



The Foundation For *Protected Growth Planning* Is...

# The Fixed Index Annuity

Providing Protection of Principal AND Income Solutions

## Understanding the Fixed Index Annuity

When it comes to thinking about our retirement savings, most people would probably agree that today's economic conditions present challenges. With the economy uncertain, with interest rates relatively low, and with memories of stock market volatility and losses still fresh in our minds, it's no surprise that appropriately managing our savings is of real concern. Interest rates on some savings vehicles provide little in the way of either current income or growth potential. Savers who want to see their money grow more quickly are sometimes faced with taking on too much risk in the hope of achieving a higher yield. In the search for better yields, investing in stocks or mutual funds may be unappealing to those who have fled the market in order to stem losses. When stocks are going up, people are happy. But when stock market losses and volatility reemerge, retirees and those planning for retirement may find themselves in a financial hole they don't have time to climb out of. This is why getting it right with our savings dollars is so important. If our savings portfolio is properly structured, protection of principal AND income solutions will be assured. This means seeking a balanced approach to our savings, and selecting savings vehicles that offer varying degrees of liquidity and long-term interest accumulation potential. Also of paramount importance is the ability to turn savings into guaranteed retirement income when that income is needed.

*Retirement income guarantees are subject to the claims paying ability of the issuing insurance company and the terms and conditions of the contract.*

Everyone should observe the common sense approach of diversification in their investment and savings choices. Each of us should also have a portion of our savings in highly liquid vehicles such as money market accounts or six to 12 month CDs.

*CD's are FDIC insured up to \$250,000, and offer a fixed rate of return. They do not necessarily protect against a rising cost of living. The FDIC insurance on CD's applies in the case of bank insolvency, but does not protect market value. Other investments are not insured and their principal and yield may fluctuate with market conditions. An investment in a money market fund is not FDIC insured or guaranteed by any other government agency. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund.*

But there is also a place, in fact a **need**, for longer-term, tax advantaged savings vehicles.

One such vehicle offers interest earnings potential linked to a stock index, but completely avoids market downturns. It's called an Equity Indexed Annuity, but is also commonly referred to as a **Fixed Index Annuity or FIA**. This financial product is a savings instrument that appeals to people who understand the long-term benefits of investing in stocks but are uncomfortable with the potential losses and volatility that are an inevitable part of investing. Index linked annuity accounts should not be viewed as investments. The reason is that index linked annuities, or FIA's, are actually savings vehicles. They are not intended to duplicate the upside potential investing may offer. They were designed to provide a return somewhere between stock market vehicles and savings instruments – somewhere between mutual funds and CDs. But given the volatility of the market over the last ten to fifteen years, and the FIA enhancements that have evolved over time, these principal protected savings instruments have proven that they can more than hold their own in the investment world as evidenced by this quote from Forbes magazine in June, 2009:

*“Since 1995, these [equity-indexed] annuities have easily outpaced the S&P 500 and bond indexes alike. ‘There is no asset category that outperformed them. We were extremely surprised, really just amazed,’ says David Babbel, professor emeritus of insurance and risk management, ... (at the Wharton School of Business...) who conducted a study of equity-index annuity returns beginning in 1995... (through January 1, 2009).*

*Equity-Indexed Annuities are not required to be registered under the Securities Act of 1933 and therefore are not considered to be securities or investment vehicles.*

## Access to Your Savings

FIA's are used not only to accumulate income, but also to supplement income. So FIA savings can be accessed in a number of ways. Many contracts allow interest to be paid from a fixed account option monthly, or via Income Rider Lifetime Payment guarantees that provide income paid monthly, quarterly, semi-annual, or annual. Most FIA contracts also permit penalty-free access to 10% of the contract's accumulated value every 12 months beginning in month 13, while some will provide that penalty-free access within the first 12 months. Withdrawals in excess of the penalty-free amount during the surrender charge period will incur a surrender penalty. Surrender charges decline incrementally to zero over anywhere from one to sixteen years depending on the contract. Surrender penalties may eat into the original premium if the annuity is surrendered early. Surrender charges vary depending on the terms and features of the FIA contract. A careful review of your financial balance sheet is required to assure your cash flow needs are properly assessed and that your liquidity position is comfortable and adequate. Consumers should know that this is part of a “suitability review” which the issuing insurance company will require your advisor to complete and submit with any FIA application.

Just as important to this discussion though, is the misplaced fear of printed surrender charges vs undisclosed, involuntary market volatility charges. Many investors feel they can always tap into (redeem or liquidate) their stock and mutual funds without penalty – it's totally liquid. Right? Not so fast. There may very well be an undisclosed, involuntary penalty. Let me explain. Let's assume you have \$100,000 in stocks and mutual funds and, for whatever reason, you decide you must have that cash in your hands. However, what if we've just had a year in the market like 2008 and your fund value is down to perhaps \$60,000? But it's totally liquid, no “surrender charges”. You also have an FIA account with \$100,000 accumulated value, and while it did not

earn any interest in 2008, it did not lose any value because an FIA protects principal and previously credited interest. It does have those “printed surrender charges” though, and after that penalty is applied the surrender value would be only \$90,000. So let’s look at this. The stock/mutual fund is “penalty-free” and it will put \$60,000 cash in your hands. The FIA has a printed, pre-disclosed surrender charge penalty and it will put \$90,000 cash in your hands. So, what’s the point here? The fear of printed, pre-disclosed surrender charges is often misplaced when compared to undisclosed, involuntary market volatility charges.

*Withdrawals in excess of the Surrender Charge-free withdrawal amount (which is typically 10% of the contract value or initial premium every 12 months) will be subject to a declining Surrender Charge during the surrender charge period. Withdrawals will be subject to income tax and may be subject to a 10% IRS penalty tax if taken prior to age 59½.*

Savers who take advantage of the security and flexibility offered through the addition of powerful income account riders and features, will find themselves positioned to receive a lifetime of market-linked income that can increase year after year, but will never decrease due to market downturns. This is contractually guaranteed! This combination of downside protection and upside interest earnings potential is the heart of an index annuity’s appeal and security.

## The history of Indexed Annuities

Let’s examine the background of fixed index annuities to understand why they have grown so popular over the past decade. An FIA is a relatively recent modernization in the design of fixed annuities. Purchased by Americans for decades, traditional fixed annuities have helped millions of retirees and those planning for retirement, safeguard their savings, enjoy interest growth and create retirement income. Traditionally, fixed annuities have credited reasonably competitive rates of interest. But like many savings vehicles, the interest rates offered by fixed annuities are tied to the general level of interest rates in our economy. In searching for a way to generate even greater interest earnings potential, a new form of fixed annuity emerged in 1995. It was similar to other fixed annuities in that it offered underlying guarantees, but it also linked interest earnings potential to the performance of a stock market index (such as the S&P 500 and other indexes).

*The S&P 500 Index is a market capitalization weighted index of 500 of the largest U.S. companies (without dividends). It is unmanaged and investors cannot invest directly in it.*

All indexed annuities utilize an index such as the S&P 500 or NASDAQ 100 (as well as other indexes) to create the potential for interest earnings based on upward movement of the index. Since 1995, indexed annuities have increased dramatically in sales volume. As you might imagine, (and as you have learned from the Wharton School of Business report) fixed index annuities have generated significant yields as a safe money instrument. Imagine if every year the market (S&P 500) went down, you could demand your money back, and then buy more at the lower price. That’s the beauty of **Protected Growth** planning using index linked annuities. Last year’s ending point is this year’s starting point. An index linked annuity credits interest based on the upward movement of an index (such as the S&P 500) while protecting principal and previous earnings from market downturns. So, in a year when the market moves down, **you retain your principal and previous earnings** (or as stated earlier “demand your money back”), and now you are

linked to this year's new lower index value (it's as if you bought more at the lower price) and you are positioned to **earn interest on any upward movement from this new lower index value**. And all this happens on auto-pilot, every year! That's why it's a strategy that works in any market.

*FIA interest crediting strategies are subject to certain caps and limitations. NASDAQ 100 Index is an unmanaged index of 100 stocks traded on the NASDAQ over-the-counter market.*

## Protecting against Risk

The last decade has seen significant volatility in the market. Many investors in stocks and mutual funds have suffered losses. This market volatility has caused many savers and investors to take a close look at index linked annuities and, in part, fueled their popularity. Indexed annuities help to insulate their owners from investment risk. When stock index performance is negative, indexed annuity contract designs will protect the principal and previously credited interest. The worst that can happen in a negative year is zero interest. If the contract owner has some (or all) of their money allocated to a fixed account option, then the fixed account interest rate would be credited to whatever percentage of the total contract value (if any) is allocated to the fixed account.

*All guarantees are backed by the claims-paying ability of the issuing insurance company.*

This protection against investment loss is one of the most significant benefits indexed annuities offer. For people who want protection of principal, AND income solutions, **Protected Growth** planning using fixed index annuities may be the solution. FIA's are very flexible, with choices to consider. With a multitude of interest crediting options, and **income riders** to consider, you'll want a qualified financial professional to advise you on which indexed annuity (or combination of annuities) best suits your needs. FIA's are used to accumulate and distribute income. **Income riders** are available which will **GUARANTEE** to more than double your **income withdrawal account** value (over a ten year period) for future lifetime income payments. This **income withdrawal account** does not have cash value, but is used to determine minimum lifetime income payments. It should be comforting to retirees and those planning for retirement to know that FIA's and FIA **income riders** are currently available, which will provide a lifetime of guaranteed income that can increase with the market year after year (but never decrease), and then pass any remaining account balance to named beneficiaries at time of death. This is contractually guaranteed. Thus, **Protected Growth** planning with FIA's works well in any market. Because certain FIA accounts will increase your guaranteed lifetime income payment each and every year there is a positive interest credit to the account value (due to either market linked growth, or guaranteed fixed account interest) your income can increase year after year, but will never go backward. And if deflation is the problem, the fact that you are never going backward with your guaranteed income, means that it now takes one dollar to buy what used to cost five dollars. So, with FIA's, you have a strategy that works well in any market, whether it be inflation or deflation.

Further evidence of the protective nature and power of FIA's is documented in this quote from Senior Market Advisor (July 2009) wherein Jack Marrion, President of Advantage Compendium,

Ltd reports: “If you could have purchased an FIA every month, beginning in August 1929, your average annual index annuity return for the Great Depression would have been 6.4%. All of this during a decade that ended 65% lower than when it began.” Jack Marrion’s research has been featured in over 100 publications including American Banker, Best’s Review, Business Week, CBS News, Investment Advisor, Kiplinger Magazine, Smart Money, The National Underwriter, Chicago Tribune, Christian Science Monitor, Los Angeles Times, The Washington Post and The Wall Street Journal. Mr. Marrion has worked as a consultant to insurance carrier and other financial firms. Mr Marrion does not sell or endorse any financial product. Additional information on safe money strategies and products is available at [www.safemoneyplaces.com](http://www.safemoneyplaces.com), a web site run by Mr Marrion.

## Guaranteed Minimum Interest Earnings

While some guarantee more, and some less, typical FIA’s provide for a minimum interest rate of between one-and-one half percent and three-percent credited on 90% of the original premium. This interest growth is guaranteed whether the performance of the associated stock index is positive or negative.

*All guarantees are subject to the claims-paying ability of the issuing insurance company.*

To illustrate minimum interest growth, let’s look at an example of an indexed annuity with a ten-year term and a minimum interest rate of 3% credited to 90 percent of the original premium. This is equivalent to a 1.92% rate of return over the 10 year period. We’ll assume that over the ten-year term there is no growth in the underlying stock index over the course of this ten year period. So even if the index was negative for ten years in a row, the indexed annuity, when held to the end of its ten-year term, would guarantee interest growth of twenty-one-percent. This means that if you purchased an indexed annuity with an initial premium of \$100,000, you would be guaranteed to have not less than \$121,000 after ten years. Remember though, that index linked interest can be credited in **any** year there is positive index movement, so this scenario is highly unlikely.

*Example based on 3% minimum interest rate credited on 90% of the original single premium, compounded over the ten-year term. This is a hypothetical illustration and is not intended to reflect the performance of any particular investment.*

The significance of this combination of downside protection and upside potential can be important to savers who are seeking a degree of protection consistent with realistic growth expectations.

## Critical Questions for Savers

Today, retirees and those planning for retirement should be asking themselves some critical questions regarding their savings: First, “How can I position my savings to achieve greater interest earnings potential without taking on investment risk?” Second, “Would I benefit from a long-term savings vehicle that safely links interest earnings to the upward movement of a stock index?” Third, “How will I protect my savings if interest rates decrease in the future?” Fourth, “How will I protect my retirement savings from inflation risk?” Fifth, “Is it possible for me to

position my savings and assets so that I will never lose money due to market downturns, and still have adequate income that will last as long as I live?” And finally, “Is there a strategy for my retirement money that works in any market, and is designed to work on auto-pilot once it is set up?” These questions recognize critical challenges for savers which indexed annuities may help meet. As a place to make your savings do more, an indexed annuity may offer benefits not offered in other savings or investment vehicles.

*An Indexed Annuity is an annuity contract issued by an insurance company. Indexed annuities (or FIA's) are subject to holding periods and surrender charges. There is a possibility of loss of principal if the annuity is not held to the end of its term due to surrender charges which may be applied. Minimum interest rate guarantees on indexed annuities vary and are subject to the claims paying ability of the issuing insurance company. Indexed annuities are not direct investments in a stock or mutual fund and are therefore not securities. Withdrawals of all or part of the value in your annuity before the end of the term of the contract may result in withdrawal or surrender charges. Earnings are taxable as ordinary income when withdrawn, and if taken before age 59½ may be subject to a 10% federal tax penalty.*

For additional information on Safe Money savings instruments, go to [www.safemoneyplaces.com](http://www.safemoneyplaces.com)

For more information on the the financial process reviewed in this white paper:

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