Insurance Made Simple

A guide to Fixed And Variable Deferred Annuities

Deferred Annuities can help a client stay focused on the long-term.

An individual Deferred Annuity is a contract between an insurance company and a policy owner. The owner makes one or more payments into an account with the option of withdrawing money in the form of income annuity prior to annuitization. Withdrawals can lower the death benefits. Deferred Annuities are best suited for clients with a long-time horizon.

How Deferred Annuities work:

A Deferred Annuity is an accumulation vehicle that grows on a tax-deferred basis. It remains a contract where both the income and taxes that are due on the growth are pushed into the future, until received by the owner by annuitizing the contract. The owner can also surrender the annuity amount in a lump sum. Most often, policy holders like the fact that Deferred Annuities allow them to defer taxes until they begin taking income from the annuity during retirement when their tax bracket may be lower than in their working years.

Deferred Annuities feature:

- Tax-deferred earnings;
- The owner pays taxes only when the money is withdrawn from the annuity;
- Funds can be withdrawn in a lump sum or received gradually over time;
- Early withdrawals may be subject to penalties and taxes, like the 10% penalty for withdrawals made by individuals under age 59 1/2;
- The death benefit features a guarantee that beneficiaries will receive at least as much as was put into the annuity if the annuitant dies before any money has been withdrawn. But it is not income tax-free to beneficiaries and guarantees are subject to the claims paying ability of the issuing insurance company;
- Surrender penalties on commissioned annuities have surrender charges that gradually decrease over time;
- Low Load Variable Annuities have no surrender charges and no sales loads. Taxes do apply to withdrawals.

The two main types of Deferred Annuities – Fixed and Variable

Fixed Annuities increase in value according to a specified stated interest rate established by the insurance company for a specified time period. The insurance company accepts the investment risk for these products. Fixed Annuities contain provisions that allow the owner to minimize the risk during market decline. Costs of fixed annuities are hidden. They may include the distribution costs of commissions, the insurance company costs of mortality and administration, state premium tax, and riders selected by the policy owner.

Variable Annuities can vary in value according to the performance of the underlying investment options. The policy owner accepts the investment risk for these products. The amount of money available for annuitization depends on the performance of the underlying investment fund options. The subaccounts in a variable annuity fluctuate with market conditions and when surrendered the principal may be worth more or less than the original amount invested. Cost of Variable Annuities may include the distribution costs of commissions, state premium tax, insurance company loads for Mortality and Expense (M&E), insurance company administration costs, fees charged by the fund managers selected by the policy holder, and riders/special features selected by the policy owner.

Riders can add value.

Riders vary greatly among companies and are subject to availability in certain states. The two most common riders are Living Benefit Riders and Guaranteed Lifetime Withdrawal Benefit Riders. Living Benefit Riders waive surrender charges on funds withdrawn from the contract if the owner qualifies for Long Term Care services. Some allow the same feature if the annuitant becomes unemployed or disabled. Guaranteed Lifetime Withdrawal Benefits can supply an annuitant with a flexible source of income as long as it is needed. Guarantees are subject to the claims paying ability of the insurance company.

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