-style-type: none">• You put in a lump sum or series of payments with your insurance company, with payments to begin at a future date.

Contract Types

Combining the fixed, variable, immediate and deferred annuity alternatives creates four annuity options based upon a combination of underlying annuity choices and when payments begin:

- **Fixed immediate annuity** — You put in a lump sum and your insurance company starts making regular, equal payments to you right away.
- **Variable immediate annuity** — You put in a lump sum and your insurance company begins making payments right away, but the amount of the payments will fluctuate based upon the return from the portfolio.

- **Fixed deferred annuity** — Your payments earn interest at a rate set by the insurance company with a guaranteed minimum annual rate of return until payout begins at a future date.
- **Variable deferred annuity** — Your options may include stock and bond funds offered by your insurance company. When payout begins, your account may be worth more or less than your initial investment, depending upon the performance of your portfolio.

Annuity Payout Options

Along with choices about how to fund your annuity and structuring your contract, you will have payout options. Common payout choices offered by insurers include:

- A **lump-sum** alternative, which allows you to withdraw the total amount of your annuity.
- An **as-needed** alternative, which allows you to withdraw the amount you need when needed.
- A **systematic** alternative, which allows you to withdraw a specified amount until your annuity is depleted. Under the systematic alternative, how much you receive — and for how many months you receive it — depends upon how much you have in your account and how much you are withdrawing each month.
- An **annuitization** alternative, under which you may receive either a **life option** where the income stream is guaranteed by the insurance company or **period-certain option** for a designated period — for example, for the rest of your life, as long as you or your spouse are alive, or a set period (such as 10 years). Common payout options include:
 - The **life option**, which provides an income stream for life because they are calculated based upon the life of the annuitant only.
 - The **joint life option**, which continues annuity payments to a spouse or another beneficiary upon the annuitant's death. The monthly payment is lower than that of the life option because it is based on the life expectancy of both the annuitant and the beneficiary.
 - The **life with cash payment option**, which provides regular payments for the lifetime of the annuitant, with any remaining balance paid to the beneficiary in a lump sum.
 - The **period certain option**, under which the payments are made over a defined period of time, such as 10, 15 or 20 years.
 - The **life with guaranteed term option**, which provides a lifetime income stream with payments guaranteed to continue for at least a specific term, such as 10 years. If the annuitant dies during this guaranteed period, the insurance company is required to continue payments to the estate or beneficiaries for the remainder of the guaranteed term.

Consult a financial planning professional to determine the best option for your situation. Remember, payout amounts for each option will depend on the amount of money in your annuity, the payout period you select and the life expectancy (based on age and gender) of the annuitant or annuitants.

6 SELECTING AN ANNUITY

Choosing The Right Annuity: Things To Know

- Understand that an annuity is a contract between you and your insurance company under which you pay the insurer a sum of money, either in one payment or a series of payments. In return, you receive periodic payments that begin immediately or at a future date.
- Consider that an important benefit of an annuity is tax deferral. You do not pay federal income taxes on the annuity's earnings until you withdraw money. At that point, the growth in funds you receive is taxed as ordinary income.
- Your contributions may be made with either pretax or after-tax dollars, depending upon your situation and the terms of your contract.
- Choose a beneficiary. If you die before your payout period begins or at some point during your payout period, your beneficiary may receive a death benefit. The benefit may be the remaining money in your account or a preset minimum. Generally this benefit is paid to the beneficiary you specify, without the potential cost, delay and publicity of probate. This can provide peace of mind to the annuity owner.
- Variable annuities offer a range of options and the ultimate value of your variable annuity will depend on the performance of the options selected. The investment options typically are mutual fund-like "sub-accounts" which may include stocks, bonds, money market instruments or a combination of the three. For this reason, variable annuities are considered securities and are regulated by the Securities and Exchange Commission (SEC).
- Remember that a fixed annuity guarantees future payments and can be a good conservative option. Fixed annuities generally are not considered securities and are not regulated by the SEC.
- An equity-indexed annuity is a fixed annuity that offers a guaranteed minimum interest rate linked to an index such as the S&P 500. If the index moves upward, the interest rate generally increases by some amount. If it moves downward, no less than the guaranteed interest rate is paid.
- When considering a variable annuity, keep in mind the fees, expenses and penalties that may affect the value of your annuity. Understand that you may incur mortality and expense-risk charges, as well as administrative fees. Any fees and expenses will be listed in the annuity contract, or in the case of a variable annuity the fees and expenses can also be found in the prospectus.
- In addition, be cautious that if you take money from your annuity prior to age 59½, you may incur a 10 percent IRS penalty in addition to any taxes for which you may be liable. Exception: All withdrawal and IRS penalties may be waived if a life based annuitization is selected.
- Since the contract is backed by the financial strength of the insurance company, be sure to review the financial ratings of the insurer.

IMPORTANT TAX INFORMATION: IF YOU TAKE MONEY FROM YOUR ANNUITY PRIOR TO AGE 59¹/₂, YOU MAY INCUR A 10 PERCENT IRS PENALTY IN ADDITION TO ANY TAXES FOR WHICH YOU MAY BE LIABLE.

Other Considerations

When purchasing an annuity, consider the following:

- Costs may include annual fees, investment management fees, insurance expenses and other charges. Extra features, such as long-term care riders and liquidity options, typically have costs associated with them.
- Some annuities offer death benefit protection or the option of continuing payments to a beneficiary after your death. This may help your loved ones avoid the time and cost of probate for these funds.
- Because annuity earnings are taxed for federal income tax purposes only when you withdraw funds or receive payouts, you may pay less federal income taxes.
- Fees are generally charged on partial withdrawals or surrenders from an annuity for some number of years before annuity payments have begun.
 - These fees, called surrender charges, are usually a percentage of the amount withdrawn.
 - Some deferred annuities offer a “free withdrawal” privilege that lets you take out a defined amount without a surrender fee.
 - Surrender fees may also be waived if you annuitize, converting your deferred contract into an income stream.
- An option for income annuities is life income with a guaranteed return of premium. Under this option, payments continue as long as you live. If something were to happen to you, payments are guaranteed to continue until all money — everything you put in — has been paid back to you or to your beneficiaries. This is referred to as a “guaranteed return of premium.”

With your financial goals in mind, you should begin any annuity selection process by asking the following questions. After you have answered them, your financial planning professional can help you make additional decisions regarding the best annuity for your needs.

HOW DO I WANT TO PAY INTO MY ANNUITY — SINGLE OR FLEXIBLE PREMIUMS?



With a **single-premium annuity**, you pay the issuing insurance company a one-time lump sum. The required minimum contribution will vary.



With a **flexible-premium annuity**, you make a series of payments to the insurer over time. You determine the payment schedule (monthly, quarterly, semi-annually or annually) and amounts (they can remain steady or fluctuate).

HOW DO I WANT MY MONEY TO BE ALLOCATED — FIXED OR VARIABLE?



Fixed annuities earn a steady interest rate set by the insurance company and guarantee an income stream for your lifetime or a specific duration. Visit www.sec.gov/answers/annuity.htm for more details.



Variable annuities let you allocate your money among professionally managed stock, bond and cash equivalent portfolios. Current value and payout amounts may vary with portfolio performance. They offer greater potential returns but are riskier than fixed annuities. Visit www.sec.gov/answers/annuity.htm for more details.

HOW DO I WANT MY MONEY TO BE PAID OUT — FIXED OR VARIABLE?



Fixed payout is a guaranteed stream of payments over the life of the annuity. The payout rate is set by the insurance company and the fixed payout amount may be made monthly, quarterly, semi-annually or annually.



Variable payout is a stream of payments where the payout amounts may vary with portfolio performance.

HOW SOON DO I WANT PAYMENTS TO BEGIN — IMMEDIATE OR DEFERRED?



Immediate annuities turn the money you provide into regular income right away — usually within 1 to 3 months.



Deferred annuities begin regular payouts in the future. A portion of early withdrawals may be subject to a surrender charge.

Before purchasing an annuity, look for a reputable, financially sound insurance company. Annuity fees, quality and security can vary widely from one company to another. Remember the following:

- Annuities are not backed by the federal government.
- Your annuity contract is only as strong as the insurance company's financial position.
- Most states have guaranty associations that may preserve some portion of your money if an insurer becomes unable to meet its obligations. However, guaranty associations limit the amounts guaranteed.
- It may be wise to consult a tax accountant or financial planning professional who can help you select the best annuity for your personal present and future needs.

Compare Insurance Companies

Selecting the right insurance company is an important decision. Consider the following factors when evaluating the financial strength of the companies you are considering.

- Is the company licensed in your state?
- Does the company have a reputation for excellent customer service?
- Is the company highly rated by independent rating agencies?

Look for a company with consistently good ratings across multiple agencies. Although a company's financial strength may not affect a variable annuity's performance, it could affect the company's ability to meet the terms of your contract.

INDEPENDENT RATING AGENCIES	TOP TWO RATINGS
A.M. Best www.ambest.com	A++ Superior A+ Superior
Fitch www.fitchratings.com	AAA Exceptionally strong AA+ Very strong
Moody's www.moody's.com	Aaa Exceptional Aa1 Excellent
S&P www.standardandpoors.com	AAA Extremely strong AA+ Very strong
Weiss www.weissgroupinc.com	A+ Excellent A Excellent

Compare Products

Once you have selected several financially strong companies, begin comparing their annuity contracts. To ensure accurate comparison, compare fixed annuities to other fixed annuities and variable annuities to other variable annuities. Be certain you have done your homework by gathering and evaluating important product information.

- Examine applicable expenses and surrender charges.
- If considering a deferred fixed annuity, examine the history of the interest rates the company has paid over time.
- If considering a variable annuity, examine the fund managers' track record and the funds' performance history.

Comparing Annuity Contracts

Different annuities offer a wide range of choices, prices, features and flexibility. Use the following chart to compare annuity contracts you are considering. Skip items that do not apply.

FEATURES	CONTRACT A	CONTRACT B	CONTRACT C
Initial minimum premium			
Guaranteed rate of return			
Current rate of return			
Projected rate of return			
3–5 year rate of return			
Portfolio options			
Sales charge			
Surrender charges/Penalties			
Surrender value			
Other fees			
Special features			

Special Needs Or Goals? Examine Alternative Types Of Annuities

In addition to the traditional types of annuities and payouts examined in this publication, there also are annuities designed to meet special needs or goals.

- A **charitable gift annuity** is a contract between you and a charitable organization. You agree to make a gift to the charity and in return, the charity agrees to make income payments to you for the rest of your life. The charity may choose to buy an income annuity from a life insurance company to fulfill the obligation, or it may take on the responsibility directly.
- **Medicaid annuities** are one of the options individuals have used to ensure they have money set aside to cover health care costs and that they also receive the maximum benefits allowable under their state's Medicaid law. Because available options on Medicaid annuities vary by state, you should consult your financial planning professional for advice and guidance about the choices available to you.
- A **split annuity** option puts two different annuity products to work for you — an immediate annuity to provide monthly income and a deferred annuity that is intended to increase in value. Once the value of the immediate annuity is depleted, you may begin withdrawals from the deferred annuity.
- A **tax-sheltered annuity (TSA)** is also known as a **403(b) Plan**. Certain employees of public educational institutions and tax-exempt organizations may be able to contribute to a 403(b) plan, if one is offered by the employer. With a 403(b) plan, you may make pretax contributions to your retirement account; which will reduce your income for federal income tax purposes; and have your earnings grow tax deferred.

A Final Reminder About Taxes

When an annuity is owned by an individual, earnings generally are tax deferred for current federal income taxes. This means that earnings are not taxed until you start taking money out of the annuity. However, there are additional tax matters you should consider.

- If you want to transfer an annuity to another individual, ask about gift and federal income tax consequences.
- If you are buying an annuity for a trust, corporation or partnership, be familiar with the tax effect of Internal Revenue Code Section 72(u).
- If you want to buy more than one annuity, ask about “aggregation.”
- If you want to move money from one annuity to another, consider a Section 1035 Exchange to protect your money from the loss of certain federal income tax advantages.
- Federal income tax may be due on the growth and possibly on the contributions. Consider seeking the advice of a tax professional.

REMEMBER: BEFORE PURCHASING ANY ANNUITY, LEARN AS MUCH AS POSSIBLE ABOUT HOW THEY WORK, THE BENEFITS THEY PROVIDE AND THE CHARGES YOU WILL PAY.

Change Your Mind?

In most states, you have a specific number of days after purchasing an annuity to terminate your contract and receive a full refund. State insurance departments typically require insurance companies to provide this “free-look” period, during which you may review your contract.

RESOURCES



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MAKING MONEY WORK FOR YOU (#523)

**PLANNING FOR RETIREMENT
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