

SAFE MONEY ADVISORY

What you need to know about Income Annuity Riders



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As George Forman stated, ***“It’s not how much money I have when I retire it is how much income I can receive.”*** Receiving an extra income stream these days—above and beyond Social Security and absent of pensions—may sound very attractive to you, but it’s important that you understand all the critical facts you need to know.

Right now, everyone in the annuity world is talking about the income rider.

What is it? It is an optional rider that you may elect to have attached to your contract, in which the insurance company promises to pay you a specific amount of money in the future.

Some income riders grow at a contractually guaranteed rate that either does or does not compound during the deferral period of the annuity, and others can lock in market gains that can be used for future income. Both sound very nice as long as you know what the difference is and which type of annuity you are purchasing in the first place—a variable or a fixed.

Income riders can work extremely well when preparing for a guaranteed check you can never outlive, using either your qualified or non-qualified accounts for your retirement years. Qualified accounts are pre-tax dollars that include your IRAs, 401(k)s, 403(b)s, SEPs, profit sharing, and pension accounts. Non-qualified is any money outside of these types of plans on which you’ve already paid taxes on, like your CDs or mutual funds in a brokerage account.

The problem I have seen is consumers comparing apples-to-apples between variable annuities and fixed annuities using income riders—without having all the facts. ***There should be no ambiguity whatsoever.***

Example: Most variable annuity owners I have talked to view the income rider rate as an actual yield. This is not true! You cannot walk away with 6% at the end of the contract; it is a rate that the income account is growing at to determine a payout down the road for you, not your actual cash value account.

A common mistake that I see is consumers attaching income riders to their variable annuities instead of a fixed annuity. Variable annuities average fees are 3.01% with 100% risk of your actual principal. Fixed and fixed index annuities have no risk of your principal and almost *always* have fewer fees on their contracts, because there are no mortality and expense charges, nor sub-account fees.

All income riders have four components:

1. **The Rate:** The percentage that it is guaranteed during the deferral period.
2. **The Period:** The amount of time the rate is guaranteed during the deferral period.
3. **The Payout:** The formula that grants the payout (taking into account age, rate, and income account values).
4. **The Fee:** The amount you pay for the income rider guarantee.

Let’s take a closer look at all four.

The Rate: Income riders can have rates typically from 4-7%, some as high as 25%. Just remember this is a rate—not an annual yield—and it is only used to calculate future payouts to you based on the formula within the contract. This is never a yield with a walk-away cash value option.

The Period: The number of years the rate is guaranteed during the deferral period, i.e., 10, 15, 20, etc.

The Payout: This is the most critical part of the equation and is almost never fully understood, because most consumers tend to get lost in the minutia of all the numbers involved here, such as age, percentage rate, and payout rates. The easiest way to grasp this is the longer you wait, the higher the payout. ***The payout is more important than the rate and should be the primary factor with your income rider decision.*** Some rates are higher than others, yet the payouts are less. For example, a 6% income rider may very well have a higher payout at your target age down the road than a 7% income rider. For example: If you were age 55 and deposited \$100,000 into an annuity with an income rider “rate” of 7% and a “payout” of 4%, your guaranteed annual withdrawal would be \$7,869. If the “payout” is 4.5% then your guarantee would be \$8,852 a year. That’s over 12% more income!

The Fees: There are riders that have **NO** fees. Others typically range from 0.50% to as high as 1.50%. Some fees are based on the **income account value of the annuity** rather than the **actual account value**, which is **critical and can cost you more money in fees than you have to pay**. The income account value will almost always be higher than the actual account value as it is growing, for example, at 6% every year. It’s very hard for the cash value to compete with that in a fixed or fixed index or variable annuity year after year.

Combine these four components to a variable annuity and its average fee schedule of more than 3%, versus a fixed or fixed index annuity’s lower fees, you are now compounding your problems with higher fees and risk of your principal.

In conclusion, annuities are the **ONLY** vehicles that can guarantee you income for life, but be sure to do the math when considering income riders on annuities and make sure you know the critical difference between a security product (i.e., variable annuity) and an insurance product (i.e., fixed or fixed index annuity) as they are apples and oranges apart. Ask your financial advisor today about a fixed or fixed indexed annuity with a Guaranteed Lifetime Income Benefit Rider.

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