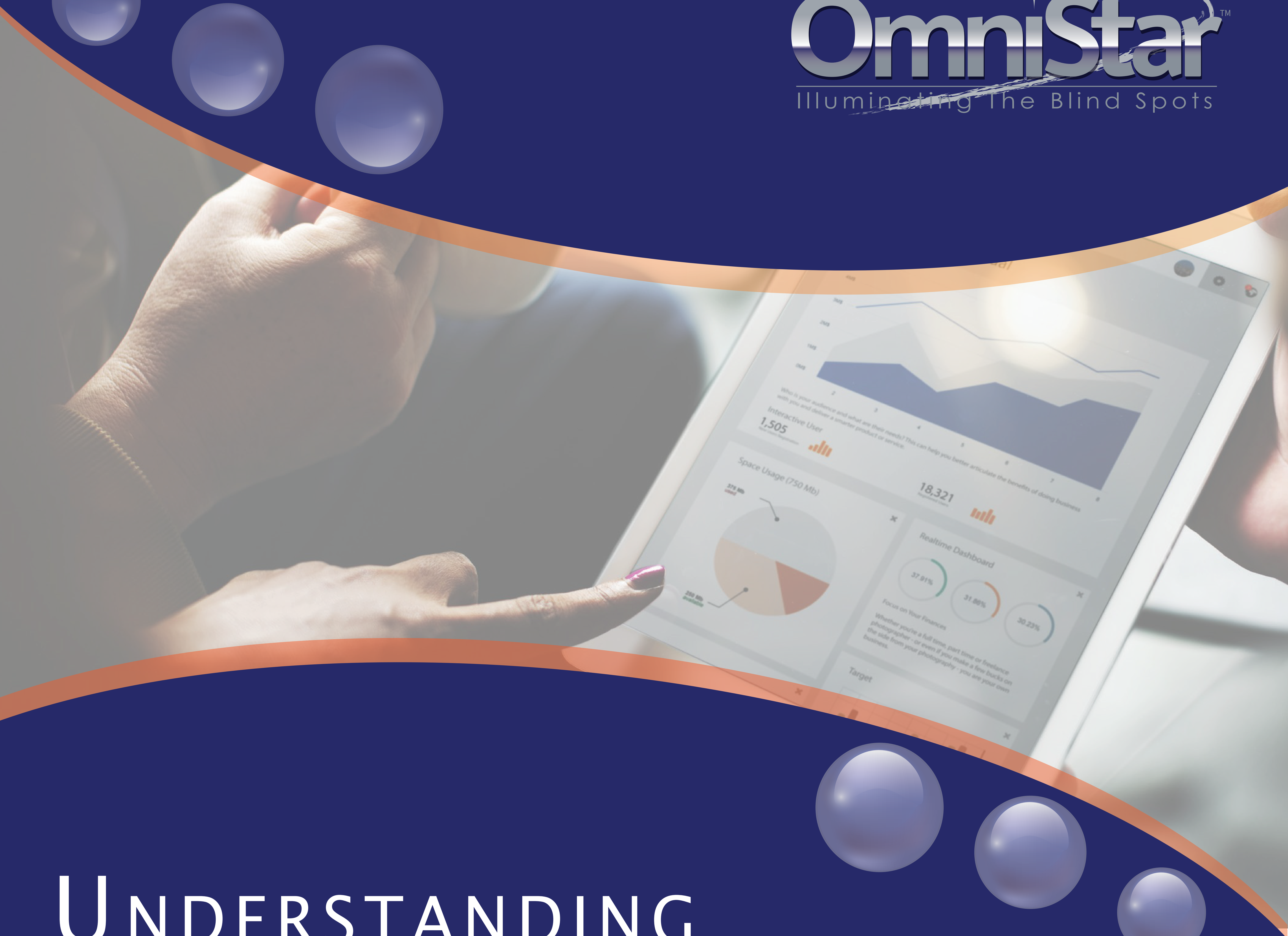

UNDERSTANDING ANNUITIES

BLIND SPOTS ILLUMINATED

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Annuities Explained

In its most basic form, an annuity is a contract between you and a life insurance company which promises a stream of income for your lifetime in exchange for a lump sum premium or series of premiums to the insurer. The income is made in payments at the beginning of the contract (an immediate annuity) or in the future (a deferred annuity). The deferred annuity provides the benefit of tax-deferred growth.

Annuities are popular among retirees but they are sold to a wide variety of consumers. Chances are, you have heard many opinions about these contracts - positive and negative. Annuities are not a "one size fits all" product. While they offer the advantage of Tax-Deferred growth, annuities are complicated instruments. Investors should be careful to avoid "high pressure" sales tactics and fully understand the terms and conditions of each contract.

Before you agree to place your money in an annuity, take care to fully understand how annuities work and the affects they can have on your financial needs.

Annuity contracts in the U.S. are defined by the Internal Revenue Code. They have features of both life insurance and investment products, but are only allowed to be sold by insurance companies. And because insurance companies are regulated by individual states, some contracts, features and options may not be available or may not be the same in all states.

Basics-Two Types

Fixed annuities, provide a fixed rate of return provided by the insurance company, for a specified period. The fixed rate is determined by the company based upon its projection of current investment market conditions. Most contracts include a guaranteed minimum rate of return.

Included in the definition of fixed annuities is the ever popular "Index Annuity" which are linked to an external equity reference or an equity index. Such as the S&P 500 or Dow Jones Industrial Average. Sales of equity indexed annuities (EIAs) have grown considerably in recent years. One of the most important features of an EIA is the method used to calculate the gain in the index to which the annuity is linked.

Variable annuities place the risks and rewards of investment performance upon the annuity holder. The annuity holder determines how his or her account funds are to be invested, by selecting among a group of portfolio types offered by the insurance company (so-called "separate accounts"). Choices may include money market funds, stocks, bonds, and may be further refined by such factors as growth, value, income, international, etc. The ultimate value of the holder's account, and the size and/or duration of future periodic annuity benefits will be dependent upon the relative performance of the holder's investment choices. This in turn will be affected by the relative success of the specific investments within the separate accounts selected by the annuity holder. Thus, the purchaser of a variable annuity contract would be well advised to investigate the investment performance history of the separate accounts, in much the same way that performance history would be evaluated before investing in a mutual fund.

COMMON ELEMENT
Immediate and deferred income options

Income and type of Return

Immediate annuity - guarantees payments, which start right away, for a specified time period or for a lifetime. This contract is generally used as a way to generate income payments. These periodic payments may be either level or increasing and designated for a fixed term or until death, in one of several combinations.

Characteristic of an immediate annuity is its ability to distribute savings with tax-deferred growth. The U.S. tax code dictates every annuity payment is a combination of return of principal (is not taxed) and payout of income (is taxed at normal income rates, not capital-gain rates). This has the benefit of stretching the tax payments over a longer time period. A common use for an immediate annuity is converting accumulated savings into an income stream during retirement.

A deferred annuity - grows tax deferred, until the contract is annuitized (put into a payment stream) or surrendered (paid out as a lump sum). A deferred annuity contract is chiefly a vehicle for accumulating savings and eventually distributing the value — either as a payment stream or as a one-time, lump-sum payment. All varieties of deferred annuities have one thing in common: the increase in account value is not taxed until those gains are withdrawn (or paid out). This is also known as tax-deferred growth. The tax-deferred status of deferred annuities has led to their popularity.

Fixed-Rate Annuity - A fixed annuity guarantees to pay a specified interest rate based on the current rate environment. The initial rate is guaranteed for one or more years and subsequent renewal rates are guaranteed to stay above a specified minimum rate. Because it provides several guarantees, a fixed annuity is viewed as a conservative financial product.

Index-Rate Annuity

An index annuity (sometimes referred to as an "equity-indexed annuity") is a special type of fixed annuity in which the interest rate is determined in part by reference to an investment-based index, such as a Standard & Poor's index or a NASDAQ index. As interest is credited, the earnings are locked in to the account value and the account will not participate in any losses.

Ostensibly, annuities are positioned as simple, easy to understand investments. Annuities are insurance company contracts designed to pay periodic payments during the lifetime of the annuity owner or annuitant. Because they are insurance contracts, annuities are given special tax treatment known as tax-deferral.

At their core, money (premiums) is paid to the insurance company, the insurance company invests the money, and eventually begins paying a stream of periodic benefits (which sometimes continue after the death of the annuitant or may terminate with a lump sum payment upon death).

Type of Tax-Status
Qualified or Non-Qualified

Qualified - this status, refers to any savings program that provides for pretax savings. For example, IRAs and employer-sponsored savings plans like 401(k)s, Simple Plans, and TSAs. These plans receive special IRS tax treatment, including pretax contributions, tax deductible contributions and deferral of tax on growth.

Non-Qualified - this status means all contributions are made with after-tax dollars and receive no special treatment from the IRS. All growth, however, is shielded from tax until and election is made to distribute funds. All growth is taxed as ordinary income.

BEYOND THE BASICS
NOT ALL ANNUITIES ARE THE SAME

Fixed Annuities generally provide a guaranteed rate of return for a pre-defined period which varies depending on the Insurance Company which issues the policy. However, most Insurance Companies adjust the fixed rate of return at on the contract anniversary or at pre-determined intervals. Fixed annuities are popular among retirees and those with a lower tolerance for risk and guaranteed income payments. Often compared to Certificates of Deposit (CD's), fixed annuities provide similar rates of return with the added benefit of tax-deferral. Unlike bank CD's, surrender charges can make it difficult to access more than 10% of the annuities value and all growth is distributed as ordinary income.

Variable Annuities have gained in popularity among brokers as an alternative to traditional investing. These contracts provide the investor with a limited number of sub-accounts (similar to mutual funds) which allow premiums to be invested in stocks, bonds, cash and other assets classes. Variable annuities are used for general investing and qualified retirement plans. Variable annuities tend to have above average costs compared to traditional investment programs - higher fees can greatly effects total return.

Equity-Index Annuities are among the most popular in today's marketplace. It combines the features of a fixed annuity and variable annuity, but the equity-index annuity is not subject to investment losses. Equity index annuities are unique in that investors have return potential based on popular market benchmarks such as the S&P 500 and Dow Jones Industrial Average.

The Index Annuity is widely marketed as an alternative to traditional investing; they are sold to all investor types. Earnings are credited using a number of complex formulas which make it difficult for untrained investors to understand. The most common sales pitch: "this contract allows you to invest in the stock market without any downside risk." In the case of the index annuity, if it sounds to good to be true.....

Irrevocable consequences - For example, once you annuitize (create income for life or a period of time), it usually becomes irrevocable. You often give up the ability to get your lump sum back or even pass it to "beneficiaries".

Delayed Access - Once you purchase an annuity, funds are subject to early withdrawal excise taxes of 10% excise tax until age 59 1/2.

Withdrawal Options - On many contracts, annual withdrawals of up to 10% of the previous contract year's annuity value are available without a surrender charge. This is often referred to as a "10% free out".

Taxes - Withdrawals from non-qualified annuities are treated as ordinary income rather than more favorable long-term capital gains treatment. Depending on your tax situation, income rates could be higher than the current capital gains rate. Death benefits may also be income taxable.

Surrender charges – Limited access to your money is common with most annuities. Until age 59 ½, you are limited from making withdrawals without a 10% excise tax in addition to ordinary income tax on gains. However, surrender charges (usually 5 to 12 years) add another layer of distribution expense. These fees can be as high as 22% in year one. Surrender charges generally decline each year.

Commissions – Most annuities are commission-based products. With commissions ranging from 2% to 7% (and sometimes more), agents reap large rewards for selling annuities. At the high end of the scale, that's $7,000 in commissions for every $100,000 invested! As an investor your should be aware of this potential conflict of interest.

Annual fees, administrative charges, mortality expenses, and other charges – Annuities can have many layers of fees which impede investment performance.

REASONS TO CONSIDER AN ANNUITY

Annuities sales have been growing significantly for several years. These investment vehicles provide many features and benefits. However, investors don't always understand the trade-off's .

Annuities are not all bad when it comes to investing and financial planning. In fact, there are many good reasons to consider an annuity.

Tax deferral for your investment gains - Just like your 401k or IRA, your contributions and earnings can grow tax-deferred until you withdraw funds. If this is in a non-qualified account (non IRA or retirement), you do not have to make mandatory withdrawals at age 70 ½.

Income for life - Sometimes referred to as a "private pension", periodic payments can compliment other retirement income sources. This reliable stream of income can last the remainder of your life.

Annuitization - you may assign the entire account / contract value to a financial institution, and in return, you receive income for life.

Guaranteed Minimum Withdrawal/Income - Riders can be purchased to make an annuity more attractive. For example, you can ask for a minimum withdrawal benefit if you do not want to annuitize and assign the contract to the financial institution.

Investment Choices and Flexibility - Variable annuities have sub-accounts which looks similar to mutual funds. Variable contracts allow for changing investment direction or allocations with little or no costs.

Death Benefit – Annuities provide a standard death benefit; premiums paid minus withdrawals. Some contracts provide increasing death benefits for additional costs.

In It for the Long(er) Haul
Annuities are not typically suited to realizing short-term financial goals because they often contain prohibitive surrender charges for early withdrawals. While these fees reduce over time, the reduction is gradual. Fees can range from 3 to 10 percent. Also note that surrender periods can reach 10 years, so make sure you understand the length of time during which you won't be able to reclaim the full amount of your initial annuity purchase.

Yes, There are Fees
Fees vary, but as annuities offer more benefits than a typical investment product, their associated fees can be higher than other products. Be sure to check and compare fees for competing products, and be clear what you are paying for.

Always Talk to an Advisor First
Of course, there is much more to annuities than the information presented in this brief overview. Before investing, be sure to talk with an advisor. By examining your options within the context of your overall financial portfolio, your advisor can help ensure that you are investing in the vehicle that best meets your needs.

CONSIDERING ANNUITIES?

CONTACT US TODAY BEFORE YOU MAKE AN IRREVOCABLE DECISION THAT MAY NOT BE A FIT FOR YOUR PORTFOLIO.

Annuities and Taxes

First, tax planning can provide many ways to manage what must be paid to Uncle Sam. This planning can be complicated and should be left to a CPA or wealth management firm that provides this expertise. This should not be left to the insurance agent selling the annuity.

Buying or cashing out an annuity may change your taxes. For example, if you sell stocks or bonds so you can buy an annuity, you may owe extra taxes. Having a conversation with your CPA or wealth advisor can help you avoid this potentially irrevocable transaction.

A primary reason people buy deferred annuities is to delay taxes. You do not have to pay taxes until you get income payments.

To get the tax benefit, you should let the deferred annuity grow as a long-term investment.

If you take out money before you reach age 59½, you pay a tax penalty (unless you become disabled or switch your money to another annuity).

The government does not set an age when you need to start taking income payments from an annuity outside of an IRA or 401(k) plan. However, your annuity contract may specify an age.

It usually does not make sense to put your annuity into an IRA, because the annuity already gives you tax deferral.

When you start receiving income payments, you have to pay taxes. Income payments are taxed as regular income, not as capital gains.

Each income payment may include principal and interest. You pay taxes on the whole income payment if you bought the annuity using pretax dollars. You only pay taxes on the interest if you bought the annuity using after-tax dollars.

Replacing an annuity:
You can move your money from one annuity to another without paying taxes. An agent may urge you to replace your annuity. Be careful. The agent gets a commission and you may pay high fees and penalties.

Annuities and Estate Planning
Estate planning helps you make sure your wishes will be followed when you die or can no longer manage your affairs.

Talk to an experienced estate-planning attorney. If your estate-planning documents are not properly prepared and completed, they may not hold up in court. This can cause lasting damage to you and your family.

An annuity can be part of an estate.
However, before you buy an annuity you should discuss it with your attorney and make sure it fits into your overall plan.

You can choose a beneficiary.
A beneficiary, also called a survivor, can get income payments after you die. This person is usually your spouse.

Are Annuities Right For You

Annuities have been around for decades, yet they have earned a stigma of being overpriced, complicated and difficult to exit. In fact, many of these things are true, but it's important for investors to understand annuities are a tool best used to transfer risk. This means if we try to use them for something in which they were never intended, chances are we will likely be disappointed. For example, growing your assets using a variable annuity - the cost of variable annuities can exceed 4% annually. Not only is this extreme, it makes variable annuities incomparable to non-annuity investments, and fixed index annuities should not be compared to growth securities in the first place.

Used correctly, however, annuities can fill a void and work really well at helping investors remove risk from their total investment strategy. Many investors have a propensity of letting their emotions drive their investment decisions. When times are good, being in the market is rewarding and feels good. In contrast, when times are bad they panic and sell everything (essentially locking in losses). Annuities cannot eliminate this behavior, but using them as a part of your investment strategy could provide income for 5 or 10 years, allowing the investor to be less concerned about short term volatility in other areas of the portfolio.

Regardless of investment strategies, creating predictable outcomes is best achieved through the use of a well constructed financial plan. Particularly one that includes growth phases and distribution phases, charitable goals, legacy planning and all elements associated with wealth management. Done correctly, investors can appreciate different approaches to reach their goals and ultimately, select a plan that fits their intended outcome. Working with a firm that places planning ahead of product is the first step to illuminating blind spots and avoiding the mistakes of buying products that may or may not fit your situation.

How do you find the right team to help you develop the right plan? First, developing a comprehensive wealth plan takes time and expertise. This kind of planning should NOT be done by someone who makes a living selling annuities. Instead, a firm that is fee based might be a good place to start. Why? You can be assured that since their compensation doesn't depend on your willingness to purchase a product, biases are eliminated. They can provide actionable strategies that work, regardless of the necessary products or services to implement the recommendations.

Financial abuse of seniors is a growing problem. Many seniors have assets because they have worked all their lives, paid off their homes, and saved for retirement.

Financial abuse can drain seniors of life savings, leaving them penniless when they need health care or long-term care. Illnesses such as dementia and Alzheimers can make it harder to recognize scams and seek help.

Agents can make high commissions on annuities.
Most insurance agents and brokers obey the laws. But some are dishonest. They may attempt to persuade you to:

Buy an annuity that is not right for you.

Replace your annuity—they get a commission and you pay extra fees.

Apply for a reverse mortgage in order to finance an annuity.

Annuities may or may not be a good choice for investors. However, if used correctly, they can potentially lower your risk (and return). Knowing how this fits your situation is best seen through solid planning.

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Illuminating The Blind Spots

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