

Variable annuities

- ✓ Lifetime retirement income; unlimited after-tax contributions
- ✓ A security: the investor picks investments and bears the risk
- ✓ Immediate vs. deferred
 - **Immediate:** a lump sum; income starts soon after
 - **Deferred:** builds value for years; need not be annuitized
- ✓ Accumulation phase
 - Contributions buy **accumulation units** in the **separate account**, apart from the insurer's general account
 - Tax-deferred growth; income is reinvested
 - Death benefit: greater of basis or account value
 - M&E charges (about 1.25% a year): mortality and expense risk
- ✓ Distribution phase
 - Lump sum or withdrawals: no lifetime guarantee
 - Annuitize: converts to a fixed number of **annuity units**
 - **AIR:** account beats it, payment rises; trails it, falls

Annuitization options

- ✓ **Straight life (life annuity):** stops at death; insurer keeps the rest
- ✓ **Life with period certain:** a beneficiary is paid for the rest of the period; pays less than straight life
- ✓ **Joint with last survivor:** two annuitants, paid until both die; usually less after the first death
- ✓ **Unit refund:** a beneficiary receives any basis not yet paid out

Annuity taxes and charges

- ✓ Non-qualified (assume this by default)
 - Only growth is taxed, as ordinary income; no RMDs
 - Withdrawals: **LIFO**, taxable growth out first
 - Annuitized: **exclusion ratio**, part growth, part basis
- ✓ Qualified (pre-tax money rolled in)
 - All of it taxed as ordinary income; RMDs from 73
- ✓ 10% penalty on the taxable part of withdrawals before 59½
- ✓ Surrender charges up to 10%; periods usually 6+ years

Fixed and equity indexed annuities

- ✓ Fixed: general account, guaranteed (low) rate
 - Insurer bears the risk, so **not a security**
 - Main risk: inflation (purchasing power)
- ✓ Equity indexed (EIA): index-linked, with a minimum guarantee; **not a security**
 - **Participation rate:** share of the index return ($80\% \times 10\% = 8\%$)
 - **Cap (ceiling):** most that can be credited
 - **Spread rate (margin, asset fee):** subtracted from the return
 - **Floor:** least that can be credited; 0% if none is given
 - Crediting methods
 - Annual reset
 - High water mark
 - Point-to-point
 - Low water mark

Life insurance policies

Policy	Coverage	Premiums	Death benefit	Cash value	Investment risk	Security?
Term	Set term	Fixed	Fixed, guaranteed	None	—	No
Whole	Lifetime	Fixed	Guaranteed	General account; fixed rate	Insurer	No
Variable	Lifetime	Fixed	Guaranteed minimum; varies	Separate account; no guarantee	Policyholder	Yes
Universal	Lifetime	Flexible	Flexible	General account; fixed rate	Insurer	No
Universal variable	Lifetime	Flexible	Flexible; often a minimum	Separate account; no guarantee	Policyholder	Yes

Anything **variable** is a security: it is registered, and its seller needs securities and state insurance licenses

Life insurance essentials

- ✓ Term: often 10, 15 or 20 years; premiums rise on renewal
- ✓ Cash value: withdraw or borrow while alive
 - Unrepaid amounts reduce the death benefit
 - Withdrawals above basis are taxed as ordinary income
- ✓ Stop paying premiums
 - Shorter coverage (term)
 - Lower death benefit
 - Surrender for cash value, less fees
 - Life (viatical) settlement: sell it, often when terminally ill
- ✓ Death benefit free of income tax; may face estate tax, unless left to a spouse (unlimited marital exemption)

Suitability

- ✓ Annuities: a supplement, after 401(k), 403(b) and IRA
 - Avoid market risk: fixed
 - Growth, or an inflation hedge: variable
 - Straight life: only if leaving no annuity assets to beneficiaries
- ✓ Life insurance: when a death means financial loss for others
 - Low cost for a set period: term (e.g., a young family in a low bracket)
 - Flexible premiums: universal
 - Inflation concern: variable
 - Guaranteed growth: whole or universal