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Bonus Annuities

Primary Benefit: Grow Your Money

Secondary Benefit: Guarantee Future Income

A Bonus Annuity is a type of annuity product that offers either an upfront premium bonus or a first year interest rate bonus. When available, upfront premium bonuses are typically found with fixed indexed annuity products, while first year interest rate bonuses are usually attached to traditional fixed annuities.

Upfront Premium Bonus – A lump sum amount that the insurance company credits to your account based upon a percentage of the premium deposit you initially make when purchasing the annuity, or when you add additional funds. For example, if you initially place $100,000 into an annuity product that offers a 5% upfront premium bonus, the insurance company would immediately add an extra $5,000 to your annuity, making the value of your account $105,000 on the issue date of your policy.

First Year Interest Rate Bonus – Usually, a set percentage of additional interest that is added to the base interest rate of an annuity contract and applied during the first year. In the second and subsequent years, the interest crediting rate is reduced to the normal non-bonus base rate which is declared each year by the insurance company, subject to a contractually guaranteed minimum. For example, if you purchased an annuity that had a base interest rate of 2% with a bonus rate of 6%, you would earn a total of 8% interest, over the course of the first contract year, on your premium deposit.

Bonus Annuity Considerations

We’ve all heard the sayings, “if it sounds too good to be true, it probably is,” or “there’s no such thing as a free lunch.” When it comes to annuity products, those sayings aren’t far from the truth. It’s a matter of fact that if an annuity product offers a large bonus, then it must be adjusted in other ways in order for it to remain profitable for the issuing insurance company; which usually means that in future years, all things being equal, it may not credit interest as aggressively as an equivalent non-bonus annuity product.

Generally speaking, the bigger the bonus, the longer your funds will be tied up in the annuity via an extended surrender period. And, most bonus annuities either apply a significantly higher surrender charge penalty for early withdrawal or alternatively, they subject the applied bonus to a vesting schedule. With a bonus vesting schedule, you are required to leave your money in the annuity for a certain number of years in order to fully benefit from the additional funds promised as the bonus. In such cases, if you take your money out early, during the surrender period, you may forfeit all or a portion of the previously credited bonus.

When do Bonus Annuities Make Sense?

1) When the underlying annuity contract features provide the best mix of benefits, when compared to other non-bonus products, to meet your needs and objectives.

2) As a general rule, you should not surrender an existing annuity policy that is still subject to surrender penalties in exchange for a new annuity policy. Transferring your funds from an existing annuity to a new annuity should always be about upgrading your contract to a new contract that will better fulfill your needs and improve your chances of meeting your financial goals. On the rare occasion when the benefits of a new annuity are so substantially better that suffering surrender penalties on your existing annuity still makes sense, recovering your surrender charges via a bonus from the new annuity can be helpful. Just remember, only exchange one annuity for another if the new product is compelling enough even without the bonus. The underlying contract features of the new annuity should be the most important thing, not the bonus.

3) If you are buying an annuity primarily for the benefits provided by an attached income rider, obtaining the largest bonus possible could help you achieve the highest amount of future guaranteed lifetime income. Keep in mind however, that there are three components that determine income rider payouts; a) the upfront bonus, b) the rollup rate and c) the payout percentage table. All three components are equally important, so don’t place too much emphasis on the upfront bonus. This is an involved topic and it is not the purpose of this article to fully explain income riders. If you would like to learn more about income riders, please visit our **Hybrid Annuities** page.

AnnuityAdvantage Opinion

The bottom line is that the decision to buy an annuity should not be based primarily on the size of the bonus. It is certainly one of the considerations, but it should not be the primary determining factor. At AnnuityAdvantage, we believe that bonus annuities have their place and do make sense in certain circumstances. But, we also believe that bonus annuities are often overemphasized and oversold by some of our competitors, with no basis for their recommendations other than the fact that the presented product comes with a big bonus. We are not saying that bonus annuities are inherently bad, but each client's situation must be analyzed independently to determine the most suitable product to meet their individual needs. Sometimes the most suitable product will be a bonus annuity, but many other times it will not.