UNDERSTANDING FIXED INDEXED ANNUITIES

Fixed Indexed Annuities combine the features of Fixed Annuities — including tax-deferred interest accumulation, a minimum guaranteed interest rate, and guaranteed income at retirement — with interest crediting options that have the potential for a better rate of interest than traditional fixed annuities when equity market indices increase in value.

INTRODUCING FIXED INDEXED ANNUITIES

Since becoming available in America over two centuries ago, Traditional Fixed Annuities have been helping people from all walks of life prepare for a secure retirement. With their combination of tax-deferred accumulation, minimum interest rate guarantees, and lifetime income options, Fixed Annuities have long been an important — and most would agree conservative — component of many Americans' financial portfolios.

Fixed Indexed Annuities (issued only by life insurance companies), are a unique type of Fixed Annuity which may offer you many of the same features, benefits, and guarantees of traditional Fixed Annuities, plus the potential for competitive interest crediting compared to traditional Fixed Annuities.

The purpose of this booklet is to help you understand what Fixed Indexed Annuities are; how they work; and how they can help you achieve your retirement asset accumulation objectives as part of an overall asset accumulation strategy. Past performance is no indication of future results.

WHAT ARE FIXED INDEXED ANNUITIES?

Fixed Indexed Annuities are probably best described as "Fixed Annuities with an interest crediting option linked to an outside index". In other words, Fixed Indexed Annuities combine the features of a Fixed Annuity — including tax-deferred accumulation, a guaranteed minimum value, and guaranteed income at retirement[1] — with an interest crediting option that generally gives contract holders a competitive rate of return over the long term, particularly when the market indices are increasing in value.

This interest crediting is called an Indexed Strategy, and it links the amount of interest credited to the annuity to the performance of a specific index; for example, the Standard & Poor's 500® Stock Index (S&P 500®).[2] Fixed Indexed Annuities give contract holders a choice. Depending on their needs and personal tolerance for risk, contract holders can select a traditional "declared" rate of interest, or they can select one or more indexed strategies, or both.

[1] Guarantees are dependent on the claims-paying ability of the issuing company.
[2] "Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500®" and "500®" are trademarks of the McGraw-Hill Companies, Inc. and have been licensed for use by American Investors Life Insurance Company, Inc. Standard & Poor's® does not sponsor, endorse, sell or promote annuity products and Standard & Poor's® makes no representation regarding the advisability of purchasing any specific annuity product.

WHAT ARE THE PRIMARY BENEFITS OF FIXED INDEXED ANNUITIES?

Guarantee of Principal: Indexed Annuities guarantee the safety of your principal regardless of market fluctuations. The annuity's premium payment is protected and does not fluctuate with changes in the value of the index to which it is linked. These guarantees are backed by the claims paying ability of the issuing insurance company. Early withdrawals that exceed the penalty free withdrawal amount may result in a loss of principal. In addition, withdrawals taken from certain interest crediting strategies may forfeit potential interest credits in the contract year or Index Term period.

The Power of Tax Deferral: Annuity values accumulate on a tax-deferred basis until they are withdrawn. You may earn interest on both the principal and the accumulated interest, allowing you to accumulate assets free of current taxes. Taxes must be paid upon withdrawal. If you are considering an annuity for your IRA, however, tax deferral is already provided. Consider purchasing the annuity for reasons other than tax deferral.

Liquidity: Many Fixed Indexed Annuities provide contractholders with penalty-free access to their money should the need arise. (Withdrawals in excess of the "penalty-free" amount, however, will be subject to withdrawal charges and market value adjustment (if any) that apply for a specified period of years (the Term Period) following the initial purchase date. Withdrawal penalties may be substantial, and therefore, it may be possible to lose money by investing in a Fixed Indexed Annuity.) Typically, contractholders can make penalty-free withdrawals of up to 10% of their contract's full accumulation value once each year after the first contract anniversary, however, withdrawals prior to age 59 1/2 may be subject to a 10% IRS tax penalty. Withdrawals are taxable as they are withdrawn to the extent there is growth in the annuity. Also, contract waivers could potentially increase their contract's liquidity.

Lifetime Income Stream: At retirement, Fixed Indexed Annuities allow contractholders to select from a variety of income options, including:

- Income payments for a specified number of years, with payments continuing to a spouse or child should the contractholder die prematurely.
- A guaranteed income for the lifetime of the contractholder or for both the contractholder and his or her spouse, regardless of how long either one lives.
- If available, a Guaranteed Lifetime Withdrawal Benefit payment (GLWB) for the lifetime of the contractholder or the contractholder and his or her spouse. The GLWB does not require annuitization and guarantees lifelong income payments, provides flexibility on how you receive those payments, and allows you to enjoy all of the other benefits of your annuity. The GLWB Rider generally incurs an annual fee typically in the range of .25% to .75% of the income account value.

Potentially Lower Income Tax Liability: Income payments from nonqualified Fixed Indexed Annuities (that is, not part of a tax-favored retirement plan), will actually include a portion that is a non-taxable return of premium, thereby reducing your income tax liability. In addition, deferred interest earned inside a Fixed Indexed Annuity is not factored into the calculation of your "provisional income" for the purposes of Social Security taxation, due to the tax deferral. This may result in lower income taxes on your Social Security benefit.

Choice: Contractholders can elect to earn a traditional declared rate of interest by choosing the fixed strategy. Contractholders can also elect an opportunity to earn higher interest credits without having to worry about loss of principal due to market fluctuations by choosing one or a combination of the indexed interest strategies. This election is made at issue and can be changed upon written request received by the company prior to the end of the Index Term Period.

HOW DO FIXED INDEXED ANNUITIES WORK?

Fixed Indexed Annuities may be purchased with a single lump sum premium or through flexible premium options, such as monthly purchase payments. Additionally, a number of companies offer flexible premium Fixed Indexed Annuities, which allow for a series of purchase payments. Where they differ from traditional Fixed Annuities, is in how interest credits are credited to contract values.

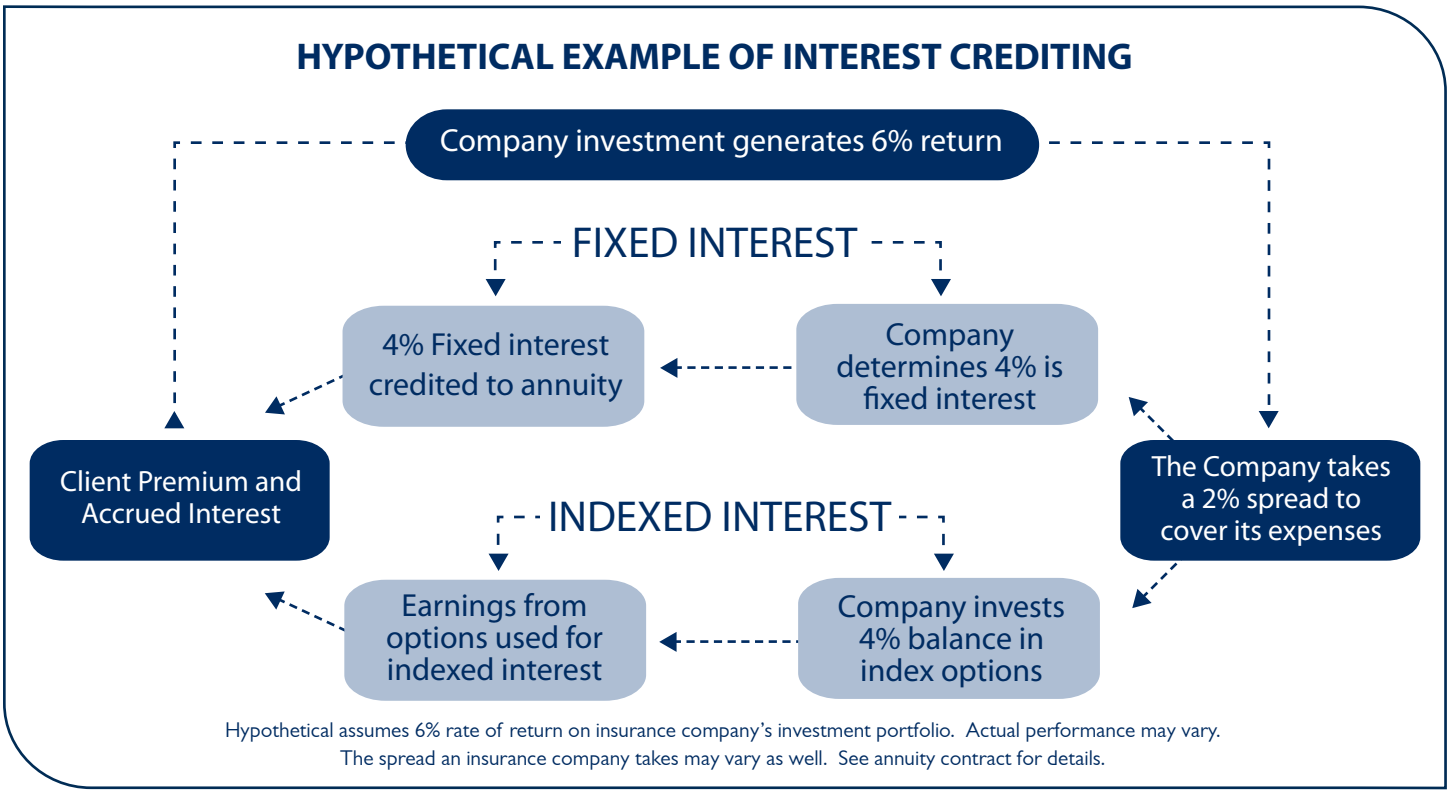
Traditional Interest Crediting: In a Traditional Fixed Annuity, as a contractholder, you earn a rate of interest declared by the issuing company.

- Premiums are paid into the contract
- The company invests the money in bonds, mortgages, or other investment grade securities
- The company takes its "spread" from the interest it earns (i.e. the amount of money it needs to pay the expenses of annuity issue and administration and make a profit)
- The company credits the declared rate of the interest to the contract

Indexed Interest Crediting: In a Fixed Indexed Annuity*, the same process is followed:

- Premiums are paid into the contract
- The company invests the money in bonds, mortgages or other investment grade fixed income securities
- The company takes its "spread" to cover costs and profits

What ***changes*** between these two annuities, is what the company does with the balance of its portfolio interest earnings after taking its spread. In a Fixed Indexed Annuity, the company takes the balance of its interest earnings — which in a traditional Fixed Annuity would be credited as "declared interest" — and negotiates and invests them in customized index options designed to match the index crediting formula. This could provide a better rate of interest over the course of the Index Term. Earnings from these index options are then used to credit the indexed interest to the annuity. Below is a hypothetical example of how this works.



*Hardy, Mary R. (2004) Ratchet Equity Index Annuities, In 14th Annual International AFIR Colloquium. H

HOW DOES THIS TRANSLATE TO ACTUAL INTEREST CREDITING?

Interest earnings are credited using an **index crediting strategy.** The three most common index crediting formulas are:

- The **Annual Monthly Average Method** is linked to the performance of an index over a 12-month period, then averages the movement in order to determine the annual percentage change. The value may be adjusted by an annual cap or annual spread, if any.

- The **Annual Point-to-Point Method** is linked to the performance of the index and the measuring of the annual percentage change between "starting" and "ending" points. This value may be adjusted by an annual cap or participation rate.

For the purposes of this example, let's assume an initial premium of $100,000 using the Annual Point-to-Point index crediting formula.

HYPOTHETICAL EXAMPLE #1

CREDITING FORMULA	SUM
Index Value at "Starting Point"	1,200
Index Value at "Ending Point"	1,380
Annual Percentage Gain Equals	12%
Contract Value at "Starting Point"	$100,000
Adjustment	8% Interest Rate Cap
Amount Credited to Contract Values	$8,000 = $100,000 x 8%
Contract Value at "Ending Point"	$108,000
Index Value at "Reset"	1,380

Hypothetical assumes index growth of 12%. Actual performance may vary. Interest rate cap may be subject to change. See annuity contract for details. Hypothetical does not reflect the impact of fees and charges if applicable.

- The **Annual Monthly Cap Method** sums both the monthly index increases (up to the Interest Rate Cap) and monthly index decreases in the index to which it is linked over a 12 month period to determine the annual percentage change. If the sum of 12 monthly changes is positive, that's the interest credit.

Caps, rates, and spreads limit the amount of interest an investor can earn. Therefore, no matter how the market performs, an investor may earn less than the market index. Additionally, some Fixed Indexed Annuities may have an asset fee that is subtracted from the interest earned. The applicable index may not include dividends which could limit an investor's earned interest.

Regardless of which index crediting strategy is used, most share a similar interest calculation. For example, a typical process is outlined here:

1. The index movement is measured over a specific index term (usually one year).
2. The annual percentage change, if any, is calculated.
3. The annual percentage change is adjusted by the interest rate cap, participation rate, or annual spread.
4. The resulting interest is credited to contract values.
5. If the resulting interest calculation is negative, the interest credit is zero.

WHAT IF THE MARKET SUFFERS A LOSS?

In the prior example, you saw how interest credits are credited to contract values following an increase in the index. Well, what would happen to contract values if the index suffered a loss? The answer is simple. Contractholders would be credited with 0% interest (protecting you against loss to your principal); the "starting value" of the index would be reset; and a new Index Term would begin. Contract fees may still apply. See your annuity contract for details.

Let's use the same hypothetical example to see how this works. Again, let's assume an initial premium of $100,000 and use the Annual Point-to-Point index crediting formula.

HYPOTHETICAL EXAMPLE #2

CREDITING FORMULA	SUM
Index Value at "Starting Point"	1,200
Index Value at "Ending Point"	1080
Annual Percentage Gain Equals	-10%
Contract Value at "Starting Point"	$100,000
Adjustment	0% Interest minimum allowed
Amount Credited to Contract Values	$0 = $100,000 x 0%
Contract Value at "Ending Point"	$100,000*
Index Value at "Reset"	1080

*Despite a loss in the index of 10 percent, there is no loss in contract value. Most fixed indexed annuity contracts offer principal protection. See annuity for details. Hypothetical does not reflect the impact of fees and charges if applicable.

WHO ARE IDEAL PROSPECTS FOR FIXED INDEXED ANNUITIES?

Fixed Indexed Annuities have become popular as retirement asset accumulation products in part because contractholders enjoy both potentially higher interest crediting during "up" markets, and the benefits of a minimum guaranteed interest rate over the long term. Therefore, suitable candidates for Fixed Indexed Annuities will generally include individuals with long-term savings goals who want to:

- Take advantage of index fluctuations, but who also want to protect and preserve principal
- Accumulate assets on a tax-deferred basis
- Have a choice of income options or guaranteed withdrawals at retirement
- Guarantee an income to a spouse or family member with special needs. Guarantees backed by the claims paying ability of the issuing insurance company.
- Pass their assets on to beneficiaries planning to avoid the costs, delays, and publicity of probate
- Reduce or possibly avoid taxes on their social security benefits

Not everyone, however, is a suitable candidate for a Fixed Indexed Annuity. Unsuitable candidates would include: Individuals with short-term investment goals; individuals who are looking for the highest possible return on their savings; and individuals who like to actively manage their investments. All investors should consult with their tax advisor or financial professional prior to the purchase of a Fixed Index Annuity.

COMMONLY ASKED QUESTIONS

Can contractholders make withdrawals from their indexed annuity during the Contract Term?

Yes. Most Fixed Indexed Annuities allow contractholders penalty-free access up to 10% of their contract or accumulated value every year following the first contract anniversary. Withdrawals in excess of the penalty-free amount would incur a withdrawal penalty and possibly a market value adjustment. Keep in mind, however, that withdrawals prior to age 59½ are generally subject to a 10% federal tax penalty, and income taxes are payable as funds are withdrawn.

Is it possible to lose money in a Fixed Indexed Annuity due to index fluctuations?

Contract values are locked-in and protected by both the interest crediting strategy and the Minimum Guaranteed Value. Guarantees are dependent upon the claims-paying ability of the issuing company. Loss of principal may occur due to withdrawal charges, market value adjustment, contract fees, or tax penalties due to early withdrawal in excess of the free withdrawal amount.

FOR YOUR QUESTIONS AND FOR ADDITIONAL INFORMATION

There is **NO** obligation to learn more about your retirement considerations or fixed indexed annuity products. You may have had important changes in your life since your last retirement planning review; or it may simply be a good time to talk about your goals, needs and options. Please feel free to call the insurance agent who gave you this booklet for more information.

DEFINITIONS	
TERM	DEFINITION
Index Term	The Index Term is the period of time over which the market index is measured.
Annual Reset	The point at which the "starting" value of the measuring index is "reset" each year for the purposes of measuring future movement.
Interest Rate Cap*	The "Cap" is the maximum amount of formula gain or interest that may be credited to the contract for the particular indexed interest formula and Index Term
Participation Rate*	An adjustment that may be applied in some indexed interest formulas by using a percentage of the calculated gain.
Annual Spread	An adjustment that may be applied in some indexed interest formulas by deducting a fee from the calculated gain.
Guaranteed Minimum Value	The minimum guaranteed surrender value regardless of the performance of the market index. Companies will typically guarantee a percentage of the initial premium (for example, 87.5% of the initial premium) at between 1.5% – 3% annual interest rate with no surrender charge. The Guaranteed Minimum Surrender Value is the greater of that value or the account value minus surrender charges. This is what makes a Fixed Indexed Annuity an insurance contract and not an investment security.

*Due to caps, rates, and/or fees, the interest credited may be limited depending on the characteristics of the crediting method selected. See annuity contract for details.

Important Information about a Fixed Indexed Annuity

A Fixed Indexed Annuity is a fixed annuity. It is a long-term savings vehicle issued by a life insurance company and offering fixed interest and indexed interest-crediting options. All contract guarantees are backed by the claims-paying ability of issuing insurance company. Fixed Indexed annuities are long-term savings vehicles and they cannot duplicate the upside potential that investing may offer. In addition, interest-crediting formulas can vary widely and may be complex. Indexed interest crediting links the amount of interest credited to the annuity to the performance of a specific market index – for example, the Standard & Poors 500 Stock Index® (S&P 500®).[1] Since a fixed indexed annuity is not a registered security and does not participate directly in the stock market or any index; it is not an investment security.

[1]"Standard & Poor's®", "S&P®", "S&P500®", "Standard & Poor's 500" and "500" are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by the issuing insurance company. Indexed annuities are not sponsored, endorsed, sold or promoted by Standard & Poor's and Standard & Poor's makes no representation regarding the advisability of purchasing the product. The S&P 500® does not include dividends may be paid by ownership of the underlying common stocks that make up the index.

A Long-term and/or Retirement Savings Vehicle

A Fixed Indexed Annuity is intended for retirement and other long-term financial needs. It is designed for individuals who have enough cash or other liquid assets to cover living expenses and unexpected emergencies. Your annuity is protected from any direct downside risk associated with the underlying index. Therefore, a negative index return can never result in an annuity principal loss. Fixed indexed annuities should not be seen as taking the place of equity-based investments.

Withdrawal Information and Charges for Early Withdrawal

Fixed indexed annuities are subject to lengthy holding periods and surrender charges. There is a possibility of loss of principal due to surrender charges if the annuity is not held to the end of the surrender charge term. Almost all annuities allow some portion of the accumulation value to be withdrawn annually without surrender charge, for example 10%. Excess withdrawals during the surrender charge period are subject to a surrender charge--a percentage of the annuity's accumulation value.

Income Tax Deferral

A Fixed Indexed Annuity allows you to save and accumulate your assets on a tax-deferred basis. Withdrawals are subject to income taxes to the extent of interest earned. Income taxes are payable as funds are withdrawn. If withdrawals are made before age 59½, a 10% federal penalty tax may apply. The purchase of a fixed indexed annuity to fund a tax-qualified retirement plan account does not provide additional tax deferral benefits beyond that provided by the plan itself.

General Advice

This information is general in scope and is neither intended to be an explanation of any specific annuity product nor a substitute for careful personal planning. Neither Creative Marketing nor any of its affiliates are engaged in providing legal, tax, investment, or accounting advice. You should obtain advice for your own situation from a qualified professional.

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