An Income Annuity Primer

An Overview

This overview of income annuities should be regarded as just that: A high-level overview.

Income annuities can offer tremendous benefits; however they are often misunderstood simply because they're less familiar than the financial instruments that often dominate the media.

While this overivew will hopefully provide a framework for understanding, it should be remembered that they are offered in a wide variety of forms and designs by long list of insurance carriers. For this reason, it may be advisable to enlist the guidance of a qualified, independent advisor capable of screening not just the various product offerings, but the investment portfolios of the carriers making the offerings.

Naturally, any financial tool utilized should be be selected and placed as part of an overall holistic financial retirement plan. I hope you'll consider IFG as a guide in your planning process.

Brought to you by:

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Life Expectancy After Retirement

Presented by: **Jim Lorenzen, CFP®, AIF®**
The Independent Financial Group

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How Long Can You Expect to Live After Retirement?

Advances in medical science and healthier lifestyles have resulted in longer life expectancies.

Male Life Expectancy	
Current Age	Life Expectancy (in years)
60	20.64
61	19.85
62	19.06
63	18.29
64	17.54
65	16.80
66	16.08
67	15.37
68	14.68
69	13.99
70	13.32
71	12.66
72	12.01
73	11.39
74	10.78
75	10.18

Female Life Expectancy	
Current Age	Life Expectancy (in years)
60	24.08
61	23.27
62	22.47
63	21.68
64	20.90
65	20.12
66	19.36
67	18.60
68	17.86
69	17.12
70	16.40
71	15.69
72	14.99
73	14.31
74	13.64
75	12.98

Source: *2001 Commissioners' Standard Ordinary Mortality Table; based on composite data (combination of smokers, nonsmokers and smoking status unknown); age nearest birthday*

With longer life expectancies, however, comes the increased risk of outliving your retirement income!

Risk of Outliving Retirement Income

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How Long Will Your Retirement Savings Last?

If You Withdraw Both Principal and Interest, How Long Will It Take to Exhaust a $250,000 Retirement Savings Fund?

Rate of Return	Amount Withdrawn at the Beginning of Each Month:		
	$2,500	$5,000	$7,500
4%	121 monthly payments (10 years, 1 month)	54 monthly payments (4 years, 6 months)	35 monthly payments (2 years, 11 months)
6%	137 monthly payments (11 years, 5 months)	57 monthly payments (4 years, 9 months)	36 monthly payments (3 years)
8%	163 monthly payments (13 years, 7 months)	60 monthly payments (5 years)	37 monthly payments (3 years, 1 month)
10%	211 monthly payments (17 years, 7 months)	64 monthly payments (5 years, 4 months)	38 monthly payments (3 years, 2 months)

If we knew exactly how long we were going to live after retirement, this arrangement might be satisfactory. The reality, of course, is that none of us knows how long we will live after retirement. This uncertainty is what makes it difficult to avoid the risk of outliving retirement income.

Income Annuity Solution

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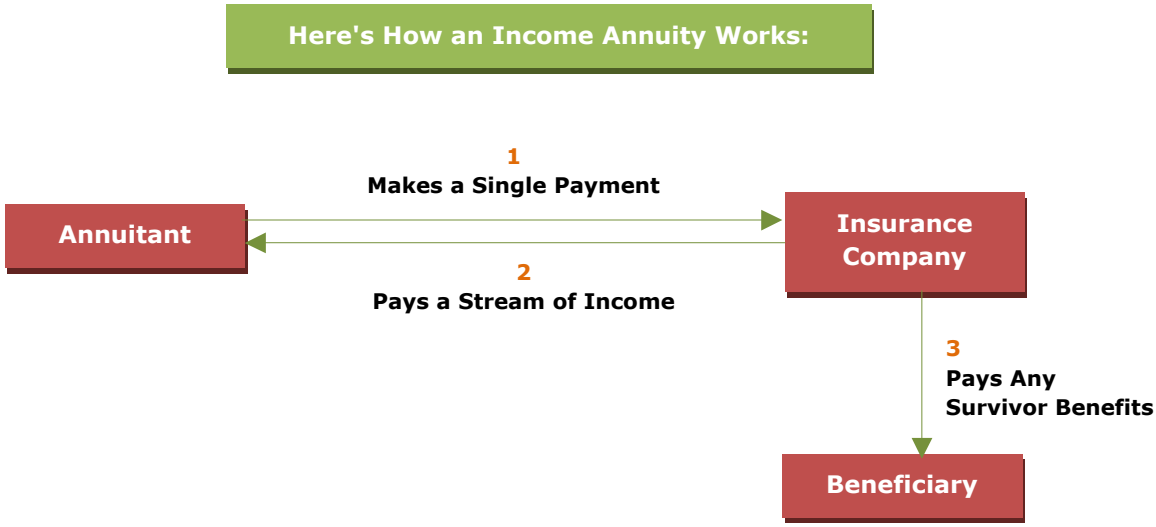
How Can an Income Annuity Protect Against the Risk of Living Too Long?

The purpose of an annuity is to protect against the financial risk of living too long...the risk of outliving retirement income...by providing an income guaranteed* for life.

In fact, an annuity is the **ONLY** financial vehicle that can systematically liquidate a sum of money in such a way that income can be guaranteed* for as long as you live!



1. The annuitant pays a single premium to an insurance company.

1. Beginning immediately or shortly after the single premium is paid, the insurance company pays the annuitant an income guaranteed* to continue for as long as the annuitant is alive, assuming the annuitant selects a life income option. There are other payout options also available.

2. The insurance company pays survivor benefits, if any, to th annuitant's death.

* Guarantee is based on the continued claims-paying ability of the issuing insurance company. Annuities are not insured or guaranteed by the FDIC or any other government agency.

Types of Income Annuities

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What Types of Income Annuities Are Available?

1. Fixed Annuities

A fixed income annuity pays a fixed dollar income at regular intervals. The amount of income is determined at the time of purchase, based on age, sex, the single premium amount and the income option selected. Once the income amount is determined, it doesn't change. **Fixed income annuities may be best suited for individuals who:**

- Prefer to rely on fixed rates of return
- Focus on preservation of assets
- Want protection from market volatility
- Prefer to delegate investment decisions and risk to the insurance company
- Understand that a fixed income may not provide a good hedge against inflation

2. Variable Annuities

The single premium for a variable income annuity less applicable charges is placed in a separate account of the insurance company, where you can invest it in one or more subaccounts. Variable annuity subaccounts consist of stocks, bonds, money market instruments and other types of investments. Income payments from the annuity will then rise and fall, depending on the investment performance of the subaccounts you selected. **Variable income annuities may be best suited for individuals who:**

- Prefer to invest in equities
- Want to make their own investment decisions
- Understand that assets can decline in value
- Are willing to assume the risk of a decrease in annuity income in exchange for the possibility of higher annuity income and a stronger hedge against inflation

3. Combination Annuities

Another alternative is to purchase a combination of fixed and variable income annuities. Fixed income payments then provide a predictable income, while variable income payments offer a hedge against inflation by taking advantage of potential growth in the stock market.

Note: Before purchasing a variable annuity contract, carefully consider the contract and the underlying funds' investment objectives, risks, charges and expenses. Both the contract prospectus and the underlying fund prospectuses contain information relating to investment objectives, risks, charges and expenses, as well as other important information. The prospectuses are available from your licensed financial representative or the insurance company. You should read them carefully before purchasing a variable annuity contract.

Income Annuity Payout Options

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What Income Annuity Payout Options Are Available?

The income from an income annuity can be structured in a variety of ways, enabling you to select the payout option that best satisfies your unique needs. The most frequently-selected annuity payout options guarantee* an income that cannot be outlived:

Life Income Option	■ Payments are made for as long as the annuitant is alive. ■ Payments cease at the annuitant's death. ■ This option produces the maximum guaranteed* lifetime income.
Life Income with Period Certain Option	■ Payments are made for as long as the annuitant is alive. ■ If the annuitant dies before a specified number of payments have been received (e.g., 120 monthly payments), the remaining payments in the period certain are made to the designated beneficiary.
Life Income with Refund Guarantee Option	■ Payments are made for as long as the annuitant is alive. ■ If the annuitant dies before payments equal to all or a specified portion of the purchase price have been received, the designated beneficiary receives the balance of the payments, up to the refund guarantee* amount.
Joint-and-Survivor Option	■ This payout option covers two lives. ■ The same payment can be received for as long as either of the two annuitants is alive or, alternatively, at the death of the first annuitant, the payment to the surviving annuitant can be structured to reduce to a specified percentage (e.g., 75%) of the payment received while both annuitants were alive. ■ A joint-and-survivor payout can also include a period certain feature. * All guarantees are based on the claims-paying ability of the issuing insurance company.
Flexibility	While these are the four basic annuity payout options most commonly selected, some income annuity contracts offer additional flexibility. See your financial advisor about contract features that may add flexibility to your use of an annuity to provide retirement income.

Income Annuity Taxation

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How Are Income Annuities Taxed?

Income Taxation:

Income tax treatment depends on whether the money used to purchase the income annuity came from **"qualified" savings**, such as IRAs or 401(k) plans, or from **"non-qualified" savings**, such as personal savings and investments, an inheritance, life insurance proceeds, sale of a business interest, etc.

Qualified Savings

- Since money in a qualified plan generally has not been previously taxed, the full amount of each annuity income payment typically will be subject to ordinary income tax as received.
- If a portion of the qualified savings used to purchase the income annuity has already been taxed, that amount is returned in equal income-tax-free amounts over the expected payment period (based on the annuitant's life expectancy).

Non-Qualified Savings

- The annuity purchase price is returned in equal income-tax-free amounts over the expected payment period (based on the annuitant's life expectancy).
- The portion of each payment in excess of the tax-free return of the purchase price is taxable in the year received.
- In summary, a portion of each annuity payment is received income tax free until the investment in the contract is recovered and the balance is taxable as received.

Estate Taxation:

- At the annuitant's death, the present value of any remaining payments due is generally included in the annuitant's estate, to the extent of the deceased annuitant's purchase price.

A professional tax advisor should be consulted for more detailed information on income annuity taxation in your situation.

Income Annuity Checklist

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Once you decide that an income annuity is right for you, there are a number of factors you should consider in evaluating the specific annuity you will purchase. These include:

Fees and Expenses

The annuity fees and expenses an insurance company charges can include:

- **Premium charges** deducted when the single premium is paid;
- An **annual maintenance fee** (e.g., $30);
- **Mortality or insurance charges** for a death benefit feature; and/or
- **Investment management fees** in a variable annuity.

Carefully evaluate fees and expenses, since they will impact the amount of annuity income you receive.

Insurance Company Ratings

Since an annuity is an insurance contract, you need to be able to count on the financial strength and claims-paying ability of the insurance company from which you purchase an income annuity. Ask for company rating information from respected sources, such as A.M. Best, Moody's or Standard & Poor's, before purchasing an income annuity. The rankings are intended to reflect the financial strength and claims-paying ability of the insurance company and are not intended to reflect the investment experience or financial strength of variable annuity accounts, which are subject to market risk.

Annuity Features

Make sure you understand the terms and limitations of the annuity contract before you purchase it, including:

- in the case of a **fixed annuity**, the annuity income amount and frequency guaranteed by the contract;
- in the case of a **variable annuity**, review the contract prospectus and the underlying fund prospectuses to understand the investment choices available, their charges, expenses and historical performance (which should not be considered a representation of future performance), any limitations on reallocating funds between different subaccounts and how annuity income payments are calculated;
- the annuity income options available;
- the right to terminate the income annuity within a specific time period and receive the value of the undistributed annuity payments;
- how any death benefit is determined.