

CHEAT SHEET

Fixed Indexed Annuities

What is a fixed indexed annuity?

A fixed indexed annuity is a long-term, tax-deferred savings vehicle that offers protection from market loss and the opportunity for upside growth through indexed interest credits. Fixed indexed annuities are sold by insurance companies through insurance and financial professionals.

Is a fixed indexed annuity the right fit for your retirement strategy? It's possible, depending on your specific needs and goals.

What are the benefits of a fixed indexed annuity?

Fixed indexed annuities offer the potential for several benefits.

- **Tax-deferral** – Any interest in a fixed indexed annuity are tax deferred. That means you won't pay taxes on interest earned while it remains inside the annuity. This can be a great benefit, as tax deferral allows your money to accumulate more quickly than if you paid taxes on interest each year. Any money withdrawn from the annuity is taxed as ordinary income, including an additional 10% IRS penalty before age 59 ^{1/2}.
- **Downside protection¹** – Most fixed indexed annuities offer principal protection, which can help shield your assets from market losses. Even if your index performs poorly in a given year, your annuity balance won't decrease due to market declines. You may not earn interest that year, but you also will not lose money.
- **Upside potential** – Fixed indexed annuities have the potential to earn interest that is linked to an external market index, such as the S&P 500, while never being invested in the market itself. This provides you with an opportunity to earn interest in a specified time period, based on how the index performs, subject to limits set by the issuing company called caps, spreads and participation rates. If the index performs poorly, you may not earn interest in any given year but you won't lose money due to market loss. If the index performs well, you may earn more interest.

¹ The cost of optional riders will be deducted even in years in which there is no interest credited, which will result in a decrease of your annuity cash value.

How do you earn interest in a fixed indexed annuity?

As the name suggests, a fixed indexed annuity is tied to an external market index.

Examples of common indexes include:

- S&P 500
- Dow Jones Industrial Average
- NASDAQ Composite
- Russell 2000

The interest paid is based on the return of the specific index over a designated period of time, and timeframes vary by contract. For example, your timeframe may be a calendar year or a 12-month period from the time you opened the contract.

During a period when your index performs well, you have the potential to earn more interest than during a period when the index performs poorly..

What happens if the index declines over the designated timeframe?

It's possible that the index your contract is tied to could go down in value over the time period that is used to calculate your interest. Fortunately, all fixed indexed annuities have a minimum guaranteed value, (typically 0%) which means that you will not lose value in your annuity due to poor market performance. During a market downturn, you would likely earn zero interest, while maintaining the value of the annuity.

Is a fixed indexed annuity's interest capped?

Yes, there's a typically a limit on the upside interest potential of a fixed indexed annuity. The specific rules vary by annuity, but limits

are often implemented through either caps or participation rates.

- **Interest caps** – An interest cap is a limit on the amount of interest you can receive in a given period. *For example*, if your contract has a 6% interest rate cap over 12 months, you would receive interest equal the index's increase up to a limit of 6%. That means interest over each 12-month period would be between 0% and 6%.

Here's how that would look at different levels of hypothetical performance.

12-MONTH INDEX PERFORMANCE	INTEREST RECEIVED
-3%	0%
4%	4%
6%	6%
10%	6%

- **Participation rates** – A participation rate is the portion of market performance that is credited to your annuity value as interest. *For example*, if your contract has an 80% participation rate, your interest will be equal to 80% of index performance.

Here's how that would look for various levels of performance over a 12-month period.

12-MONTH INDEX PERFORMANCE	INTEREST RECEIVED
-3%	0%
4%	3.2%
6%	4.8%
10%	8%

- **Participation rates** – A participation rate is the portion of market performance that is credited to your annuity value as interest. *For example*, if your contract has an 80% participation rate, your interest will be equal to 80% of index performance.

Fixed Indexed Annuity Considerations

There are several important considerations to keep in mind before purchasing a fixed indexed annuity.

- **Liquidity** – Fixed indexed annuities are not liquid vehicles. Most have multi-year surrender schedules, which means you'll pay a penalty if you surrender a policy or take an excess withdrawal during the restricted period. Before committing to this type of annuity, it's important to have other sources of liquid assets on hand in case of emergency.
- **Taxable distributions** – Interest earned within a fixed indexed annuity is tax deferred. However, in most cases, distributions from fixed indexed annuities are taxed as ordinary income. If you plan on using the annuity for income in retirement, be sure to have a tax planning strategy in place to help limit your tax exposure. In addition, withdrawals before age 59^{1/2} may incur an additional 10% IRS penalty.
- **Limited upside** – Fixed indexed annuities can be effective vehicles for those who are willing to accept limited upside potential in exchange for minimal downside risk. However, they may not be appropriate for those who have a high risk tolerance and wish to accept greater risk in the pursuit of higher returns.

Interested in learning more about whether a fixed indexed annuity makes sense for you?

Schedule a call to discuss your overall financial strategy and long-term goals.



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