Fixed Index Annuity (FIA) Basics

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What is a fixed indexed annuity (FIA)?

A fixed indexed annuity is a contract between a contract owner and an insurance carrier designed for long-term accumulation and income in retirement. In exchange for premium 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. However, the contract owner and annuitant are generally one and the same.

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, as well as receive annuity payments. Depending on insurance carrier rules, the contract may be annuitant or owner-driven, which means upon the death of either the annuitant or owner, the death benefit would be paid to the named beneficiary(ies). If no beneficiary is named on the annuity, the death benefit would go through probate. Under some circumstances a spouse named as sole primary beneficiary, may be able to continue the contract.

How does the FIA contract value grow?

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. Indexed interest is interest earned based on the performance of an index. There may be multiple indices and crediting options to choose from. The crediting option is how the indexed interest is calculated each crediting period.

A fixed indexed annuity is not directly invested in the market; therefore, the principle is insulated from downside risk. An annuity is credited indexed interest based on the growth of an index and the amount credited is subject to a specified participation rate and/or cap. There may also be a spread or margin, which is a percentage deducted from the total calculated change in the index value. Any indexed interest would be locked in each crediting period. This feature is commonly found in fixed indexed annuities and is referred to as "annual reset." Not only does this mean that future decreases in the market will not affect index or interest credits already applied, but with each new contract year there would be a new index value starting point.

Inside of an FIA, the contract value grows tax deferred. This means no ordinary income tax is paid until 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 non-qualified annuity and income tax would only be paid on the interest or indexed interest when withdrawn.

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Fixed Index Annuities:

The Basics of FIAs

Annuities purchased after August 13, 1982, follow the Last in First Out (LIFO) rule which states that any interest or indexed interest will be withdrawn before the principle. If an annuity is purchased with pre-tax dollars, any amount withdrawn will be subject to ordinary income tax. A Roth IRA would be an exception, if all requirements are met for income tax-free withdrawals.

When can a fixed indexed annuity 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 each year after the first year, penalty free. It's important to note that although the withdrawals are surrender-charge free, they may be subject to taxation, including penalty for early withdrawal pre-59½.

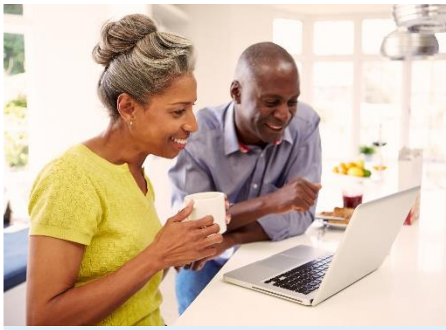
The annuity owner would also have the option to "annuitize" their contract. This is the process of converting an annuity contract value into a series of periodic income payments or for the life of the annuitant. Typically, this is an irrevocable decision; once an owner chooses to annuitize, they cannot reverse it.

Other riders and waivers may be available for free or for a fee that allow 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, a fixed indexed annuity 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.



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

Someone who would like to:

- Accumulate savings for retirement.
- Protect their retirement savings from the downside risk of the stock market.
- Allow their money to grow tax-deferred during their working years.
- Access their account via penalty-free withdrawals.
- Have a guaranteed income they cannot outlive.
- Have an additional source of retirement income besides Social Security or an employer-sponsored pension.

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During the distribution phase of an FIA, an owner may choose to take payments from an income rider. Generally, an income rider must be added at issue (but not always) and there is typically an additional charge for it. The income rider has its own separate income value that grows based on a specified “rollup rate.” This value is then used to calculate guaranteed lifetime income payments, which the owner can choose to take after a specified amount of time based on the rules outlined by the carrier.

Additionally, an annuity is the only product designed for lifetime income. An annuity allows the owner to specify a payout of the contract value over a set number of years or spread payments over the annuitant’s lifetime. An income rider or benefit (sometimes called Guaranteed Lifetime Withdrawal benefits, or GLWB) is an additional feature available with some annuities and is generally optional and can come with additional costs. Income benefits are designed to provide income options above and beyond the standard annuitization or free withdrawal features in annuities. An annuity helps protect against longevity and can help lessen the concern of running out of money in retirement.

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When you buy a fixed index annuity, 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 fixed index annuities. Before making a decision to purchase a particular product be sure to review all of 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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