



## ANNUITIES

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Today most working Americans face a retirement challenge: Because we're living longer, we'll need more retirement income than any generation thus far. But at the same time, most traditional sources of retirement income -- personal savings, employers' pension programs, and even social security -- are all under threat. Just take a look at these gloomy statistics:

- Most experts say that you'll need anywhere from 70 to 90 percent of your pre-retirement income at retirement in order to avoid major reductions in your standard of living. -
- If you'll be pursuing those expensive retirement dreams that include vacations, classes, or other costly adventures, you'll need closer to 100 percent of your pre-retirement income.
- On average, affluent Americans have \$69,000 in their retirement savings accounts . . . but they'll need \$1 million or more. The average American of more modest means, on the other hand, isn't doing much better and has saved less than \$35,000 for retirement

Given the challenges ahead of us when it comes to saving for retirement, we've got to make the most efficient use of the funds we've managed to set aside. For decades, the annuity has been one of the most popular retirement savings vehicle. It has also been popular with families looking for effective ways to build a legacy for the next generation.

### WHAT IS AN ANNUITY?

Simply put, an annuity is a financial product you buy -- usually from an insurance company -- that pays you an annual distribution of money when you retire or as early as age 59 ½, if you desire. How much money you receive each year depends on several factors, such as how large an annuity you purchase, your age and life expectancy, and the type of annuity you purchase.

Like other qualified retirement savings vehicles, certain rules apply to annuities:

- Your contributions are NOT tax deductible but your annuity funds grow income-tax deferred.

## THE ANNUITY: KEY PLAYERS

### INSURANCE COMPANY:

Entity that issues the annuity.

**POLICY OWNER:** The individual or entity that purchases the annuity and has rights over it.

**ANNUITANT:** The individual who receives distributions from the annuity, and whose life expectancy is used to determine the amount of annual distributions.

**BENEFICIARY:** The person or entity that may receive any funds remaining in the annuity if the annuitant dies before receiving all distributions.

- You may not withdraw funds from your annuity before age 59 without experiencing a 10 percent tax penalty. In general, any early withdrawals you make are considered to be withdrawals of interest earnings and are taxed accordingly.
- Annuity distributions made after age 59 are considered to be one-part return of principal and one-part interest earnings. The portion that is return of principal is not taxed, but the portion that is considered interest earnings is taxed as ordinary income.
- Any funds remaining in your annuity at death will be counted as part of your estate and may be subject to estate taxes.

## WHAT KIND OF ANNUITY IS RIGHT FOR YOU?

Annuities are versatile products and can often be tailored closely to your needs and your preferences as an investor. Among the two most important considerations to keep in mind are:

- When do you want to receive distributions?
- What kind of underlying investments do you want in your annuity?

## TIMING IS EVERYTHING

When you want to begin receiving retirement distributions will help determine what type of annuity you'll want to purchase. Here are the two options for you to consider:

### DEFERRED ANNUITIES

Do you need a source of retirement income for some time in the future? Then you'll want a deferred annuity. By purchasing the annuity today, you'll be able to use tax-deferred growth to help your funds grow so that you'll have more money for your distributions at some future date. In most cases, you'll be able to purchase your annuity with contributions made over time, rather than making one sizable lump-sum contribution. Or you may be able to fund it with a lump-sum payment.



## **IMMEDIATE ANNUITIES**

Do you want to begin receiving payouts right away and do you have a considerable sum of money available to allocate to your annuity? Then, you'll want to purchase an immediate annuity. Once you make your single lump sum payment, you'll begin receiving distributions based on your age and life expectancy. Because it requires a sizable upfront contribution, immediate annuities are often ideal for those cases in which you've received a windfall from a settlement, retirement fund distribution, life insurance proceeds, etc.

## **WHAT'S YOUR INVESTMENT PERSONALITY?**

Whether you purchase an immediate or deferred annuity, your funds are invested by the insurance company into investment vehicles that earn a rate of return. Which vehicles you choose will depend on your tolerance for risk as an investor. Here are the investment options available to you:

### **FIXED ANNUITIES**

Fixed annuities offer safety of principal and stable investment returns over risk and potentially higher rate of return. Most fixed annuities are invested by the insurance company into its general account, with the insurance company itself backing the investment. In exchange for this high degree of safety, you may usually expect a guaranteed minimum interest rate and a guaranteed distribution for life.

### **VARIABLE ANNUITIES**

For the potential for a higher rate of return, a variable annuity allows you to participate in the financial markets. The variable annuity invests your contributions into subaccounts. These subaccounts usually offer you a considerable range of investment options in which to allocate your money. Typical subaccounts may include stocks, bonds, a blend of stocks and bonds, money market accounts, and precious metals.

While participating in the financial markets allows you to take advantage of the opportunities for greater growth, it also exposes you to the risk of loss. That's why many of the top companies offer products with plan guarantees, such as a minimum guaranteed annual rate of return of 5 percent or market rate, or some combination of both. Some

companies also offer features such as a lock-in rate based on market highs established on an annual, monthly or even daily basis. This provision means that your annuity's rate of return will not fall below this lock-in rate even if market performance falls below it.

Because each company's products differ, be sure to evaluate carefully the prospectus of any variable contract you may be considering.

## IMPORTANT FEATURES TO CONSIDER

Many annuities offer you much more than just a steady stream of retirement income. Depending on the product you choose, you may also be able to purchase these additional riders and add-on coverages:

- **DEATH BENEFIT PROTECTION** . . . Some contracts will pay your beneficiary whichever is greater: your current account value or the original contract value compounded at a rate of 5 percent per year. If you want to be able to add to the legacy you leave to loved ones, then this is an important rider to consider.
- **LONG-TERM CARE COVERAGE** . . . Some contracts offer riders that will provide additional coverage for this costly expense.
- **QUARANTEES** . . . Depending on the insurance carrier, you may be able to select guaranteed rate of returns on some variable contracts or guaranteed payouts at retirement. These features vary from carrier to carrier, so be sure to read the prospectus carefully.
- **ACCOUNT OPTIONS** . . . This feature is especially important for variable annuities. If you want to participate in the markets with your annuity, then you want to make sure the company backing the product offers high-quality investment choices for you to choose from. You'll also want the option of switching between subaccounts periodically as necessary to re-balance your annuity as market conditions dictate. Not all companies allow you to do so. That's why you'll want to carefully consider the prospectus and product literature to ensure this option is available to you.

## EVALUATING THE OPTIONS

First the good news: The great demand of baby boomers for effective retirement savings vehicles have encouraged most insurance companies to offer competitive annuity products. But the bad news is that all annuities are not created equal. There can be a world of difference between one company's contract versus another. So, you have to pay attention to the product's prospectus and its disclosure of benefits, features, expenses and fees. As you do so, keep these points in mind:

- **FEES, EXPENSES, AND CHARGES . . .** How much is the insurance company going to charge you? Variable contracts, in particular, are subject to a number of fees and charges, including those for investment management, administrative fees, etc. These fees will take a bite out of your overall rate of return.
- **THE STRENGTH OF THE COMPANY BACKING THE PRODUCT . . .** Annuities are not insured by the FDIC as your savings deposited with an FDIC-insured financial institution might be. So make sure the insurer backing your annuity is financially sound.
- **SURRENDER CHARGES . . .** Annuities are meant to be long-term investments, not ATM accounts that you can access daily. If you pull your money out early, you'll pay for it. So, even though you may be committed to the long haul, be sure to evaluate how much the company will charge you if you surrender your annuity early, just in case disaster strikes and that's exactly what you'll have to do.

## FINAL CONSIDERATIONS

Annuities have stood the test of time as one potential way to build funds for retirement. But they are a long-term investment and you should carefully evaluate your options before making a decision. Make sure to carefully review the product literature -- and the prospectus for any variable contract you may be considering -- before you make a decision to buy.

And by all means, let us help. The financial professionals at DMG Financial literally have decades of experience helping consumers find the right retirement savings strategies,



such as annuity products. We can show you a wide range of annuity products on the market today and provide you with illustrations that will show you how each one may meet your needs. So let us help you sort through the many options to find just the right product for you. Call us today at 800.983.4448.

## **A B O U T   D M K   A D V I S O R   G R O U P ,   I N C .**

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