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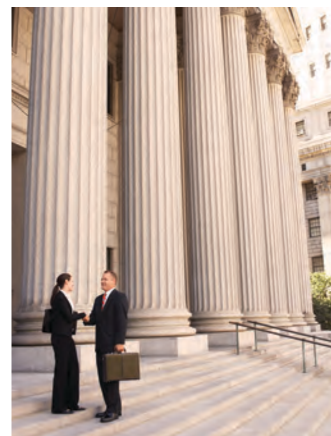
Financial Planning

THE BASICS OF FIXED INDEXED ANNUITIES



Who might be a good fit for a fixed indexed annuity?

SOMEONE WHO WOULD LIKE TO:

- Accumulate savings for retirement
- Downside risk in the stock and bond markets
- Allow their money to grow tax-deferred during their working years
- Access their account via penalty-free withdrawals
- Have an additional source of retirement income besides Social Security or an employer-sponsored pension

What is an annuity?

A fixed indexed annuity (FIA) is a contract between a contract owner and an insurance carrier designed for long-term accumulation and income in retirement. In exchange for payment or a series of payments, a contract owner would receive the benefits the insurance carrier guarantees. An annuity has four potential parties to the contract: the owner, the annuitant, the beneficiary, and the issuing insurance company. In most cases, the owner and the annuitant are the same, but there are some clear distinctions between them. The life expectancy of the annuitant is used to calculate lifetime payments, and it's the owner who is allowed to make decisions about the annuity, access the contract value, and receive annuity payments.

How does an FIA work?

Many indexed annuities are tied to broad, well-known indexes like the S&P 500. But some use other indexes, including those that represent other segments of the market. Indexed annuities expose you to more risk (but more potential return) than a fixed annuity but less risk (and less potential return) than a variable annuity. As a result, the return on these products may be higher or lower than the guaranteed rate of return on conventional fixed annuities. The industry generally offers two types of indexed annuities — equity-indexed annuities (EIAs) and registered index-linked annuities (RILAs). Both EIAs and RILAs calculate rates of return based on the performance of one or more selected market indexes, but only EIAs offer a guaranteed minimum rate of return.[1] An FIA generally has two phases: the accumulation phase and the distribution phase. During the accumulation phase, the annuity will earn fixed interest or indexed interest. Inside an FIA, the contract value grows tax-deferred. This means no ordinary income tax is paid until the money is withdrawn or distributed. This allows the deferred annuity contract value to compound and potentially grow faster. If the annuity is purchased with after-tax dollars, this is called a nonqualified annuity, and income tax would only be paid on the interest of the indexed interest when withdrawn.

[1] FINRA — https://www.finra.org/investors/insights/complicated-risks-and-rewards-indexed-annuities

When can an FIA owner access their money?

Because an FIA is designed for long-term growth to be used for retirement, withdrawal amounts in excess of the penalty-free amount are typically subject to surrender charges. The surrender charge percentage and duration vary by product.

Generally, an annuity will allow for a portion, such as 10% of the contract value or the interest earned, to be withdrawn penalty-free each year after the first year. It's important to note that although the withdrawals are surrender charge-free, they may be subject to taxation, including a 10% penalty if you withdraw the funds before you reach age 59½.

Other riders and waivers may be available for free or for a fee that allows for enhanced income payments. The surrender value of an annuity will never be less than the minimum guaranteed contract value, which is 87.5% of the premium received, less any withdrawals, accumulated at the minimum guaranteed interest rate.

How does an annuity help mitigate retirement risk?

For those nearing retirement, an FIA can help preserve accumulated retirement savings. Because an indexed annuity is not directly invested in the market but tied to the performance of an index, when the market is up, the contract value could increase based on the specified cap or participation rate, but when the market is down, the FIA is protected from loss of principal.

When you buy an FIA, you own an insurance contract. You are not buying shares of any stock or index. This is not a comprehensive overview of all the relevant features and benefits of FIAs. Before making a decision to purchase a particular product, be sure to review all the material details about the product and discuss the suitability of the product for your financial planning purposes with a qualified financial professional.

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ADDENDUM: EXPLANATION OF TERMS

Administrative fees or margins: charges that amount to the difference between the percentage gain in the index and the actual amount credited to the annuity contract.

Annual free withdrawal percentage rate: the percentage of available funds that may be withdrawn from an annuity contract, generally on an annual basis, and is stated in the annuity contract.

Asset fees: the fees the insurer charges that are a percentage of the value of the annuity contract, such as rider charges.

Death Benefit Amount: the net amount that would be paid to the annuitant's designated beneficiary or beneficiaries of an existing annuity, or the death benefit that the proposed replacement policy would pay as of the contract issue date.

Contract type: the generic type of the contract form; examples of contract types are variable annuity (VA), fixed annuity (FA), fixed indexed annuity (FIA), universal life (UL), variable universal life (VUL), whole life.

Initial bonus percentage or amount: a bonus paid by the insurer, generally, at the inception of the annuity contract, and may be expressed as a percentage of the initial premium or other amount, or a dollar amount, and must be stated in the annuity contract.

Interest rate cap: the maximum interest earnings that will be credited to the annuity contract; example: if an account is based on some known performance, like index growth yielding 11.50%, the declared interest rate cap, 5.00%, would be the maximum interest credited to the account.

Market value adjustment: the increase or decrease in the surrender value of the contract that is adjusted to reflect market fluctuations.

Marketing name: the name adopted by the insurer to identify the contract form.

Nursing home: an institution or special nursing unit of a hospital located in the United States, which is further defined in the applicable contract.

Potential loss of bonus if exchanged: refers to whether any bonus would be lost if the annuity contract was exchanged or terminated for any reason.

Surrender charge: the amount deducted from annuity contract values upon surrender of an annuity or for withdrawals exceeding any free withdrawal provision of the contract, regardless of how this charge is titled in the policy; e.g., deferred sales charge.

Surrender charge percentage schedule for remaining years: the percentage rate that would be deducted from the existing annuity contract if surrendered or for any withdrawals exceeding the free withdrawal limit.

Surrender charge period: the number of annuity contract years for which a surrender charge may be applicable.