

Shopping for an Individual Retirement Account

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



MontGuide

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AN INDIVIDUAL RETIREMENT ACCOUNT (IRA), whether it be a Traditional IRA or Roth, is one of the tax-advantaged savings alternatives available to help Americans achieve their goal of a financially secure retirement.

For information on the tax advantages for IRAs refer to MSU Extension MontGuide *Individual Retirement Accounts (IRAs)*, [MT199807HR](#). In addition to evaluating and comparing the tax advantages of IRA, 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 MontGuide 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. 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 but the interest/earnings are not taxed. However, distributions from a Roth IRA are not considered taxable income.

What are the contribution limits?

During 2009, eligible individuals are allowed to contribute up to \$5,000 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 contributions limits and tax benefits of IRAs refer to MSU Extension MontGuide *Individual Retirement Accounts (IRAs)*, [MT199807HR](#).

Where can I open an IRA?

Federal regulations require that IRAs be managed by custodians or trustees such as banks, credit unions, insurance companies, mutual fund 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 MontGuide.

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, or precious metals. Each type of investment offers different risks, opportunities and fee structures. Understanding the differences between investment choices can help you select the appropriate investment for your needs. Not all trustees offer each of the investments alternatives. Deciding the type of investment that meets your level of risk tolerance can help in selecting “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 very 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 principle 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 prior to the contract length. 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 principle 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 very 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, domestic or foreign stocks) of the fund that will be purchased. Reading and understanding the prospectus will help you evaluate the mutual fund that will best fit 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. 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 one percent of the value of the shares. Some mutual funds charge less. Other 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 the 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. But 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, or solid waste districts). The interest rates vary depending upon several factors including:

- The credit worthiness of the issuer
- The type of bond
- 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 the fee structure can help in selecting an IRA investment broker that will offer the best value for particular investment needs. Investment companies may also 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 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, however, 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

Individual Retirement Accounts can be a very 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 MontGuide provides information about how to compare different IRA options.

Further Information

The Internal Revenue Service provides an in-depth publication on IRAs. Publication 590 can be ordered from the IRS (1-800-829-3676) or downloaded at www.irs.gov.

Acknowledgments

Representatives from the following have reviewed this MontGuide and recommend its reading by all Montanans.

- Montana Credit Union Network
- Montana Bankers Association
- Montana Society of Certified Public Accountants

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 & 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?						



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