## A Safe, Risk-Taking Annuity?

Submitted by Mark Fried on Fri, 07/06/2012 - 12:00pm

Annuities give you income for life, but the two biggest categories of them, fixed and variable, have drawbacks. A newer variety, though, takes the best features of both.

The fixed annuity sends you a set amount every month, based on current interest rates and your age at the time of purchase, but inflation can erode that payment. The variable annuity invests in the market and may bring you great bounty, but you are open to market meltdowns like that of 2008.

The relative newcomer annuity—its popularity growing over the last 20 years or so—is called *fixed ind*ex. It gives you the dependable payouts of the fixed annuity, plus a chance to capture market returns like a variable.

A fixed index annuity puts you in a position to make considerably more than a fixed annuity, without the risk of the variable. Here's how insurers, who sell annuities, do it.

First, your money is invested in a bond portfolio in the insurance company's reserve account, where there is a fixed rate of return. Then the insurer takes the bonds' interest, not the principal, and invests it in the market, using an index fund such as one linked to the Standard & Poor's 500. Meanwhile, the principal is secure.

If the market goes up, you reap the gains and get a better return than you could have if you were invested in a fixed annuity. These gains are immediately taken out of the market and allocated to your account. That means it as added to your principal and is no longer exposed to market risk. The insurer guarantees that your principal can never go down.

What if the market crashes and your account flat lines? Then, the insurer does not allocate any interest to the stock index. If in the next year the market goes back up, then your account goes up again. All along you pay no taxes on the money that you make.

And unlike with a fixed annuity, your heirs can receive the proceeds from the contract after you die. With a fixed annuity, the insurer often keeps all the money.

But for a fixed index annuity, the negative is you don't get all of the market gain.

The insurer limits the gain by using one of two mechanisms: a cap or a spread with a participation rate. A cap places a ceiling on your gain. If the cap is 5% and the market goes up 15%, you only get 5%.

A spread is a fee charged against the interest you earn. A participation rate is the percentage of the market gain used to calculate the interest paid on your principal. So if the participation rate is 50% and the spread is 3% then if the market goes up 15%, your share is 7.5% (50% or half of 15), which is then reduced by the spread: 7.5% - 3% = 4.5%. You only get 4.5%.

How do you get your money out? With a fixed annuity, you can't. Yet a fixed index contract has a bit more leeway. You can't take out the entire amount, and must pay a penalty for removing a portion of your principal.

I can't tell you how many people come into my office and say: "I need the cash now and don't understand that all of it is not available to me in a lump sum." An annuity is not like a bank account or a money market fund, where you can withdraw every penny whenever you want.

Normally, there is a surrender charge period, which can last from five to 16 years. During it, you pay around 10% for removing money. On the plus side, most insurance companies allow you to pull out up to 10% without paying a penalty after the contract's first year.

You can get a break if your health is involved. Some annuities waive all surrender charges or increase the guaranteed income if you go into a nursing home. Some pay out a special bonus amount to your heirs at death.

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