

History of Annuities

In 1653, a Neapolitan banker named Lorenzo Tonti developed a method for raising money in France called the tontine. Under this arrangement, subscribers purchased shares in exchange for income generated from the capital investment. As shareholders died off, their income was spread among the surviving partners until the last person alive collected all the benefits. The use of tontines spread to Britain and the United States where governments used them to finance public works projects. However, the practice was eventually banned because it created an incentive for shareholders to bump off their partners in exchange for a greater payout.

The tontine was an early predecessor to two of today's most popular retirement vehicles: the deferred annuity and the immediate annuity. Of course, other investors no longer have a stake in your annuity income, but all annuities share three basic benefits that can potentially help you reach your retirement goals.

Annuity Basics to Remember

Before making a purchase, be aware that the guarantees of fixed annuity contracts are contingent on the claims-paying ability of the issuing insurance company. Annuity withdrawals are taxed as ordinary income and may be subject to surrender charges plus a 10 percent federal income tax penalty if made prior to age 59½. Most annuities have surrender charges that are assessed during the early years of the contract if the contract owner surrenders the annuity. Generally, variable annuities contain mortality and expense charges, account fees, investment management fees, and administrative fees. Variable annuity sub-accounts fluctuate with changes in market conditions, and when surrendered, the value may be more or less than the original amount invested. Variable annuities are long-term investment vehicles designed for retirement purposes. They are sold by prospectus only. Be sure to read the prospectus carefully before deciding whether to invest.

Three Basic Annuity Types

Tax Deferral

With an annuity, your contributions are invested during the accumulation phase. Any earnings grow tax deferred and are taxed as ordinary income when you begin making withdrawals.

Unlimited Contributions

Federal law typically limits the amount you can contribute to many tax-deferred retirement programs such as IRAs or 401(k) plans, but annuities are subject only to the sponsoring company's contribution limits.

Flexible Withdrawals

An income stream for life is one option when you begin withdrawals from your annuity, but there are many alternatives. You can take a lump sum or make withdrawals when you need cash. You can even leave the money to continue growing tax deferred as a reserve for unexpected expenses or as a legacy for your heirs, subject to mandatory minimum distribution requirements.

Annuities have come a long way since 1653. Taking time to understand how they work can help you decide whether an annuity is right for you.