CD vs. Fixed Deferred Annuity

Which Best Meets Your Needs?
They're both quality financial tools. If you're debating whether the best place for your money is a certificate of deposit (CD) or fixed deferred annuity, the answer depends upon your individual financial situation and investment objectives. Both CDs and fixed deferred annuities are savings vehicles used by individuals to accumulate wealth. However, these two products are quite different; each has its own unique strengths and uses. For the sake of comparison, let's look at two similar versions of these products — an individually owned, non-tax qualified bank CD and an individually owned, non-tax qualified single premium fixed deferred annuity earning an annually renewable fixed rate of return.

Objectives
Safety of Principal: Both CDs and fixed deferred annuities are considered low-risk investments. CDs are generally issued by banks and, in most cases, are insured by the Federal Deposit Insurance Corporation (FDIC) for up to $100,000 per depositor. Should the bank fail, the FDIC guarantees CDs up to this amount.

Fixed deferred annuities, on the other hand, are issued by insurance companies and are not insured by the FDIC. They are backed in their entirety by the financial strength of the issuing insurance company, ***regardless of the amount***. Additionally, most states have what is known as a State Guaranty Association. The purpose of the association is to provide additional “safety net” coverage to all residents of the state who purchase certain insurance products.

All insurers licensed to do business in North Carolina are required by law to be members of the association. In the unlikely event of an insurance company failure, **each owner of a fixed annuity (not variable) is covered up to $300,000, if the policy was issued in North Carolina.** Before purchasing an annuity however, you should make sure the issuing insurance company is financially sound. You can determine financial stability by requesting the findings of independent rating companies such as **A.M. Best, Standard & Poor's, Moody's and Fitch.**

Short-Term Accumulation: When deciding between a CD and a fixed deferred annuity, your investment horizon should be a key factor. Your investment horizon is the amount of time you need to save for a specific goal. For short-term goals, such as a down payment on a home, a new car or a vacation, a CD may prove to be a better choice for you. In most instances, you can select a maturity date for your CD that corresponds to your time horizon. Maturity periods can be as short as one month or as long as several years.

Long-Term Accumulation: On the other hand, a fixed deferred annuity is generally the product of choice for the long haul. Fixed deferred annuities are designed to help accumulate money for retirement or to protect funds already saved up once you've reached retirement. They can even be used to provide a legacy for your heirs. In later years, a fixed deferred annuity also provides more flexibility for accessing your money.

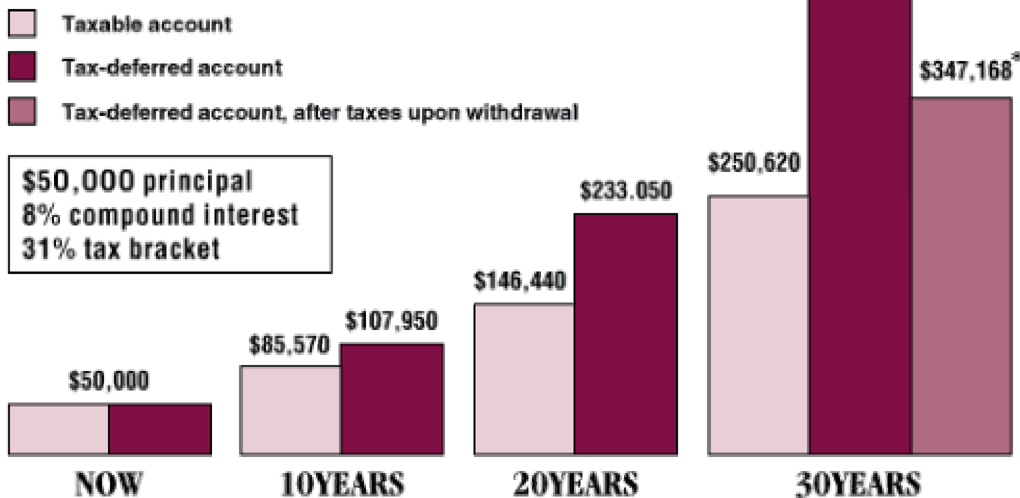
Interest Return: CDs offer a guaranteed rate of return for a specified period of time. Interest rates will vary depending on current market conditions and the length of time to maturity. Generally, the shorter the period of time to maturity, the lower the rate. **There is no guaranteed minimum for renewal rates, with a CD.** With a fixed deferred annuity, a guaranteed interest rate is locked in for an initial period, usually one to three years. After that, interest rates may be adjusted periodically, generally each year, but never below a guaranteed minimum rate. Because annuities are long-term vehicles, their interest rates tend to be higher than comparable CDs.

Fixed deferred annuities also offer a guaranteed minimum interest rate. Regardless of market conditions, the annuity will pay at least the minimum guaranteed rate time of purchase.

Tax Savings: If taxes are a concern, a fixed deferred annuity may be a better option for several reasons:

Earnings on CDs are taxable in the year the interest is earned even if you don't take the money out. With fixed deferred annuities, on the other hand, earnings accumulate free of current taxation. **Earnings inside an annuity are not treated as taxable income until they are withdrawn.** This allows more of your money to work harder towards achieving your long-term goals and gives you a measure of control over when you pay taxes and how much you pay. **This tax deferral feature is one of the greatest advantages of fixed deferred annuities.**

As you can see from the chart below, when saving for the long term it makes good investment sense to have the power of tax deferral on your side. Keep in mind that withdrawals from the earnings portion of a fixed deferred annuity are taxable and, if you're under age 59 1/2, these earnings may be subject to a 10% tax penalty.



Fixed deferred annuities may also help reduce or eliminate the taxes on your Social Security benefits. By leaving your money in a fixed deferred annuity you can reduce your taxable income, keeping it below the level where you would begin to owe taxes on your Social Security benefits. **But with CDs, your interest earnings count in the calculation to determine how much of your Social Security benefits will be taxed — even if you don't withdraw the earnings.** As much as 85% of your Social Security benefits could end up subject to taxation.

At death, the annuity's account value will be paid directly to your named beneficiary or beneficiaries, avoiding the costs and delays associated with the probate process. This is not the case with a CD, which may be subject to probate. Please note, however, that both annuities and CDs are taxable as part of your estate and that the annuity's earnings are still subject to taxation. When purchasing a fixed deferred annuity, one that distributes the full account value to beneficiaries is preferable. Some companies apply surrender charges on death benefit proceeds.

Liquidity: If you need access to the funds in a CD prior to the maturity date, you may pay an interest penalty ranging from 30 days' to six months' interest. Of course, you can limit your exposure to surrender penalties by investing in several CDs with staggered maturity dates.

A fixed deferred annuity also provides you with access to funds should the need arise. Most companies will give you the flexibility to withdraw a portion of your fixed deferred annuity's account value, usually 10% each year, without a company-imposed surrender charge. Withdrawals from fixed deferred annuities can be made in response to a one time cash need or set up systematically to respond to a continuous need. In fact, most fixed deferred annuities offer the opportunity to systematically withdraw funds on a monthly, quarterly, semi-annual or annual basis.

Keep in mind that fixed deferred annuities are designed to build your retirement nest egg. Withdrawals of earnings prior to age 59 1/2 may be subject to a 10% penalty tax. Plus, most insurers assess a surrender charge if the contract is terminated during the first several years.

Distribution Options at Maturity: When a CD reaches its maturity, you can take the CD's lump sum value in cash, renew the CD for the same or different maturity period or examine other investment alternatives (such as a fixed deferred annuity).

In a fixed deferred annuity you may elect to withdraw your money in a lump sum or you may want to select a lifetime income option, which will provide you with a consistent flow of income that you cannot outlive. Or, you can simply elect to let your funds accumulate until a need arises.

These are just a few of the factors to consider when making your selection between a CD and a fixed deferred annuity. Depending upon your investment horizon, you may want to allocate a portion of funds to a CD to cover short-term needs and a portion to a fixed deferred annuity for the long term.

Consultation

At no charge to you, an advisor/agent — professionally trained and experienced — can help you analyze your needs and recommend appropriate solutions through insurance and financial products and concepts.

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