# Annuities

## Safe Money Products that Stimulate Financial Growth & Preserve Wealth

**"Safe Money" is for money you cannot afford to lose.**

**Learn why Annuities are considered to be a Safe Money Place and how these financial products can help secure a safe retirement.**

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# What Are Annuities? How Do They Work? What Are The Benefits?

**Prior to the late 1970s annuities were primarily used as a retirement income vehicle. The textbook definition of an annuity in those days was "A periodic income for a specified length of time, for life, or a combination of the two." Today, however, annuities can mean much more.**

## ANNUITIES CAN PROVIDE:

- **A means of accumulating interest on a tax advantaged basis.**
- **An estate instrument that PRESERVES and PROTECTS assets.**
- **A guaranteed income for life that also lets you access the principal.**

Today, most people do not convert the money they have in their annuity into a guaranteed income stream (called annuitization); instead, they treat the annuity value they have accumulated as any other asset. Anecdotal evidence suggests that almost all of these **accumulated annuity values are passed onto the heirs in a big lump sum** and not turned into an income stream by the buyers of the annuities. The consensus is that less than 2% of deferred annuities are annuitized.

# Fixed And Variable Annuity Differences

The differences between variable annuities and fixed annuities are significant. In a variable annuity, because your income or account value is based on the value of the stocks or bonds backing the annuity assets, the income and/or account values fluctuate. **When you read or hear about annuities in the media, most of the time the subject is VARIABLE annuities NOT FIXED annuities.**

## PLEASE NOTE:

**Variable Annuities ARE NOT CONSIDERED "Safe Money Products" because:**

- The owner of the annuity takes the investment risk.
- You can lose the principal.
- Gains and losses are tied to the stock market, which is out of the annuity owner's control.

Unlike with fixed annuities, **the annuity owner bears the investment risk with variable annuities**. Therefore, **variable annuities are considered investment securities** and would be a "risk money place" for your money.

| | Fixed Rate Annuity | Fixed Index Annuity | Variable Annuity |
|---|---|---|---|
| Management Fees | No | No | Yes |
| Registered as Security | No | No | Yes |
| Guaranteed Prior Earnings | Yes | Yes | No |
| Guaranteed Principal | Yes | Yes | No |
| Minimum Interest Guarantee | Yes | Yes | No |

# Fixed Annuities

Fixed annuities provide a guaranteed minimum interest rate and are considered savings instruments. Insurance companies issue all fixed annuities. They are not government or bank obligations, so naturally they are not FDIC insured. However, fixed annuities have an **extraordinary record of safety** and offer other benefits.

## Interest Earned And Minimum Guarantees

**Fixed annuities provide a minimum guaranteed return**, which is a safe money feature that annuities have in common with Series EE Savings Bonds. However, unlike Savings Bonds, you do not need to wait twenty years for the annuity's guarantee to kick in. If the insurance company believes they can pay extra interest from their general account, above and beyond its minimum guarantee, the company will declare a fixed rate of interest and pay the annuity owners a stated interest rate for a defined period. Or, in the case of a fixed index annuity, they could use the extra interest to link the earning of interest to the performance of an external index for a period. The major difference between a *fixed rate annuity* and a *fixed index annuity* is in the crediting of excess interest above the minimum guarantee.

## Tax Advantages

Money remaining inside an **annuity grows without being taxed until withdrawn.** Unlike qualified retirement accounts where you must begin taking out money around age 70, most annuity contracts permit the owner to enjoy the advantage of tax deferral until age 85, 90, or even later. **Tax deferred does not mean tax-free;** interest is taxed when withdrawn. Also, the Treasury Department charges a 10% penalty on interest, in addition to regular taxes, if withdrawals are made before age 59.

## Annuity Tax Deferral In Qualified Plans

**Annuity interest grows tax-deferred**. Money in qualified plans grows tax-deferred. An annuity inside, say, an IRA is already growing tax-deferred because it is in a **qualified plan**, which leads some people to say a fixed annuity should not be used in a qualified plan. This logic assumes that the main reason one buys an annuity is for tax-deferral; however, our research indicates that most people buy annuities primarily for the potentially higher yield. If your IRA choice is an annuity yielding 6% or a similar non-tax-deferred vehicle yielding 5%, which one would you pick? **The decision to buy an annuity is primarily based on return, not tax benefits.**

## How Much Can I Put Away

Although one can find fixed annuities with a minimum premium as low as $ 50, typically an annuity requires a $ 5,000 initial premium ($ 2,000 for IRAs). Some annuities are single premium - meaning that you cannot add to them, and others are flexible premium - meaning you may contribute more in the future if you wish. Many carriers require advance notice if you are going to put away more than a million dollars at a time. Advantage Compendium reports the average annuity premium is around $ 50,000.

## Liquidity And Penalties

**Fixed annuities offer a wide variety of term choices.** The fixed annuity selected may have a penalty for early withdrawal ranging from as short as a year to as long as twenty years, although most permit the withdrawal of at least the interest earned each year without penalty. Insurance companies use these penalties, also known as surrender penalties or charges, to recoup initial costs if an annuity is cashed in prematurely.

A surrender penalty only becomes a charge if the policy is surrendered; therefore, **you need to determine whether the term of the annuity and liquidity provisions match your liquidity needs.**

## Market Value Adjustment (MVA)

An MVA feature means changes in the interest environment are taken into account if and only if the annuity is surrendered prematurely. What this can mean is if rates have risen since you started the annuity, the penalties for cashing out could be higher than the schedule stated in the policy, and if rates have fallen since you took out the annuity, the penalties could be lower or even zero. The reason behind Market Value Adjustments is found in the "*Buyer's Guide To Fixed Deferred Annuities*" produced by the *National Association of Insurance Commissioners*. Since you and the insurance company share the risk, an annuity with an MVA feature may credit a higher rate than an annuity without that feature. **If you don't surrender the policy during the period, you never pay the MVA** and you might get a little better rate.

## Death Benefit

In the event of death, the vast majority of fixed annuities pay the account value to the named beneficiary and no penalties are charged. Some annuities do assess surrender penalties at death, though a few others require the account value to be paid out over time. Therefore, you should determine if the annuity's terms meet your needs. If you desire, **you can set up an annuity so that your surviving spouse may keep the annuity in force.** The California Insurance Department recently released an annuity report that says "in a fixed annuity the amount remaining in the annuity at the annuitant's death stays with the insurance company." This is WRONG - it would only be true if you chose the most restrictive annuitization payout option. The insurance company DOES NOT KEEP YOUR MONEY IF YOU DIE when you own a deferred fixed annuity. We hope California fixes this incredible misstatement in their report soon!

## Maturity Date

Not to be confused with the *surrender period,* the *maturity date* is the longest one can keep annuity interest deferred before you must take it out. *Maturity dates* usually occur when the annuitants celebrate their 80th birthday. Not to be confused with the *surrender period*, the **maturity date is the longest period one can keep annuity interest deferred before withdrawing it.** Again, maturity dates usually occur when the annuitant celebrates their 80th to 90th birthday, though some new policies may extend the maturity date to age 100 (remember, the annuitant is the person upon which the annuitization life income is based). A maturity date is not life without parole. The maturity date is not how long you must keep your annuity, but how long the insurer will *let* you keep your money with them. To repeat, the annuity owner may take their money out or annuitize the contract *prior* to the maturity date. The maturity date is the longest time an annuity owner may force the carrier to keep the contract, not the other way around.

## Fees And Charges

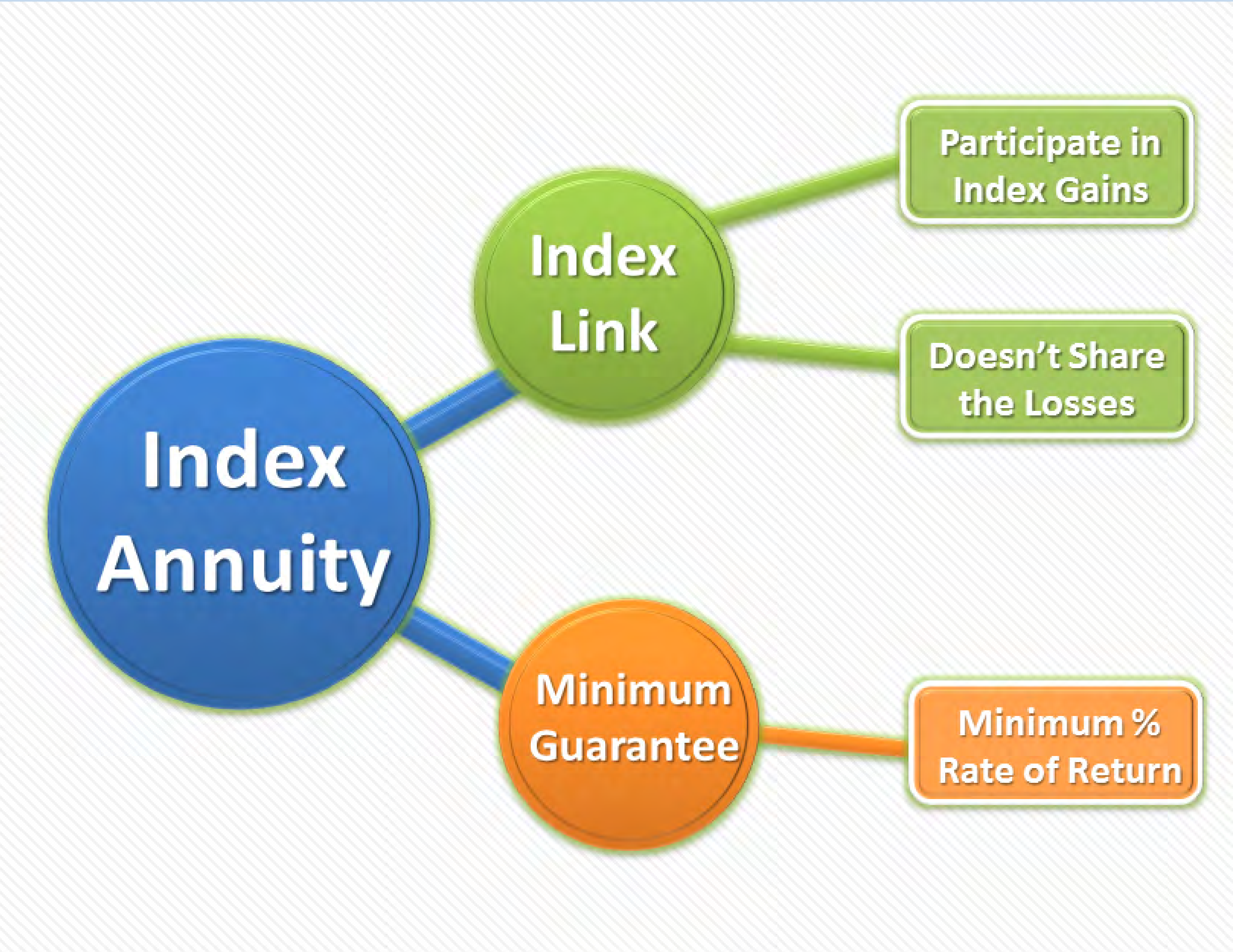
There are always costs, but *fixed annuity* fees and expenses are not charged in the same way that a *variable annuity* or *mutual fund* does; these types of products are charged fees and expenses in a more similar way that a bank charges its fees and expenses.

For example, let's say the bank says they will pay 4% interest on their CD. Okay, what are the bank's fees and expenses on this CD? If your answer is you cannot tell and it doesn't matter because all you really care about is the final rate you get on your money, the same logic applies to fixed annuities. **The insurance company doesn't deduct a management fee and share a net return with the customer.** Instead, just like the bank, the insurer pays a fixed return, which may be stated as a fixed rate or as fixed participation in an index. Might some banks have lower operating costs or higher revenues than others and thus offer a higher rate? Yes, and an insurer could spend less on office supplies than another insurer and thereby ultimately be able to pay a higher rate on fixed annuities. Who knows how you could translate all of this into fees?

**Annuities do have penalties for early withdrawal if the customer surrenders the annuity early, which is why you need to match the period with your goals, keeping in mind that all annuities are designed to be long-term savings instruments.** States permit annuities to charge annual contract fees of up to $ 50 a year, and many variable annuities do charge annual fees; however, we find *no evidence* of any fixed annuities charging this type of fee.

## Safety Of Principal

Fixed annuities do not subject principal and credited interest to market risk. A fixed annuity is as safe as the insurance company issuing the annuity. Insurance companies have an exceptional record of safety, which is why they are a safe money place.




# Fixed Index Annuities

Fixed index annuities link the interest paid to the performance of an index and state what your participation in the index will be.

## How Index Annuities Earn Interest

Fixed annuities provide a minimum guaranteed interest rate. If the insurance company believes it can pay extra interest from their general account, above and beyond its minimum guarantee, it uses the extra interest to link the earning of interest to the performance of an external index for the period. **The major difference between a *fixed rate annuity* and a *fixed index annuity* is in the crediting of excess interest above the minimum guarantee.**

## How Do They Pay Interest?

It might be easier if we compare how an index annuity pays interest with the way a bank pays interest. As you know, when you place your money with the bank they invest this money, earn a return, and, after subtracting their costs, pay you net interest rate for a stated period. **Your principal does not fluctuate, but the interest you receive can and usually does fluctuate from period to period.** Furthermore, this fluctuation can be extreme. But in any case, this sums up how a CD works.

An index annuity operates the same way, except that you place your money with an insurance company instead of a bank. When you place your money with the insurance company they invest this money, earn a return, and subtract their costs. The difference between the CD and the index annuity is that the amount of interest paid is linked to the movement of an external index. When the index goes up, the amount of interest earned increases. However, because this is a safe money place and not an investment, the index annuity does not share in any decreases of the index.

## What Do They Invest In?

A score of years ago you could say that banks earned their money by making loans and that insurance companies made their money by primarily buying bonds, but only half of that is still true. The change is that due to the securitization of debt - a topic for another lengthy discussion - many banks own few direct loans, but rather own lots of bonds, possibly some preferred stocks, and perhaps some real estate. Conversely, the bulk of insurance company holdings are still bonds. They may own a smattering of direct loans, possibly some preferred stocks, and perhaps some real estate, but by and large insurance companies buy bonds because of the **predictability of the income.** If you look back over time, the stock market has gone up many more years than it has gone down, but when it does go down it can hurt, sometimes a lot!

What the *index annuity* lets you do is benefit in the up periods without sharing in the losses. The worst thing that can happen, from a market-risk point of view, with an index annuity is that you don’t lose money – you can never lose principal or credited interest if the index declines.

## What’s The Catch?

Though it’s not really a “catch,” because it costs insurance companies to provide this valuable protection, you probably are not going to get all of the upside.

## One Year Or Multiple Year Rate Lock-Ins

All index annuities guarantee the rate of participation in the index annuity for a full year. Typically, an index annuity will guarantee index participation for one year at a time and declare the new index participation on the policy anniversary for the next year. Some index annuities lock-in all of the initial participation elements for two years, three years, or even for the entire penalty period of the annuity.

The amount of index participation may be expressed in many different ways. Some index annuities state that you will receive a stated percentage of any calculated index gains over the periods; others may give you all of the calculated index gain up to a certain interest ceiling or cap; others may use averaging or other variations. No index-link method is good or bad and any method can be the winner in a given period. The key is understanding how it works. If you cannot understand the method, do not get the annuity.

## How Much Interest?

The index annuity offers an alternative to concerns over rising interest rates by linking interest to changes in an equity index. An index annuity benefits in increases calculated for the index over a period, but even if the index goes down you can never lose principal or previously credited interest.

The highest index annuity interest rate credited for one year was over 40%. In 2002 and 2008 the major stock market indices went down and index annuities linked to these indices credited 0% for the year, but no previous interest was lost. Index annuities are designed to provide a long term return somewhere between stock market vehicles and other safe money places – always protecting principal and credited interest from market risk - and they have performed as intended.

## Minimum Guarantee

A *fixed annuity* guarantees to credit a *minimum* yield and that’s what makes a fixed annuity a fixed annuity instead of an investment. In the case of an *index annuity*, the minimum guarantee is usually structured to simply protect the premium and perhaps pay back a few extra bucks, rather than crediting a minimum interest rate each year

For example, an *index annuity* might guarantee to return a minimum of $ 1.10 for each

original $ 1 of premium at the end of seven years. If the index does not produce at least this minimum index-linked return, the insurance company will retroactively go back credit enough interest to reach $ 1.10.

## Living Benefits On Fixed Index Annuities

**"Lifetime Income Benefit Riders"** are known by a variety of terms. Some companies refer to these products as "**Guaranteed Income Withdrawal Benefits**," The bottom line: This rider, unlike annuitization allows the annuitant to take a lifetime income from the annuity without losing control of this retirement asset. In short, you can stop and start at any time and the account value can continue to grow. The Lifetime Income Rider assures the annuitant that he/she will never run out of money or live too long. These payouts can provide "single life income" or "joint lifetime income."

"**Chronic Illness, Terminal Illness, Confinement Waivers**" are riders that provide important benefits, such as: complete liquidity after a certain period of confinement, and increased payouts in the event the annuitant experiences some degree of incapacity that prohibits him from operating independently. Other riders for **inflation and death benefit enhancement** are also available. *Please make sure to look at each company's riders as they differ from company to company.*

**Bottom line: an index annuity with an income rider and a confinement rider can make retirement more enjoyable with a lot less stress.**


**Call Grisel Saez at 787.306.3887**
**For More Information About Annuities**

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