

Understanding Fixed Indexed Annuities



Conservative investors seeking guaranteed principal and ongoing retirement income are turning their attention to [fixed index annuities](#), despite previous debate about the product's merits. According to LIMRA, a leading industry research firm, fixed index annuity sales in 2013 were 20% higher than the previous decade, with over \$33 billion in reported new sales.

Fixed indexed annuities offer investors a number of benefits worth considering and are appealing alternatives to traditional conservative investments such as bank certificates of deposit (CDs) or bonds. However, as with any [annuity](#), it's critical to understand the product's "bells and whistles" before paying the premium.

Fixed Index Annuity Cap Rates

Generally, fixed annuities are insurance contracts offering annuity owners a fixed interest rate as well as a fixed income stream at a future point. Fixed indexed annuities link their annual interest rates to a market benchmark, such as the S&P 500 or Nasdaq. [insurers](#) offer market loss protection in exchange for upside growth limitations known as rate caps (or participation rates). Rate caps set the maximum return the contract owner can receive in any given year. For example, if an annuity's cap rate is set at 7% and the market posts a return of 15%, the annuity owner would receive the lesser amount of 7%. In many cases, investors are willing to accept this limited upside in exchange for guarantees against loss of principal.

Fixed Index Annuity Riders

Beyond the basic benefits offered to contract holders, a fixed index annuity can be offered with optional riders for additional premium. Some fixed index annuities offer a guaranteed minimum lifetime income benefit as a rider. During turbulent market years, this guarantee helps to ensure that the annuity owner's income remains constant, thus protecting his purchasing power. This is appealing to individuals seeking to secure a baseline monthly household income stream. Another popular rider is inflation protection, which can increase the ongoing income stream by a set percentage, also designed to protect the annuity owner's purchasing power.

Early Surrender Considerations

Annuities are typically offered with set surrender schedules which apply to early withdrawals from the contract. While some contracts have surrender schedules that range from 10 to 15 years or longer, many attractive annuities are offered with surrender schedules of 10 years or less.

If you are considering a fixed indexed annuity as part of your retirement portfolio, consider the following buying tips:

- Seek clarity about the product's mechanics prior to placing premium within any annuity product.
- Review any cap or participation limits placed on potential gains and choose a product that offers maximum flexibility.
- Review potential surrender charges and choose a product that best matches your future withdrawal needs. Also review the optionality for partial withdrawals.
- Keep in mind that annuities are designed to provide retirement income stream. Early withdrawal tax penalties may apply to withdrawals taken prior to the established IRS retirement age of 59½.