What is an annuity? — The basics

Part 1 of 9

You may be considering an annuity, and, if that's the case, it is important that you know what an annuity is — and isn't. Basically, an annuity is a contract with an insurance company — a long-term investment for future retirement income. An annuity will make income payments to you at regular intervals in return for your purchase premium (payment).

A popular feature, and one that is unique to annuity contracts, is the lifetime payout option. Yes, an annuity contract can offer you an income stream in retirement that you cannot outlive. Generally, you may choose from a variety of payout options when you're preparing to receive payments from your annuity — the lifetime option being just one. Your annuity payments are guaranteed by the insurance company from which you purchased your annuity, so be sure you investigate the strength and claims-paying ability of the company you choose.

The federal government allows annuities to earn interest tax deferred — and that's to encourage individuals to set aside money for retirement. Annuities are designed to be long-term contracts — they are not appropriate for short-term investment goals. Early withdrawals can incur federal restrictions and tax penalties.

The market offers a variety of annuity types. You can certainly find an annuity to serve your individual needs. But that also means you can wind up with the wrong product if you don't research and ask questions. In our next installment, we'll begin to explore annuity types.