Eight Reasons to Consider a Fixed Index Annuity

1. Gain Compounded Earnings While Deferring Income Taxes

Earnings within an annuity contract are tax-deferred. This means you don't pay income taxes on the earnings until you withdraw gains from your account. Therefore, there are no annual 1099 forms to file or earned-interest entries to make on your 1040. Tax deferral also means that annuity earnings do not offset Social Security benefits as with earnings from bonds, CDs, and other investments. Income generated by tax-exempt municipal bonds (for which no federal income tax is due) must be counted to determine any offset to Social Security benefits. Investors with investments currently allocated as "cash" should consider annuities for their tax deferral benefits. Over time, tax-deferred compounding may produce a greater overall return than other non-qualified investments.

2. Earn Higher Interest Rates

Fixed index annuities may credit higher interest rates than bank CDs or fixed interest rate deferred annuities.

3. Make Contributions to Your Tax-Deferred Account

Investors who have maximized contributions to their qualified retirement plans (i.e. 401k, IRAs and pensions) are permitted to contribute without limit to a tax-deferred annuity.

4. Protect Your Principal from Downturns in the Credit Markets

When interest rates trend upward, annuity accounts are insulated from loss of principal; increasing interest rates often negatively impact government bonds and bond mutual funds. Unlike bonds which lose principal value during periods of rising interest rates, the account value of a fixed index annuity is guaranteed. In addition to offering loss protection, if your annuity contract offers annually renewing rates, you may be presented with higher cap rates or participation rates, reflecting increased prevailing interest rates. In short, your principal and earnings are protected no matter what direction interest rates may take.

5. Retire Early Without Penalty

Annuities can offer valuable tax-savings for employees under the age of 59½ who receive large, lump-sum distributions from their 401(k) profit-sharing plans as part of an early retirement or severance package. Such amounts can be "rolled over" into an annuity policy without having to recognize taxable income. Penalty-free withdrawals can then be taken by setting up a program known as "Substantially Equal Periodic Payments" (SEPP). This exemption to the IRS pre-59½ early-withdrawal penalty allows you to withdraw funds from a tax-deferred account you thought couldn't be touched until retirement!

6. Satisfy Required Minimum Distributions (RMDs)

Retirees over the age of 70½ are required to begin taking withdrawals from their IRA or Pension plans, known as Required Minimum Distributions (RMDs). The IRS penalty for not doing so is a substantial 50% of any amount that falls short of the Required Minimum Distribution. IRA funds rolled over into a fixed index annuity will be monitored for RMD amounts by the insurance company free of charge. This can save you the annual fee that your accountant or attorney would otherwise charge for making these calculations.

7. Retire With Lifetime Income

Today, a healthy 65 year old male has a 25% chance of living to age 90; a 65 year-old woman is likely to live even longer. Retirees concerned about outliving their investments can protect themselves by creating a guaranteed lifetime income stream.. By "annuitizing" your IRA or fixed index annuity, you can exchange its value for an "immediate annuity" income stream in any of several forms (see earlier discussion on "Immediate Annuities"). Many FIAs offer optional income riders which provide withdrawal benefits similar to immediate annuities. This type of annuity provides you with a monthly check, guaranteed to remain constant over the duration of your lifetime.

8. Create Probate-Free Inheritance

The legal process of going through probate was established to protect a decedent's estate and to insure its proper distribution to designated heirs. Probate can be a time-consuming and expensive experience for heirs to endure. Purchasing an annuity is one way to protect your beneficiaries from having to undergo this costly delay in estate distribution. Your named beneficiary or beneficiaries are paid directly and promptly, as soon as the insurance company has been notified about your passing.

FIA Interest Crediting

Fixed index annuities credit interest based upon the performance of a benchmark stock market index (S&P 500, Dow Jones, NASDAQ). There is zero downside risk in negative stock market years. In return for that safety, your potential gains are normally "capped" (i.e., determined by a cap rate or participation rate).

Cap Rates

A cap rate is the highest percentage gain that the insurance company will credit to your account during the specified period. Currently, cap rates range between 3% and9%, depending on the duration of your annuity. This means that if your annuity has a cap rate of 6% and the benchmark S&P stock index goes up 12%, you will be credited with 6% interest.

Participation Rates

A participation rate refers to the percentage of the benchmark index gain the insurance company will credit to your annuity for a specified period. For example, if the participation rate is 25%

and the stock market index goes up 12%, you will be credited with 3% interest (i.e., 25% of the stock market index's gain).

Premium Bonus

Many fixed index annuities offer premium bonuses, which are credited to your annuity at the moment premiums are added. Currently, premium bonuses range from 4% to 12%, depending on the duration of the annuity. As alluring as these premium bonuses may seem, they usually come with trade-offs. FIAs with premium bonuses generally offer lower cap rates and participation rates than FIAs without bonuses. Additionally, some companies only pay the bonus if you annuitize with that company at some point in the future. . If you choose to withdraw your money in a lump sum before the surrender fee period is over, the insurer may retroactively remove a portion of your premium bonus.

Expenses

Fixed index annuities do not have upfront sales charges. It would also be unusual for FIAs to charge maintenance fees. Because of this, 100% of your premium—without any deductions—goes directly to work for you in your account. Fees will only be applied if you surrender the annuity early, or if you purchase riders (i.e. income rider).

Penalty-free Withdrawals and Surrender Fees

Most insurance companies allow you to withdraw earned interest without having triggering a surrender fee. Some allow penalty-free withdrawals up to 10% of your account value (principal plus accumulated earnings) each year after the first year. If you want to withdraw more than 10% of your contract value, you will likely be charged an Early Surrender Penalty. This is assessed as a percentage of the amount that exceeds the Penalty-Free Withdrawal amount. In financial services jargon, this is called a "back-end load." These charges should not be confused with the 10% early withdrawal penalty the IRS imposes if you withdrawal funds from an FIA before you reach the age of 59½.

Surrender penalties vary amongst insurance companies, but may be as high as 15% in the first contract year. Typically, surrender charges reduce by 1% per year. Such fees are sometimes waived when the contract is "annuitized" under a payment option or in the event of the policyholder's death. Many policies also waive surrender fees if the annuitant is confined to a nursing home.

FIAs typically offer a 30-day window at the end of the Rate Guarantee Period (RGP) during which the full account value (principal plus interest) may be withdrawn without penalty. However, if the policy owner does not surrender, exchange or rollover his account during this 30-day period, the annuity is automatically renewed and surrender charges are reset to the previous schedule.

Market Value Adjustment ('MVA')

An early withdrawal from an FIA may trigger a "Market Value Adjustment" (MVA) which may increase or decrease total penalties incurred on "excess" withdrawals or an early surrender from your contract. A typical MVA is determined using a formula comparing the base interest rate of the contract at issued with the interest rate (of a similar contract) when a withdrawal or surrender is requested. If the interest rate has declined during the period, the MVA will have a positive impact on the value of the policy. This means the MVA may offset some or all of the surrender charges. Conversely, if interest rates are higher at the time of the proposed withdrawal, the MVA will have a negative impact and add additional charges to the surrender fees deducted from the value of the policy.

Other Withdrawal Options and Annuitization

It's essential to know what withdrawal options are available when your fixed index annuity is no longer subject to surrender penalties. You can reinvest your money with the same company at the current rate or switch your account to another insurer (called a "Section 1035 Exchange"). Or, you can simply withdraw your money from the annuity in a lump sum, in which case you'll owe federal income tax on ALL the earnings in that single year. Additionally if you're younger than 59½ at the time of the withdrawal, you'll owe an additional penalty of 10% of the amount that is taxable income.

There are three ways to postpone this potential tax bite while turning your annuity into a reliable income stream. One way is to "annuitize" your policy—exchange the accumulated value of your fixed index annuity into an "immediate annuity." While your present insurance company will certainly want you to annuitize your account with them, it's a good idea to "shop the market," since there may very well be other companies that offer more generous settlement rates. Settlement rates are the current, guaranteed purchase rates per $1,000 of account value used to exchange deferred annuity cash values into monthly income. These rates move up and down in tandem with interest rate fluctuations in bond markets. If you do find better rates with another insurance company, you can transfer your account balance using a procedure called a "Section 1035" exchange. Section 1035 is the portion of the IRS code that contains the rules governing such a tax-free exchange.

Annuitizing your fixed index annuity may also offer a tax advantage, such as letting you postpone paying taxes on some of the earnings you've accrued. However, this is true only for annuities which were originally purchased with "non-qualified" or after-tax dollars (that is, monies which were not previously exempt from taxes). Non-qualified monies include personal savings held in bank CDs or money market accounts, as well as securities and other investments held in your own name. If your immediate or deferred annuity represents a "qualified" or pre-tax investment—such as an IRA or IRA "rollover" of pension plan funds—then the entire monthly income check will be taxable.