



# Annuities: Creating Guaranteed Income for Life

Retirement today requires more planning than in previous generations. Sources of steady retirement income have changed, as fewer and fewer workers are covered by traditional employer-provided pensions that provide a lifetime benefit. In addition, advances in medicine have resulted in increased longevity—today's retirees may spend 20, 30 or more years in retirement.

Given this landscape, workers nearing retirement face an imminent crisis: how to generate a stream of income that is guaranteed to last throughout retirement. Whether they have access to employment-based retirement plans or not, achieving stable and secure income in retirement is a challenge for many Americans.

With the decline of defined benefit plans and increased popularity of defined contribution plans, such as 401(k)s, responsibility for managing retirement savings has shifted from the employer to the individual. Unlike traditional pensions that provide a stream of payments to retirees for life, defined contribution plans typically offer a lump sum that retirees must then manage on their own.

Other than Social Security and the defined benefit system, the only means to create a guaranteed income stream in retirement is through an annuity. An annuity is an insurance contract that offers an efficient solution to what otherwise could be an overwhelming asset management task: creating a steady paycheck in retirement that cannot be outlived. It helps to ensure retirees don't overspend and run out of money in retirement and that they don't live too frugally either. Individuals without access to workplace retirement savings plans have an even greater challenge: to independently accumulate savings during their working years and manage those savings to last throughout retirement. An annuity can address both of those needs.



AMERICAN COUNCIL OF LIFE INSURERS



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## SUCCESS OF THE PRODUCT

Annuities offer solutions to both sides of the retirement equation: They provide ways to accumulate retirement savings and to turn savings into an income stream that cannot be outlived.

The lifetime income option through annuitization allows retirees (and their spouses) to maximize retirement income without having to worry about payments stopping while they are alive. At the time of purchase, annuity owners are guaranteed that if they choose to annuitize at a later date, they will receive a benefit based on the purchase rates at the time the annuity was issued or annuitized—whichever rate is more favorable to the annuity owner. Given the changes that can occur over time with respect to the economy, longevity, or an insurer's costs, this is a valuable consumer benefit.

Many insurers offer additional annuity options—such as the guaranteed minimum withdrawal benefit—which allow consumers to create and manage income flow to meet various income needs as they age while still offering guaranteed income for life. Other income options, which do not have a lifetime guarantee, also are available.

Annuities are popular among middle-income Americans: Two-thirds of individual annuity owners have annual household incomes below \$75,000; nearly half have household incomes below \$50,000; and one-third have annual household incomes below \$40,000.<sup>1</sup>

## CURRENT TAX TREATMENT

By encouraging long-term savings during the working years and helping individuals manage assets during retirement, the current tax treatment of annuities promotes financial discipline.

For those who are years away from retirement, or are retired and have assets that don't need to produce income right away, a deferred annuity allows savings to build up, free of current federal income tax. When payments are received, the portion that comes from earnings is taxed as ordinary income.

To encourage long-term savings for retirement, there are tax penalties for withdrawals from deferred annuities before age 59½ in addition to the income tax due on earnings. The tax penalty is not applied to certain lifetime payouts, death benefits, or payments made if an annuitant becomes disabled. Other exceptions may apply.

The current tax treatment has served as an effective savings incentive: 77 percent of individual annuity owners report that they have set aside more for retirement than they would have if the tax-deferred growth of annuities was not available. A large majority cite the tax treatment of annuities as a "very" or "somewhat" important reason for their purchase.<sup>2</sup>

The current federal income tax treatment of annuities is reflective of sound public policy that recognizes the annuity's unique role in helping Americans accumulate savings for retirement and guarantee a steady stream of income for life.

## CONCLUSION

An annuity can help American workers meet the challenges of the changing landscape of retirement. In fact, eight out of 10 individual annuity owners say they will use their annuity savings for retirement income.<sup>3</sup> With the shift from defined benefit to defined contribution plans and increased longevity, the role of the annuity in retirement has never been more important. Policy-makers should explore ways to encourage more Americans to turn to annuities for long-term savings and guaranteed lifetime income.

## ISSUES AND TRENDS

- Sixty-six percent of individual annuity owners have household incomes below \$75,000; 48 percent have income below \$50,000; 34 percent have incomes below \$40,000.<sup>4</sup>
- Eight out of 10 annuity owners say they will use their annuity savings for retirement income.<sup>5</sup>
- During 2006, payments into annuities increased 9 percent to \$329 billion.<sup>6</sup>
- Americans spent \$187 billion on individual annuities in 2006.<sup>7</sup>
- Individual annuity owners received \$42 billion in benefit payments in 2006.<sup>8</sup>

## AALU

Founded in 1957, the Association for Advanced Life Underwriting (AALU) is a professional trade association representing 2,000 life and health insurance agents and financial advisors nationwide. The mission of AALU is to promote, preserve and protect advanced life insurance planning for the benefit of its members, their clients, the industry and the general public.

[www.aalu.org](http://www.aalu.org)

## ACLI

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association. Our 353 member companies represent 93 percent of the industry's total assets, 93 percent of life insurance premiums, and 94 percent of annuity considerations in the United States. They offer life insurance; annuities; pensions, including 401(k)s; long-term care insurance; disability income insurance, reinsurance; and other retirement and financial protection products. [www.acli.com](http://www.acli.com)

## NAIFA

Founded in 1890 as the National Association of Life Underwriters, the National Association of Insurance and Financial Advisors (NAIFA) comprises nearly 800 state and local associations representing the business interests of 225,000 members and their employees nationwide. Members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members. [www.naifa.org](http://www.naifa.org)

## NAILBA

The National Association of Independent Life Brokerage Agencies (NAILBA) is a nonprofit trade association with 353 member agencies in the U.S., representing 100,000 producers who deliver more than one billion dollars in first year life insurance premiums annually. NAILBA is dedicated to fostering the growth of its member agencies by providing educational resources, industry standards and a collective voice for legislative and regulatory efforts. Each of NAILBA's members commits to a statement of responsibilities to ethically and responsibly serve their clients' best interests. [www.nailba.org](http://www.nailba.org)

<sup>1</sup> Committee of Annuity Insurers, *2005 Survey of Owners of Non-Qualified Annuity Contracts*. (Conducted by The Gallop Organization and Mathew Greenwald & Associates.)

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

<sup>4</sup> Committee of Annuity Insurers, *2005 Survey of Owners of Non-Qualified Annuity Contracts*. (Conducted by The Gallop Organization and Mathew Greenwald & Associates.)

<sup>5</sup> Ibid.

<sup>6</sup> ACLI, *Life Insurers Fact Book 2007*.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.