

FIXED INDEXED ANNUITIES

These conservative investments have become a popular alternative to bonds.

provided by David Gatesman

Fixed indexed annuities can be very useful investments. As the name implies, FIAs are fixed annuities linked to the performance of a stock market index (often the S&P 500). Because of this stock market exposure, they can sometimes bring conservative investors very nice returns - often, considerably better returns than CDs, bonds, or money market accounts. They really aren't designed to outperform the stock markets; they are designed to outperform the fixed markets.

Principal protection and a chance to benefit from market gains. During the accumulation phase of an FIA, you have the opportunity to benefit from stock market gains while your principal is protected against stock market losses. The annuity contract usually guarantees you a minimum rate of interest on your purchase payments while the annuity is growing; the insurance company involved will credit you with either the minimum return stated in the contract or a return based on the performance of the linked index.¹

If you are skittish about stock market investment, you can potentially realize the benefits of stock market participation through this comparatively low-risk investment.

Participation rates to note. Each FIA has a particular participation rate. The participation rate signifies the percentage of the invested assets within the annuity keyed to the linked index.

Let's say you have an FIA linked to the S&P 500 and the participation rate is 60%. That means 60% of your invested assets are exposed to the index. If the S&P 500 gains 10% across a year, this means your annuity gives you a 6% return for the year (before any fees and administrative charges). Compare that 6% potential return to so many CDs and money market accounts which generate a pittance of interest.

Some FIAs measure an index's gain on an annual basis, others over the entire term of the annuity. Sometimes there are "ceilings" on just how high a return you can realize. From time to time, participation rates may be reset by the insurance company. Occasionally, a margin or "spread" determines the index-linked interest rate instead of a participation rate. In this case, if your annuity gains 10% and the spread is 2.5%, your credited gain is 7.5%.²

Tax-deferred growth, an income stream, and often a death benefit. Most FIAs give you all the features of a fixed annuity: your earnings are not taxed, and when the distribution phase of your annuity starts, you can receive periodic (usually monthly) income payments. (Sometimes you can take the entire value of your annuity as a lump sum at the end of the contract term. It is your withdrawals that are taxed.) There is

often a guaranteed minimum death benefit payable to your beneficiary when you pass away.

No annual contribution limit. If you need to put away more retirement savings NOW, the contribution limits on IRAs and 401(k)s can be frustrating. Would you rather have a retirement account you can only put \$5,000 or \$6,000 in annually, or an account to which you can contribute as much as you want? FIAs (and other types of annuities) have no contribution ceiling, and there are no IRS-imposed income limits above which you cannot contribute.³

Make no mistake, these are long-term investments. Many of these annuity contracts are 6-7 years or longer. If you need to withdraw your money from the annuity in the accumulation phase, there is usually a considerable penalty. Fixed indexed annuities do require a long-term outlook and a long-term commitment.

Would you like to learn more? If you are planning to maintain or improve your quality of life in retirement, maybe you would like to see how fixed indexed annuities can potentially help you. If that's the case, then ask a qualified insurance or financial advisor about these hybrid annuities today.

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Citations.

¹ sec.gov/answers/annuity.htm [7/19/05]

² newsobserver.com/293/story/222312.html [10/23/05]

³ finance.cch.com/sohoApplets/FixedAnnuity.asp [10/29/08]