

Shopping for an Individual Retirement Account (IRA)

An IRA can be an important tool to help achieve a financially secure retirement. This guide explains how to evaluate different IRAs before investing. A worksheet is provided to help compare various IRA options.

An Individual Retirement Account (IRA), whether it be a Traditional IRA or Roth IRA, is one of the tax-advantaged savings alternatives available to help Americans achieve a financially secure retirement.

For information on the tax advantages of IRAs refer to *Individual Retirement Accounts* (MF3212). In addition to evaluating and comparing the tax advantages of IRAs, potential IRA contributors must also evaluate the investment choices, fee structures, and other contract terms offered by IRA custodians and trustees.

IRA accounts offer different risks, rates of return, penalties for early withdrawals, fees, maturity periods, and minimum contribution limits. This guide provides information on comparing these features when shopping for an IRA. Also included is a worksheet to help organize the information you obtain.

What are the tax benefits of IRAs?

There are two types of IRAs, Traditional and Roth IRAs. Traditional IRAs generally offer a tax deduction for contributions to the account and the earnings are allowed to grow tax free. Distributions from a Traditional IRA are considered taxable income but the taxation is deferred to retirement when tax brackets are often lower. Roth IRAs do not offer tax deductions for the amounts contributed; however, distributions and earnings from a Roth IRA are not considered taxable income.

What are the contribution limits?

Eligible individuals are allowed to contribute up to \$5,500 annually to an IRA. Individuals over age 50 are eligible to contribute an additional \$1,000 each

year to an IRA. The IRA contribution limit will be adjusted annually based on an inflation index. For more information about contribution limits and tax benefits of IRAs refer to *Individual Retirement Accounts* (MF3212).

Where can I open an IRA?

Federal regulations require that IRAs be managed by custodians or trustees such as banks, credit unions, insurance companies, investment brokers, or any other entity approved by the Internal Revenue Service (IRS) to act as trustee or custodian. For simplicity, the term trustee is used to refer to both trustees and custodians in this guide.

Is my IRA account insured?

Banks, credit unions, and other similar financial institutions often offer savings accounts and certificates of deposit as investment options for potential investors. Many of these investments have the added benefit of being insured by the Federal Deposit Insurance Company (FDIC) or the National Credit Union Administration (NCUA) for up to \$250,000. The \$250,000 insurance limit for IRA accounts is separate from the insurance limit for non-IRA assets held at the same institution. This type of insurance helps protect the investment in the case of the failure of the financial institution.

What are my investment options?

The investment options that are available to IRA investors are nearly unlimited. Common IRA investments include mutual funds, certificates of deposit, savings accounts, stocks, bonds, annuities, and precious metals. Each type of investment offers

different risks, opportunities, and fee structures. Understanding the differences between investment choices helps you select the appropriate investment for your needs. Not all trustees offer each of the investment alternatives. Deciding which type of investment meets your level of risk tolerance can help you select “the best” trustee.

Investment Choices

Savings accounts. Savings account interest rates are often variable, with adjustments to the interest rate occurring one or more times per year. Occasionally, interest rates are fixed for a certain time period (for example: six months or a year). Rates vary among institutions, so shopping for the highest annual percentage yields can result in more dollars at retirement. Generally, savings accounts charge few fees if a minimum account balance (commonly between \$100 and \$10,000) is maintained. IRA savings accounts offered by banks and credit unions are typically insured for up to \$250,000. The potential for losing the principal balance of an IRA savings account is low.

Certificates of deposit. Certificates of deposit offer a fixed interest rate for a specified period of time. Common maturity periods for certificates of deposit are 30 days to 60 months. The interest rate is generally fixed during this period. Fees are charged if a withdrawal is made before the end of the contract period. Minimum account balances may be required to open a certificate of deposit or to obtain a higher interest rate. IRA certificates of deposit offered by banks and credit unions are typically insured for up to \$250,000. The potential for losing the principal balance of an IRA certificate of deposit is low.

Mutual funds. Mutual funds offer a broad range of investment features, depending on the management of the fund. A share of the mutual fund represents ownership of a small part of a large and often diversified pool of investments. The underlying pool of investments determines the risk and return of the mutual fund. The investment goals of a particular fund are described in the prospectus for that fund. The prospectus provides information about the type of investments (such as municipal bonds and domestic or foreign stocks) the fund will purchase. Reading and understanding the prospectus helps you evaluate the mutual fund that best fits your needs. Mutual funds

do not guarantee a specific rate of return and can lose money when the assets owned by the fund decline in value. Historical investment returns are provided by mutual fund companies to help investors evaluate the risk and past management of the fund, but past performance does not guarantee future returns. IRA investments in mutual funds are not federally insured.

Fees are charged for managing mutual funds. Most funds charge an annual management fee of about 1 percent of the value of the shares. Some mutual funds charge less. Some funds also charge sales fees. The sales fee is commonly paid as a commission to a broker (a load). When there is no commission, the fund is referred to as a no-load fund. Information on fees is provided by the mutual fund company in a prospectus.

Stocks. Stocks represent ownership of a part of a company. The rate of return of the stock is directly tied to the performance of the company. If the company does well, the stock will likely gain in value or pay a dividend. If the company fails to perform adequately, the stock may lose value and dividend payments may be reduced or eliminated. The risk of the investment is directly related to the risk of the business activities of the company. IRA investments in stocks are not federally insured.

Bonds. Bonds are basically a loan given by an investor to a company, government, or other entity (for example: schools, water districts, and solid waste districts). The interest rates vary, depending on several factors, including:

- the creditworthiness of the issuer,
- the type of bond, and
- the current credit market.

The rate of return for a bond is not guaranteed. If the bond is held to maturity and the issuer does not default, the rate of return is fairly certain. IRA investments in bonds are not federally insured.

Generally, stocks, bonds, and mutual funds are purchased with the help of an investment broker (or an online account offered by an investment brokerage firm). The investment broker may offer investment advice or simply help facilitate the purchase of an investment. Investment companies charge fees for their services. These fees may be monthly account fees, a percentage of assets, transaction fees, statement fees,

inactivity fees, or a variety of other fees. Understanding fee structures helps in selecting an IRA investment broker that offers the best value for particular investment needs. Investment companies also may require minimum balances to open an account.

Investments purchased through a brokerage firm are not insured against loss due to normal market action. However, securities held in an IRA account are protected up to \$500,000 by the Securities Investor Protection Corporation (SIPC) if the brokerage firm is unable to meet its financial obligations.

Annuities. Many insurance companies offer annuities to IRA investors. Annuities give investors a choice of fixed or variable rates of return.

Fixed-rate annuities earn a guaranteed rate of interest for a specific time period, such as one, three or five years. Once the guarantee period is over, a new interest rate is set for the next period. The guarantee of interest and principal makes fixed annuities similar to Certificates of Deposit (CD) purchased from a bank.

Unlike a typical CD, an annuity is not backed by the Federal Deposit Insurance Corporation (FDIC). The security of an annuity is directly related to the financial health of the company that sells it.

Variable-rate annuities typically offer a range of investment or funding options that include stocks, bonds, and money market instruments. The principal and the earnings on variable annuities are not guaranteed, as they depend on the performance of the funding options. If the funding options perform well, variable annuities may exceed the fixed rate annuity returns. If they do not, an IRA owner may lose not only prior earnings but also part of the principal.

Precious metal assets. An IRA investor can choose to invest in precious metals. Certain gold, silver, palladium, and platinum bullion and coins are eligible investments for an IRA. The rate of return for these assets is determined by market conditions. These assets can provide a positive or negative return. Some IRA investors choose precious metals to help diversify their investment portfolio. Precious metal assets are not insured by the federal government.

Comparing Options

The worksheet on page 4 is designed to help you compare various IRA features. Talking to an IRA specialist at various financial institutions can be a useful resource for understanding the features of a particular IRA investment. IRA custodians and trustees can also provide potential investors with written information about these features.

Summary

IRAs can be a valuable tool for saving for retirement. The wide range of account features and investment options can make it challenging to select the most appropriate IRA. This guide provides information about how to compare different IRA options.

Further Information

The IRS provides an in-depth publication on IRAs. Publications 590A and 590B can be ordered from the IRS (1-800-829-3676) or downloaded at www.irs.gov.

Disclaimer

This publication is designed to provide educational information on IRAs, not to render legal, accounting or other professional advice. If legal advice or other expert tax assistance is required, the services of a competent professional (attorney, certified public accountant, or certified financial planner) should be sought.

Worksheet: Shopping for an Individual Retirement Account (IRA)

	Bank	Credit Union	Insurance Company	Mutual Fund Company	Brokerage Firm	Other
Interest rate?						
Guaranteed rate? (fixed or flexible)						
Compounding and crediting frequency						
Origination fee?						
Annual administration management fees?						
Charge or limits on rollovers?						
Charge for direct transfers?						
Distribution charges?						
Close-out fees?						
Funds federally insured?						
Minimum deposit requirement?						
Minimum balance requirement?						
Commission, front-load or end-load fee?						
Disclosure statement provided?						
FIDC, NCUA, or SIPC insured?						

This guide is adapted, with permission, from materials originally prepared by Joel B. Schumacher, Extension Economics Associate Specialist and Marsha A. Goetting, Ph.D., CFP®, CFCS, Professor and Extension Family Economics Specialist, Montana State University – Bozeman, *Shopping for an Individual Retirement Account*, MontGuide MT2002-7HR 7/09. Adapted by Debra Wood, CFP®, Family Resource Management Agent, K-State Research and Extension – Central Kansas District #3, 300 W Ash, Room 111, PO Box 5040, Salina, KS 67402. Updated February 2017.

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Kansas State University Agricultural Experiment Station and Cooperative Extension Service

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MF3211 rev. February 2017