Exact Wealth: Your Guide to Indexed Annuities

What is an Indexed Annuity?

Fixed indexed annuities have surged in popularity among retirement savers – in 2024, Americans purchased a record $125.5 billion worth of fixed indexed annuities (a 31% jump from the prior year). Despite this growth, annuities remain somewhat underutilized overall. In fact, fewer than 1 in 20 U.S. adults (under 5%) owns any kind of annuity, which means many people approaching retirement may not be familiar with how indexed annuities work. An indexed annuity is essentially a fixed annuity whose interest credits are tied to a market index (like the S&P 500) – offering upside potential when the index rises, while protecting your principal from market losses. This blend of growth opportunity with downside protection is a big reason why so many people are now turning to indexed annuities to help balance safety and returns in their retirement portfolios.

Benefits of an Indexed Annuity

In today's volatile market environment, many investors value protection and guaranteed income. Surveys show 45% of investors say recent stock volatility made them more interested in investments with downside protection – which is exactly what indexed annuities offer (they shield your principal from losses during market downturns). Likewise, more pre-retirees are seeking lifelong income streams: for the first time, a majority (51%) of workers in 2022 said they'd consider converting part of their savings into a guaranteed annuity for retirement, up from just 33% a few years earlier. An indexed annuity can address these needs by providing steady growth with no risk of loss and the option for lifetime income payouts. It's no surprise that 86% of Americans (in a 2022 study) agreed that having a source of lifetime-guaranteed income gives them peace of mind in retirement. In short, indexed annuities combine growth potential, principal protection, and the ability to secure income for life – benefits that are especially valuable as people live longer and face uncertain markets.

What happens to my money if I pass away?

One common concern is whether the insurance company "keeps" your money if you die – but with most annuities, that's not the case. The vast majority of deferred annuities are never annuitized into irrevocable lifetime payouts without a guarantee. (In fact, a GAO study found that in 2008, less than 1% of deferred annuities sold were converted into lifetime income payments – meaning almost all contract values remained available to be left to beneficiaries.) If you pass away during the accumulation phase or while taking withdrawals, any remaining account value typically goes directly to your named beneficiaries, often bypassing probate. Insurance companies are indeed paying out these benefits: in 2023, U.S. life insurers paid a record $104 billion in annuity benefits to annuitants and their beneficiaries. This ensures that your loved ones would receive the remaining proceeds of your annuity. (Do note: if you had opted for a life-only annuitization with no refund or period-certain, payments would stop at death – but most people choose options that protect heirs, such as joint life payouts or guaranteed periods, precisely to avoid leaving nothing behind.)

Are annuities FDIC insured?

Annuities are not insured by the FDIC (Federal Deposit Insurance Corporation) because they're not bank deposits – they are contracts with insurance companies. However, there is a safety net: all 50 states (plus D.C. and Puerto Rico) have life & health insurance guaranty associations that protect policyholders if an insurer fails. Individual annuities are typically covered up to $250,000 in present value (per owner, per insurer) by these state guaranty funds. While insurance company failures are very uncommon, history shows that even in the rare event of a major insolvency, policyholders usually recover the vast bulk of their annuity value. Industry data indicate that in most significant life insurer failures, the failed insurer's own assets ended up covering 85%–95% of policyholders' liabilities – and state guaranty associations stepped in to cover much of any shortfall . In other words, although annuities don't have federal FDIC backing, they are safeguarded by a robust state-level system and strict regulations that require insurers to hold substantial reserves for annuity obligations. This system has a strong track record of protecting annuity owners' money even under worst-case scenarios.

What types of annuities are available?

There are several major categories of annuities, each with different features. Fixed annuities (including traditional declared-rate fixed and fixed indexed annuities) offer principal protection and credit interest at either a set rate or an index-linked formula. These have become the most popular recently – in fact, fixed annuity products accounted for about 74% of all annuity sales in 2022 as more consumers sought safe growth. On the other hand, variable annuities invest in sub-account funds and can rise or fall with the markets. Traditional variable annuities have seen declining demand (annual VA sales dropped from a $184 billion peak in 2007 to around $61.7 billion in 2022) because many buyers now prefer the guarantees offered by fixed and indexed contracts. There are also immediate annuities (which start paying income right away) and deferred annuities (which accumulate money first and pay income later). Within deferred annuities, you'll find multi-year guarantee annuities (MYGAs) that function like multi-year CDs with a fixed rate, and registered index-linked annuities (RILAs) that are a hybrid (offering partial downside buffers and upside caps). In short, the annuity universe spans from fixed to variable, immediate to deferred, and even hybrids – allowing individuals to choose a product that best fits their risk tolerance and retirement timeline.

CDs vs. Fixed Annuities

Both bank Certificates of Deposit (CDs) and fixed annuities are popular for safe, interest-bearing growth – but they have some differences in rates and tax treatment. Recently, rising interest rates have benefited both: fixed-rate deferred annuity sales more than doubled to $112.1 billion in 2022 (a 111% increase from 2021) as savers flocked to lock in higher yields. Traditional bank CDs also saw a huge resurgence – balances in "small" CDs (under $100k) held by banks, which had nearly dried up during years of ultra-low rates, surged from practically zero in early 2022 to about $1.19 trillion by August 2024. This shows how both instruments became more attractive when interest rates rose. Fixed annuities often offer higher yields than comparably-termed CDs, especially on a tax-adjusted basis, because annuity interest grows tax-deferred. For example, at one point a tax-deferred annuity credited 2.75% for an investor in the 32% tax bracket, which would require a 4.04% rate in a taxable CD to net the same after-tax return. Unlike CDs, annuities do come with longer commitment periods (surrender charge periods) and IRS rules (like the 59½ age rule for withdrawals). But many retirees use fixed annuities as a "CD alternative" for the potentially better rates and tax advantages – especially if they don't need liquidity for a set number of years.

Variable Annuities: Pros & Cons

Variable annuities (VAs) offer market-driven growth and optional lifetime income guarantees, but they come with higher fees and risk compared to fixed annuities. It's important to know the cost structure: a typical variable annuity has an annual

mortality & expense (M&E) insurance fee of roughly 1.3%–1.6% of your account value. On top of that, the underlying investment funds (subaccounts) have their own expense ratios (often ~0.5%–1% or more), and any elective riders (like guaranteed lifetime withdrawal benefits) might add another ~1%. All in, many VA contracts have total annual fees around 2%–3% of the account – an amount worth weighing against the benefits. On the plus side, VAs provide tax-deferred investment growth and can offer guaranteed income or death benefits that mutual funds alone do not. But market exposure means your account can fluctuate – e.g., a downturn like 2008 would reduce the account value (though guarantees can protect income or death payout levels). Perhaps as a result of cost and market risk, fewer people are buying traditional VAs than in the past: sales of variable annuities have fallen from about $184 billion in 2007 to roughly $62 billion in 2022. Many investors have instead gravitated to buffered annuities (RILAs) or indexed annuities for some market participation with less downside, or to lower-cost investment products. In summary, a variable annuity can be valuable if you desire market growth and insurance guarantees in one package – just be mindful of the fees and ensure the benefits align with your needs.

Accessing Your Money & Taxes

Annuities are designed as long-term retirement products, so there are rules about accessing your funds. During the surrender period (which typically lasts a set number of years after purchase), most contracts let you withdraw up to 10% of the account per year without penalty, but taking out more incurs a surrender charge. Additionally, the IRS imposes a 10% additional tax penalty on withdrawals taken before age 59½ from an annuity (except in certain special cases). This is similar to the early withdrawal penalty for IRAs/401(k)s and is meant to discourage tapping your retirement nest egg too soon. The flip side is that annuities enjoy tax-deferred growth – you don't owe taxes on interest or investment gains until you withdraw the money. This tax deferral can significantly boost growth over time. For example, over a 36-year period at a 6% annual return, a tax-deferred investment grew to about $800,000 before withdrawal; even after paying taxes on a lump sum, it netted roughly $569,000, compared to only about $400,000 if the same investment had been in a taxable account all along. In that scenario, tax deferral provided roughly 42% more after-tax wealth than a taxable investment. When you do start withdrawals, gains are taxed as ordinary income (just like IRA distributions). Annuity payouts can also satisfy required minimum distributions if held in an IRA. The key takeaway: plan on leaving the money in the annuity until at least age 59½ (and ideally through the surrender term) to avoid penalties, and appreciate the tax-deferred compounding while it stays inside the annuity.

How Do Annuities Grow Over Time?

Annuities grow through the power of compounding interest and/or investment returns, and their growth will depend on the type of annuity. A fixed annuity grows by the interest the insurer credits; an indexed annuity earns interest based on an index's performance (subject to caps or participation rates); a variable annuity's account value grows or declines with the market investments chosen. Over time, even moderate rates can yield impressive results thanks to compounding. For example, an investment growing at 6% per year will roughly double in value every 12 years (this comes from the "Rule of 72"). So if you put $100,000 into an annuity earning 6%, it might grow to around $200,000 after about 12 years, $400,000 after 24 years, and so on – assuming no withdrawals. Annuities also grow tax-deferred, which means the full interest can continually compound without annual drag from taxes. This can lead to a substantially larger balance over decades compared to a taxable account. It's worth noting that annuity growth rates often reflect prevailing interest rates and market conditions. For instance, as interest rates rose in 2022–2023, insurers were able to credit higher interest rates to annuity owners – in fact, industry leaders noted that in 2023 annuity crediting rates were significantly higher than the low-rate years prior. On the variable annuity side, long-term growth will mirror market performance; historically, diversified stock portfolios have delivered strong returns over multi-decade periods (the S&P 500's annualized return over the past 30 years has been around 8%–10%, though future results can vary). The main point: given enough time, the combination of compounded returns and tax deferral can make an annuity grow substantially, helping fund your retirement income later on.

Understanding Fees & Bonuses

It's important to understand the costs associated with annuities, as well as incentives like bonus credits, so there are no surprises. Fees in annuities can include insurance charges (for mortality & expense risk, administration), investment management fees (in variables), and rider fees (for optional guarantees). These are typically built into the contract rather than billed separately. Another cost to be aware of is the surrender charge on withdrawals during the early years of the contract. Most annuities have a surrender charge period that usually lasts about 5 to 10 years from purchase. For example, an annuity might start with a 7% charge if you cash out in the first year, then 6% in the second year, and so on until the charge disappears after year 7 (the exact schedule varies by contract). The good news is contracts allow penalty-free withdrawals of a portion (often 10% annually) during this period – you'd only pay a surrender fee if you exceed that free amount or fully surrender the policy early. Now, bonus annuities: some annuities (especially certain fixed indexed annuities) offer an upfront premium bonus, where the insurer adds (say) a 5% or 10% credit to your initial investment. While it sounds like "free money," these bonuses come with trade-offs. Insurers recoup the cost through features like lower ongoing interest rates or caps on your annuity, and often longer surrender periods and higher surrender penalties to ensure they retain your funds longer. In short, the bigger the bonus, the more likely the other terms are less favorable compared to a non-bonus product. Always compare the effective earnings rate and surrender terms – you may find a standard annuity with a higher rate can outperform a bonus annuity over time. The key is to read the contract charges and conditions carefully: for example, does the bonus vest over time? what are the annual fees? Understanding these details will help you avoid missteps and choose an annuity that truly aligns with your goals.

Who Should (or Should Not) Consider an Annuity?

Annuities can be beneficial for some people and not as suitable for others, depending on financial goals and circumstances. Who typically buys annuities? They are generally purchased by those near or in retirement who want to secure lifetime income or protect their savings. The average age of an annuity buyer is in the early 60s, and the majority of annuities are purchased by individuals between ages 55 and 70 – basically as they approach retirement and look to convert a portion of their 401(k) or savings into a steady, pension-like stream or safe growth vehicle. People with a need for guaranteed income, principal protection, or tax-deferred growth often find annuities attractive. For instance, someone without a pension who is concerned about outliving their money might use part of their savings to buy an income annuity that they can't outlive. On the other hand, who might not want an annuity? If you anticipate needing full access to your money in the near term, an annuity's surrender period and IRS age restrictions (59½ rule) could be a drawback – in such cases, keeping funds in more liquid accounts may be better. Also, if you're very fee-sensitive and comfortable with market risk, you might prefer low-cost investments (though you'd be giving up the insurance guarantees). It's telling that interest in annuities has been growing as more people focus on retirement security: 51% of workers in a 2022 survey said they are willing to consider turning a portion of their nest egg into a guaranteed lifetime annuity, a notable rise from only 33% in 2018. This suggests that many see value in what annuities provide – especially in an era when traditional pensions are scarce. In summary, those who should consider an annuity are pre-retirees or retirees seeking longevity insurance (income for life), principal protection, and tax-advantaged growth and who do not need the money for other short-term purposes. Conversely, those who might not are individuals with sufficient liquidity needs, or who have other guaranteed income and prefer to invest their assets freely. As with any financial product, the decision should be based on your personal retirement plan: if steady income and safety are priorities, an annuity could be a fitting piece of the puzzle; if flexibility and maximum growth are the goal (and you have other income backstops), you might opt to forego annuities. The good news is that with the help of a financial professional, you can determine whether an annuity aligns with your situation and, if so, which type would serve you best.