

FIXED ANNUITY CONTRACTS

- The basics
- Traditional fixed annuities
- Interest-indexed annuities
- Equity-indexed annuities
- Certificate annuities

Traditional deferred fixed annuities have been around for a long time. And although these contracts can take several forms (some of which are relatively new), they all have common traits.

The basics

A fixed annuity is a contract sold by an insurance company. The purchaser makes contributions (investments) into the annuity either as a lump sum (referred to as a single premium annuity) or over a period of time. The annuity returns the investment and any earnings to the owner at a later date.

Like all annuities, contributions to a fixed annuity are made on an after-tax basis (unless the annuity is in a qualified plan or IRA), but the interest on the contributions accumulates tax deferred until the time when the money is paid out. At payout time, the portion of the annuity payment attributable to the contribution is not taxable, and the rest of the distribution is taxable.

There are also unique tax rules governing annuities. Distributions taken before age 59½ are subject to a 10 percent early withdrawal penalty tax on earnings. Gifting an annuity policy for less than full value to individuals (other than a spouse or a former spouse as part of a divorce decree) and using an annuity as collateral for a loan can have adverse consequences. And no matter how long you own an annuity, the gain is always taxed at ordinary income tax rates rather than at capital gains tax rates.

A fixed annuity usually penalizes a purchaser who decides to opt out of the contract before a specified period of time. This is known as a surrender charge, which is typically about 7 percent in the first policy year and decreases by 1 percent per year. The charge is generally waived if the amount of the withdrawal is 10 percent of the contract value or less, or if the annuitant dies (contracts vary regarding surrender charge rates and waivers).

Traditional fixed annuities

Traditional fixed annuity contracts offer an initial guaranteed rate of return for a limited period of time. After the guarantee period, the annuity issuer is free to change the rate. However, you'll always be offered a minimum guaranteed rate (often 4 percent or less) for the life of the contract.

In many cases, the performance of newer fixed annuity products is tied directly to the performance of the stock market or some other competitive index. The amount of credited interest is often determined, at least in part, by how a portfolio of stocks has performed. There are several categories of these new fixed annuity products.

[See disclaimer on final page.](#)

Interest-indexed annuities

As the name implies, these products are indexed to an interest rate barometer, such as the 10-year Treasury bond rate.

Typically, the contract guarantees a fixed rate of return for a number of years (typically 3 to 5), and then, after the guarantee period, interest is credited in accordance with the rate provided by the index.

Equity-indexed annuities

Similar to interest-indexed annuities, these products tie the rate of return to the performance of an equity index, such as the Standard & Poor's 500 Composite Index.

Typically, an equity-indexed annuity will guarantee a minimum rate of return, around 3 percent. Any additional investment credits are tied to how well the market has performed. So, even in a down year for the market, the policy will still have some investment income.

Certificate annuities

This annuity product is meant to mirror a bank certificate of deposit (CD). Certificate annuities are meant to closely emulate the interest that the annuity purchaser could get if the money were invested in a CD instead.

With a true certificate annuity, the initial rate guarantee period is the same as the initial surrender charge period. For example, the certificate annuity guarantees 5 percent interest for three years with three years of surrender charges.

Certificate annuities are generally renewable, much like bank CDs. Once they are renewed, there is a new guaranteed interest period.

Neither Forefield Inc. nor Forefield Advisor™ provides legal, taxation or investment advice. All the content provided by Forefield is protected by copyright. Forefield claims no liability for any modifications to its content and/or information provided by other sources.
Copyright 2003 Forefield Inc. All Rights Reserved.
Final Page - Disclaimer

[See disclaimer on final page.](#)