



## What is a Fixed Rate Annuity (FIA)?

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# FAQs

Frequently Asked  
Questions

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FOR FIAs



What is a fixed indexed annuity?

# What exactly is an FIA?

A fixed indexed annuity (FIA) is a contract between you and an insurance carrier that provides income and principal-protection guarantees. FIAs offer potential growth based in part on the performance of a specified index, such as the S&P 500®. This stock, bond or commodity index serves as a benchmark only, and the policy pays interest based on a formula related to index performance per individual policy contract terms.

It is important to remember that because your money is not actually invested in the stock market, the principal you put into the policy is not affected by market downturns, it is instead guaranteed by the financial strength and claims-paying ability of the insurance carrier. Any interest credited—usually annually—is “locked in” to the policy’s principal.

## WHAT ARE THE FINANCIAL COMPONENTS OF AN FIA?

### SURRENDER PERIOD

FIA policies will charge fees for the first five to 10 years if you make withdrawals or surrender the policy. This is called the “surrender period.” Many contracts will allow you to withdraw a certain amount, typically 10% each year, without imposing a surrender charge. Additional withdrawals over this amount (if any) will be subject to a surrender charge if taken during the surrender charge period. After the surrender charge period, surrender charges will not be applied to withdrawal amounts. Withdrawals will reduce the contract value and the value of any protection benefits.

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### SPREAD

Some annuities with a participation rate also include a spread. The spread is a percentage that is deducted before interest is credited. For example, if the index rose 10% and there was a 100% participation rate, a 2% spread would mean that 8% interest is credited. A spread will never reduce the interest-crediting rate below 0%.

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## CAPS

Some FIAs use a “cap,” which is a maximum interest rate the annuity can earn in a given period. If the index selected exceeds the cap, the cap is used to calculate your interest. Uncapped policies are also available, offering you unlimited potential growth. If the index selected is negative, the contract can be credited with 0% interest, and in some cases, may lose value based on expenses charged to the account.

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## PAYOUTS

In general, there are two ways to receive income payments from an FIA—annuitization payments or income withdrawals through an add-on rider (typically with an annual fee). There are different tax ramifications for each option, so it is important to get tax advice from your accountant or qualified tax professional before choosing a payout method.

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## PARTICIPATION RATE

With some FIAs a specific percentage is given relative to an index’s performance. For instance, if the participation rate was 75% and the market rose by 10%, the contract would receive 7.5% in indexed interest. This is generally applied after caps and before a spread.

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## TAXES

While all annuities are tax-deferred, withdrawals can be subject to taxation, and the rules differ based on whether you purchased the annuity with qualified (not-yet-taxed retirement funds) or nonqualified (already-taxed funds). For instance, if the annuity is purchased with qualified money, withdrawals will be taxed as ordinary income, plus they may be subject to a 10% federal tax penalty if taken prior to age 59-1/2. Withdrawals from nonqualified accounts may cause the credited interest portion of the withdrawal to be taxed as ordinary income. It is important to work with a tax professional to understand how taxes will work in your case.

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# What are the benefits of a Fixed Indexed Annuity (FIA)?

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## PROTECTION & SAFETY

In 2008, people lost an unprecedented amount of retirement savings because of stock market volatility. The money people had in FIAs, however, was 100% protected from market risk during the financial crisis. Since then, there has been a growing interest in FIAs from retirement savers who are uncomfortable with the volatility that comes with traditional stock market investing.

Some investment industry experts<sup>1</sup> think that FIAs more closely approximate bonds or other fixed rate products, but with the potential for greater gains during up markets. With FIAs, gains are credited systematically based on your specific contract.

An FIA is backed by the strength of the insurance company that underwrites the policy.

## TAX-DEFERRED

FIAs offer tax-deferred growth, and tax-deferred interest can help the money in your contract grow faster. Depending on whether you purchase your FIA with qualified or nonqualified funds, the tax advantages vary. With nonqualified annuities, you can defer paying taxes on your contract's interest until you receive money from the contract. With qualified annuities, once you start receiving payouts, just like a 401(k) or traditional IRA, an FIA's distributions are taxed as ordinary income, and, if taken prior to age 59-1/2, an additional 10% federal tax penalty may apply.

Remember that unlike 401(k)s, traditional IRAs or Roth IRAs invested in mutual funds, stocks or bonds, FIAs offer guarantees and protection against market downturns based on the strength of the underlying insurance company.

## INTEREST AND ACCUMULATION POTENTIAL

With FIAs, retirees no longer have to choose between safety and growth. An FIA may be a good choice if you want the opportunity for accumulation, but don't want to risk losing money in the market. FIAs are credited interest based, in part, on an external index. But because you are not actually participating in the market, your principal is not affected by market downturns.

If you're a retiree or pre-retiree uncomfortable with market volatility and risk, you may have moved money into savings or money market accounts. If so, you've experienced the historically low interest rates being paid on these accounts. FIAs have become a popular option by offering the potential for competitive growth and compound interest along with principal guarantees.

## WHO SHOULD CONSIDER AN FIA?

People who are retired or getting ready to enter retirement are often the ideal candidates to consider fixed indexed annuities as part of their financial portfolio.

Today's longer life expectancies increase the need for sustainable, reliable income in retirement.

About one out of every three 65-year-olds today will live past age 90, and about one out of seven will live past age 95.

FIAs offer guarantees that make them very attractive to retirees who do not want to outlive their income.

# Annual reset.

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A common FIA feature is the annual reset. At the end of the contract year, your annuity's index values are automatically reset, meaning this year's ending value becomes next year's starting value. This locks in any interest your contract earned during the year.

# How is interest credited to an FIA?

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Because FIAs don't directly participate in any stock or equity investment, an FIA's value will not be affected by negative markets, a benefit which is sometimes called "downside protection." On the other hand, if the index has a positive return for the year, the FIA policy may be credited with interest, based in part on the changes of the external index.

# Common crediting methods.

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Each FIA policy has a formula for the way interest is calculated and credited. This is called the crediting method, and below are three of the most common ones. They are used in conjunction with the components discussed earlier (caps, spreads and participation rates). Some annuities may have only one component, others may have several. Keep in mind that components can change annually (for example, caps may be raised or lowered) but are typically subject to lifetime maximums or minimums.

## POINT-TO-POINT / TERM

- This method compares the values of the index at two distinct points, such as at the end and beginning of the contract term, ignoring fluctuations between. Typically, this comparison is done annually.

## ANNUAL HIGH-WATER MARK WITH LOOK BACK

- Typically, the index level is noted at various points during the term, typically the policy anniversary dates, and then compares the highest level to the start date to calculate interest.

## MONTHLY AVERAGING

- Measures the index performance once a month on a specified day, and then at the end of each year, the insurance company adds them up and divides by 12. If the result is negative, no interest is credited, if it's positive, interest will be applied (subject to any other adjustments from caps, spreads, and/or participation rates).

# What are some other options available with FIAs?

Through optional riders, FIAs offer features which can be added to FIA policies for additional fees, allowing customization based on individual need.

For instance, one popular rider with retirees is the lifetime income option. (NOTE: Some FIA policies now feature lifetime income as part of the main policy itself.)

Other riders include guaranteed death benefit for beneficiaries, long-term-care coverage, future cost-of-living or inflation adjustments, joint or spousal survivorship, and surrender charges waived for disability, unemployment or terminal illness.

Each policy is different, and insurance companies offer varying stipulations and coverages as they compete and improve their policies and riders based on consumer demand.



# More about FIAs

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Annuities are continuously evolving, and the features and benefits of an FIA today are much different than they were even a few years ago, as insurance companies continue to innovate.

FIAs have attracted the attention of thousands of people seeking a balance between risk and reward. In times of market volatility, fixed indexed annuities can have even greater appeal. Annuity sales in the U.S. were \$310.6 billion in 2022 according to LIMRA, exceeding sales records set during the 2008 economic crisis.

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Sources: <https://www.cnbc.com/2023/02/02/annuity-sales-record-2022-higher-interest-rates-stock-market-recession-fear.html>

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