Comparing Fixed Indexed Annuities with Other Retirement Savings Options

Helping clients choose the right accumulation vehicle for retirement can be difficult. There are many choices available – and, with differing needs and goals, choosing just the right option can prove to be challenging.

On the one hand, those who are approaching retirement want to ensure that their funds are safe. Given the recent ups and downs of a sometimes volatile market, many clients don't want to chance losing any of their hard earned savings. Many pre-retirees are also striving to boost their returns with the hopes of increasing their overall nest egg – something that is difficult to do in fixed rate options with today's still historically low interest environment.

In the past, clients had few choices but to take their chances in the market and hope for the best, or to go with the safer guaranteed options, knowing that they may need to cut back in other areas due to the potential low return on their retirement saving methods going forward.

The good news is that now another option is available where clients can obtain market-linked growth, along with safety of principal – the fixed indexed annuity. These financial vehicles essentially combine both growth potential and protection from downside market risk all in one, making them a viable alternative to more traditional retirement vehicles.

Fixed Indexed Annuity Advantages

When looking at the variety of retirement savings options available, fixed indexed annuities have a number of key advantages.

Protection of Principal

A key benefit of all annuities, and specifically fixed indexed annuities (FIAs), is the principal protection that these contracts can provide. An FIA can allow the annuitant to transfer the risk over to the insurance company.

Over the past decade, many Americans have faced a significant amount of market volatility. Many of those who have owned stock and mutual fund shares have suffered losses in their portfolios. Fixed indexed annuities can help clients insulate their funds from potential downside market risk due to a fluctuating market.

When the performance of the underlying index in a fixed indexed annuity is negative, the annuity contract will protect the annuitant's principal, as well as their previously credited amounts of interest.

Unlike stocks, mutual funds, or variable annuities, when the market encounters a negative return year, those who own fixed indexed annuities will never be credited less than zero. Nor will they have to make up for those losses just to get back to "break even."

With a fixed indexed annuity, the worst case scenario is that a year with a negative index return is simply a zero-interest year for the annuity holder – and most clients would likely agree that getting no interest in a down market is much more appealing than having interest losses.

Growth Potential

There are many types of retirement saving options that offer the potential for growth. Yet, in order to attain the opportunity for larger amounts of growth, clients must typically take on higher amounts of risk as well. In this scenario, there is usually also the potential for more loss.

With a fixed indexed annuity, owners can reap the benefits of growth in a particular market index (or indexes) without having to directly or indirectly invest in the market. The issuing insurance company will use a set crediting method to track the performance of the underlying index or indexes.

At the end of the crediting period, if the return is positive, the client will receive the indexed interest, which is typically subject to a cap, participation rate, or spread. Unlike stocks or mutual funds, this gain will then be locked in so that it cannot be lost in the future, even if the underlying index declines in the future.

In addition, just as with other types of annuities, this growth inside of a fixed indexed annuity takes place on a tax-deferred basis. This means that no tax will be due on the gain until the time of withdrawal – which typically does not take place until retirement. This compounding can allow annuitants to accumulate more money over a shorter period of time, thereby earning an even greater return overall.

A fixed indexed annuity can provide an effective method of saving for retirement – especially in comparison to other market-related savings options. For example, investments in stocks and other growth-related equity investments may offer the potential for unlimited returns. However, these same investments can also put clients at a much higher degree of risk, too.

When looking for retirement strategies on the more conservative side, a fixed indexed annuity can offer a higher amount of return than "safe" alternatives such as bonds or certificates of deposit.

In fact, those who own fixed indexed annuities will not lose the initial amount of principal that they deposit into the annuity – and over time, the interest that is gained is locked in so that the annuity resets new periods with a new and higher base value.

Guaranteed Lifetime Income

As with other types of annuities, a fixed indexed annuity will allow an annuitant to convert the annuity's value into a series of income payments. These can be a fixed amount for a certain period of time. Or, if the lifetime option is chosen, income can be received for the remainder of the annuitant's life, regardless of how long that may be.

Fixed indexed annuity holders will typically have two choices when it comes to receiving income from their FIA. These options can include either income withdrawals or annuitization payments. It is important to note that there can be tax differences, depending on which method is chosen.

As an example, if the fixed indexed annuity is not being held in a retirement account such as a 401(k) or an IRA, then a portion of each annuitization payment will be considered as taxable interest and another portion will be considered as a tax-free return of principal. In addition, those who are under the age of 59 1/2 may also face an additional 10% IRS early withdrawal penalty on the amount that is being withdrawn.

Likewise, in many cases, annuity holders may be subject to surrender penalties over the first several years of the contract. So, it is important to be aware of these. FIAs should be considered long-term financial vehicles, and funds that may be required for an emergency or other short-term need should not be placed into a fixed indexed annuity.

Lifetime income riders can be a powerful option for many clients. A guaranteed "paycheck" in retirement can help to provide income for covering ongoing necessary living expenses. Once this guaranteed, sustainable income is in place, other assets can still be positioned for growth.

By having lifetime income covered, market volatility will not have an effect on the reliability or the amount of this guaranteed paycheck from the indexed annuity – essentially allowing annuitants the ability to maintain control over their income, even during life's uncertainties. Having a guaranteed paycheck can also help to fill any income gaps that clients may have – especially if they retire earlier or live longer than expected.

In addition to these income benefits, a fixed indexed annuity may also offer additional optional income riders that allow income payments to increase in order to keep pace with inflation in the future.

Other Benefits

There are other benefits that can be gained through owning a fixed indexed annuity that clients typically cannot obtain through other types of retirement saving options. For example, a fixed indexed annuity can allow their holders to leave a legacy for their loved ones.

Should the annuitant not receive back all of his or her deposited principal in the form of annuity income, a named beneficiary can receive these proceeds. These funds can be received either via lump sum or through a series of regular payments – and they will bypass the costly and often time-consuming process of probate.

In addition, in many states, under annuity protection laws, annuities are also protected from creditors and lawsuits – including bankruptcy. Most other types of assets do not provide this type of protection.*

The Bottom Line on Fixed Indexed Annuities

While fixed indexed annuities may not be the right fit for all clients, they can provide the ideal mix of market-linked growth without the exposure to market risk, offer principal protection from downside risk, and accumulation on a tax-deferred basis.

When FIA owners are ready to retire, a fixed indexed annuity can then be converted to an ongoing income that cannot be outlived, regardless of how long the income is needed. There is no other retirement vehicle in the market today that can offer the myriad of options that are provided by the fixed indexed annuity.

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Under current tax law, the Internal Revenue Code already provides tax deferral to qualified money, so there is no additional tax benefit obtained by funding a qualified contract, such as an IRA, with an annuity; consider the other benefits provided by an annuity, such as lifetime income and a Death Benefit.

Fixed indexed annuities are not stock market investments and do not directly participate in any stock or equity investments. Market Indices may not include dividends paid on the underlying stocks, and therefore may not reflect the total return of the underlying stocks; neither an Index nor any market-indexed annuity is comparable to a direct investment in the equity markets. Clients who purchase index annuities are not directly investing in a stock market index.

Guarantees provided by annuities are backed by the financial strength and claims-paying ability of the issuing insurance company and are not guaranteed by any bank or the FDIC. Guaranteed lifetime income available through annuitization or the purchase of an optional income rider for a charge.

*It is important to obtain legal advice regarding specific state laws and annuities.