AN INTRODUCTION TO ANNUITIES

Introduction

Let’s assume that you don’t know what an annuity is. No worries. Almost everyone knows what life insurance is, so let’s start by making a comparison to life insurance.

Life insurance protects against the risk of death, or dying too soon; if the insured person(s) die, the insurance company pays out a sum of money to one or more designated beneficiaries.

An annuity is sometimes referred to as “the opposite of life insurance.” Annuities insure against the risk of life, or living too long; the insured person receives a stream of income he or she cannot outlive from the insurance company.

With an annuity, the purchaser pays a premium to the insurance company. In exchange, he or she receives a regular stream of income payments from the insurer that begin either immediately or at some time in the future. The payment stream continues until the purchaser dies — even if that occurs at age 127½!

Hold on! An annuity is one of many financial products that are available as a retirement income vehicle. You should work with a trustworthy professional when determining which of these vehicles best suits your needs and retirement goals.

In light of this trade-off, there are three questions that must be answered, when researching what type of annuity may be right for you.

What level of risk am I willing to assume with the annuity?

If interested in high minimum guaranteed interest, regardless of the lower level of interest crediting/gains, consider a Fixed Annuity.

If willing to accept a lower minimum guarantee than a fixed annuity, but looking for potentially greater interest crediting/gains, consider a Fixed Indexed Annuity.

If willing to accept no minimum guaranteed interest, and the possibility of unlimited loss in exchange for the possibility of unlimited interest crediting/gains, consider a Variable Annuity.

How soon will I need the regular stream of income payments from the annuity?

If income will be taken within the first year, consider an immediate annuity (offered in Fixed, Fixed Indexed, and Variable types).

If income will be taken at some time further in the future, consider a deferred annuity (offered in Fixed, Fixed Indexed, and Variable types).

How many premium payments will I be making into the annuity?

If only a single payment will be made into the annuity, consider a single premium immediate annuity or a single premium deferred annuity.

If making more than one payment to the annuity, consider a flexible premium deferred annuity.

Risk/Reward Trade-off:

A direct inverse relationship between possible risk and possible reward, which holds for a particular situation. To realize greater reward, one must generally accept a greater risk, and vice versa.
What is a deferred annuity?
Deferred annuities are insurance products where at least a year will elapse between when the lump sum or series of premium(s) are paid, and the annuity is transitioned into a stream of income through annuitization. Deferred annuities can be fixed, fixed indexed, or variable in nature.

What is an immediate annuity?
Immediate annuities are insurance products where a lump sum premium is paid, and the annuity is transitioned into a stream of income through annuitization within one year from the date of purchase. Immediate annuities can be fixed, indexed, or variable in nature.

Deferred Annuity vs. Immediate Annuity

Deferred Annuity
Immediate Annuity

ANNUITY RISK SPECTRUM

<table>
<thead>
<tr>
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<th>Guaranteed Interest</th>
<th>Upside Potential</th>
<th>Indexed Participation</th>
<th>Client’s Risk Tolerance</th>
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<tbody>
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<td>Fixed</td>
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<td>(Traditional)</td>
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<tr>
<td>Indexed</td>
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<td>Variable</td>
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<tr>
<td>Annuity</td>
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Indexed Annuities provide limited gain potential and are not intended to perform comparably to securities products. Fixed Indexed Annuities merely credit interest typically based on the performance of stock market, commodities, or bond index. Don’t be confused; these annuities do not allow you to invest directly in the stock market. They do, however, provide the opportunity to outpace fixed money instruments such as Certificates of Deposit (CDs) or Fixed Annuities.

If a salesperson suggests that Indexed Annuities provide unlimited gain potential, RUN! This individual either misunderstands or is misrepresenting the product.
<table>
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<tr>
<th>What is a Fixed Annuity (FA)?</th>
<th>What is a Variable Annuity (VA)?</th>
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<tr>
<td>A contract issued by an insurance company that guarantees a minimum interest rate with a stated rate of excess interest credited, which is determined by the performance of the insurer's general account. Multi-Year Guaranteed Annuities (MYGAs), a type of Fixed Annuity, guarantee a minimum interest rate for more than a one-year period; this rate is also determined by the performance of the insurer's general account. A Fixed Annuity is considered a low risk/low return annuity product.</td>
<td>The sale of an annuity has to benefit the three parties to the annuity transaction: The annuity purchaser - via fair interest rate crediting/gains The annuity salesperson - via fair compensation The annuity issuer (insurance company) - via a fair profit, i.e. a spread</td>
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<tr>
<td>What is an Fixed Indexed Annuity (FIA)?</td>
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<td>A contract issued by an insurance company that guarantees a minimum interest rate of zero, where crediting of any excess interest is determined by the performance of an external index, such as the Standard and Poor's 500® index. In addition, Indexed Annuities have a secondary guarantee that is payable in the event of death, surrender, or if the external index does not perform. This secondary guarantee is referred to as a Minimum Guaranteed Surrender Value (MGSV); it credits a rate of interest between 1% and 3% on a percentage of the premiums paid in to the annuity.</td>
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<tr>
<td>What is a Variable Annuity (VA)?</td>
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<td>A contract issued by an insurance company that has no minimum guaranteed interest rate, where crediting of any excess interest is determined by the performance of underlying investment choices that the annuity purchaser selects. A Variable Annuity is considered a high risk/high return annuity product. In your evaluation of annuities, it helps to understand the &quot;300 foot view&quot; of the annuity transaction. The sale of an annuity has to benefit the three parties to the annuity transaction: The annuity purchaser - via fair interest rate crediting/gains The annuity salesperson - via fair compensation The annuity issuer (insurance company) - via a fair profit, i.e. a spread</td>
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So, let’s consider an example, using Fixed Annuities as a point-of-reference.

The Fixed Annuity purchaser submits a payment of $100,000 to the insurance company for her 10-year annuity; the insurance company invests the annuity purchaser’s premium payment in bonds (This ensures that they will receive a guaranteed return on the monies and be able to pay the annuity purchaser a guaranteed interest rate); Assume that 10-year bonds are paying a rate of 4.00% to the insurance company; the insurance company then credits [4.00% - X] to the annuity purchaser’s 10-year fixed annuity contract [the value of X is determined by knowing what amount the insurer needs to cover their expenses (i.e. salesperson’s compensation) and the amount of profit the insurance company intends to keep].

Now, with Fixed Indexed Annuities, the example above is only modified slightly. The insurance company still invests the annuity purchaser’s premium payment in bonds but not 100% of it; the difference of less than 5% of the payment is used to purchase options (options are what give the insurance company the ability to credit interest to the annuity purchaser, based on the performance of a stock market index); the determinant in the rate that is credited to the annuity is: a) the cost of the option, and b) the stock market index’s performance.

So, we have established that there are several different types of annuities, the primary categories being Fixed and Variable. These products are very different, despite the fact that they both may be used for the same purpose.

Closing Thoughts

Now you should understand what an annuity is, who can sell them, and who regulates them. You should also understand quite clearly what an annuity is not. Fixed, Fixed Indexed, and MYG Annuities are not alternatives to Variable Annuities, stocks, bonds, or mutual funds; these products are “risk money places.” Fixed, Fixed Indexed, and MYG Annuities are more accurately classified as “safe money places” and generally viewed as an alternative to CDs or other fixed-rate savings instruments.

This whitepaper was published to give readers a very general understanding of the different types of annuities that may be available. The majority of the information in this document was provided by Source Wink http://www.looktowink.com/insurance-basics/annuities/ if you are considering purchasing an annuity, you should read the prospectus and/or contract as well as discussing your situation with a financial professional. When you contact a financial professional, you should consider requesting information, including product and fund prospectuses/contracts that contain complete details on investment objectives, risks, fees, charges, and expenses as well as other information about the investment company, which should be carefully considered. Please read the prospectuses/contracts carefully prior to purchasing. The prospectuses/contracts contain this and other information on the product and underlying portfolios.