Annuities 101

What are Annuities?

Annuities are long-term, tax-deferred vehicles designed for retirement and sold by insurance companies. Because annuities are designed for retirement, there may be a 10% penalty for withdrawals made before age 59½. Annuities are the only financial product that can guarantee lifetime income.

To me, they are sort of the opposite of life insurance. When you buy a life insurance policy, the contract states that if you pay the life insurance company a certain amount each month or year, if you die, they will pay your beneficiary the agreed to amount. So, in effect, the insurance company is betting you will live a long time so they can collect and invest those premiums long enough to make enough to pay off your beneficiary without having lost any money. If you do pass before the insurance company thought you would, they lose money.

In an annuity, you give the insurance company a large sum of money. They, in turn, start paying you a certain amount each month or year. If you live a long life, they may wind up paying you more than they made on your original premium. But if you die during the time that your mortality table said you should, the insurance company gets to keep the money they were going to pay you had you lived on.

So, with a life insurance policy, the life insurance company is, in effect, betting you are going to live a long time. With an annuity, the insurance company is betting you will die sooner than expected. Many life insurance companies have become very wealthy betting on both sides of that equation.

In this section, however, we'll discuss annuities. I believe annuities certainly have their place. I'm not like some people you have seen on TV saying they hate annuities. I may not believe annuities are appropriate for every circumstance that the "annuity guys" on the radio believe they are, but they are appropriate in many instances. Let's take a few moments to discuss the different kinds of annuities.

Immediate and Deferred

Immediate annuities are instruments in which you give the insurance company a sum of money and they immediately begin paying you an income. A pension is a type of immediate annuity. You worked for your company for 40 years. The company socked money away in your account the whole time. Now you have a choice. Either take all the money sitting in your account or receive a monthly income for the rest of your life. With the latter choice, the company is simply taking the money and buying you an immediate annuity.

With a deferred annuity, you deposit the money with the insurance company with the expectation of taking an income from it at some point in the future. During the time between when you deposit the funds and when you start to receive the income, you make a return on the annuity. What kind of return you get depends on what kind of annuity you choose, and the investment experience you have between those two dates. There are basically three types of annuities.

Fixed, fixed index and Variable Annuities

Fixed Annuities

For fixed annuities, I will be focusing specifically on multi-year guaranteed annuities (MYGAs), although there are multiple types of fixed annuities available. Fixed Annuities are contracts in which you receive a fixed percentage rate as a return on your annuity. Most insurance companies will give you a stated rate of interest when you first buy the contract. They also have the right to change the interest rate in subsequent years. They may raise or lower your interest rate on the anniversary date of the contract. Also known as a MYGA (multi-year guaranteed annuity), a fixed annuity can help you diversify your portfolio while earning higher than bank deposit rates. If you are an investor with access to liquid capital and are interested in a source of growth potential outside of the stock and bond markets, you may consider investing in a fixed annuity. In retirement, an annuity can also provide you guaranteed income to supplement your other retirement income.

How Does a Fixed Annuity Work?

The most common type of fixed annuity is a guaranteed fixed annuity with a set interest rate that remains in effect for multiple years. By guaranteeing a rate over multiple years, MYGAs aim to offer more stability and predictability than other types of annuities. With the MYGA, interest rates and contract term are specified up front. This means that since the rates are locked in, your contract can stipulate exactly how your money may grow for the entirety of the contract term.

Benefits of Fixed Annuities

1. Tax-deferred growth: A key benefit of fixed annuities (MYGA) is their ability to be a safe harbor from taxes. If the funds are kept in the fixed annuity, the investor will not owe taxes on the gains. Tax-deferral allows interest to compound faster – this ultimately helps investors grow their savings more quickly than they would with a taxable account; where gains are taxed each year when credited, even if the gains cannot be accessed without a penalty.

Caveat: The federal government considers all non-qualified fixed annuities to be LIFO (last-in, first-out). That means that all withdrawals taken out, down to your cost basis, are taxable at your marginal rate. Income from annuities gets no capital gain tax treatment.

2. Principal protection: Fixed annuities offer investors a way to shelter their capital from market downturns, essentially eliminating market risk. As an added benefit, there are no contribution maximums for a fixed annuity. In this regard, fixed annuities can be a good option for those who do not want to risk their retirement funds to market forces, or for those who want broader diversification to reduce the overall risk of their portfolios.

Caveat: Along with the principal protection comes no market participation. Your fixed rate annuity receives no bump in value should the stock market perform well. A fun fact here is that, according to Wikipedia, in the 52 years between 1970 and 2021, the S&P 500 index has experienced 5 years of double-digit losses, while it has experienced 32 years of double-digit gains.

3. Some liquidity: Fixed annuities are typically used as long-term investments but do allow early withdrawal. If you are over 59½, fixed annuities offer more liquidity because you avoid a 10% federal tax penalty when withdrawing funds. For this reason, fixed annuities might be more suitable for investors who might be less likely to need such funds pre-59½. Caveat: Because they are long-term savings instruments, they normally carry 7 to 10 year surrender penalty periods. Make sure you are comfortable with the current, as well as the guaranteed, return before signing onto an annuity you must hold onto for that long.

4. Simplicity: A key benefit to fixed annuities is that they are easy to understand based on the contract terms, and as a result, are less complicated than other annuities, such as variable and fixed index annuities which come with a complex structure and nuanced investment terms and fee provisions. Fixed annuities have no hidden fees and offer predictable results if no withdrawals are made. If a beneficiary is named, fixed annuities do not go through the costs and delays of probate upon the death of the individual – a beneficiary can simply be named and changed as needed.

Questions to ask before buying a Fixed Annuity (MYGA);

For how long is there a surrender charge after I buy the annuity? ____
What is the surrender charge schedule?
Year 1 ____
Year 2 ____
Year 3 ____
Year 4 ____
Year 5 ____
Year 6 ____
Year 7 ____
Year 8 ____
Year 9 ____
Year 10 ____
Year 11 and beyond ___________________________
How long does the initial interest guarantee last? ____
What is the minimum interest rate guarantee? ____
If the insurance company were to lower my interest rate prior to the end of the surrender charges, would I be given the choice to move my assets from the annuity without a surrender charge? ____

Fixed Index Annuities

A fixed index annuity is an insurance contract that provides you with income in retirement. With a fixed index annuity, payments are based on the performance of a stock market index, like the S&P 500. Unlike owning stocks, you're protected against most losses—but your total returns may also be limited.

How Does a Fixed Index Annuity Work?

A fixed index annuity is a type of annuity contract that provides steady retirement income payments that have some resemblance to the performance of an underlying stock market index. Since FIAs don't offer a variable annuitization option, the income payments would not fluctuate based on the return of an index.

Fixed index annuities offer some of the features of investing in index funds, since they track the performance of indexes like the S&P 500, the Nasdaq Composite or the Russell 2000. But fixed index annuities don't invest in those indexes directly. They pay an interest rate that is based off the return of the index and the crediting method elected. This means you won't lose any of the money you put into a fixed index annuity should you hold it past the surrender charge period. This protection against losses, however, comes at a cost. You won't receive the exact return of the market index. Instead, the annuity will limit both your potential gains and your losses. This makes an indexed annuity less risky than an index fund.

A fixed index annuity will most likely limit your annual gains as well as your annual losses. Some of the common components for limiting gains or losses include:

• Loss floor - A fixed index annuity may limit your losses, even in a bad year for the market. It's common for the floor to be 0%, so worst case you just break even in a downturn.

• Minimum return - A fixed index annuity might pay a small, guaranteed interest rate or return, so no matter how the market index performs you earn at least some money.

• Adjusted value - Your fixed index annuity could use an adjusted value method to protect against losses. This means the annuity company would periodically adjust the minimum value of your contract based on the returns you've already earned. This locks in your gains so you can no longer fall below this threshold.

• Cap Rate - Your annuity company could also set a limit to your gains. For example, it might say that no matter how high the index return, the most your balance could grow in a good year is 5%.

• Participation rate - Your annuity company may choose to limit your gains through a participation rate. The participation rate is the percentage of your money that's eligible to earn market returns. For example, if the participation rate is 50%, you would receive half of the index's returns. If the market index return is 8%, your balance would only grow by 4%.
• Spread/margin/asset fee - Your annuity company could also deduct a spread/margin/asset fee from your return each year. If their fee is 3% and your return is 8%, your money would only grow by 5%.
A fixed index annuity contract might tack on one or more of these features. Be sure to closely study the contract to see exactly how your gains and losses will be limited.

Fixed Index Annuity Withdrawals

When you're ready to start taking money out, you can convert your fixed index annuity balance into a stream of future income. These payments can last for a fixed period, like 20 years, or for the rest of your life. The amount you'll receive depends on your account balance, your return and how long you want the payments to last; a longer period means smaller monthly payments.
Alternatively, you could also make a lump sum withdrawal or take all your money out at once, but this has some downsides. Annuities typically have a surrender period that lasts between five to ten years after you buy the contract.
If you take out a lump sum withdrawal, the annuity company could charge this fee, which can be 10% or higher, though it may decrease each year you hold an annuity. Consider this surrender period before signing up. If you're under 59 ½, you may also be subject to a 10% penalty by the IRS for early withdrawals.
Fixed Index Annuity Fees
Fixed index annuities do not charge an upfront fee. Instead, the annuity company will deduct its fees from your account balance each year.
Some of the possible charges include:
• Riders. When you sign up for an annuity, you can choose to purchase riders that provide extra benefits for the contract. For example, you could buy one that guarantees a minimum death benefit over the life of the contract. You'll pay an annual fee for each rider.
• Surrender charge. You'll owe a fee called a surrender charge if you cancel the contract or make a lump sum withdrawal within the first few years of your fixed index annuity.

Advantages of a Fixed Index Annuity

• Limit on your losses. During big market downturns, you don't have to worry about losses with a fixed index annuity. From 2000 through 2021 there have been five years in which the S&P 500 lost value.

• Possible guarantees for your earnings. An index annuity could pay a guaranteed minimum return, even when the market index loses money. It may also lock in your earnings over time to protect you from even greater losses.

• Inflation protection. The long-term expected return on a fixed index annuity is higher than other guaranteed accounts. This can help grow your savings more than inflation.

• Tax-deferred growth. An annuity delays taxes on your gains until you take the money out, much like an individual retirement account (IRA) or 401(k). This can help boost your after-tax return over comparable money held in a regular brokerage account. This tax-advantaged status, however, also opens you up to a 10% penalty if you need to withdraw from your annuity before age 59 ½.

Disadvantages of a Fixed Index Annuity

• Limit of potential gains. Fixed index annuities cap your potential upside, so you don't earn as much in good years as investing directly in the market.

• Surrender charges. If you cancel your contract before the surrender period, you could owe a significant fee to the annuity company.

• Some return uncertainty. Even with the loss cap and minimum return features, there is still some uncertainty over how much you'll earn each year with a fixed index annuity.

There are a total of 15 financial shows that are air each weekend on local radio, by 8 different providers. Some of those shows are very good and provide useful information about different financial planning topics. I enjoy listening to some of them. Then there are a few of the shows that are obviously selling annuities. While they will rarely call them annuities (because of the negative connotation), they are selling them, nonetheless. You may remember the radio host, Paul Harvey. He always had a segment on his show titled "The Rest of The Story." In this segment he would tell you the beginning of a story. He would then cut to a commercial. When he came back, he would finish the story with a surprise, or unexpected ending. Well, here I'd like to tell you what the annuity salesmen in my market tell you about their products, and about financial advisors that do business the way I do. Then I will tell you "The Rest of The Story" (TROTS).

1. “You can make an ‘uncapped’ return in my product.”
(TROTS) Always ask what the ‘participation rate’ is. If it is, say, 40%, and the index grows by 20% that year, you’ll only get 8% (40% of 20% = 8%). Sometimes the participation rate will be 100% or even more. But it is usually of an index you’ve never heard of. If you want a clear understanding of how much of a stock market index the insurance company is willing to pay you, ask the salesman what the participation rate is on the S&P 500.
2. “You can make 100% of whatever the index makes.”
(TROTS) In this instance, ask which index and up to what amount? This is where the insurance company will pay you everything the index makes, until you have reached the ‘cap.’ This is where the insurance company will go no higher. We discussed this earlier.
3. “You never have to worry about paying me because the insurance company will pay me my compensation. That way, all your money goes to work in your account right away.”
Let's look at 3 and 4 together.
4. "The insurance company will give you a 10% bonus if you put your money in this contract."
(TROTS) Taking these two statements together, it looks like a terrific deal for the annuity buyer. I mean, they'll give the buyer an extra 10% in his annuity, turning his $100,000 investment into an instant $110,000. Then the company will turn right around and pay the salesman a 5% to 10% commission. So, the insurance company is out an immediate $15,000 (at least) before they get a single day's worth of return on your initial investment. How in the world can the insurance company make it if they are giving away that kind of money at the front of the contract? Well, they really can't. While they will show you on your quarterly or annual statement that the money is in your account, just try to get them to send it to you. You'll find out right quick that you cannot get your hands on it. No, they are not taking their money and depositing it into your account; they're just using an accounting gimmick to make it appear as if they have put an extra 10% in your account. Then, when they credit you the interest you have coming, they will credit you the extra 10% of interest, making it continue to appear that the bonus amount is still there in your account.
The claim that the insurance company will pay them, so all your money goes to work in your account right away, has a twist that is worth knowing. All these contracts come with what is called a 'contingent deferred sales charge' (CDSC). That means while it is true the insurance company puts all your money in the

contract, they have the contractual right to take the commission they paid the salesman, and even more, back should you decide to ask for your money before the end of the surrender period. You see, for the insurance company to make back their acquisition costs (the cost of acquiring your premium deposit), your money in that contract needs to stay put for a long time. Therefore, they will impose a "surrender charge" against your account should you try to take it all out. The typical surrender charge is 10% or more in the first year. The typical surrender charge period is ten years, though some insurance companies have longer and some have shorter surrender periods. If they credited your account with a 'bonus,' they will also take that back. And finally, some companies will even take back all the interest they credited to your account upon surrender of your contract if done within the surrender period.

5. “None of my clients have ever lost a penny in my product due to the stock market.”

(TROTS) The final five words of that statement is the 'tell.' The reason someone can make that statement is that none of the money that goes into one of the annuities he will sell you is ever invested in any equity investment, ever! If none of your money is going into the stock market, how can you lose any money IF the stock market goes down? You may notice, however, that he never makes that statement without those five words at the end. That's because if he ever had a client that asked for the money in his contract in the first few years of it, most likely he DID lose a substantial amount of his money. The amount he will lose will be based on the wording in his annuity contract.

6. "This account is guaranteed not to lose any money. If your index loses, your account stays even, at zero return. And in this case, zero is your hero."

(TROTS) Zero is your hero. What they mean by that is it is better not to make any return than it is to have a negative return. I can see the logic in that statement. My question has always been this; what must you give up in the good years not to experience the occasional bad year?

Here are some statistics right straight out of Wikipedia.

From 1970 through 2021 the S&P 500 has experienced 10 losing years out of 52. The biggest annual loss was 37% (2008). The biggest annual gain was 37.58% (1995).

Annual losses of over 30% - 1

Annual gains of over 30% - 9

Annual losses of over 20% - 3

Annual gains of over 20% - 19

In my opinion, one of the biggest traps an investor can fall prey to are massive

amounts of generalities annuity salesmen throw at them. Once you start studying the real data, however, the picture clears up very well. While it is true that past experience is no guarantee of what the future will hold, I can say with a lot of confidence that Michael Jordan in his prime could beat me at basketball in my prime right at 100% of the time. Why? Because of past experience. Jordan was the greatest basketball player of all time (my opinion), while Swain didn't even make his high school team. So, if I was choosing an investment to hold for the next 52 years, I believe it would be prudent to take the one that had returned more than 20% 19 times rather than one that had avoided losing 20% just 3 times.
7. "There are no fees associated with my product. If your advisor charges you an ongoing fee, he makes his whether you do or not. He may even make more money on your account than you do."
(TROTS) I actually heard one of the radio annuity guys say this on his show one Sunday. He sure made it sound bad to pay an advisor an ongoing fee for the work he does on your account. After all, the annuity salesman makes all the commission he's going to make on your account right at the time you write the check to his insurance company. And, after all, if you leave your money in that annuity for the entire ten years that the surrender period is in force, you'll never have to pay that salesman any commission out of your pocket. Whereas, with a real financial advisor, you do pay that ongoing fee each year. And if your account does happen to experience a negative return one year, that fee does continue to be withdrawn from your account. So, in that period, the advisor WILL wind up making more on your account than you do. But that's not the whole story.
To answer that question fully, and to cover the claim that the insurance company charges no fees, let discuss how the insurance company does make money on your account. After all, they don't exist just to make you money, they must also be profitable, or they will cease to exist.
Insurance companies are highly regulated by the states in which they exist. They have rules regarding how they are allowed to invest. They have thousands of contractual obligations, so they are not allowed to take too many chances with the money you place with them. Since they cannot take your money to Vegas and put it all on red, they must make a profit on your money very slowly. So, they invest it in bonds and mortgages, but not very much, if any, in stocks. On those investments, because they are investing so much at one time, they will receive a better rate on the money than you would be able to get on your own, even if you were investing in the same way. They will keep the difference between what they pay you in interest and what they receive on your money. That's called the 'spread.' If they can make a two or three percent spread on the money you put

with them for ten years, then they have made back all their costs for acquiring your money to begin with, and a good profit to boot. So, while there is no 'fee,' per se, there is the 'spread,' and it can really reduce what you make with that part of your retirement money.
Fixed Index Annuities are not bad in and of themselves, they're just often sold in a disingenuous way by salesmen who want to be seen as on the same level as real financial advisors.
Fixed Index Annuities are a good alternative to fixed annuities and Certificates of Deposit. They were never meant to be, however, competitive with Variable annuities, mutual funds, or most any kind of equity investment.

Questions to Ask
Should you be considering the purchase of a fixed index annuity, it is important to get the best one you can find. Therefore, you may want to consider multiple options.

What is the Surrender Charge Fee schedule?
Year 1 ____% Year 2 ____% Year 3 ____% Year 4 ____% Year 5 ____%
Year 6 ____% Year 7 ____% Year 8 ____% Year 9 ____% Year 10 ____%

What is the compensation you will receive upon my investment in this annuity?
_____% of total purchase

What is the Cap Rate on this annuity? ____%
Can the Cap Rate change, either up or down? ____

What is the minimum Cap Rate on this annuity? ____%

What is the Participation Rate on your S&P 500 index? ____%

Can the Participation Rate change, either up or down? ____

What is the minimum Participation Rate on this annuity? ____%

Is there a Cap Rate or Participation Rate reduction on this annuity that would ever trigger my ability to surrender the contract during the surrender period without a surrender charge? ____

On a separate sheet of paper, list the Guaranteed Living Benefits you are suggesting I add to your recommended contract, and the reasons I should add them.
Guaranteed Living Benefit 1 - Annual Charge ____% or $ ____
Guaranteed Living Benefit 2 - Annual Charge ____% or $ ____
Guaranteed Living Benefit 3 - Annual Charge ____% or $ ____
Guaranteed Living Benefit 4 - Annual Charge ____% or $ ___
_
Total Annual Charge for this annuity ____% + $ ____

What investment account(s) are you recommending I place my money in?

What is the average annual return on investment (ROI) it has made over the last 10 years? ____ You could also ask for an illustration that would sow how the contract would have performed in up, down, and most recent scenarios, keeping in mind that past performance is no guarantee of future results.

Variable Annuities

What Is a Variable Annuity?

A variable annuity is a contract between you and an insurance company. It serves as an investment account that may grow on a tax-deferred basis and includes certain insurance features, such as the ability to turn your account into a stream of periodic payments. You purchase a variable annuity contract by making either a single purchase payment or a series of purchase payments.

A variable annuity offers a range of investment options from the issuing insurance company. The value of your contract will vary depending on the performance of the investment options you choose. The investment options for a variable annuity are typically mutual fund-type accounts (called subaccounts) that invest in stocks, bonds, money market instruments, or some
combination of the three.

Each variable annuity is unique. Most include features that make them different from other insurance products and investment options. Keep in mind that you will pay extra for the features offered by variable annuities.

First, variable annuities have insurance features. For instance, if you die before the insurance company starts making income payments to you, many contracts

guarantee that your beneficiary will receive at least a specified amount. This is typically at least the amount of your purchase payments. It may also offer additional insurance features such as promising you the
ability to make withdrawals up to a certain amount each year for the rest of your life or an increased death benefit to your heirs.
Second, variable annuities are tax-deferred. That means you pay no federal taxes on the income and investment gains from your annuity until you make a withdrawal, receive income payments, or a death benefit is paid. You may also transfer your money from one subaccount to another within a variable
annuity without paying federal tax at the time of the transfer. When you withdraw your money, however, you will pay tax on the gains at ordinary federal income tax rates rather than lower capital gains rates. Under certain circumstances, the death benefit may not be subject to federal estate tax. In general, the benefits of tax deferral may outweigh the costs of a variable annuity only if you hold it as a long-term investment.
Third, variable annuities let you receive periodic income payments for a specified period or the rest of your life (or the life of your spouse).
This feature offers protection against the possibility that you will outlive your assets.

Tax Rules

- The federal tax rules that apply to variable annuities can be complicated. In addition, there may be state tax implications. Before investing, you may want to consult a tax adviser about the tax consequences of investing in a variable annuity.

What Should I Do Before I Invest in A Variable Annuity?

- Variable annuities could help you meet retirement and other long range goals. Variable annuities are not suitable for meeting short-term goals. Substantial taxes and surrender charges may apply if you withdraw your money early.
- Variable annuities involve investment risks just like mutual funds do. If the investment choices you selected for the variable annuity perform poorly, you could lose money.
- Contract fees may go towards your financial professional’s compensation. That means they may receive higher compensation for selling some contracts or investment products than for others.

How Variable Annuities Work
A variable annuity has two phases: an accumulation phase and a payout (annuitization) phase.
During the accumulation phase, you make purchase payments. The amount of the purchase payments that go into the account may be less than you paid because fees were taken out of the purchase payments. The money in the account gets invested in a menu of investment options—typically mutual funds—that you can select.
In addition, you may be able to allocate part of your purchase payments to a fixed account. A fixed account, unlike a mutual fund, pays a fixed rate of interest. The insurance company may reset this interest rate periodically, but it will usually provide a guaranteed minimum (e.g., 3% per year).
The money in the account will vary according to the amount of premiums you pay,
the amount of contract fees and expenses, and the performance of the investment
options you choose.
Example: You purchase a variable annuity with an initial purchase payment of $100,000. You allocate 50% of that purchase payment ($50,000) to a bond fund, and 50% ($50,000) to a stock fund. Over the following year, the stock fund has a 10% return, and the bond fund has a 5% return. At the end of the year, your account has a value of $107,500 ($55,000 in the stock fund and $52,500 in the bond fund), minus fees and expenses.
Your most important source of information about a variable annuity's mutual fund investment options are the funds' prospectuses. They are available without charge from your financial professional. Typically, you should read them carefully before you pick your investment options. You should consider a variety of factors with respect to each fund option, including the fund's investment objectives and policies, management fees and expenses that the fund charges, the risks and volatility of the fund, and whether the fund contributes to the diversification of your overall investment portfolio. However, in my experience, almost nobody ever bothers to read the prospectus. They may even sign a form that declares they have read it, but most annuity buyers rely on the representative to tell them what they need to know. Why? Because it's boring. Not only that, but it is written in such a way that covers all the legal obligations of the issuing insurance company. Now if you understand it? Well, that's just an unintended benefit.
During the accumulation phase, you can typically transfer your money from one investment option to another without paying federal tax on your investment

income and gains. However, the insurance company may charge you for transfers beyond a certain number.

Also, during the accumulation phase, you may choose to withdraw all or a portion of your purchase payments plus investment income and gains (if any) as a lump sum payment. However, if you withdraw money from your account during the early years of the accumulation phase, you may have to pay "surrender charges" (discussed below). In addition, you may have to pay a 10% federal tax penalty if you withdraw money before the age of 59½.

The payout phase begins if you choose to "annuitize" your contract. If you do, you may choose to receive your contract value as a stream of income payments at regular intervals (such as monthly). Your contract may automatically annuitize at a certain age, typically an advanced age such as age 95.

You may have a number of choices of how long the payments will last. Under most annuity contracts, you can choose to have your income payments last for a period that you set (such as 20 years) or for an indefinite period (such as your lifetime or the lifetime of your spouse). You may be able to choose between receiving income payments that are fixed in amount or payments that vary based on the performance of the subaccounts.

The amount of each periodic income payment will depend, in part, on the time period that you select for receiving payments. Be aware that, in general, annuities do not allow you to withdraw money from your account once you have started receiving income payments.

In addition, some annuity contracts are structured as immediate annuities. This means that there is no accumulation phase and you will start receiving income payments shortly after you purchase the annuity.

The Death Benefit and Other Optional Insurance Features

A common feature of a variable annuity during the accumulation phase is the death benefit. If you die, a person you select as a beneficiary (such as your spouse or child) will generally receive the greater of: (i) all the money in your account; or (ii) some guaranteed minimum (such as all purchase payments minus prior withdrawals).

Example: You own a variable annuity that offers a death benefit equal to the greater of account value or total purchase payments minus withdrawals. You have made purchase payments totaling $100,000. In addition, you have withdrawn $20,000 from your account. Because of these withdrawals and investment losses, your account value is currently $75,000. If you die, your designated beneficiary will receive $80,000 (the $100,000 in purchase

payments you put in minus $20,000 in withdrawals).
Some variable annuities allow you to choose optional death benefits for an additional charge. For example:
Variable annuities commonly offer other optional insurance features, which also have extra fees. Many of these optional features are available only during the accumulation phase of the contract. Collectively, these features may be referred to as “living benefits.”

Variable Annuity Fees and Expenses

You will pay several fees and expenses when you invest in a variable annuity. Be sure you understand all the fees and expenses before you invest. These fees and expenses will reduce the value of your account and the return on your investment. Often, they will include the following:
The surrender charge often declines gradually over a period of several years, known as the “surrender period.” For example, a 7% charge might apply in the first year after a purchase payment, 6% in the second year, 5% in the third year, and so on. Typically, after six to eight years or sometimes as long as ten years, the surrender charge may no longer apply. Often, contracts will allow you to withdraw a portion of your account value each year without paying a surrender charge.
Example: You purchase a variable annuity contract with a $100,000 purchase payment. The contract has a schedule of surrender charges, beginning with a 7% charge in the first year, and declining by 1% each year. In addition, you can withdraw 10% of your contract value each year free of surrender charges. In the first year, you decide to withdraw $50,000. This is one-half of your contract value of $100,000 (assuming that your contract value has not increased or decreased because of investment performance). In this case, you can withdraw $10,000 (10% of contract value) free of surrender charges. You will pay a surrender charge of 7%, or $2,800, on the other $40,000 withdrawn.
Example: Your variable annuity has an M&E charge at an annual rate of 1.25% of account value. Your average account value during the year is $100,000, so you will pay $1,250 in M&E charges that year.
Example: Your variable annuity charges administrative fees at an annual rate of 0.15% of account value. Your average account value during the year is $100,000. You will pay $150 in administrative fees.
Other fees may also apply. These may include initial sales loads/charges or fees for transferring part of your account from one investment option to another. You

should ask your financial professional to explain to you all fees and expenses that may apply. You can also find a description of the fees and expenses in the prospectus for any variable annuity that you are considering.
Remember:
- A variable annuity may offer different share “classes” with different fees and expenses (including differing M&E charges) and different surrender charge periods. For example, “L class” shares may have a shorter surrender charge period, but may have higher ongoing fees, while “B class” shares may have a longer surrender charge period and lower ongoing fees. Consider how long you expect to own the variable annuity and your need to access funds when you think of any tradeoff between the length of the surrender charge period and the level of ongoing fees.
- Contract fees may go towards your salesman's compensation. That means they may receive higher compensation for selling some contracts (and for different share classes of the same contract) than for others.

Exchanging One Variable Annuity for Another
Bonus Credits
Some insurance companies offer variable annuities with “bonus credit” features. These contracts promise to add extra money to your contract value based on a specified percentage (typically ranging from 1% to 10%) of purchase payments.
Example: You purchase a variable annuity contract that offers a bonus credit of 3% on each purchase payment. You make a purchase payment of $100,000. The insurance company issuing the contract adds a bonus of $3,000 to your account.
Before purchasing a variable annuity with a bonus credit, ask yourself and your annuity Rep whether the bonus is worth more to you than any increased fees and expenses you will pay for the bonus. This may depend on a variety of factors such as the amount of the bonus credit and the increased fees and expenses, how long you hold your annuity contract, and the return on the underlying investments. You also need to consider the other features of the annuity to determine whether it is a good investment for you.
Example: You make purchase payments of $100,000 in Annuity A and $100,000 in Annuity B. Annuity A offers a bonus credit of 4% on your purchase payment, and deducts annual fees and expenses totaling 1.75%. Annuity B has no bonus credit and deducts annual fees and expenses

totaling 1.25%. Let's assume that both annuities have an annual rate of return, prior to expenses, of 10%. By the tenth year, your account value in Annuity A will have grown to $229,780. But your account value in Annuity B will have grown more, to $231,360, because Annuity B deducts lower annual fees and expenses, even though it does not offer a bonus.
You should also note that a bonus may only apply to your initial purchase payment, or to purchase payments you make within the first year of the annuity contract.
Remember:
- Take a hard look at variable annuities offering bonus credits. In some cases, the "bonus" may not be in your best interest
- Variable annuities with bonus credits may impose higher fees and expenses than variable annuities that do not offer bonus credits. Higher expenses can outweigh the benefit of the bonus credit offered.
- In certain circumstances (such as death, annuitization, or surrendering your contract within a few years of purchasing it) you may be required to repay any bonus credits to the insurance company.

Questions to Ask
This part of the sales interview is one in which the representative can become uncomfortable. But so that you can make a good buying decision, you need the information contained in the answers to the following questions.
Do NOT buy a Variable Annuity before asking these questions
What is the Mortality and Expense or Core Contract charge for this annuity? _____
What is the Administration fee? ____
Is there a threshold where the administration fee is waived?
What is the Surrender Charge Fee schedule?
Year 1 ____% Year 2 ____% Year 3 ____% Year 4 ____% Year 5 ____%
Year 6 ____% Year 7 ____% Year 8 ____% Year 9 ____% Year 10 ____%
What is the compensation you will receive upon my investment in this annuity?
_____% of total purchase
Do you receive an ongoing fee? _____ If so, how much? ______
On a separate sheet of paper, list the Guaranteed Living Benefits you are suggesting I add to your recommended contract, and the reasons I should add them.
Guaranteed Living Benefit 1 - Annual Charge ____% or $ ____
Guaranteed Living Benefit 2 - Annual Charge ____% or $ ____

Guaranteed Living Benefit 3 - Annual Charge ____% or $ ____
Guaranteed Living Benefit 4 - Annual Charge ____% or $ ____
Total Annual Charge for this annuity ____% + $ ____
Remember, the higher the total annual charge is for this variable annuity, the less opportunity it will have to maintain a good long-term growth rate.
Let's assume you invest $100,000 in a variable annuity. The investments within the annuity average 8% per year before expenses. In example 1 the total expenses are 1.5% per year, in example 2 the expenses (because of the guaranteed living benefits) average 4%.
Example 1: Example 2
In 10 years the value will be; $187,714 $148,024
In 20 years the value will be; $352,365 $219,112

Conclusion:
Variable annuities can be a smart way to save for retirement. They do offer many advantages over other types of investments. However, it is very important to weigh any advantage they pose against what they charge, as you can clearly see. As with any investment, approach variable annuities with as much information and knowledge as possible.

Annuities are long-term financial vehicles designed for retirement purposes. Withdrawals may incur a surrender charge and market value adjustment, if applicable. Withdrawals before age 59½ are taxed as ordinary income and may be subject to a 10% federal tax penalty. Products may not be available in all states, and product features may vary by state. Current yield applies when held for the entire guarantee period. Surrender value will not be less than the minimum value required by your state. There may be age eligibility requirements, minimum premium amounts, systematic withdrawal limits, and qualifying requirements for waiver of withdrawal and surrender charges. For complete details, including limitations and exclusions, ask your financial professional. Guarantees are based on the claims-paying ability of the underlying insurance company and are not FDIC insured.

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