Safety and Guarantees of Variable Annuities vs. Fixed Indexed Annuities

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Ever wonder why so many people include annuities in their financial plans? It's most likely because they're looking for safety and guarantees. The most popular annuities today are variable annuities and fixed indexed annuities. One of them offers safety from direct market loss; the other does not.

Variable annuities do not offer any downside protection from market loss to the investments within the annuity. If you have a variable annuity, this may come as a shock to you, so please read on.

When one purchases a variable annuity, they're purchasing an underlying portfolio of mutual funds that fluctuate with stock market volatility.

Many variable annuity companies tout the fact that they're offering 6%-8% guarantees. Don't be fooled by this! This guaranteed rate of return is not on your "real money" – the value invested in the underlying mutual funds – but likely on an income rider account. The income rider amount is typically a separate value from your account value. Instead, it's a factor the insurance company uses to determine how much lifetime income they will pay you. The income rider is **never** a real cash-out/walk-away value.

Variable annuities are also considered by some to be the "King of the Fees" in the investment arena. An article published in Forbes in 2012 states that variable annuity fees usually cost the investor 3%-4% per year.[1] The largest of these internal fees is usually the fee for the income rider. In many contracts, the income rider fee is calculated from the income rider account value. Then that fee is deducted from the account value in the variable annuity.
Think about it: If 3% is being taken off the top of your investment for fees, how do you think that impacts the interest and growth you are making in the end?

Fixed indexed annuities (FIAs), also known as equity indexed annuities, are built different. FIAs guarantee protection from downward market fluctuations and allow for the policy owner to participate in a portion of the growth of the market index chosen. Every FIA has its own crediting method that computes how much of the market-linked growth the insurance company will credit the investor. There are usually **zero fees** on the base contract of a fixed indexed annuity, and you may be eligible to take out up to 10% of the accumulation value each year without being penalized. At the end of the surrender period, the money is 100% liquid to the investor. Most FIAs also have an optional income rider that can be added to the policy. This guarantees a pension-like lifetime income stream to the account holder on a single or joint life basis, should that be desired. If an income rider is selected on an FIA, the fee for this is usually around 1%.

So, if you can make market-linked gains when markets go up and not risk losing money when the market goes down, what's the catch to a fixed indexed annuity? It sounds too good to be true, right? Well, you remember what your mother told you about things that sound too good to be true?

The catch is that the FIA usually won't credit the investor **all** of the growth of the market index. However, there's good news for today's baby boomers. FIAs have grown increasingly popular because of their performance and the added peace of mind they offer clients who want to protect a portion of their portfolios from market risk. There are several insurance companies offering FIAs today, and they're all competing for your business - trying to develop strategies that credit the investor more interest than their competition.

The important thing is to work with an independent fiduciary advisor who has your interests at heart and has access to the various fixed index annuities on the market. They'll help you find the annuity that fits your needs for the portion of your portfolio you're looking to protect from market risk while still participating in potential market-linked growth.

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[1]Forbes. July 2012.
https://www.forbes.comisites/feeonlyplanner/2012/07l02/9-reasons-you-need-to-avoid-variable-annuities/#Sfae9 bae5f19