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Understanding Annuity Expenses





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What is it?

For the most part, **annuities** will impose various administrative charges and fees. At first, the expense may seem minimal. However, over time, the cumulative effect of the charges and fees can be substantial. These expenses typically arise when dealing with variable annuities. However, fixed annuity contracts may also assess fees in the form of surrender charges.

Fixed annuities

Fixed annuities usually do not impose express charges and fees (except for surrender charges). Because there are fewer fees involved with fixed annuities, it may seem that it is the cheaper alternative to the variable annuity. However, this may not always be the case, because a fixed annuity will usually contain implicit charges that are reflected in the interest rates in the underlying contract. These implicit charges arise when the insurance company sets the interest rate that it promises to pay at a lower rate than the rate it expects to earn on its investments (sometimes, the difference is called the spread). This spread allows the insurance company to make sure that it will recover its administrative costs.

Variable annuities

Annual maintenance charge

The annual maintenance charges for variable annuities may typically range from \$0 to \$100. These charges are usually deducted from the various investment accounts in which the annuity holder has placed his or her funds.

Example(s): Mr. Smith purchases a variable annuity from ABC Insurance Company. Mr. Smith has placed 20 percent of his funds in a money market fund and 80 percent of his funds in a growth fund. ABC has an annual maintenance charge of \$50. Mr. Smith's money market fund will be charged 20 percent or \$10. Mr. Smith's growth fund will be charged 80 percent, or \$40.

Tip: Some contracts will waive this charge when the annuity's value exceeds a certain amount (e.g., \$25,000).

Investment management fees

Investment management fees pay for an investment management group that advises the insurance company on which investments to buy and sell. Investment management fees for variable annuities may range from 0.25 percent to 0.75 percent. While a variable annuity account can be charged a flat percentage rate, some variable annuity contracts will call for each type of fund to incur a different percentage cost.

Example(s): Mr. Smith purchases a variable annuity from ABC Insurance Company. Mr. Smith's funds are within a money market fund and a growth fund. ABC charges an investment management fee of 0.35 percent for the money market fund and 0.60 percent for the growth fund.

Mortality and expense risk charge (M & E charge)

The mortality and expense risk charge (M & E charge) is imposed by insurance companies to protect against risk associated with the annuity contract (e.g., an annuitized contract paying out income longer than mortality tables projected the life expectancy of the annuitant). Generally, the M & E charge ranges between 1 percent and 1.5 percent of the value of the variable annuity account. The M & E charge is deducted proportionately from the variable accounts, similar to the annual maintenance charge (discussed previously).

Transfer fee

Some variable annuities will charge a fee for the transfer of funds between investment accounts. These charges can range anywhere between \$0 and \$15 per transfer. Some annuity contracts will allow a certain number of transfers per year without charge, assessing a charge for any transfers over the permitted number.

Surrender charge



Most annuity contracts will assess a charge for partial and full surrenders from the contract during a certain time period after the annuity is purchased (usually 5 to 10 years). This charge is often referred to as the surrender charge and can have a wide range that decreases over time. Depending on the annuity contract, the surrender charge percentage will be applied either to the full amount surrendered or the portion of the withdrawal that exceeds the earnings of the contract. Some annuity contracts allow some withdrawals without a surrender charge (e.g., 10 percent of the contract value or the contract earnings). The surrender charge is intended to prevent annuity owners from moving funds in and out of the annuity and allows the insurance company to recoup its losses if the contract does not remain in force for a lengthy time period.

Tip: Some annuity contracts will provide that there will be no surrender charge if the annuity holder dies or becomes disabled.

Tip: Keep in mind that if you surrender your annuity when you are under the age of 59½, you may also be subject to the 10 percent penalty tax that applies to premature withdrawals.

Miscellaneous fees

Variable annuities might also levy charges for administrative expenses, such as record maintenance, accounting, and reporting. In addition, a variable annuity may charge extra for certain guarantees to be written into the annuity contract. Finally, several states levy a state premium tax on annuity premiums. The tax is generally a percentage of the gross premium paid and it is generally deducted prior to the computation of sales charges. Some insurance companies choose to add the cost of the tax into the price of the premium, rather than levy a direct tax.

Caution: Variable annuities are sold by prospectus. You should consider the investment objectives, risk, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the variable annuity, can be obtained from the insurance company issuing the variable annuity or from your financial professional. You should read the prospectus carefully before you invest.

To schedule an appointment with Faye Sykes, click [here](#) .

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