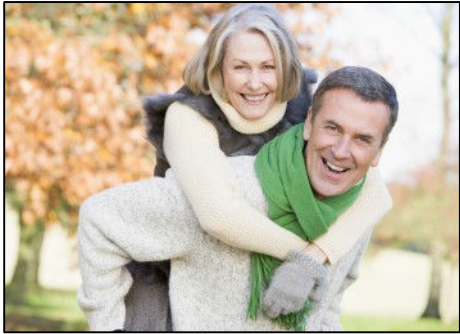




The  
**‘Safe Money’**  
Guide



**An Insiders Guide  
to Annuities**



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# Insider's Guide to Annuities

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Plus Secrets...the Insurance Companies don't want you to know!

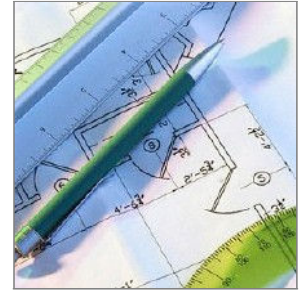
*Whatever your picture of retirement, the best way to get there – and enjoy it once you've arrived – is with a focused, thoughtful plan.*



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# Introduction

Over the past few years, retirement planning has become increasingly complex. Today, you need to balance a wider range of financial issues than ever before; from IRA and 401(k) accounts, to estate planning, income distribution strategies, tax changes and even how working will affect your Social Security benefits.



Adding more complexity to this is the fact that people are living longer than ever – making retirement more expensive – highlighting why good, solid retirement planning has become so critical.

When you combine the above with the tumultuous economic and political environments we are witnessing at both the national and international levels, it is not difficult to see how timely and important the notion of “**safe money**” has become.

The goal of this guide is to **introduce you to annuities** in the context of your financial and retirement planning. It will certainly not answer all of your questions (as every personal financial situation is different), but it should provide a solid understanding of annuities, how they work, and how they may or may not fit into your overall planning.

## What is Safe Money?

We've all seen the headlines... the slow economy, political instability, the mortgage meltdown, never-ending budget deficits, skyrocketing health care costs – the list goes on and on... It doesn't take a financial professional to tell you that this has created a climate that puts a premium on solid retirement planning and a focus on stability.



Given this context, what exactly is “**Safe Money?**” As you might expect, it means different things to different people. To a younger investor it might mean taking a calculated risk on a portion of their investment portfolio. To a pre-retiree it might mean money that will be there when it is needed. For a retiree it might be money that is truly risk free.

Regardless of the definition of **Safe Money** that fits your situation, a new trend is developing within the retirement planning world, where “income” has displaced “cash” as the new King. All of us, from the young investor to the retiree, can and should be looking for safe, stable returns that ensure our retirement savings are not swallowed up by market downturns or depleted prematurely.

### The New Retirement Rule - Safe Money

So if the old adage, “Cash is King” is no longer true – especially for the new few generations of Baby Boomers, then what is? That answer is simple: Income is the New King.

How could a long-standing investing rule have changed so drastically? How could an entire group of people (Baby Boomers) be so dependent on income? How could the “live free” generation be so concerned about their financial security?

Remember, financial security begins by asking important questions:

- When are you planning to retire?
- What is your “time” horizon?
- How do you avoid risk?
- Where do you invest?
- Whom do you trust?
- Is safety & security even a possibility anymore?

The interesting (and critical) takeaway here is that the questions for the Baby Boomer generation are no different than for previous generations, **but the answers are different.** How do we guarantee income that will last our whole lives? How do we increase our standard of living? What decisions are right for us at this juncture? The following information will assist you in creating a viable long-term plan.

## Annuities... the first step towards Safe Money!

Annuities are an important part of any retirement plan as they are safe, secure and risk free. An annuity allows you to accumulate funds for retirement on a tax-deferred basis, and upon retirement you'll receive income from the annuity that can be guaranteed by the insurer to last either a fixed number of years, or as long as you live.



A quick summary of annuity benefits includes:

- Tax deferred earnings
- No contribution limits
- Flexibility in distribution / payouts
- No forced distributions
- Proceeds not subject to probate

Annuities represent a formidable option for someone looking to enhance their retirement planning strategy. Not only do they add to the mix of tax-deferred growth you may be getting from your IRAs or 401(k)s, but they also offer significant investment and distribution options.

There are many types of annuities, offered by many insurance companies. The first step is to speak with a qualified professional to receive an annuity quote so you can best gauge how an annuity would fit into your specific financial plan.

### » Annuities = Safety

#### **The Importance of Compound Interest**

This really isn't a secret (we hope not!), but it's worth mentioning anyway... Delaying retirement savings can keep you from realizing your retirement dreams because the power of compound interest only works when it has time. A quick estimator is to use the mathematical "rule of 72", where you divide the interest rate you receive on an investment into the number 72, and the result is the number of years it will take for your money to double.

\* When considering taxation issues, always consult your tax professional for information regarding your specific situation

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## What is an Annuity?

In its simplest definition, an annuity is an amount payable annually. For our purposes, however, an annuity describes a contract offered by an insurance company that allows you to accumulate funds for retirement on a tax-deferred basis. Upon retirement, you'll receive income from the annuity that can be guaranteed by the insurer to last either a fixed number of years, or as long as you live.



An annuity is neither life insurance nor a health insurance policy, and it's not a savings account or a bank Certificate of Deposit. Your value in an annuity contract equals the premium payments you pay in, plus interest credited, less any applicable charges. The insurance company uses this value to calculate the amount of the benefits you'll receive from them when you begin taking distributions.

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**You can convert your IRA to create income for life. A bank cannot do this. \***

If your IRA is at a bank and earning interest all you can ever receive is the value of your IRA plus any interest earned. That same rule does not apply to insurance companies. You are allowed to convert your IRA to an income that will pay for as long as you live.

\* Based on your current age and your life expectancy.

## How Does an Annuity Work?

An annuity is an investment vehicle primarily for accumulating retirement savings. Again, you pay premiums to the insurer and, in return, they pay you an income stream at a later date. Based on this description, you'll see that there are two phases to an annuity:

- The Accumulation phase
- The Payout phase

During the *Accumulation phase*, the money you put into the annuity earns interest, less any applicable charges by the insurer. The earnings that occur during this phase grow tax-deferred – you won't owe taxes until you make withdrawals. Because of this tax-deferral, your funds will grow faster than if taxes had to be paid out annually on any gains. Also, the longer you leave your funds in this *Accumulation phase*, the greater the impact this tax-deferral will have on your annuity value.

During the second phase, called the *Payout phase*, the company pays income to you, or to anyone else you choose. Unlike many other retirement savings instruments, you will typically have flexibility in how you receive your funds. For instance, you can choose to receive, say, a 10-year payout, 20-year payout, or even a lifetime payout of income.



## How Do Annuities Best Serve Investors?



The two primary reasons to invest in an annuity are:

1. You want to save money tax-deferred for a long-range goal (like retirement)
2. You want an income stream for a certain period of time.

There are other strategic estate planning situations where annuities may be warranted as well, but these will be dependent on your specific financial situation. The rest of this guide will focus on understanding how annuities work, the various types that exist and what role annuities should play in your financial planning.

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### **Naming a beneficiary can avoid probate \***

If a beneficiary is named in an annuity, the funds are paid immediately and without delay. The proceeds will not be subject to probate and may be passed directly to your designated beneficiary.

\* Always seek legal advice regarding wills, probate and estate planning issues

## Types of Annuities

While annuities might seem complex at first, by breaking them into the following components they become easier to understand.

- How money is **paid** into the annuity contract
- How money is **withdrawn**
- How the funds are **invested**



There are two broad classes of annuities: “Deferred” annuities and “Immediate” annuities. Each class has numerous sub-classes.

### Deferred Annuities

A **deferred** annuity is most appropriate for people who want to:

- Save for future retirement
- Not touch the principal and interest until age 59½ or older
- Find an investment that will earn tax-deferred interest for many years
- Save more than the maximum annual contribution of their IRA or 401(k)

With a deferred annuity you pay a premium to the insurance company which issues a contract promising to pay interest made on the premium while deferring the income and the taxes until you actually withdraw the money or begin receiving an income.

There are three major types of deferred annuities:

- (1) Fixed Deferred annuities
- (2) Equity-Indexed annuities
- (3) Variable Annuities

### Fixed Deferred Annuity

A fixed deferred annuity pays a guaranteed “fixed” interest rate (based on the current market rates of interest) where the earnings compound and grow tax-deferred. Fixed annuities offer safety of your principal from typical day-to-day market fluctuations in the stock, bond or other investment markets. However, since this rate of return is fixed, it is important to consider the impact of inflation on your investment.

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#### **Tax deferred annuities work in favor of inflation. \***

The benefit is based on the concept that when the taxes are paid in the future the net out of pocket in real dollars will be reduced **because the tax will be paid with inflated dollars**. The actual tax liability could be lessened by the reduction in the net out of pocket cost because of inflation.

\* When considering taxation issues, always consult your tax professional for information regarding your specific situation



You will also want to consider the financial strength of the annuity-issuing insurance company, since the return of principal and interest is guaranteed by them. Several independent financial analysis companies such as A.M. Best and Standard & Poor's rate the strength of such insurance companies for you.



### Equity-indexed Annuity

An equity-indexed annuity differs from a fixed deferred annuity in that the rate of return on your investment is based upon *the better of* either a) the growth of a named stock market index, such as the Dow Jones Industrial Average, or b) a minimum guaranteed interest rate.

Many equity-indexed annuities offer you a portion (not a full 100%) of the index gains. Still, this type of annuity does allow for potentially higher returns than a typical fixed annuity, since you can participate in a rising stock market, yet be protected on the downside by the minimum guaranteed rate of return.

### Variable Annuity

A variable annuity allows the flexibility to invest your funds in a wide range of investment options through "sub-accounts." Sub-accounts are somewhat similar in design to mutual funds, and allow for investing in stocks, bonds, money markets – even guaranteed fixed rate instruments.

The ability to choose, and change, investment options provides you the advantage of participating fully in any market gains (not fractionally), thus potentially providing even higher returns than equity-indexed annuities. However, unlike equity-indexed annuities, many variable annuities offer no guaranteed rate of return. Therefore, the value of the variable annuity and its sub-accounts will fluctuate day-to-day, based on the performance of the underlying investments you choose.

Such an annuity may be better suited for those investors with a longer-term time horizon, who can afford these day-to-day market gyrations. As with a fixed annuity, any gains in the variable annuity credited to the account are tax-deferred until the funds are withdrawn. Unlike a fixed deferred annuity, your funds are not guaranteed by the insurer against market fluctuations, including risk of principal. A key benefit of variable annuities is the ability to transfer assets among the various investment options, as necessary, in response to market conditions or your changing investment goals without incurring current taxes on any capital gains and/or income.

### Immediate Annuity

An **immediate** annuity is most appropriate for people who want to:

- Retire in the very near future, or are already retired
- Begin drawing an income from a lump sum of money that they currently have
- Receive an immediate and predictable payout for life (based on life expectancy)

The immediate annuity allows you to deposit a lump sum and begin receiving regular payments normally within one year after the deposit. It is usually funded with a single premium, and purchased by retirees with funds they have accumulated for retirement. These annuities can provide a predictable stream of payments that will continue for a time period you choose (including for life).

## Fixed vs. Variable Annuities



The choice of fixed versus variable annuity depends primarily on the specific needs of the investor.

A **fixed annuity** is most appropriate for people who want to:

- Earn a tax-deferred fixed rate of interest without any market risk
- Save on contract expenses and management fees

A **variable annuity** is most appropriate for people who want to:

- Have the opportunity to make more substantial gains, depending on market and sub-account performance
- Respond to changing market conditions by transferring money to different funding options within a variable annuity, without paying taxes on any earnings you have made.

Proceeds from annuities are not subject to probate and may be passed directly to your designated beneficiaries.

Features	Variable	Fixed
<b>Time Horizon</b>	10 or more years. Targeted for the Accumulation Phase when saving for retirement	3 to 10 years. Targeted for the Payout Phase just before or during early retirement
<b>Investment Objective</b>	Growth-oriented – based on your tolerance for risk you allocate your assets in a range from conservative to aggressive	Growth-oriented with a focus on preservation of assets and protection from market volatility
<b>Investment Options</b>	Self-directed – you choose how your investments are allocated among equity, fixed income, asset allocation, and money market funds	In exchange for a fixed rate, you delegate investment decisions – and risks – to the annuity provider

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### Use the 1035 exchange to achieve the highest rate possible.

To our benefit we can change contracts and move our money from company to company or contract to contract. The IRS has allowed transfers without assumption of tax liability by using the 1035 exchange option. This can be achieved by keeping our annuity funds in movement. Use the 1035 exchange to achieve the highest rate possible.

\* Actual crediting rates will vary substantially between companies and annuity contract. Please consult your company and your specific contract for information regarding your situation.

## Retirement Income Considerations

You will have several options when it comes to deciding how you want to receive your annuity income. Here are a few things to consider before making your decision:



### Your Age and Health:

Life expectancy continues to increase. The average person, living a healthy lifestyle, may expect to live longer. Studies show that there is a 48% chance that one member of a couple age 65 today will live to be age 95. It is conceivable that you could spend as many years in retirement as you did working towards retirement.

### Sources of Retirement Income:

In the past, defined plans such as Social Security and an employer-sponsored plan were the major sources of retirement income. Today, these plans provide a smaller portion of retirement income requiring you to provide a larger portion of your retirement income.

### Inflation:

Inflation, regardless of rate, will erode the value of your savings and reduce your spending power. Taking this into account, it is important that you plan your retirement carefully. You need to review all sources of income so that you can determine whether you will have sufficient income for your entire retirement.

### **Insurance companies do not care if you live or die!**

They just don't. If you live a long time then someone else didn't. They base their income liabilities on the mortality table which the IRS uses to determine life expectancy.\* How do you protect yourself and your heirs in the event of a premature death? If you decide to convert your annuity to a lifetime income consider placing an underlying guarantee rider on the payout. This would place a guarantee of a certain number of years that would be paid to your beneficiary in the event of a death. These guarantees can be almost any time period from 5 years to a 30-year guarantee. Many contracts have a number of options, so make certain you fully understand how these guarantees can benefit you.

\*Future liabilities are based on the mortality table and insurance companies make their assumptions from a large number of people.

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## Choosing a Payout Option

When it's time to begin taking withdrawals from your annuity, you have various choices. Most people choose a monthly annuity-type payment, although a lump sum withdrawal is possible.



The size of your payout (settlement option) depends on:

- The value of your annuity contract
- Whether there are minimum required payments
- Your life expectancy (or other payout period)
- Whether payments continue after your death

The most common forms of payout include:

**Fixed Amount:** A fixed monthly amount that continues until the annuity is used up.

**Fixed Period:** A fixed amount over the time period you choose (example: 10 years)

**Lifetime or Straight Life:** Payment continues until you die, with no payments to survivors.

**Life with Period Certain:** Payment continues as long as you live, but with a minimum period during which you or your beneficiary will receive payments.

**Installment-Refund:** Payment continues as long as you live and guarantees that should you die early, whatever is left of the original investment is paid to a beneficiary.

**Joint and Survivors:** Monthly payments are made during the annuitants' joint lives, with the same or a lesser amount paid to whoever is the survivor.

### Fixed or Variable Payments

You may choose fixed or variable income payments or a combination of both, depending on the options offered by the insurance company.

**Fixed Income Payments:** Provide a fixed dollar amount for each payment. The fixed dollar amount may not keep up with or out-pace inflation. **Variable Income Payments:** Provide a payment, the value of which varies based on the market value of the underlying investments. Therefore, payments may decrease during periods of market downturn. However, variable payments may provide better protection against inflation.

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## Tax Treatment of Annuities

Below is a general discussion about taxes and annuities.



### During the Accumulation Phase:

- Earnings credited on the funds in an annuity are tax deferred, meaning that the earnings are not taxed while they remain in the annuity.
- Withdrawals from a tax-deferred annuity during the accumulation phase are treated as withdrawals of earnings to the extent that the cash value of the annuity exceeds the total premiums paid and are taxed as income in the year withdrawn. To the extent that a withdrawal exceeds any earnings, that portion of the withdrawal is considered a non-taxable return of principal.
- In addition, a 10% penalty tax may be imposed on withdrawals made before age 59½, unless certain conditions are met. The penalty is in addition to the regular income tax on the withdrawal.
- If the annuitant dies during the accumulation phase, the value of the tax-deferred annuity is generally included in the annuitant's estate, to the extent of the deceased annuitant's proportional contribution to the annuity purchase price.

### During the Payout Phase:

- The annuity purchase price is returned in equal income-tax-free amounts over the expected payment period (based on the annuitant's life expectancy).
- The portion of each payment in excess of the tax-free return of the purchase price is taxable in the year received.
- In summary, a portion of each annuity payment is received income tax free and the balance is taxable as received.
- At the annuitant's death, the present value of any remaining annuity payments due is generally included in the annuitant's estate, to the extent of the deceased annuitant's proportional contribution to the annuity purchase price.

#### **Your Annuity May Have a Death Penalty; You May be Penalized if You Die! \***

Some annuity contracts have a penalty when you die, which means that if you die before the end of your surrender period, the insurance company may charge your beneficiary the balance of the surrender charge rather than paying the full account value! Make certain that you understand this portion of your contract. It is easy to find an annuity that does not charge this penalty so make certain that you fully understand all aspects of your contract. Be informed.

\* Many contracts make provisions for alternative forms of payouts to the beneficiary. Please consult your specific contracts for details.

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## Taxes and Employee Pension Benefit Plans

Annuities used to fund certain employee pension benefits plans (those under Internal Revenue Code Sections 401(a), 401(k), 403(b), 457 or 414) defer taxes on plan contributions as well as on interest or investment income.



Within the limits set by the law, you can use pretax dollars to make payments to the annuity. When you take money out, it will be taxed. You can also use annuities to fund traditional and Roth IRA's under Internal Revenue Code Section 408.

If you buy an annuity to fund an IRA, you'll receive a disclosure statement describing the tax treatment.

### Qualified vs. Non-Qualified Annuities

The way your payouts are taxed differs for qualified and non-qualified annuities.

A **tax-qualified annuity** is one used to fund a qualified retirement plan, such as an IRA, Keogh plan, 401(k) plan, SEP (simplified employee pension), or some other retirement plan. The tax-qualified annuity, when used as a retirement savings vehicle, is entitled to all of the tax benefits—and penalties—that Congress saw fit to attach to such qualified plans.

A **non-qualified annuity** is purchased with after-tax dollars. You still get the benefit of tax deferral on the earnings. However, you pay tax on the part of the withdrawals that represent earnings on your original investment. With a non-qualified annuity, you are not subject to the minimum distribution rules that apply to qualified plans after you reach age 70½.

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#### **Annuities Can Reduce Taxation on Social Security. \***

Annuities can help reduce this taxation because interest credited to an annuity contract is not taxed until used. If your earned interest is not immediately needed then an annuity may reduce your overall tax liability.



## Summary of Annuity Benefits

### Beneficiary Protection

While annuities can provide the satisfaction of knowing that you will have income for the remainder of your life, the death benefit provided by variable annuities provides protection to your beneficiaries. If you die before receiving income from your annuity, the death benefit will provide your beneficiary with the guaranteed benefit. The amount of the death benefit will vary depending on the type of annuity you purchased. Also, by simply naming your beneficiary, the assets of your annuity can be transferred directly and immediately to your beneficiary, bypassing probate.



### Tax-Deferred Compounding

Earnings from an annuity grow tax deferred, meaning that any income taxes that would have been paid on interest, dividends or capital gains are deferred until you make a withdrawal from your account. Therefore, money invested in an annuity may grow faster than in a taxable investment with a similar rate of return, since the money that would have been used to pay taxes remains invested in the annuity. Also, if you wait until retirement to make withdrawals, you may be in a lower income tax bracket since you are no longer working.

### Unlimited Contributions

Non-qualified annuities offer an advantage over other tax-favored retirement plans such as 401(k)s, IRAs, SEPs and Keoghs, in that there is no limit to the amount that can be invested for tax-deferred growth (subject to insurance company maximums).

### Tax-Free Transfers

Variable annuities allow for moving money among the annuity's investment options without incurring a current income tax liability.

### No Forced Distributions

Unlike many retirement plans that require distributions of funds by age 70½, non-qualified annuities allow you to defer withdrawals until age 90, or longer in some cases. Annuities funded with qualified assets will still be subject to the terms of the qualified plan.

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### Surrender Fees May Mean More Contractual Benefits for You\*

Almost all annuities have surrender fees. These fees are in place to guarantee the insurance company has the use of your funds for a longer or specific term. Is this bad? No, the flip side is with the insurance company holding your funds for a longer time period means that more benefits may be provided to you!

\*Some annuity contracts waive fees for certain benefits and there are some contracts that do not have surrender fees, please consult your specific contract for details.

## Summary

When you plan your retirement, you're not just planning for yourself, but for your family as well. Financial decisions are much more complex because they affect not only your future, but also the future of the people closest to you. It's both a challenge and a responsibility – and a time when objective help can mean the most.



### **Safe Money is an answer... but not the “only” answer**

The financial decisions we each need to make will be made based on a combination of factors and variables unique to each of us. The idea of “**safe money**” however, is a theme that is common to everyone. We all need retirement options that include guaranteed income that cannot be outlived, inflation protection, safety, security, and risk management. These options should be blended with versatility and the ability to make necessary changes and adjustments over a period of time.

As we point out with all our reports, we strongly advise you to speak to a qualified financial professional to discuss the specific options available to you that fit your retirement needs. We live in a different era than our parents, and the products, options and strategies available reflect that. The changes we are experiencing make planning for retirement complex and time consuming, but how you respond and adapt to these changes is undoubtedly one of the most important things you'll do in your life. We all have dreams of how we want our retirement years to be. With careful planning you'll be in a better position to realize those dreams.

## Glossary of Annuity Terms



### **Annuitizations**

The period of time when you receive income payments from your annuity.

### **Death Benefit**

The amount of money your beneficiary receives if you die before you start receiving payments from your annuity.

### **Deferred Annuity**

Your contributions grow tax-deferred until you start receiving payments, usually when you retire.

### **Fixed Annuity**

Your money earns a fixed rate of interest that is guaranteed by the insurance company.

### **Flexible Payment Annuity**

A fixed or variable annuity purchased by making ongoing contributions.

### **Immediate Annuity**

Once you make a lump-sum contribution, income payments usually begin within a month.

### **Joint and Survivor Option**

An immediate annuity with a joint and survivor option guarantees that income payments will continue for the life of the primary owner and the person he or she chooses.

### **Life Option**

An immediate annuity with a life option guarantees a specified income for as long as you live.

### **Single Premium Annuity**

A fixed annuity purchased by making a single lump-sum payment.

### **Surrender Fee**

A fee charged if you surrender, or cash in, your annuity within a specified time period, usually the first seven years of owning it.

### **Variable Annuity**

Variable annuities offer a range of investment options like stocks, bonds, and money market accounts. Your earnings depend on the performance of the option you choose.

### **Tax-Deferred**

You do not pay taxes on the earnings in your annuity until you begin receiving payments.

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