4 Things To Keep In Mind When Buying A Deferred Annuity Plan

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A deferred annuity plan could help you with a steady cash flow in your retirement years. That said, it's important to not buy one that doesn't align with your retirement needs

Everyone would want to feel secure in their old age with a proper retirement fund in kitty to help them smoothly sail through the final years of their life.

As life expectancy has increased, it has also become necessary to have a proper retirement plan in place. While there are several products in the market that one could use to plan for one's retirement, ideally, the retirement portfolio should consist of a mix of all of these products.

This also makes it important to invest in the right product and not be a victim of mis-selling, especially when investing for one's retirement years.

In this context, let's understand the basics of deferred annuity plans.

A 'deferred annuity' is a contract with an insurance company to receive either a regular income or a lump sum amount after a certain period or on a specific date in future. A deferred annuity plan helps one in two ways: build a corpus for retirement, and generate income in retirement.

Usually, most policy buyers use deferred annuity plans as a means to supplement their retirement income. While immediate annuities are the ones that start paying right away, deferred annuities are different in that context.

A deferred annuity is designed specifically for long-term savings. It is an insurance contract that doesn't start paying you immediately.

Buyers can also indefinitely delay the payments, though, during this time duration, the earnings on it are tax-deferred.

One can also increase the annuity's value by adding funds to the account. One advantage they offer is that it allows withdrawing a lump sum amount from it whenever needed.

It is also possible to transfer the annuity to any financial institution or withdraw it, if possible. The insurance company allows for easy conversion of the annuity into a stream of payments at a certain date in the future. Over time, it will also earn interest on the assets that are present in the annuity. However, one has to pay fees or taxes for each option.

Things To Check Before Buying Annuity

Not every annuity product may be right for you. So, here are the things you need to check before buying deferred annuity plans that the agent won't tell you.

Not Every Product Is For You: Someone selling you 'deferred annuities' might not clearly tell you everything. So, before buying the product, you should understand whether it is actually useful for you or not.

“While these products are meant to ensure income generation after retirement, there could be instances of mis-selling, like padding up the returns. High commissions on such products are also a reason for agents mis-selling them to gullible buyers. So, one should always keep in mind that not every product is right for you, as well as understand the product clearly before choosing it,” says Anant Ladha, founder, Invest Aaj For Kal, a financial advisory firm.

Annuities Are Taxable: One can claim a maximum deduction of Rs. 1.5 lakh per annum under Section 80CCC of the Income-tax Act, 1961, but the taxation on withdrawals is at the normal tax rate, depending on one’s income slab rates. So, one should always keep this in mind while calculating the internal rate of return (IRR).

Remember IRR: While buying a deferred annuity plan, one should also keep in mind the concept of IRR. It’s a metric that would help you to determine the profitability of the product.

While calculating IRR, the present value or the net value of the future cash flows is taken as zero. To put it simply, it is the effective interest rate that one would be earning if one assumes that the money one eventually gets out of the investment is equal in value in today’s rupees to the money that one invests to begin with.

Says Vishal Dhawan, CEO and founder, Plan Ahead Wealth Advisor, and a Securities and Exchange Board of India (Sebi) – registered advisor: “The IRR typically ranges between five and seven per cent per annum. As IRR is not spoken of that much, a lot of times, we find absolute numbers being mentioned. Annuity buyers find it difficult to relate it to the time value of money and current discounted values.”

Take Note Of Inflation: It’s important to understand that inflation is the real culprit here. Let us say that today your monthly expenses are Rs 60,000. If you are 35 years old, and retire at 60, you will require Rs 2.57 lakh in the first month of retirement to maintain a similar standard of living, assuming that the inflation is six per cent. Every month, the money you require will go up.

“The annuities are not inflation-adjusted, and so the values that you get from the annuity may not be sufficient to help you meet your cash flow needs when you retire, as expenses will keep going up due to inflation,” says Dhawan.