FAQs - Ready to Retire

Explanation of Annuity Choices

LVIG
LEHIGH VALLEY
INVESTMENT GROUP

If you are the beneficiary of an annuity, or if you set up one for yourself years ago, one of the most difficult decisions to make is how to start using the annuity for income.

The options are many and there can be a lot of money on the line when you make your decision. So, let's look at issues.

First, let me explain annuities because there are several ways that you can take the money out and there's a trade-off between certain aspects of each option.

Option 1

Called annuitization. This version gives you the maximum amount of monthly/yearly income but gives you the least flexibility in terms of accessing the money and leaving anything for a beneficiary. This is most like the classic pension that people used to get. Once you start, it's a fixed amount paid every month for as long as you live. If you live one year and get run over by a bus, the payments stop. If you live to 105, the payments keep coming. It's a roll of the dice.

No matter how long you live, there is no money left to be paid to any beneficiary and you have no access to the funds. This is a "use it or lose it proposition; once you start collecting, the funds are tied up and unavailable. And there's no payment to anyone else other than you.

There is one wrinkle to this which is that you can name a successor or "joint" payee. If the payee is a spouse, you can have the payments last as long as one or the other of you lives. Otherwise, if your joint payee is a non-spouse, you can only stipulate how long the payments can last. For example, if you choose a "10 year certain" option, you would get paid as long as you live and then the successor would get paid ONLY if you had lived LESS than 10 years. The successor would collect until the 10th year was done. Then all payments stop. If you live beyond 10 years, you get paid but the successor never would.

You can do this typically with 5-year, 10-year and 20-year options. You get paid the most if there is NO successor. If you name a successor, the monthly payment drops based on which version of the above options you choose and the age of the successor. The reduction in payment is between 10%-40% depending on the version you pick.

Option 2

Guaranteed withdrawal. This version is a variation on the #1. Like all variations that follow, this variation will be a trade-off between taking a lower monthly payment in exchange for having more flexibility on the money.

Again, you will start with a monthly amount of money that will be paid to you as long as you live. Live to be 105 and everything is great! They keep paying. However, if you don't live that long, then the beneficiary (same as the successor I referenced above) will be able to claim any of the money left over in the account. Funds are invested with the annuity company while you are waiting to use them. So, if there's $100,000 in the account when you die, then the beneficiary gets that money.

Option 3

Lump sum. In sum cases, the annuity company or the pension fund will allow you take all the funds out at once. If the account is a pension or an IRA, then you are generally allowed to roll over the funds into an IRA and avoid paying the income tax. As a caution, make sure to have a professional do a present value calculation for you before you decide to make sure that the lump sum value is "actuarially fair" relative to your age and a reasonable rate of interest. Company pension plans that offer "lump sum buyouts" often low-ball the retiree with their lump sum offer. So make sure you understand the present value of the benefits before deciding.

Explanation of Annuity Choices

Contact Us

With a better understanding of annuities and the options available to you, you can feel more confident about your financial situation as you near retirement. We're always here to help or answer any questions you may have. Send us a message on our website, www.lehighvalleyinvestmentgroup.com or call us at 610-419-4800 and let's chat.