# AN INTRODUCTION TO ANNUITIES

***Funding Your Future***

TRG THE RETIREMENT GROUP LLC

PARTNERS IN RETIREMENT

# What is an Annuity?

- An insurance-based contract between you and the issuer
- You pay premiums with after-tax dollars
- Issuer invests your money
- Earnings accumulate tax deferred
- Earnings are taxed as ordinary income when distributed

This is basically how annuities work: You pay after-tax dollars to the issuer, the issuer invests the money for you, and any earnings accumulate tax deferred. At some point, the issuer pays out the principal and earnings to you or to your beneficiaries. Earnings are taxed as ordinary income when they're distributed. Why consider buying an annuity?

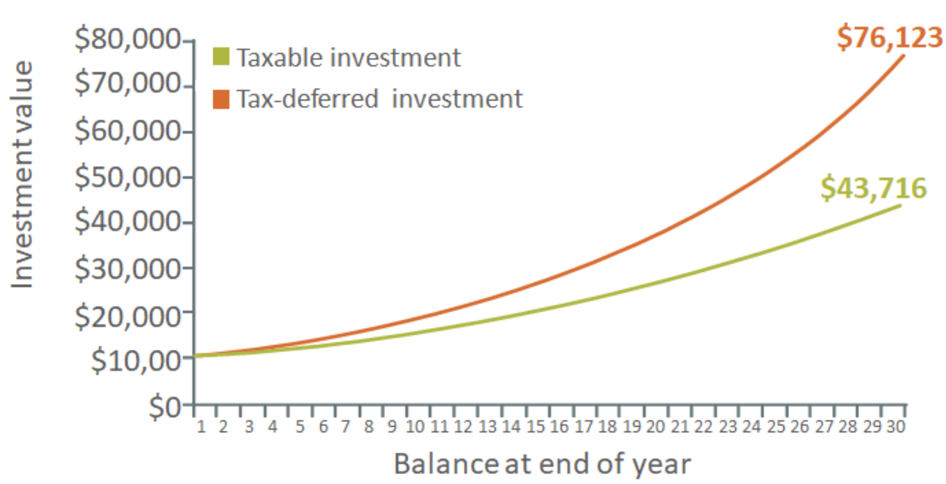
# Why Buy an Annuity?

- To receive tax-deferred growth for savings and a dependable stream of income for life
- To save for a specific purpose
- To supplement other sources of retirement income
- To maintain financial independence

The primary features of annuities are tax-deferred growth for savings and a steady stream of income that can last for the rest of your life. These characteristics allow annuities to be used for many purposes.

For example, annuities can be used to invest for a specific purpose or long-term goal such as saving for retirement, providing a legacy for your heirs, or making a charitable gift. The income provided by annuities can be used to supplement retirement income from sources such as Social Security, pension plans, or other employer-sponsored retirement plans like 401(k)s.

The income and savings provided by an annuity may help you remain financially independent, so that you won't be dependent upon your children for financial help or caregiving. For example, you can use the annuity income to pay for your own long-term care expenses, rather than rely on your children for care. But one of the primary benefits of an annuity is its tax-deferred growth.




- Assumptions:
- $10,000 initial investment
- Tax rate 28%
- Growth rate 7% (after-tax growth rate 5.04%)
- Annual end of period compounding

This hypothetical example is for illustrative purposes only, and its results are not representative of any specific investment or mix of investments. Actual results will vary. Taxable investment assumes earnings are taxed as ordinary income and is not reflective of possible lower maximum tax rates on capital gains and dividends which would make the taxable investment return more favorable thereby reducing the difference in performance between the accounts shown. Applicable annuity charges are not reflected in this illustration. Had they been included, the return of the annuity would be lower. You should consider your personal investment horizon and income tax brackets, both current and anticipated, when making an investment decision as these may further impact the results of the comparison.

Here's an illustration of the advantage of tax-deferred earnings growth over earnings growth that's taxed every year. Let's assume you make a lump-sum investment of $10,000 that will compound annually at the end of the year, and you're in the 28% income tax bracket. Let's also assume all investments earn 7% each year in income. If you invest that money in an alternative that's taxed each year, in 30 years you'll accumulate a total of $43,716.

But if you invest that money in a vehicle that allows tax-deferred growth, in 30 years you'll accumulate $76,123--more than you'd have earned investing the same amount for the same length of time in an alternative that's taxed annually. Why? Because the money that's not going to taxes keeps compounding, and as Albert Einstein is reputed to have said, "Compound interest is the greatest mathematical discovery of all time."

While the annuity's earnings accumulate tax-deferred, they are subject to income tax when you withdraw them. Of course, annuities aren't the only choice that offers tax-deferred growth potential; retirement plans such as 401(k)s and individual retirement arrangements (IRAs and Roth IRAs) do that as well.

| Feature | Annuities (Nonqualified) | 401(k)s and Traditional IRAs | Roth IRAs |
|---|---|---|---|
| Tax-deferred earnings | ✓ | ✓ | ✓ |
| Tax-deductible or pretax contributions | | ✓ | |
| Unlimited contributions | ✓ | | |
| *Guaranteed minimum death benefit | ✓ | | |
| RMDs | | ✓ | |
| *Tax on withdrawals | ✓ | ✓ | |
| *Guaranteed lifetime income | ✓ | | |
| *Fees and charges | ✓ | ✓ | ✓ |

***Guarantees are subject to the claims-paying ability and financial strength of the issuer. The earnings portion of annuity withdrawals is subject to income tax at ordinary income tax rates. Pretax or tax-deductible contributions and pretax earnings are subject to income tax at ordinary tax rates when withdrawn. Annuities, particularly variable annuities, may impose higher fees, charges, and expenses than the other plans.**

As long as you satisfy specific requirements, withdrawals from Roth IRAs are not subject to income tax.

However, all distributions of pretax contributions and earnings from 401(k)s and IRAs are taxed as ordinary income. Only the earnings portion of annuity distributions is subject to income tax.

Here's what may be one of the most important distinctions between annuities and other retirement plans: an annuity can be annuitized, or converted into a stream of payments you, or you and your spouse, can't outlive. While it's entirely possible that the funds you accumulate in an IRA or 401(k) could last for your entire life, there's generally no guarantee--it's possible you could outlive your funds.

Each of these plans has some fees and charges that can differ based on the investment vehicle selected. Annuities, particularly variable annuities, may impose higher expenses than 401(k)s, IRAs, and Roth IRAs.

There are different types of annuities, which we'll discuss briefly, but there are some basic characteristics common to most types of annuities.

# Parties to an Annuity

The **owner**:

- Purchases the annuity
- May make withdrawals
- Receives annuitization payments if elected

The **issuer**:

- Issues the annuity
- Accepts the premiums
- Promises* to pay the annuity benefits

*Guarantees are subject to the claims-paying ability of the annuity issuer.

The **annuitant**:

- Provides the measuring life for determining annuity payouts
- Typically, the annuitant is also the owner

The **beneficiary**:

- Is named by the owner
- Receives the remaining benefits, if any, at the owner's death

There are generally four parties to any annuity contract. The **owner** usually purchases the annuity, pays the premiums, and names the beneficiary (if any) in the event of death. The owner can make withdrawals from the annuity or surrender it, and is generally the party who receives the payments if the annuity is annuitized.

The **issuer** of the annuity contract is generally an insurance company. The issuer accepts the premium payments, invests them in accordance with the annuity contract, and promises to pay whatever benefits the annuity contract stipulates.

The **annuitant** provides the "measuring life" used to determine the amount of the payments if they're made for life, called annuitization. Typically, the annuitant is also the owner of the annuity.

The **beneficiary**, named by the owner of the annuity, receives the proceeds of the annuity if the owner dies before annuitization, or receives the remaining benefits (if any, depending on the annuitization option chosen) at the time of the owner's death.

# Putting Money in an Annuity

The accumulation phase is the time period when you're making the premium payments. You can make:

- One lump-sum payment
- A series of equal or variable payments over time

There are two distinct phases to any annuity contract. The phase where you put money in is called the accumulation phase. The phase where you take money out is called the distribution phase. In the accumulation phase, you can choose to pay premiums in one of two ways:

You can pay in one lump sum or you can make a series of premium payments over time. These payments can be of equal amounts contributed at equal intervals (for example, $500 a month), or you can make payments of variable amounts at irregular intervals, depending on the terms of the contract.

You can put money in an annuity and let it earn interest, or you can begin to receive payments almost immediately.

**Immediate Annuities**

- Typically purchased with a single lump-sum premium
- Payouts begin within one year of purchase

**Deferred Annuities**

- Typically purchased with periodic payments
- Payout begins at some future date, allowing time for tax-deferred growth

Annuities are classified as either immediate or deferred annuities. These terms simply refer to when the distribution phase of the annuity begins.

Immediate annuities convert a lump sum of cash into an income stream. They are typically purchased with a single payment, and the distribution period usually begins within a year of the purchase.

Deferred annuities may be purchased with a single lump-sum premium payment, or with a series of periodic payments. The distribution period begins some time in the future, which allows any earnings to grow on a tax-deferred basis. However, you may be able to make withdrawals at any time, as we'll discuss later. There are different types of deferred annuities as well.

### Fixed Annuities

- Guaranteed return of principal and minimum interest
- Fixed interest earnings
- Generally no fees

### Variable Annuities

- Generally no guaranteed earnings based on sub-account performance
- Investment choices in sub-accounts
- Fees and charges assessed to account value

Let's look now at the two basic types of deferred annuities -- fixed and variable.

There are many similarities in how both fixed and variable annuities work: both involve the same four parties (owner, issuer, annuitant, and beneficiary), both offer tax-deferred growth potential on an investment that can be of an unlimited amount, both offer the freedom of discretionary withdrawals subject to surrender charges, both may be annuitized in the distribution phase, and earnings for both are taxed in essentially the same fashion--as they are distributed from the annuity.

But there are also some significant differences between fixed and variable annuities.

Fixed annuities guarantee that the principal you invest will be returned to you; what's more, the issuer guarantees a minimum rate of interest on your investment. Of course, all guarantees are subject to the claims-paying ability of the annuity issuer.

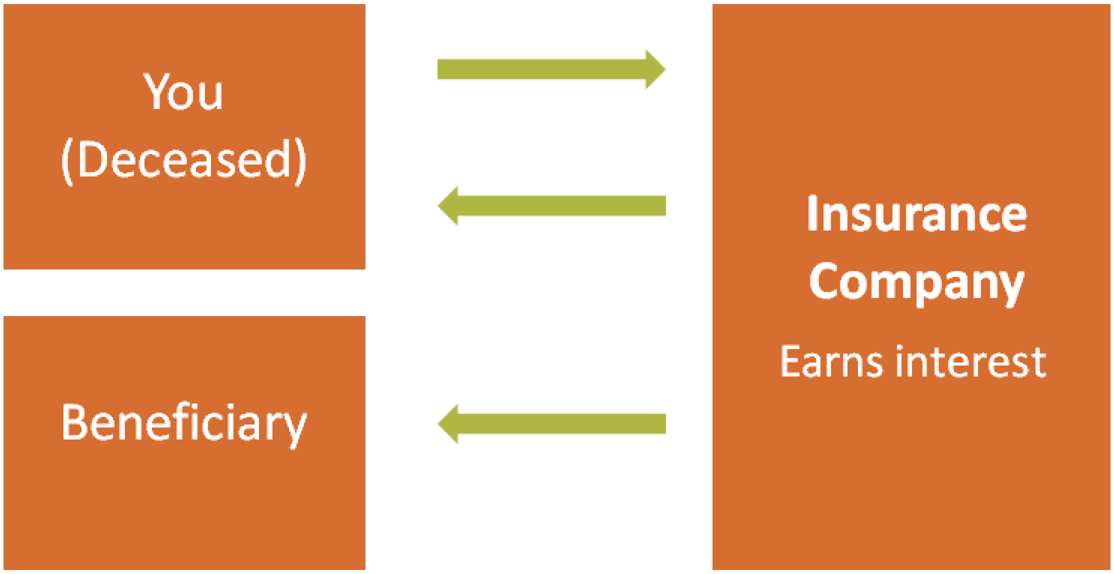
This is not the case with variable annuities. Generally, the issuer of a variable annuity offers you no guarantees. You typically assume all the risk relating to the performance of the underlying investments you choose, and any earnings are solely dependent on those investments. In fact, if the investments perform poorly, you could actually lose principal.

When you invest in a fixed annuity, you can't choose how your money is invested. Instead, your earnings are based on a fixed interest declared by the insurer periodically according to the terms of the particular contract.

But with a variable annuity, you're allowed to choose how you want to invest your money within sub-accounts. We'll explore this difference in more detail in a few minutes. Generally there are no fees or charges associated with fixed annuities. All of your premium investment is eligible for earnings. However, fees and charges are customarily assessed by variable annuities against your account values. Now let's look more closely at how a fixed annuity works.

*Guarantees are subject to the claims-paying ability and financial strength of the annuity issuer.

# Putting Money in a Fixed Annuity




Guarantees are subject to the claims-paying ability of the issuer.

Funds invested as part of the issuer's general account are subject to the claims of the issuer's creditors.

With a fixed annuity, you make your premium payments to the annuity issuer.

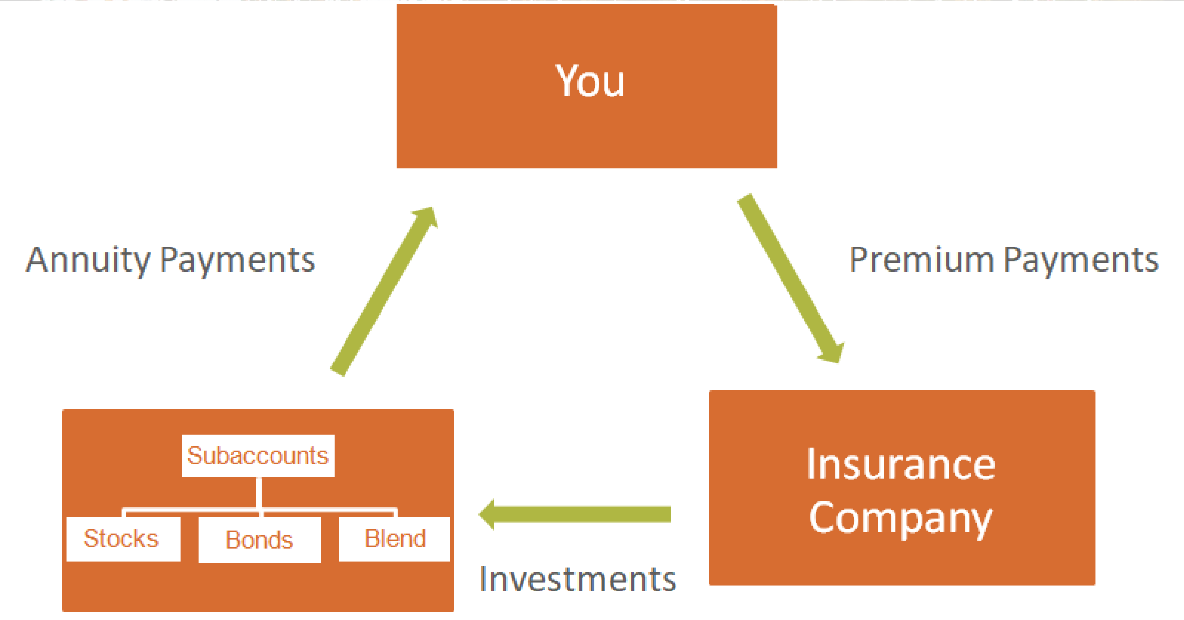
The issuer invests your payments in its general account, where the funds are managed by the issuer's own money managers. Because these funds are part of the issuer's general assets, they are subject to the claims of its creditors. You should be aware that you're assuming this risk when buying fixed annuities. As we'll see, this isn't the case with variable annuities.

# Putting Money in a Fixed Annuity

Your investment earns a fixed rate of interest declared by the annuity issuer and the interest rate can vary periodically, but the company guarantees the return of your principal and a minimum interest rate. Any earnings on the money you invest grow tax deferred. You don't pay taxes on the earnings until you begin taking money from the annuity, either through withdrawals or by annuitizing. (Withdrawals made prior to age 59½ may be subject to an additional 10% penalty tax.)

Your annuity contract offers withdrawal options to you. Usually, you can take withdrawals periodically, subject to surrender charges, or you can annuitize the contract in which case you'll receive the same payments for a specified period of time, or for the rest of your life or for the lives of you and your spouse.

Most fixed annuities also provide a death benefit at your death depending on the account value and payment options you selected. Now let's look at what happens when you invest in a variable annuity.




Guarantees are based on the claims-paying ability and financial strength of the annuity issuer.

Variable annuities work much like fixed annuities, except you can invest your premium payments in a wide variety of investment choices called sub-accounts.

Generally, you make premium payments to the insurance company.

You then can allocate your premiums to sub-accounts specializing in different investment options, such as government securities, corporate bonds, or common stocks, depending on what the annuity issuer offers. These sub-accounts are generally not accessible to the issuer’s creditors. You can also transfer funds among sub-accounts without incurring commission charges or triggering a taxable event. However, with the exception of a sub-account in which the issuer guarantees a minimum rate of interest, variable annuities don’t offer any guarantees on the performance of their sub-accounts. It’s possible that the sub-accounts will perform poorly, and you may lose money, including principal. You should only consider purchasing a variable annuity if you’re willing to assume the risk inherent in investing. As with a fixed annuity, earnings grow tax deferred.

Variable annuities offer a variety of withdrawal options including periodic distributions, subject to applicable surrender charges (withdrawals made prior to age 59½ may be subject to an additional 10% penalty tax). Like fixed annuities, you can choose to receive fixed payments for a fixed period of time or for the rest of your life or for your life and that of your spouse. However, unlike fixed annuities, you can elect to have your variable annuity payments tied to the performance of your sub-accounts in which case the amount of each payment may fluctuate based on sub-account performance.

Variable annuities usually offer a minimum guaranteed death benefit equal to your premium payments less any withdrawals you might have taken. This death benefit ensures that your beneficiary will receive at least the return of your investment in the annuity, even if poor sub-account performance caused your annuity to lose principal. Let's look at annuity death benefits a little closer.

# Guaranteed Death Benefit

Annuities can provide guaranteed* death benefits to your named beneficiaries.

- If death occurs before annuitization, full repayment of premiums
- If death occurs after annuitization, some payout options continue payments to your beneficiary

Annuities are considered a form of insurance. It's not surprising, then, that both fixed and variable annuities can provide a guaranteed death benefit when you die.

If you die before the annuity is annuitized, your named beneficiary will generally receive at least 100% of the premiums that you've paid, less any withdrawals you may have taken. Or, you can structure the contract to pay your beneficiary the cash value of the annuity at the time of your death. Death benefit proceeds are not subject to probate, and so are paid to your beneficiary without delay.

If you die after annuitization has started, both fixed and variable annuities offer several annuitization options that may be available to your named beneficiary after your death. We'll explore these in more detail in a few moments when we look at the different annuitization options available to you. Let's look now at the fees and expenses associated with annuities.

*Guarantees are subject to the claims-paying ability and financial strength of the annuity issuer.

# Taking Money Out of an Annuity

- Withdraw principal and/or earnings  (withdrawal of earnings prior to age 59½ may be subject to 10% additional tax)
- Select a guaranteed* income option of a fixed or variable amount over a specific period of time or for life (annuitization)
- Nonqualified annuities aren't subject to required minimum distributions (RMDs)

Generally, you can take disbursements from an annuity in one of two ways: You may withdraw money at your own discretion, although there are tax penalties for doing so before you reach age 59½, which we'll discuss later. These withdrawals can be taken at either regular or irregular intervals, and may be of either fixed or varying amounts. Also, withdrawals may be subject to surrender charges during the early years of the annuity, although most deferred annuities allow for a certain amount that can be withdrawn each year without incurring surrender charges. Check with the particular annuity contract or prospectus for details.

If you own a fixed annuity, withdrawals come from the issuer's general account. If you own a variable annuity, you can choose the subaccounts from which you make withdrawals.

You can also elect at some point to annuitize the annuity, which is the term used when you convert the annuity to periodic income payments. Depending on the annuity, you can elect to receive a fixed or a variable amount for each payment, which you can receive monthly, quarterly, semiannually, or annually. You can elect to receive payments for a fixed time period, for your lifetime, or for your lifetime and the lifetime of another person.

Unlike 401(k)s and traditional IRAs, annuities are not subject to minimum distribution requirements after age 70½. Unless your annuity contract stipulates otherwise, you can let your earnings accumulate tax deferred for as long as you wish. Now let's look more closely at what happens if you elect to annuitize.

# Annuitizing an Annuity

- Fixed annuities convert to a stream of guaranteed* fixed payments
- Variable annuity options:
  - Convert to guaranteed* fixed payments
  - Take variable payments
  - Combination fixed and variable payments
- Once annuitized, you usually can't invest further or take other withdrawals

Generally, annuitizing converts your annuity into a stream of payments.
With a fixed annuity, the current value of your annuity is converted into a stream of guaranteed payments. You'll receive periodic fixed payments on a schedule of your choosing.

With a variable annuity, you can convert the current value of your account into a stream of guaranteed fixed payments, just as you can with a fixed annuity. As an alternative, you can either choose to receive variable payments, where the amount you receive will depend solely on the performance of the sub-accounts underlying your annuity, or you may choose a combination payment consisting of a fixed portion and a variable portion.

Once you annuitize, you usually can't change your mind--you're no longer allowed to invest further in the annuity, make any other withdrawals, or select a different payout option, although there are some exceptions to the general rule. Let's look at some of the factors affecting your annuitization payments.

*Gurantees are subject to the claims-paying ability and financial strength of the annuity issuer.

# Factors Affecting Annuitization Payments

- The cash value of your account (fixed annuities)
- The performance of your underlying investments (variable annuities)
- The age and gender of the annuitant
- The payout option you choose

If you own a fixed annuity (or if you choose to convert a variable annuity to a stream of guaranteed fixed payments), the cash value of your account at the time you annuitize will affect the amount of your payments. The larger the cash value of your annuity, the larger your payments will be, all other factors being equal.

If you own a variable annuity and choose any payout option other than a stream of guaranteed fixed payments, the amount of your payments will be determined by the performance of the subaccounts underlying the annuity.

You may remember that the annuitant provides the “measuring life” used to determine your payment amounts. Among other things, gender differences (women generally live longer than men) and individual life expectancies are taken into account to arrive at a payment amount. All other factors remaining constant, the younger the annuitant, the smaller the annuity payments.

The payout option you choose will also affect the amount of your annuitization payments. Generally, all other factors being equal, the longer the payout option will provide payments, the smaller each payment will be. Let’s take a look now at some of the payout options that may be available to you.

# Annuity Payout Options

- Payments for life
- Payments for a specified period
- Payments for life with term certain
- Refund life
- Joint and survivor life
- For variable annuities, the amounts of your payments may vary with the performance of your underlying investments

You may be offered a variety of payout options if you annuitize. When you select a payout option, you should bear in mind that your choice is often irreversible, unless your contract provides otherwise, so think carefully about the option that works best for you.

You can elect to receive payments for your lifetime. With this option, payments end at your death. There generally is nothing paid to your beneficiary.

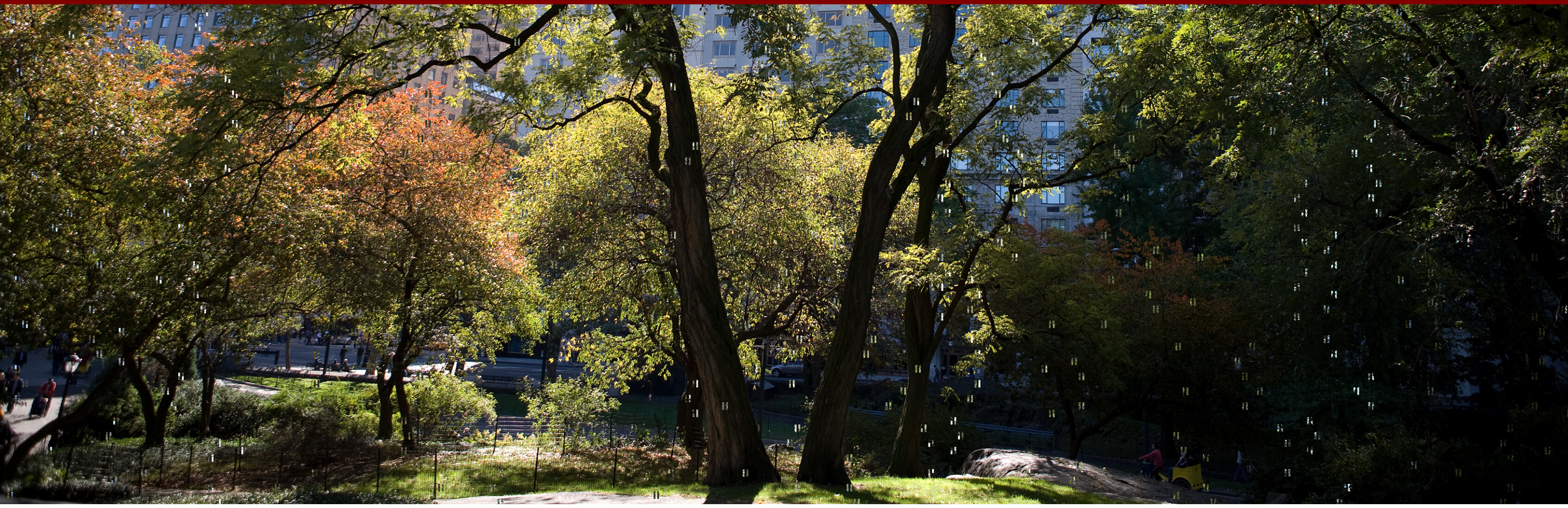
Or, you can choose to receive payments for a specified period of time. If you die before the end of the period, your named beneficiary will receive the remaining payments. If you outlive the specified period, however, neither you nor your beneficiary will receive any payments once the period has ended.

You can combine the first two options and have payments made for the rest of your life, or a guaranteed period of time, whichever is longer. With this option, if you die before the time period has elapsed, your beneficiary will receive the remaining payments.

The refund life option provides you with payments for life, but if you die before you've received the total balance of the annuity, the remaining balance will be paid to your named beneficiary, either in a lump sum or in installments.

The joint and survivor life option provides two persons--first one and then the second--with income. When the first person dies, the second person continues to receive the payments (or some portion of them) for life, or for a specified time period.

It's important to remember that, while both fixed and variable annuities offer guaranteed fixed payment options, variable annuities also offer payouts that will fluctuate with the performance of your underlying subaccount investments. Should your selections perform well, your payments may increase. However, if your investments perform poorly, this may be reflected in smaller payments, and you could lose money. Now, let's look at how withdrawals and annuitization payments are taxed.



- Income tax imposed at ordinary income tax rates on earnings portion of withdrawals or payouts
- Withdrawals are considered to be made from earnings first; annuitization payments are part return of principal and part earnings
- With certain exceptions, an additional 10% premature distribution tax imposed on distributions of earnings made prior to age 59½

The federal income tax consequences are essentially the same for fixed and variable annuity withdrawals. The portion of any withdrawal or payout that's considered earnings will be taxed as ordinary income.

Generally, withdrawals are considered to be coming from the earnings portion of the annuity first, then from the principal. If you annuitize, however, each payment is considered to be partially a return of your principal investment and partially a distribution of earnings on that investment.

With a few exceptions, in addition to the ordinary income tax on the earnings portion of a withdrawal, a 10% premature distribution tax will be imposed on earnings you take from your annuity prior to the date you reach 59½ years of age. Gifting an annuity may also have tax consequences for the annuity owner, and, generally speaking, the value of an annuity contract is includable in a deceased owner's gross estate. Your state may also impose taxes on annuities. Because taxation of annuities can be complicated, you should consult your advisor with any tax questions you may have. Now, let's look at some options that can be added to certain annuities.

# Common Annuity Riders

**Fixed Annuities**

Living needs/long-term care

Disability/unemployment

Terminal illness

**Variable Annuities**

Guaranteed withdrawal benefit

Guaranteed accumulation benefit

Guaranteed minimum income benefit

**Immediate Annuities**

Commuted payout benefit

Cost-of-living benefit

Cash/installment refund

Guarantees are subject to the claims-paying ability and financial strength of the annuity issuer.

Aside from the common features of each type of annuity we've discussed thus far, annuity issuers frequently offer additional options in the form of riders. Most riders are available at a cost--from as little as .1% to 1% or more of the annuity's value each year. Riders and their availability differ from one issuer to the next, and depend on the type of annuity purchased.

Common fixed annuity riders waive some or all applicable surrender charges allowing more access to your annuity's cash value for such needs as long-term care, disability, unemployment, or if you suffer from a terminal or life threatening illness.

Common variable annuity riders offer guarantees not provided by the basic policy. These guarantees include restoration of your premium if the annuity falls below that amount due to poor investment performance. You may be able to access this amount either through periodic withdrawals (the guaranteed withdrawal benefit rider) or in a lump sum after a stated number of years (the guaranteed accumulation benefit rider), or you can receive a guaranteed income for a fixed period of time or for your life without annuitization (guaranteed lifetime withdrawal benefit).

Immediate annuity riders offer features including access to the balance of the immediate annuity in a lump sum (commuted payout rider), increasing payments each year to offset the effects of inflation (cost-of-living rider), or the assurance that if you don't live long enough to collect payments at least equal to your premium, then the balance will be paid to your beneficiary in either a lump sum (cash refund rider) or in a series of payments (installment refund rider).

# Important Information about Variable Annuities

- Variable annuities are long-term investments suitable for retirement funding, and are subject to market fluctuations and investment risk, including the possibility of loss of principal. Variable annuities contain fees and charges including, but not limited to, mortality and expense risk charges, sales and surrender (early withdrawal) charges, administrative fees, and charges for optional benefits and riders.

- Variable annuities are sold by prospectus. You should consider the investment objectives, risk, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the variable annuity, can be obtained from the insurance company issuing the variable annuity, or from your financial professional. You should read the prospectus carefully before you invest.

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