InsuranceNewsNet Magazine

June 1, 2023 InsuranceNewsNet Magazine

Unlocking the power of FIAs in a secure retirement plan

By Jim Poolman

The modern-day retiree's portfolio has its work cut out for it. As Americans live longer, they are dealing with ever-increasing health care costs. In addition, lifestyle choices differ from those available 30 or 40 years ago (including the demand for subscription services and devices and a desire to travel), employers are no longer fronting the cost of defined benefit plans (pensions) and the future of Social Security income is unpredictable. Put it all together and it becomes clear just how important it is for your clients to grow their retirement savings.

Annuities Awareness Month is an opportunity to help your clients explore fixed indexed annuities and how they can help clients reach their retirement goals. If your client is in an earlier stage of their career and hasn't given their retirement much thought, then June could be their lucky month.

Types of annuities

Understanding the basics of an annuity is a good place to begin. An annuity is a financial product based on a contract between an individual and an insurance company. In exchange for an initial payment or a series of payments, the insurance company agrees to make regular payments to the individual at a future date. Individuals can receive these payments in different ways, such as a guaranteed income for a certain period or for the rest of their lives. The payment amount is determined by various factors, including the initial payment amount, the chosen payout option, and the individual's age and life expectancy at the time they begin receiving payments.

There are two types of annuities: variable and fixed. With variable annuities, the insurer invests the initial payment in a portfolio of stocks, bonds and other securities, with the potential for greater returns but also greater risk. Fixed annuities guarantee a specific rate of return. FIAs are a type of fixed annuity. However, the interest earned is tied to a stock market index, providing the potential for higher returns.

LIMRA reports more than $310 billion in annuities were sold in the U.S. in 2022, representing a significant retirement savings market. FIA sales were $21.9 billion in the fourth quarter of 2022, a 32% increase from the prior year. FIA sales were $79.4 billion for the entire year, up 25% from 2021 and 8% higher than the record set in 2019.

How FIAs work

FIAs generally have an interest rate floor, which is the minimum interest that will be credited each period (typically 0%), a participation rate (the percent of an index used to calculate interest crediting) and a cap (the maximum interest that will be credited). The interest rate floor, participation rate and cap determine the amount of interest earned.

The interest earnings rate will always remain between the floor and the cap, and it will not rise above the cap, even if the index goes higher. Conversely, it will always stay above zero, even if the index declines in value. The value of your clients' money will never decline due to market loss for as long as it is in the FIA, although it can increase with a rising index.

If your clients withdraw their money from an FIA before an index term ends, the annuity may add only some of the index-linked interest for that term to their account. Additionally, like many long-term financial products such as certificates of deposit or mutual funds, FIAs have a surrender fee for early withdrawal, the terms of which depend on the contract.

A bright future for FIAs (and retirees)

The benefits an FIA provides appeal to Americans as the trend toward annuities — FIAs in particular — continues ticking upward. Annuity predictions for 2023 include a higher interest rate environment and new opportunities provided by the SECURE Act.

The SECURE Act has broken barriers for annuities in the retirement space and has led to their inclusion as options in retirement accounts. Higher interest rates will also boost FIAs, since higher rates mean more significant annuity returns.

One of the primary benefits of an annuity is that it can provide a guaranteed income stream for life. Research from the Indexed Annuity Leadership Council found that 77% of Americans say it is important that they don't outlive their income in retirement, and 86% of Americans who plan to retire say guaranteeing their income in retirement is important. Therefore, annuities offering lifetime income guarantees have become more popular. A 14% rise in total annuity sales is forecast for 2023, driven by an expected 25% rise in FIAs. Other market trends impacting FIAs include:

» **Enhanced flexibility:** Insurance companies are likely to continue improving the flexibility of FIAs to meet the evolving needs of consumers. For example, FIAs may allow partial withdrawals or provide enhanced death benefit options.

» **Regulation standardization:** As the popularity of FIAs continues to grow, regulatory standardization is likely to occur. The National Association of Insurance Commissioners has been working on a model regulation for FIAs, which could lead to more uniform standards across states.

» **Focus on education:** As FIAs continue to gain popularity, there may be a greater focus on educating consumers about the benefits and risks of these products. This could include increased disclosures and educational materials to help consumers make informed decisions.

Benefits of FIAs

In addition to a guaranteed income stream, an FIA offers additional benefits. First, FIAs can provide tax-deferred growth, meaning that the earnings on the interest earned are only taxed once they are withdrawn. This can help savings grow more quickly over time.

Second, FIAs aren't exposed to market fluctuations. The interest credited will never fall below zero, even in a negative market return. Third, since FIAs are designed for the long term, they are a diversification tool, ensuring your clients aren't placing all their eggs in one basket.

Finally, because FIAs offer predictable income, Americans feel more comfortable withdrawing funds from these retirement vehicles than they do from an individual retirement account or a 401(k). Ultimately, no matter what happens in the market, your clients can count on receiving payments throughout their golden years.

Are FIAs the right choice?

Determining whether an FIA is a good option depends on your clients' financial goals, risk tolerance and overall financial situation. Here are some things to consider:

» **Retirement income needs:** An FIA provides guaranteed income for life, which can be especially valuable if your clients are concerned about outliving their retirement savings.

» **Risk tolerance:** An annuity might be a good option if your clients are risk averse. Fixed annuities can protect against market volatility, making them a lower-risk option than investments such as stocks or mutual funds.

» **Tax considerations:** An FIA can offer additional tax-deferred growth if a client already maxed out contributions to tax-advantaged retirement accounts like 401(k)s and IRAs.

More than half (54%) of Americans have never heard of an FIA despite its value. Yet, once it's explained to them, 51% of Americans would consider setting up an FIA in the next 12 months.

Even more interesting, 77% of Americans ages 18-34 said they are more likely to consider FIAs, once it was explained to them what they were.