



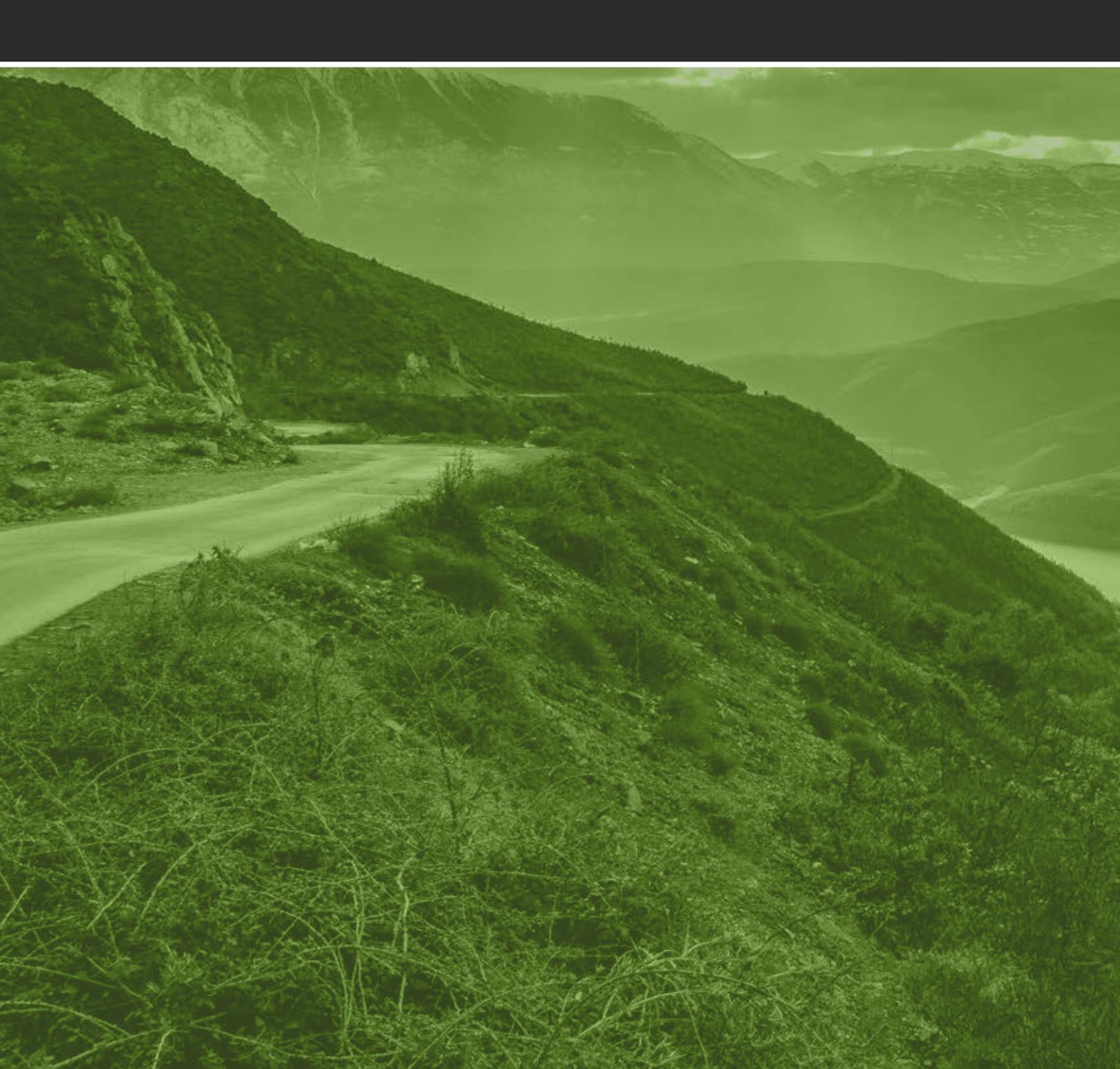
ROADMAP to

# RETIREMENT INCOME

THE ROLE ANNUITIES CAN PLAY



[www.IQWealth.com](http://www.IQWealth.com)





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*This document is designed to provide general information on the subjects covered. Pursuant to IRS Circular 230, it is not, however, intended to provide specific legal or tax advice and cannot be used to avoid tax penalties or to promote, market or recommend any tax plan or arrangement. Please note that our firm, its representatives and employees do not give legal or tax advice. You should consult your tax advisor or attorney.*

## Preface

First introduced in America back in 1759, the annuity concept of making a one-time payment in exchange for a lifetime of payments is as old as the concept of life insurance — only the annuity was developed to provide payments while a person is still alive.

*(Source: SaveWealth Financial Retirement. "History of Annuities." <http://www.savewealth.com/retirement/annuities/history/>. Accessed April 6, 2015.)*

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The annuity has undergone substantial changes since the 18th century, as noted by the National Association for Fixed Annuities. According to NAFA Executive Director Kim O'Brien, "The investment community has historically used fixed annuities as a stable value component of an integrated investment strategy...recent innovations within the fixed annuity insurance industry are expanding the role of these products. These innovations provide new opportunities for financial advisors to diversify risk and complement the investment side of an individual's retirement plan with guarantees and insurance."

*(Source: Kim O'Brien. "Fixed Annuities Complement Investment Planning." Society of Actuaries' Product Matters! February 2011. 24-25. <https://www.soa.org/library/newsletters/product-development-news/2011/february/pro-2011-iss79-obrien.aspx>. Accessed April 6, 2015.)*

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Retirees today are finding that annuities can play an important role in their retirement income strategies. When considering an annuity, you should choose one that is suitable for your personal financial situation to help ensure that it works in concert with the rest of your overall retirement income strategy. When utilized correctly, an annuity can be a very effective retirement income vehicle.

The objective of this informational resource is to help you understand the basics of annuities and how they can work within your overall retirement income strategy.

More importantly, this manual is designed to help you assess your need for retirement income down the road and construct a strategy to help you reach your destination. In doing so, you will learn the role an annuity can play in your retirement income strategy.

*"The Treasury and the IRS are announcing steps that will ease regulatory barriers in the market for annuities and other forms of lifetime income."*

*(Source: Alan Krueger. Council of Economic Advisers, WhiteHouse.gov. Feb. 15, 2012. "An America Built to Last: Strengthening Economic Security in Retirement." <https://www.whitehouse.gov/blog/2012/02/15/america-built-last-strengthening-economic-security-retirement>. Accessed April 6, 2015.)*

***So buckle up, start your engine and take this manual out for a spin.***

## The Basics

Before we go much further, it's important to have a basic understanding of just what an annuity is. Put simply, an annuity is a contract you purchase from an insurance company. In exchange for the premium you pay, you receive certain fixed and/or variable interest crediting options that compound tax-deferred interest until withdrawn. When you're ready to receive income, an annuity offers a variety of guaranteed payout options through a process known as "annuitization."

There are an array of annuity contracts on the market today, and each one will be examined more closely later in this manual. The options include variable, immediate, fixed and fixed index annuities. These choices can allow you to match very specific individual needs with a suitable product. Within each contract, you have the flexibility to select from a range of payout terms and death benefits, and you may have the possibility of purchasing optional riders for additional benefits. An annuity purchase can be strategically positioned within your overall retirement savings strategy for any number of personal objectives, such as income for your spouse should you die, a death benefit for your children or as help addressing inflation concerns. Coverage is available for two people within one contract, so you don't have to purchase a separate contract for your spouse. All annuity product guarantees and protection benefits are backed by the financial strength and claims-paying ability of the issuing insurance company.

Annuities are designed to meet long-term needs for retirement income. Interest on annuities is earned on a tax-deferred basis, which means no taxes are paid on interest credited until payments are received or withdrawals are taken. However, withdrawals will reduce the contract value and the value of any protection benefits. Withdrawals taken within the contract surrender charge schedule will be subject to a surrender charge. All withdrawals are subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10 percent federal additional tax.

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## It's Personal: 3 Questions to Ask Yourself

There's an old saying: "That's why they make Chevys and Fords," that is used to help explain the differences in people. The fact is, there are at least as many different types of financial vehicles as there are motor vehicles from which to choose.

An annuity is not suitable for everyone: It all comes down to personal choice. Your circumstances, income and financial resources, objectives, tolerance for market risk and retirement timeline are all very unique to you. There is no one cookie-cutter financial product or strategy that is a perfect fit for all retirees. That's what makes preparing for retirement so difficult — trying to figure out an appropriate strategy to meet your specific needs.

### Retiree Spending

- 48% of today's retirees report a lower level of spending during retirement
- 21% say that they spend more

(Source: Nevin Adams, Craig Copeland, Mathew Greenwald and associates. Employee Benefit Research Institute. March 2013. "The 2013 Retirement Confidence Survey: Perceived Savings Needs Outpace Reality for Many." [http://www.ebri.org/pdf/surveys/rcs/2013/EBRI\\_IB\\_03-13.No384.RCS.pdf](http://www.ebri.org/pdf/surveys/rcs/2013/EBRI_IB_03-13.No384.RCS.pdf). Accessed April 6, 2015.)

It really comes down to the lifestyle you want and your retirement income goals. An annuity is just a vehicle to help you on the road to your retirement income goals. Establishing your financial goals and objectives can help shed some light on which vehicle(s) may be appropriate to help you accomplish them.

In the context of the manual, it comes down to three simple questions:

- **How much income do I need in retirement?**
- **How much income do I want in retirement?**
- **What roadblocks may affect my progress toward my financial goals?**

*According to Warren Buffet, the perfect amount to leave children is "enough money so that they would feel they could do anything, but not so much that they could do nothing."*

## **Question #1: How much income do I need in retirement?**

Historically, the recommendation many financial professionals have provided to retirees is to anticipate needing 70 percent to 80 percent of their pre-retirement income during retirement.

*(Source: Michael Kitces. Nerd's Eye View. March 21, 2012. "In Defense of the 70% Replacement Ratio in Retirement." <https://www.kitces.com/blog/in-defense-of-the-70-replacement-ratio-in-retirement/>. Accessed April 6, 2015.)*

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The following are four categories of expenses you should consider when evaluating how much money you may need in retirement.

### **Housing & Utilities**

Regardless of any fluctuations in home equity you may have experienced in recent years, you should be aware of whether your mortgage will be paid off by the time you retire. Also consider whether you will be inclined to downsize to a smaller home, which may result in lower utility costs, or move into a retirement community — many of which can be quite expensive.

From a health care perspective, living in your own home may not always be an option if you become injured or infirmed and need assisted living or skilled nursing care. In any of these scenarios, you may want to consider working with a qualified financial professional to help determine what residential options make sense financially.

### **Food, Clothing, Travel, Entertainment & Gifts**

You need to eat well and be clothed, but many retirees find they spend less money on these expenses in retirement. Compared to the expenditures of a household headed by a 65 year old, spending falls significantly by age 75, according to the Bureau of Labor Statistics Consumer Expenditure Survey.

*(Source: Bureau of Labor Statistics. Sept. 12, 2014. "Consumer Expenditure Survey." <http://www.bls.gov/cex/#tables>. Accessed April 6, 2015.)*

## Transportation

Your transportation needs may change as you get older. If you get to the point where driving is no longer comfortable or feasible, your transportation options may become more expensive.

## Health Care

Health care expenses will be discussed in more depth later in this manual, which you should consider carefully when planning for your retirement expenditures.

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## Question #2: How much income do I want in retirement?

What do you want your money to do for you in retirement — to simply provide a comfortable existence where your basic needs are met, or to allow you to do more, like entertain and travel extensively? Do you wish to leave a financial legacy for your loved ones and/or any charitable causes you support, or are you inclined to spend more of your money now and leave less to your loved ones? As for how much to leave as an inheritance, consider Warren Buffet's philosophy that the perfect amount to leave children is "enough money so that they feel they can do anything, but not so much that they could do nothing."

Most of us won't face Buffet's dilemma with regard to the amount of inheritance to leave our loved ones, but the sentiment is evident: Don't live your life as if its value is only worth as much as you leave your children. Does it seem reasonable to not spend your money on housing, health care, long-term care and your own quality of life just so that you can leave a larger inheritance to your loved ones? If your goal is to both live comfortably and leave an inheritance, now may be the time to begin working toward that goal.

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## Question #3: What roadblocks may affect my progress toward my financial goals?

### Economic & Job Instability

As a nation, we're just starting to come out of a difficult few years. Some have suggested that the bailouts and economic stimulus distributions that helped us out of the recent recession may lead to income tax hikes and rising interest rates, which could potentially result in a slower-than-usual economic recovery, a slow housing market recovery and continued market volatility.

This booklet is for informational purposes only. It is not intended to provide tax or legal advice. Speak to a qualified tax advisor or attorney regarding your personal circumstances.

*"The median net worth of households headed by someone between age 65 and 74 declined from \$250,800 in 2007 to \$206,700 in 2010."*

*(Source: Emily Brandon. U.S. News. July 23, 2012. "Retiree Net Worth Declines." <http://money.usnews.com/money/retirement/articles/2012/07/23/retiree-net-worth-declines>. Accessed April 6, 2015.)*

*"The future ain't what it used to be."*

*-Yogi Berra, The Yogi Book: "I Really Didn't Say Everything I Said" by Yogi Berra.*

## Taxes

Taxes may cause a wrinkle in retirement income strategies in part because regulations can be changed, repealed or back-dated depending on the economy and who is in office. When it comes to retirement income, it may be advantageous to pursue tax-deferred growth for potentially higher long-term interest accumulation. Whatever current tax-advantaged vehicles are available should be considered for retirement income strategies. You should consult a financial professional and your personal tax advisor before adopting a specific tax strategy for retirement.

## Market Losses

If you're like many retirees, your investments lost money — at least on paper — during the latest market downturn. As you get closer to retirement and have less time to recover lost gains, you may want to consider limiting your exposure to market declines as you transition away from asset accumulation and into income distribution.

Please keep in mind that financial professionals must hold the proper securities registration and be currently affiliated with a broker-dealer or Registered Investment Advisor to recommend the liquidation of funds held in securities products, including those within an individual retirement account (IRA) or other retirement plan.

## Perils of the Road

- Inflation Pressure: Cost of Living
- Maintenance Costs
- High Mileage: Life Expectancy
- Unstable Ride: Market Volatility

## Inflation Pressure: Cost of Living

When preparing for retirement you should take into account the potential impact of long-term inflation on income over a long lifespan.

Inflation can make a big difference when estimating how much you can spend in retirement. To help maintain your desired lifestyle, you should prepare for a level of income that can help you offset the effects of inflation. For many years, a lot of retirees have relied upon the so-called 4 percent rule. This generally accepted “rule of thumb” in planning for retirement income suggests that you should be able to withdraw 4 percent from your retirement savings in the first year of retirement and then increase your withdrawal each year to account for inflation without running a big risk of running out of money.

This was generally a good rule of thumb, but as a result of recent market volatility, historic market volatility and longer life expectancies, even those who follow the 4 percent rule oftentimes encounter financial issues. It has become more common for retirees to frequently adjust how much they withdraw, based on changes in wealth, age and market conditions.

Retirees face a more unique type of inflation risk than the rest of the population. So much so that since 1987, the U.S. Department of Labor’s Bureau of Labor Statistics began tracking a separate consumer price index — one specifically weighted for elderly Americans — called the CPI-E Index.

From December 1982 through December 2011, the last time the CPI-E was calculated, the CPI-E increased an average annual rate of 3.1 percent as compared to 2.9 percent for the Consumer Price Index for All Urban Wage Earners and Clerical Workers (CPI-W). The CPI-W and CPI-E are both subsets of the CPI-U, which is the Consumer Price Index for All Urban Consumers.

*(Source: Bureau of Labor Statistics. March 2, 2012. “Consumer Price Index for the elderly.” [http://www.bls.gov/opub/ted/2012/ted\\_20120302.htm](http://www.bls.gov/opub/ted/2012/ted_20120302.htm). Accessed April 6, 2015.)*

## Housing

Having your house paid off prior to retirement is a good idea, but it may not provide the decrease in overall expenses you anticipate. As you age, you may encounter health conditions that can impact your monthly expenses. For instance, it may take longer to recover from an injury or illness and acute health conditions may require home health assistance for recovery. In-home professional health services can be costly. Additionally, you may find yourself in the situation where you or your spouse have medical issues requiring full-time nursing care, while the other spouse continues to live in the family home. So whether it's in-home services or confinement in a senior living facility, it's important to understand the potential impact of these costs on your retirement savings.

## Health Care

Today, retirees spend about 15 percent of their income on out-of-pocket expenses, according to the Employee Benefit Research Institute's February 2012 Issue Brief.

*(Source: Sudipto Banerjee. Employee Benefit Research Institute. February 2012. "Expenditure Patterns of Older Americans, 2001-2009." [http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content\\_id=4992](http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=4992). Accessed April 6, 2015.)*

As illustrated in the accompanying table, a couple both age 65 in 2013 could need up to \$360,000 to cover premiums for health insurance coverage and out-of-pocket expenses during retirement.

### Savings needed for 90% chance of having enough savings to cover health costs in retirement (premiums and out-of-pocket expenses)

Retirement age	No employer-based health care benefits Medicare, Medigap & Part D; ranges based on drug expenses
Man age 65 today	\$172,000
Woman age 65 today	\$195,000
Couple age 65 today	\$360,000

*(Source: Employee Benefit Research Institute. October 2013. "Notes." <http://www.ebri.org/pdf/notespdf/EBRI.Notes.Oct13.RetSvgs1.pdf>. Accessed April 6, 2015.)*

## Maintenance Costs

Much like your car or home, many financial vehicles require "maintenance" fees or expenses. However, what many retirees don't realize is that even small differences in fees from one product to the next can translate into large differences in your asset accumulation over time.

## Cost vs. Benefit: Finding the Right Balance

Annuities are commonly criticized for their administrative fees and surrender charges, but the fact is many financial vehicles contain some sort of fee or charge.

For example, mutual funds generally offer liquidity, diversification and are professionally managed. In return for those benefits, there are a variety of potential costs that could be incurred, including asset management costs, transaction costs and marketing and distribution costs.

Regardless of the financial vehicles you choose for your retirement income strategy, it's important to consider not only the fees and charges you may incur, but also the benefits you will receive in return.

### Among the most common annuity fees are:

- **Mortality & Expense Charge (M&E)** — These charges generally pay for the sales commissions, administrative expenses and insurance guarantees (including the death benefit and income payouts for life) of the contract. In a variable annuity, M&E charges will be deducted from the value of the investment. With a fixed annuity, you generally won't see a deduction for these charges on your annual statement. Rather, these charges are built into the pricing of the product and are reflected in benefits and guarantees you receive.
- **Surrender Charges** – When an insurance company issues an annuity contract, it incurs costs in commissions to the selling agent, in processing the application, etc. Therefore, most insurance companies limit the amount of withdrawals you can take during the early years of a contract and impose a surrender charge on any withdrawals in excess of that preset limit to help offset the costs incurred by the company. Surrender charges are generally applied during the first 10 to 14 years of the contract and can be significant, but over time the surrender charges typically reduce to zero. The amount of the surrender charges will vary by product and by state.

Ultimately, you need to make the determination whether the fees you're being charged are worth the benefits you're receiving.

"Three in 10 retired widows report that they had not even considered how they would respond following the loss of their spouse."

*(Source: Mathew Greenwald & Associates Inc. The Society of Actuaries. December 2013. "2013 Risks and Process of Retirement Survey Report Findings." <https://www.soa.org/Files/Research/Projects/research-2013-retirement-survey.pdf>. Accessed April 6, 2015.)*

## High Mileage: Life Expectancy

The longer you live, the greater your chance of running out of money. If you start withdrawing retirement income too early, withdraw too high a percentage or don't allow opportunities for growth potential within your retirement income plan, you may spend down your retirement assets too soon.

If you're married, your ability to prepare adequately may be even more complex. You may need long-term income not only for yourself but a spouse as well, and if you or your spouse experience an illness or require long-term medical assistance your need for income may be even greater.

Even more difficult to prepare for is the volatility of the market. The longer you live, the more likely you are to experience additional market and economic ups and downs. The accompanying table illustrates just how often dips, corrections and bear markets may occur.

### DJIA's history of declines, 1900-2012

TYPE OF DECLINE	AVERAGE FREQUENCY <sup>1</sup>	AVERAGE LENGTH <sup>2</sup>	LAST OCCURRENCE	PREVIOUS OCCURRENCE
-5% or more	About 3 times a year	47 days	October 2013	August 2013
-10% or more	About once a year	115 days	October 2011	July 2010
-15% or more	About once every 2 years	216 days	October 2011	March 2009
-20% or more	About once every 3 ½ years	338 days	March 2009	October 2002

(Source: American Funds. "What Past Market Declines Can Teach Us." <https://www.americanfunds.com/individual/planning/market-fluctuations/past-market-declines.html>. Accessed April 6, 2015.)

The following examples demonstrate how retirement assets may be impacted both before retirement — when you're trying to accumulate assets — and after retirement when you are actually withdrawing assets. These hypothetical examples are for illustrative purposes only, should not be deemed a representation of past or future results and are no guarantee of return or future performance. These examples do not represent any specific product and/or service.

### Value of \$100,000 during a hypothetical 3-year market decline

YEAR	MARKET RETURN	YEAR-END VALUE
2000	-6.2%	\$93,800
2001	-7.1%	\$87,140
2002	-16.8%	\$72,500

(Source: ForecastChart. "Dow Industrial Average Stock Market Historical Graph." <http://www.forecast-chart.com/historical-dow-industrial.html>. Accessed April 6, 2015.)

### Value of \$100,000 with 5% annual withdrawals during a hypothetical 3-year market decline

YEAR	MARKET RETURN	5% WITHDRAWAL AT YEAR START	YEAR-END VALUE
2000	-6.2%	\$5,000	\$89,110
2001	-7.1%	\$4,456	\$78,644
2002	-16.8%	\$3,932	\$62,160

Not only does a market decline during retirement reduce your opportunity to reasonably earn back the depreciated assets, but if you are withdrawing income from your assets at the same time, it can be even more challenging to recover from any market losses.

### Unstable Ride: Market Volatility

Historically, stock and bond markets have generally moved out of tandem, so that whenever one market dropped, the other was typically performing well. This meant a diversified investment portfolio still had the potential for growth, while also offering downside protection on a portion of the portfolio through more conservative holdings. Globally, the same was true. When domestic markets faltered, there was generally growth somewhere overseas and vice versa.

The domestic markets have largely recovered, and the economy should as well — it always has. However, given a shorter investment timeframe and the fact that the new global economy has investments moving in tandem can impact how long your retirement savings last.

One thing to consider is incorporating an annuity that can offer the potential for interest accumulation to help meet the challenges of a long life and the impact of long-term inflation on cost-of-living expenses and health care, and also provide a source of guaranteed income to help ensure that daily essential living expenses will be met. Guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company.

## Your Three-Point Turn

As mentioned in the preface, an annuity can be an important part of your retirement income strategy, however it's not a good idea to put your entire nest egg into an annuity. That's because annuities are designed to be long-term income accumulation and/or distribution vehicles.

You have to live in the here and now, so you may want to have income for today, retirement income for tomorrow and emergency income at any time. This means that throughout retirement, you should not have all of your assets tied up in an annuity. You should have a financial resource that you may tap immediately should you need to put your hands on cash in a hurry.

When considering your retirement income needs, here are a few of the many categories you may consider:

### Emergency Assistance | Standard Essentials | Discretionary Options

#### Emergency Assistance

An emergency constitutes an immediate financial need, ranging from out-of-pocket expenses for medical care to losing your job. Many financial professionals suggest an emergency fund of three to six months of expenses.

#### Standard Essentials

Essential expenses tend to be constant from month to month, such as food, clothing, rent or mortgage payment, utilities, basic transportation, medical insurance and health care expenses. Retirees are spending increasingly more on these essential categories.

*(Source: Pamela Villarreal. National Center for Policy Analysis. Jan. 22, 2014. "How Are Senior Spending Their Money." <http://www.ncpa.org/pub/ib135>. Accessed April 6, 2015.)*

#### Discretionary Options

The amount of discretionary income you have in retirement will depend upon how well you've provided for your essentials. Discretionary income is generally used to pay for a new car, entertainment, vacations and travel, hobbies and recreation.

But remember, no matter the amount of income you plan on having when you retire, you will inevitably need more as time goes on. As a result of long-term inflation, if you had retired back in 1976 on \$30,000 a year, your annual income would need to be \$123,755 today to support the same lifestyle.

*(Source: Bureau of Labor Statistics. "CPI Inflation Calculator." [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm). Accessed April 6, 2015.)*

You may want to consider an annuity, in addition to Social Security and any pension you may receive, to provide guaranteed income to help ensure that your essential living expenses in retirement will be covered.

This booklet is for informational purposes only. It is not intended to provide tax or legal advice. Speak to a qualified tax advisor or attorney regarding your personal circumstances.

In its 2013 research paper titled, "Life Annuities: An Optimal Product for Retirement Income." The Research Foundation of CFA Institute quoted a 2007 Wharton Financial Institutions Center policy brief by Davide Babbel and Craig Merrill as saying:

*"By covering at least basic expenses with lifetime income annuities, retirees are able to focus on discretionary funds as a source for enjoyment. Locking in basic expenses also means that the retiree's discretionary funds can remain invested in equities for a longer period of time, bringing the benefits of historically higher returns that can stretch the useful life of those funds even further. The key in all of this is to begin by covering all of the basic living expenses with lifetime income annuities. Then, to provide for additional desirable consumption levels, you will want to annuitize a portion of the remainder of your assets, while making provisions for extra emergency expenses and, if desired, a bequest."*

In other words, a guaranteed stream of income can provide you with a level of reassurance that your basic expenses will be covered.

This strategy also helps protect a portion of your retirement income from the fluctuations in the stock market and allows you to do what you want with the rest of your nest egg.

## Performance & Guarantees

On one hand, the long-term rising cost of living can reduce the buying power of a fixed income, but on the other hand, market volatility can dramatically impact the performance of your retirement savings.

When it comes to safeguarding your retirement income, financial professionals often recommend annuities because they can offer you both the potential for interest accumulation and the security of guaranteed income payments. Annuity guarantees are backed by the financial strength and claims-paying ability of the issuing company.

Ibbotson research has illustrated that over a 30-year timeline, incorporating a guaranteed income component to conservative, moderately conservative and moderate portfolios can increase the average sustainable income and decrease shortfall income risk.

*(Source: Aite. NFP Advisor Services Group. August 2012. "The Missed Opportunity: Guaranteed Income as an Asset Class." <http://www.fa-mag.com/userfiles/docs/whitepapers/2012/Income-white-paper-FINAL.pdf>. Accessed April 6, 2015.)*

## Annuity Models

In the past, retirees could typically count on three sources of retirement income that divided roughly into thirds: government entitlement programs (i.e., Social Security and Medicare), employer-sponsored plans and personal retirement savings.

With this traditional scenario, both the government entitlement programs and employer-sponsored plans were considered “fixed” — reliable income sources that may be adjusted for inflation. Only one-third, individual savings, was considered variable.

Today, however, the majority of the responsibility for retirement income has largely shifted to the individual. That’s because Social Security is continually being re-evaluated and benefits are being scaled back. Employer-sponsored plans have evolved from guaranteed pension payouts to more defined contribution plans — which result in a payout in retirement based upon level of participation and long-term market performance.

You may want to consider a guaranteed, fixed-income component to your retirement income. In short, adding an annuity to your retirement income may be an opportunity to help ensure a portion of your retirement income will be guaranteed.

An annuity is a contract you purchase from an insurance company. For the premium you

pay, you receive certain fixed and/or variable interest crediting options able to compound tax-deferred until withdrawn. When you are ready to receive income distributions, this vehicle offers a variety of guaranteed payout options through a process known as “annuitization.”

Most annuities have provisions that allow you to withdraw a percentage of credited interest each year up to a certain limit without annuitizing the contract. However, withdrawals can reduce the value of the death benefit and excess withdrawals above the restricted limit may incur surrender charges, typically within the first 10 to 14 years of the contract.

Because annuities are designed as a long-term retirement income vehicles, annuity withdrawals made before age 59 ½ are subject to a 10 percent federal additional tax and all withdrawals may be subject to ordinary income taxes.

### The Annuity Inventory

- Variable Annuity
- Immediate Annuity
- Fixed Annuity
- Fixed Index Annuity

## Variable Annuity

A variable annuity is comprised of professionally managed portfolios that vary in both investment objectives and representative holdings. If you are working with a qualified investment advisor or registered representative, you may allocate your purchase payments across any number of these portfolios in whatever percentage you choose, with regard for your financial objectives and tolerance for market risk. Taxes on earnings from these portfolios are not due until distributed, and you may transfer assets between portfolios without having to pay taxes on gains.

However, because these various portfolios are managed by professional money managers, the fees you pay for each portfolio, combined with the overall M&E and administrative fees, have the potential to be quite high.

Many variable annuities also offer optional riders guaranteeing minimum annual income for a specific number of years or even for life, available for an additional fee. Annuities with optional income riders tend to have fees commensurate with the additional risks as underwritten by the issuing insurer.

### Optional Variable Annuity Income Riders:

- **Guaranteed Minimum Income Benefit (GMIB)** — guarantees you a minimum income stream.
- **Guaranteed Minimum Accumulation Benefit (GMAB)** — guarantees that your account value will accumulate to a certain amount at a specific date in the future.
- **Guaranteed Minimum Withdrawal Benefit (GMWB)** — guarantees you a minimum income stream without having to annuitize the contract.
- **For-Life Benefits** — This type of benefit allows you to receive a percentage, usually 4 to 6 percent, of your original investment for as long as you live.

*Any transaction that involves a recommendation to purchase or liquidate funds held in a securities product, including a variable annuity, can be conducted only by individuals currently affiliated with a properly registered broker-dealer or Registered Investment Advisor. Please consult with a broker-dealer representative or Registered Investment Advisor for guidance on securities holdings.*

## Immediate Annuity

With an immediate annuity, you use a lump sum of money to purchase a contract from an insurance company in return for a guaranteed series of payouts. This stream of income is guaranteed for a specified period of time or for the rest of your (and even your spouse's) life — no matter how long you live. The amount of the payout is based on several factors:

- **How much money you use to buy the contract**
- **The interest rate environment at the time you purchase the contract**
- **The payout option you select (typically at the time the contract is issued)**
- **Your life expectancy — based on current age and gender**
- **The date you select for your first payment (within one year of issue date)**
- **Any additional features you choose**

Immediate annuity income payouts may be either level or increasing periodic payments for a fixed term of years or until the end of your life, whichever is longer.

Your income payouts will be taxed at ordinary income tax rates rather than the lower capital gains rates.

One thing to take into consideration with an immediate annuity is, because there is no accumulation phase, you must annuitize immediately to receive income distributions. Once you annuitize with the life-only option, the transaction is irreversible and you no longer have access to your assets in a lump sum. When you die, any remaining contract value that could have been left to your beneficiaries is forfeited to the insurance company.

## Fixed Annuity

A traditional fixed annuity provides a guaranteed interest rate for a specific number of years. Fixed annuities offer fixed interest rate periods, typically over one, three, five, seven or 10 years, as well as a variety of annuitization payout options — including the option for guaranteed income for life.

With a fixed annuity, you defer paying taxes on the interest earned in the contract until you begin taking withdrawals or receiving scheduled annuitization payments. Once you begin withdrawals, they will be taxed as ordinary income and, if you take withdrawals prior to age 59 ½, a 10 percent federal additional tax may apply. Tax deferral may allow your assets to grow faster than in an alternative financial vehicle that is taxed annually.

The fixed annuity can help you conservatively accumulate assets to help cover fixed living expenses in retirement.

*“Consumers can benefit from these products by having a steady stream of income regardless of how their investment assets perform or how long they live, while at the same time maintaining access to their assets for unexpected or other expenses.”*

*(Source: U.S. Government Accountability Office. Dec. 10, 2012. “Retirement Security: Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies Across States.” <http://www.gao.gov/products/D03768>. Accessed April 6, 2015.)*

## Fixed Index Annuity

The fixed index annuity combines tax deferral and the potential for interest based on positive changes of an external index without actual participation in the market.

A fixed index annuity may offer a choice of indexes. The insurance company uses a crediting method to track the performance of the index(es) during a specified time period, which is typically one contract year but could be multiple contract years. At the end of each time period, the company calculates the indexed interest. If the result is positive, the annuity is credited interest up to a predetermined amount. If the result is negative, nothing happens, and the annuity's value doesn't decline. In addition to potential indexed interest, you may also have the option to receive fixed interest.

Like a traditional fixed annuity, under current federal income tax law, any interest earned in a fixed index annuity is tax-deferred until you begin receiving money from your contract. If you purchase a fixed index annuity with after-tax dollars, you will only pay ordinary income taxes on your interest earnings (not on premium payments) when you begin withdrawing money.

Purchasing an annuity inside a qualified plan (retirement plan) that provides a tax deferral under the Internal Revenue Code provides no additional tax benefits. An annuity used to fund a tax qualified retirement plan should be selected based on features other than the tax deferral. All of the annuity's features, risks, limitations and costs should be considered prior to purchasing an annuity inside a qualified retirement plan.

Some fixed index annuities allow you to withdraw credited interest without penalty up to a certain amount each year. However, withdrawals will reduce the contract value and the value of any protection benefits. Be aware that withdrawals in excess of the "free" amount each year and during

the contract's surrender charge period may incur a surrender charge.

Most fixed index annuities have components that help determine how much interest can be credited in a given year. The most common are:

- **Participation Rate.** A participation rate determines what percentage of the index increase is used to calculate your indexed interest. For example, if the insurance company sets the participation rate at 80 percent, your fixed index annuity will be credited with interest based on 80 percent of any increase in the value of the external index.
- **Spread.** The spread is a percentage that is subtracted from any increase in the value of the index during the term period. For example, if the annuity has a 4 percent spread and the index increases 10 percent, then the annuity would be credited 6 percent.
- **Interest Rate Cap.** Some fixed index annuities set a maximum interest rate (or cap) that the contract can earn in a specified period. If the index increase exceeds the cap, the cap is used to calculate the credited interest.

A fixed index annuity is designed to provide a combination of benefits that can give you confidence in your retirement income strategy. Whether the market is up, down or flat, the fixed index annuity provides protection of your principal and any credited interest from possible market downturns and the potential for interest linked to the performance of a market index. As long as you abide by the terms of the contract, your principal is protected against market loss and any credited interest is locked in at the end of each term period and cannot be taken away as a result of a future market downturn.

*The interest credited on your contract may be affected by the performance of an external index. However, your contract does not directly participate in the index or any equity or fixed interest investments. You are not buying shares in an index. The index value does not include the dividends paid on any equity investments underlying any equity index or any interest paid on any fixed income investments underlying any bond index. These dividends and interest are not reflected in the interest credited to your contract.*

## Insurance Coverage

### Death Benefits

If you pass away before you begin to receive scheduled annuity payouts, your beneficiary(ies) will receive a death benefit. Even if you pass away after annuity payouts have begun, it's still possible your beneficiary(ies) will receive a death benefit. The value and the manner in which your beneficiary(ies) can receive the death benefit may vary based on the product selected and insurance company through which it is issued.

### Annuitization

Annuitization is the process of converting the account value of an annuity into a series of guaranteed periodic income payments, such as monthly or annual payments.

### Guarantees

Because an annuity is issued by an insurance company, all guarantees related to fixed account rates, annuitization payouts and death benefits are backed by the financial strength and claims-paying ability of the issuing company.

# Owner's Manual

## Contract Structure

How you structure your annuity will affect its income payouts and death benefits. The following are all the participating entities involved in an annuity contract.

- **Insurance Company** – issues the contract, provides contract information and is responsible for all payout guarantees.
- **Owner** – purchases the annuity and makes all decisions regarding allocations, income distributions, annuitants and beneficiaries.
- **Annuitant** – typically the same person as the owner; annuity income payouts are based upon the life expectancy of the named annuitant (who generally must be younger than age 85 at the time the contract is issued).
- **Beneficiary** – the person who receives the contract's death benefit. Naming a beneficiary (person, charity or trust) is important to help the annuity potentially avoid probate.

## Company Ratings

Because annuity product guarantees are backed solely by the insurance company that issues the annuity contract, it is important to consider the strength of the issuing insurance company when purchasing an annuity. Factors such as the size of the company, the length of time it has been in business and its investment profile are all considerations that you should carefully discuss and research with your financial professional. There are a number of independent agencies that rate the financial strength of insurance companies. One of the most well-known of these companies is A.M. Best, which rates companies on a 16-point scale from an A++ (superior) down to an S (suspended).

## A 1035 Exchange

In recent years, annuities have evolved into more effective retirement income vehicles than in the past. Therefore, you may currently own an annuity contract that may be less effective for accomplishing your goals than newer annuity contracts on the market today.

If you and your financial professional determine you would be better suited to replace or exchange a current annuity contract for a different one, you may be able to take advantage of what is called a "1035 Exchange," named after Section 1035 of the Internal Revenue Code. The IRS allows you to exchange an insurance contract that you own for a new life insurance or annuity contract without paying tax on the income and interest earned on the original contract at the time of the exchange.

However, you should be aware of the following requirements involved with making a 1035 Exchange:

- The current insurance contract must be directly exchanged for a new contract — you may not receive a check and apply the proceeds to the purchase of a new insurance or annuity contract.
- You may make a tax-free exchange, provided certain requirements are met, in only the following situations:
  - From a life insurance contract to another life insurance contract
  - From a life insurance contract to an annuity contract
  - From one annuity contract to another annuity contract.
- A 1035 Exchange does not include the exchange of an annuity contract for a life insurance contract.

### **Considerations Regarding a 1035 Exchange:**

- While surrender charges eventually expire on an existing contract, be aware that a new surrender charge period may be imposed when you trade in an old contract for new a contract, or may increase the period of time for which the surrender charge applies.
- You may have to pay higher annual fees for the new contract.
- When exchanging one contract for another, the new contract must be suitable for you and provide benefits that, when compared to the existing contract, better meet your financial goals and objectives.

Insurance professionals recommending an annuity 1035 Exchange are required to inform you of the pros and cons of the exchange. Your insurance professional should make a recommendation only if it is suitable for you and only after evaluating your personal and financial situation, needs, tolerance for risk and ability to pay for the new contract.



## Conclusion

An annuity could play an important part in your overall retirement income strategy. So, how do you know whether an annuity may be appropriate for you?

- Are you retired or nearing retirement?
- Do you currently have a retirement income strategy in place?
- Do you have predictable, reliable income streams or are you working with defined contribution plans, such as a 401(k) or IRA?

If you do not currently have predictable and reliable income streams to cover your basic expenses in retirement, you may want to consider an annuity for a portion of your retirement income strategy to provide supplemental income that can help offset the risk of outliving your money.

Together you and your insurance professional should have a thorough discussion about whether an annuity is suitable for you.

*All annuity contract and rider guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company. Annuities are not a deposit of, nor are they insured by any bank, the FDIC, NCUA or by any federal government agency.*

Prepared For



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