THE LITTLE RED BOOK OF RETIREMENT

The Basics of Annuities

***EVERYTHING* you need to know to help generate guaranteed income in retirement.**

PRESENTED BY DAVE LOPEZ

The Little Red Book of Retirement

THE BASICS OF ANNUITIES

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FOREWORD

BY DAVE LOPEZ

My favorite teacher in School was Mr. A., my 7th grade shop teacher. The first day we walked into class, was like walking into Santa's workshop. Hundreds of tools hanging on the wall, machines, supplies, workbenches, and we were going to use all of them. I will never forget the lesson he gave us that first day. I still use it today.

"Right Tool for the Right Job".

That was his advice. He said many projects were ruined by using the wrong tool. Usually the builder did not take the time to learn about all the tools at his disposal and get a clear understanding of the advantages and disadvantages of each. "Only then", Mr. A said, "Are you ready to begin a project."

Over the last 10 years I have built hundreds of retirement plans and that advice is invalable when building out your retirement plan.

You see, investment strategies and investment tools are no different than the tools in Mr. A's shop. Each have advantages and disadvantages. They are neither good nor bad. The results they give will be dictated by your ability to choose the, "Right Tool for the Right Job".

This basic investment concept is exemplified clearly with Annuities. I have met those who have discarded annuities as a viable option for their plans based on misinformation, incorrect information or myths. When asked to explain their concerns or which type of annuity they were referring to, I would hear crickets.

Their challenge? They lacked the facts and, as a result, were making their decisions based on hearsay from friends or family, or a sound bite from a commercial or from the internet.

The result? They could be losing money or taking on excessive risk because they may be using inefficient tools to accomplish their goals.

The hard reality is that we get one chance to get this stuff right. There are no do-overs. And we do not want to lose money, lose time, or lose opportunity because we did not know of an investment tool that could have benefited us. Unfortunately, most of us have no formal training, education, or understanding of the intricacies of retirement planning

We don't know what we don't know.

Whether you are building a project in shop class or building out the retirement plan that you hope will allow you to live the life you have worked so hard for; you want to get the pertinent information about as many investment tools as possible. This will help give you the greatest chance for success. The more information you have the better the position you will be in to pick the investment tool that will be in your best interest.

This Little Red Book it a starting point for you to begin to obtain the knowledge you need to make informed decisions about the investment tools called Annuities. Most don't even know that there are four distinct types of annuities and each are completely different tools.

I encourage you to keep an open mind as you read through this book. You do not want to limit your success, or create more risk than necessary because you discarded an investment tool based on misinformation or myth.

It is my hope that this book helps you to a more fruitful and comfortable retirement.

Founder of ILG Financial

www.ilgfinancial.com

INTRODUCTION

Don't Run Out of Money Before You Run Out of Breath

The retirement landscape has evolved dramatically over the last several decades. Previously, people typically worked for the same company for their entire career, had a fully funded company pension, collected Social Security, retired at 65, and lived 10 years.

Today, the average worker changes jobs seven times. In addition, pensions have been replaced by 401ks and IRAs, shifting the responsibility to the individual employee to save and plan for their retirement needs. These retirement accounts are tied directly to the market, and as such, pose the benefit of gains and the risk of losses.

Further, people are looking to retire at younger ages yet are living much longer lifespans than their parents and grandparents enjoyed. Compounding this problem is the uncertainty of Social Security, a source of guaranteed income for life that may not be large enough to support our full retirement needs. By the Census Bureau's estimates, there will be 78 million Americans aged 65 and older by the year 2035.[1]

According to a study, 49% of Americans cite running out of money at their primary retirement concern. That's more than the 44% who cited declining health was their chief concern.[2] Further, the American Institute of CPAs surveyed financial planners to investigate the top retirement concerns among their clients. The result was unsettling: Over half of financial planners surveyed indicated that **outliving their savings was their clients' number one financial concern**[3].

When working with a client on their retirement planning, there are a few things that can be really beneficial to solving their biggest concern, which is "running out of money before they run out of breath."

One of those things is a healthy pension—or any pension at all. The greater predictable income the retiree has, the less pressure it puts on the rest of their assets to do all the work. Naturally, if a person has a healthy amount of income from various assets that they can count on plus

1 https://www.aarp.org/home-family/friends-family/info-2018/census-baby-boomers-fd.html

2 https://www.aarp.org/retirement/planning-for-retirement/info-2019/retirees-fear-losing-money.html

3 https://www.aicpa.org/press/pressreleases/2019/going-broke-remains-top-concern-in-retirement.html

Social Security benefits, there's less pressure on their 401ks, IRAs, and Roth IRAs[4] to comprise a large portion of their supplemental income. The greater the amount of predictable income an investor has may allow them the flexibility to leverage other investments like stocks and bonds more strategically.

Annuities have increasingly become a very important ingredient to the retirement recipe by offering retirees asset protection and predictable income, particularly when pensions are not present or minimal. Extensive research has shown that a balanced approach of an "Income Annuity," an annuity that provides a contractually guaranteed income for the lifetime of one or both spouses that they can't outlive, along with a 401k or IRA and, ideally, a Roth IRA,[5] can provide a very efficient supplement to Social Security.

Annuities can be used to achieve multiple strategic objectives. There are many different types of annuities and annuity plans, and many different companies that offer them. While annuities can be a cornerstone of your retirement plan, it's important to know how one might work best work for you. The more informed you are about your choices, the better prepared you will be to make the most prudent decision.

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4 See Disclosure 10

5 Ibid.

We believe that partnering with a financial professional who understands your needs and how an annuity could work for you, is a sensible first step in the process.

Our hope is that this book will help you gain a better understanding of annuities, how they can fit into your retirement future, and foster a deeper understanding of retirement income planning altogether. It should provide you with a high-level overview of what an annuity is, your options, how annuities work, their benefits, downfalls, and things to keep in mind before adding an annuity as a component to your comprehensive financial plan.

CHAPTER ONE

What Is An Annuity?

An annuity is an insurance-based financial product designed to accept funds by an individual, which will be paid back to that individual at a later date in a stream of payments or a lump sum. It is the "promise" by the insurance company to take in payments over a period of time or in a lump sum, until a certain event occurs (i.e.: an amount of time, age, death), and pay it back at a certain rate all at once or for a predetermined period of time, including "for life."

All insurance products are designed to alleviate risks that consumers face. Let's use the concept of life insurance as a comparison. Life insurance requires that the policy owner pay a monthly premium to the insurance company to insure against the risk of dying too soon. When you pass, your loved ones receive the insurance money.

An annuity is the exact opposite of a life insurance policy. Annuities are financial products that insure against the risk of outliving your money by disbursing payments to you while you're still alive. They may seem complicated, but the general concept is quite simple: you place money with an insurance company in exchange for an income stream for a specified period of time (or for life) that grows at either a fixed rate or changing rate depending on the type of annuity.

The participants in an annuity purchase are the insurance company, the owner and/or the annuitant, and the beneficiary. The insurance company is responsible for backing the guarantees of the annuity like the interest rate or payments to be made. The contract owner and annuitant are often the same person, but the owner is the purchaser of the annuity who makes the decisions of who the proceeds go to. The annuitant is the person whose life expectancy is used to calculate the payments that will be received. Finally, the beneficiary is the person who will receive an annuity's death benefit if you were to pass before your income payments began. In most instances, you may have already begun receiving income and your beneficiary may still be eligible to receive a death benefit depending on your contract.

Payments can be made into an annuity in either a lump sum - with no annual limit to the amount that can be contributed with contributions made after-tax - or in periodic installments for a specified amount of time. With your other retirement accounts (like a 401k, IRA, or Roth IRA), there are annual contribution limits depending on factors like your age and income. The money in an annuity is invested by the financial institution and grows until the date that the payments are to be distributed to the annuity holder. These distributions can be disbursed for either a set period of time, all at once, or until the annuity holder or his/her spouse passes. All guarantees, like interest or market protection, are backed by the financial strength and claims paying ability of the issuing insurance company. Things to look out for when deciding on which insurance company to purchase an annuity from include:

- A high rating by independent rating agencies like Standard & Poor's or Moody's.
- High solvency ratios.
- Risk management capabilities in the sense that they've made it through potentially extreme market events.

- A management philosophy that relates to stability, reliability, and long-term performance.

Tax Treatment Comparison				
	Annuities	**IRA**	**Life Insurance**	**CDs/Mutual Funds**
Premiums	Non-deductible	May be deuctible	Premiums	Non-deductible
Growth	Tax-deferred	Tax-deferred	Tax-deferred	Reported annually on tax return
Distribu-tions	Partially taxable	Fully taxable if contributions are deducted	Non-taxable to beneficiaries	Partially taxable

One significant benefit of annuities is the fact that you pay no taxes on any gains until money is withdrawn. For someone looking to (or needing to) provide a supplement to their other retirement resources, a tax-deferred annuity can be a very tax-efficient enhancement to their retirement needs, especially when you consider the contribution limits with other retirement accounts like an IRA, 401k, or Roth IRA.

If you pay for an annuity with after-tax dollars, your basis (dollars you put in) will be returned to you tax-free. The gains will then be taxed as ordinary income. There are many ways you can distribute this so that the taxation can be favorable for your individual situation. *Please consult with a tax professional and financial advisor in conjunction to understand how to best take your income and how your distributions will be taxed.*

Example: See Disclosure 14 *Suppose you inherit $100,000 in your mid 50s. Instead of putting the money into a CD, Money Market Account, or Non-Qualified Mutual Funds, you place this money into an annuity. If you assume a return of 4%, this sum will have grown to about $180,000 in 15 years. If the account was liquidated in one year, it would trigger an income tax on the $80,000 of gain in that year. Alternatively, if the annuity were paid out over a 20-year period, only 44% of each check received would be subject to tax since 56% of the $180,000 (the $100,000 contributed) was already taxed before being invested (or if an heir inherited the annuity, it would come to the individual tax-free). Strategies like these can help to lower the overall taxes paid on all of the other resources, such as an IRA and Social Security, for example.*

Withdrawals & Surrender Charges: See Disclosure 14
Most annuities allow you to withdraw a certain percentage of your premiums, typically between 5-10% per year, without a penalty. This amount may be subject to taxes,

a 10% federal penalty if taken before 59½, and could reduce a death benefit or income stream you receive later on. There is also a surrender period with surrender charges associated with making an early withdrawal that is above the allowed withdrawal rate known as the "free withdrawal". This period usually decreases over a five to ten-year period, and the charge is typically a percentage of what you withdrew.

> **Quick Client Case Study**: See Disclosure 14 *Josie purchases an annuity contract for $20,000 with a schedule of surrender charges that started at 8% per year and declined by one percent each year. She's allowed to withdraw 10% of her contract's value each year without surrender charges. So, if she wanted to withdraw $10,000 in the first year, she could withdraw $2,000 without surrender charges, but she'd pay a $640 surrender charge on the other $8,000.*

Overview: Annuities are designed to help you meet long-term needs for your retirement income. Over time, they've evolved from this premise to their present state with countless options. Depending on the type of annuity, some provide guarantees against the loss of your principal while others may offer a death benefit for beneficiaries. Additionally, some retirees use annuities to pay for long-term care costs. Overall, annuities aim to help you accumulate assets for retirement, in certain types protect the principal (what you deposited), or have the option to generate an income plan that lasts for life.

CHAPTER TWO

Types of Annuities

In this section, we're going to start at the broadest level of annuity options and continue to get more specific. Don't worry, we won't get into the intricate details, just enough to give you a better understanding of your choices for creating a lifelong income stream.

Level 1: Do you want retirement income now or later?

Looking at annuities from a 20,000-foot view, most can either be categorized as immediate or deferred. Immediate annuities are just as they sound and are designed to disburse payments shortly after your premium is applied to your annuity. Immediate annuities must be paid for with one single lump-sum payment. These may be appropriate for individuals close to retirement age because you can either receive annuity payments for a specified period of time or for as long as you (or your spouse) live.

> **Example:** See Disclosure 14 *Julie's husband has just passed. After receiving life insurance, she would rather that a portion of that money be distributed to her as payments over the course of her life. She would then purchase an immediate annuity with one single investment to begin receiving payments for the rest of her life.*

Deferred annuities, on the other hand, get paid into during what's known as the accumulation phase, like how you'd pay premiums on any other insurance contract. You may pay either with a lump sum or payments for a specified amount of time. The payout is then delayed until you elect to receive income at a later date. These annuities are often purchased by those who have multiple years before retirement or retirees who want to have this portion of their retirement income stream start later into their retirement, usually 7-10 years down the road.

Annuity Phases:

An annuity contract has two distinct phases: an accumulation (growth) phase and annuitization phase, also known as your systematic withdrawal or income phase.

Accumulation:

In simple terms, the accumulation period is when you're paying into an annuity. For immediate annuities, there is no accumulation period since they are paid for with one single payment. During the accumulation phase, your annuity is earning interest based on the crediting method specified in your annuity contract. Crediting options vary on their risk and the potential interest you could accrue. Unlike CDs or mutual funds, your annuity will grow throughout this phase and you will not be taxed until you start to begin receiving payments or withdraw. In other words, growth is tax-deferred.

If for some reason you decide to stop making payments into your deferred annuity, nonforfeiture provisions state that you will not lose the value that you've accumulated up to that point. Often times, the amount you have in your account will become a paid-up contract and you'd begin receiving annuity payments based on this amount either immediately or later on. You may also surrender the contract for its cash value during the accumulation period, but not after payments begin.

Surrender charges may apply depending on the year you are in and the surrender charge schedule associated with your annuity. That's why the annuitization or systematic withdrawal decision is extremely important.

Annuitization:

In the annuitization phase or income phase, you begin receiving your income payments from your annuity. These distributions are subject to ordinary income tax on the interest and any portion not paid for with after-tax dollars. Like many other retirement investments, there are penalties if your annuity payments are withdrawn earlier than age 59 ½. With annuities, the older you are when you annuitize a sum of money, the greater the monthly check you'll receive since there are fewer years of income expected to be paid to you by the insurance company.

Level 2: Payout Options: How do you want to receive your income?

The annuitization phase either lasts as long as you live or for a certain period of time. This brings us to your options for receiving income:

- **Life (Income Guaranteed for Life—Most Common*):**

  Most often, those who purchase an annuity are looking for a guaranteed income stream for life. Life annuities can be broken down even further to include various insurance-like features, such as leaving the income stream to a beneficiary. The more features you add, the more expensive the annuity becomes. Features can be added to the annuity for a fee.

- **Straight Life:**

These are the cheapest of the life annuities because they simply provide the annuitant (and only the annuitant) with an income stream for the rest of his/her life. They provide no other added benefits if you were to die prematurely, other than a potential return of premium to your beneficiaries if you pass before your payments ever begin. In order for the beneficiary to receive any options upon death of the owner in this type of annuity, the said owner would have to choose the option for an installment or cash refund. If, for example, you purchased a $100,000 annuity, the straight-life option would provide you with the greatest monthly payout compared to the annuities to follow since it only is set to cover your life and offers no insurance-like features. Once payments begin, if you pass during the income phase, no money will be available to a beneficiary as straight life annuities do not allow annuitants to designate a beneficiary.

> **Quick Case Study**: See Disclosure 14 *Joe purchased a straight life annuity to begin payments at age 65. If Joe lives past 65, he will continue to receive income payments for as long as he lives. If he passes at age 60, the premiums he has paid up until this point will be returned to his beneficiaries. If, however, he passes at 66, the payments cease and his beneficiaries receive nothing.*

- **Joint-and-Survivor**:

If you would like to continue the income stream after the first annuitant passes, a joint and survivor annuity is designed to provide a solution. A retiree and their spouse would be most appropriate for this sort of annuity. The monthly payout that accompanies a joint and survivor annuity is the lowest of the three options described given the extra insurance-like feature of covering both lives until the last passes. With joint and survivor annuities, you can purchase a policy where the payout remains at the full 100% payout after the first annuitant passes, or choose another percentage of the initial annuity amount.

> **Quick Case Study**: See Disclosure 14 *Paul and Carly have a joint and survivor annuity. While both are alive, they receive the full annuity payment of $500 per month. When Paul passes, Carly continues to receive payments, but her income stream is down to $250 (50% of the initial payment).*

- **Period Certain Annuities (Income for a Guaranteed Period of Time):**

Period or term-certain annuities pay an annuitant for a specified period of time with no additional insurance benefits. With little to no risk assumed by the financial institution, these annuities are usually less expensive and are often preferred by those who simply want a guaranteed stream of income for a specified period of time. If you were to pass prior to the end of the period you specified, the remaining balance would go to a beneficiary. Payments to the beneficiary would only pay for the remainder of the specified amount of time selected for the income stream.

Quick Case Study: See Disclosure 14 *Suzy purchases a 15-year-period certain annuity to begin payments at age 65. If Suzy were to die at age 75, the payments would go to her husband for the remaining five years. If she lives past 80 however, her payments will cease.*

One example where a period-certain annuity is particularly appropriate is when someone has a healthy pension and decides to retire before the traditional retirement age. This type of person can rely on Social Security and a pension for the rest of their lives, and can supplement with income for a fixed period of time with an annuity rather than spending through their other assets too soon.

Detailed Client Case Study: See Disclosure 14 *Joan and Greg are a couple in their early 60s who have both retired. Joan has a pension and 403b and Greg has an IRA. Both intend to delay Social Security to age 67 or 70 if they're still healthy. They create their financial plan with the assumption that they'll live to age 90 or later in order to maximize their needed income for the long term.*

Joan and Greg have decided to spend down their 403b/IRA assets aggressively over the next 10 *years so that they can maximize their travels, roaming from RV park to RV park throughout the winter months and returning to their cottage on a lake in the woods for their summers.*

They've also decided to annuitize a segment of these retirement accounts into a 10-year fixed income annuity. This plan will guarantee them "mailbox money" over the next 10 years in an amount they can count on, as the payments are guaranteed by the insurance company. Their intent is to maximize this stream of income by spending principal and interest such that this pile is spent in those ten years instead of just taking whatever their interest or earnings rate is and trying to preserve the principal.

You may also add a period certain option onto a lifetime income annuity in which you'd have monthly benefits paid for a period of time, even if you or a joint owner or beneficiary were to pass too soon. In this way, you'll continue to receive income for life, but your beneficiaries will receive income for a specified period of time if you pass in a particular time frame.

- **Riders:**

Beyond just providing income for life, some may use annuities for their added features. For a fee, riders may be added to annuities. Here are some of the most common riders found in annuity contracts:

1. **Long-Term Care Riders**: *These are most popular in fixed deferred annuities and are intended to help with long-term care costs (in home or nursing home) by adding income to help cover the added costs if a long-term care event does occur. They may allow you to double your monthly income payout, have greater access to the accumulation value of your annuity without penalty, or a combination of the two.*
2. **Cost of Living Riders**: *These are common with immediate annuities. They help you to hedge against inflation by raising the monthly income by a particular percentage each year.*
3. **Refund Riders:** *These are associated with immediate annuities and allow your beneficiaries to receive a cash refund of the amount you've paid into the annuity and not received. It may be paid out as a cash refund in a lump sum or as an installment refund that makes payments over time.*
4. **Impaired Risk Riders:** *These riders get added to an immediate annuity and will kick in if you have an illness that would reduce your life expectancy. When in force, they increase your monthly payout each month.*
5. **Commuted Payout Riders:** *These are often associated with immediate annuities and allow for you to take a lump sum from the annuity if a need should arise. It's usually a time-specific rider that is capped by a percentage.*
6. **Disability, Unemployment, and Terminal Illness Riders:** *These riders kick in if you were to become disabled, lose your job, or find out that you are terminally ill. They allow you to access more than you may normally be able to without facing surrender penalties.*

There may be other riders associated specifically with variable annuities, but we will discuss those later in this book. It's important to work with an advisor who understands your goals and objectives and helps you to understand your options with riders as they can impact the features and added benefits you may receive.

Level 3: How do you want your annuity to grow? Fixed v. Fixed indexed v. Variable

If we go one step further, there are three distinct types of annuities: fixed, fixed indexed, or variable. Each differs on their potential benefits, levels of risk, and goals they aim to accomplish. Speaking with a trusted financial professional can be helpful in determining which annuity, if any, is a suitable investment for your needs and financial future. The appropriate annuity for you will come down to your risk tolerance, timeline to retirement, desire for growth versus the need for protection and safety, and your understanding of the product's provisions.

CHAPTER THREE

Fixed Annuities

With fixed annuities, an insurance company guarantees to return a fixed interest rate and the payout may be distributed now or at some point in the future, much like a CD. This guaranteed minimum interest rate is earned through the accumulation phase and on the balance in your account during the annuitization phase.

As with all annuities, guarantees are backed by the financial strength and claims paying ability of the issuing insurance company.

Fixed annuities aim to provide you with predictability and stability when planning for your retirement as you will know exactly how much interest you'll receive. These interest rates are independent of the stock market and appeal to those investors who prefer to steer clear from market volatility.

> **Quick Case Study:** *See Disclosure 14* *Suppose Bill buys a fixed annuity that guarantees an interest rate of 3% for the next 10 years. In any given year, if the insurance company only earns 2%, Bill will still receive his guaranteed 3% rate. If the company earns more than 3%, the insurance company keeps the excess earnings.*

It's not uncommon for a company to offer a rate above the guaranteed interest rate for the first year. One way to secure a higher rate with a fixed annuity is to purchase a single premium deferred annuity. These offer higher rates than those paid into periodically or distributed right away, because the insurance company may reinvest your larger sum for a greater return over the long-term, and has no risk of the annuity owner defaulting on payments.

Considerations to Keep in Mind:

1. A*s with all annuities, a deferred annuity is a long-term product that should be utilized with a long-term savings outlook. If you were to withdraw early, you could face heavy surrender charges for doing so. As long as you use the annuity as intended and follow the contract guidelines, surrender charges will not be an issue.*
2. *It's important to be aware that rates may only be fixed for a period of time and could drop in a given yeafr. This should be specified in your contract. When an interest rate drops, some retirees attempt to withdraw their money from the annuity, but heavy surrender charges may apply with early withdrawals, decreasing the value you receive.*
3. *While a minimum rate of return is guaranteed with fixed annuities, the declared interest crediting rates may be below what the market is currently returning.*
4. *If you choose to have fixed payments for life, these payments do not take inflation into account meaning that what seems like a good income stream today could diminish in value later on.*

CHAPTER FOUR

Fixed Indexed Annuities

Another type of annuity is a fixed indexed annuity (FIA). Unlike fixed annuities, fixed indexed annuities don't typically pay a fixed interest rate. They aim to provide increasing income for retirement in an effort to hedge against inflation and cost of living increases.

The amount of interest you'll receive over the specified period of time is dependent on the crediting method you choose for your annuity. Fixed indexed annuities may have crediting methods with a cap, which could be based on a blend of index returns minus a "spread", or may offer a participation rate on a stock market index. All of these crediting methods offer a floor of zero, meaning you cannot lose money on the annuity investment in a given year.

Crediting Methods See Disclosure 13

With a fixed indexed annuity, you may choose from several different crediting methods. While each crediting method varies in its sensitivity to market volatility and interest potential, there is not one single crediting method that guarantees the greatest interest potential.

For those annuities that allow a participation rate on a market index, your investment and annuity is not directly invested within the index. So, if you have a fixed indexed annuity tied to the performance of the S&P 500, you don't actually have money invested in the S&P 500 but the S&P 500's performance plays a role on the interest credit you receive from the insurance company.

The indexed credit you can receive in a given year is first dependent on if the index credit received a positive or negative result. If it received a negative result, no indexed interest is added for that year, but your account loses no value. So, if your FIA is tied to the S&P 500 and it dropped by 5%, the credit you receive is 0%.

If instead, the index received a positive result, the indexed interest your annuity is credited can be determined by the following three things, depending on the crediting method you choose: a cap, the participation rate, and the spread. It's important to note that these may change annually, but are typically subject to lifetime maximums or minimums.

1. *A cap is the maximum interest that you may receive in a specified period. For example, if your annual cap is 4% and the value of one index rose by 6%, you'd only receive the 4% interest. If instead the index only rose by 2%, you'd receive 2% interest since that is below this 4% cap.*
2. *A participation rate is the percentage of the increase of a particular index that you'll receive if it increases over a given contract year. For example, if the S&P 500 saw a 10% increase in one year, and your indexed annuity had a participation rate of 50%, the amount of interest that would be credited to your annuity would be 5%, not the full 10%. Participation rates are often applied after a cap, but before the spread.*
3. *A spread is calculated by subtracting a percentage from any gain the index receives in a given period. If your annuity has a spread of 3% and your index achieves 7%, you'd be credited 4% indexed interest. If the index achieved 2% however, you'd receive no indexed interest and your contract value would remain unchanged.*

From there, crediting methods can be broken down to the annual point-to-point, monthly average, and monthly sum methods.

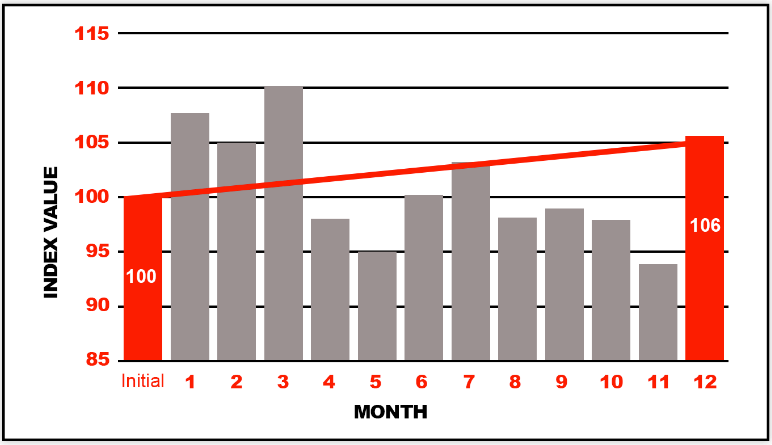
Annual Point-to-Point Method:

The simplest crediting method and least sensitive to volatility in the market is the annual point-to-point method. In this sense, its interest potential is lower than the other two methods, but that does not guarantee it would receive less than any other method.

With the annual point-to-point method, your indexed interest is based on changes in the indices on a year-over-year basis. It takes the beginning index value and compares it to the ending index value.

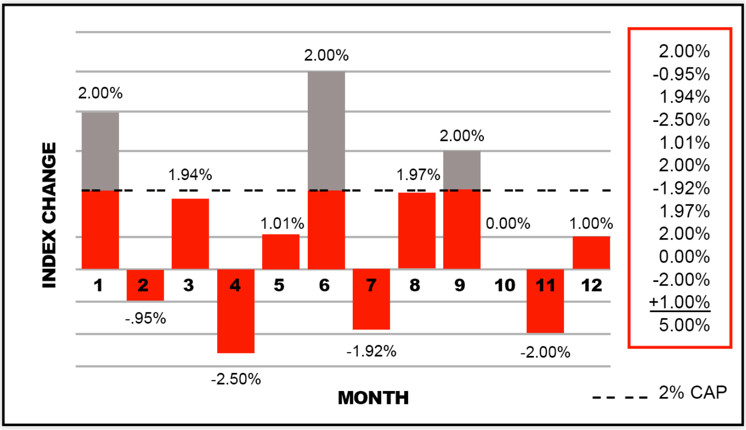
So, if your index increases by 6% over a contract year, as in the example below, you'd receive the indexed interest that year based on your cap, participation, and spread against that 6% positive change.

If instead the index dropped from 106 to 100, you'd have no change and receive no indexed interest as your annuity would not lose value when the index declines.



Monthly Average Method:

When the market is more volatile, the monthly average method helps to reduce volatility by finding the average of the highs and lows over the course of a year. The monthly average adds the total monthly index values and divides that value by 12 to find an average. The starting value of the index is then subtracted from the average to determine whether or not the index had a positive or negative change. This difference is then divided by the starting value to determine what percentage of interest is credited to the annuity. If the final result is negative, as with all crediting methods, you'll receive no indexed interest but your contract value will be protected.

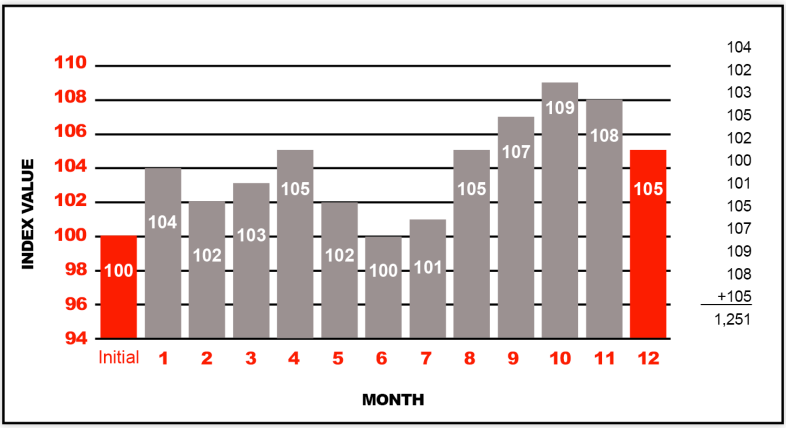


Monthly Sum Method:

The monthly sum method is the most impacted by incremental changes in the market and has the highest interest potential, yet is again not guaranteed. The monthly sum method takes individual monthly increases and decreases in the index value and adds them up over the course of one year. The sum of this helps to determine the indexed interest credited to your investment.

So, if your index increased by 10% in 6 months out of the year, dropped by 5% for 4 months of the year, and increased by 2% 2 months of the year, the most your indexed interest could be would be 7% before your cap, spread, and participation rate were taken into account. If instead, the sum over the year was negative, you'd receive no indexed interest, but the value of your contract would remain intact.

1. *The example above shows a monthly sum crediting method with a 2% cap. Adding up each month's gains and losses allows you to end at a 5.00% indexed interest before applying a participation rate or spread.*



Ask your financial professional to take you through how each crediting method pertains to any annuity you're considering as well as how the caps, participation rates, and spreads will enter into the calculation of the interest you could receive.

Annuities Compared to CDs from a Performance Standpoint: If both are considered "safe" why would I purchase an annuity over a CD or money market accounts?

Before 2008, CDs were a wonderful tool for plenty of clients. Inflation was low, and CDs, as well as money markets, were paying well over 5%. The advantage of the CD was that you could lock in the rate for a period of time, but they lacked liquidity without substantial penalty if withdrawn early. Money markets are more liquid, but with both, investment taxes were to be paid each year on any interest earned. Back then, both CDs and money markets were generally safe in the sense that they were secure from loss and were beating inflation.

After 2008, the rate paid on money markets dropped from over 5% to generally 0.01%. Let's assign some figures to this. Before 2008, an investor with $250,000 in a money market was enjoying in excess of $12,500 in risk free earnings annually. After 2008, this investor received a whopping $25 per year. By comparison, I recently looked up the 5-year CD rates of 2 of the largest national banks. They offered 0.15%. A $250,000 investment in this would produce about $375 per year. Over the course of 5 years, an investor would cumulatively earn below 1%, is locked into this rate, and has virtually no liquidity. Granted, there are other banking institutions offering in the neighborhood of 1% on a 5-year CD, but this rate of return does little to combat inflation.

When you compare both CDs and money markets' performance over the five-year period to the potential returns of a fixed indexed annuity tied to a participation rate on the stock market index without a ceiling, the FIAs appear far more attractive.

For illustration purposes: [See Disclosure 14] Let's assume you invested $250,000 in a 5-year CD offering 1%. At the end of 5 years, you could receive total earnings of $12,500.

Conversely, let's assume you purchased a 5-year fixed indexed annuity offering 35% participation on the S&P 500 returns. Also, assume for illustration purposes, the S&P returned 5%, -5%, 10%, -10% and 15% in the 5 years you owned this annuity. Since only the positive years count toward your annuity's returns, the math says this hypothetical situation would yield $26,250 of earnings. The CD, on the other hand, would yield more if markets had 5 years of consecutive losses, something rarely or never witnessed. The annuity may also allow for a penalty free withdrawal of 10% of your balance annually, making them much more liquid than most CDs. As with all annuities, the tax deferral provides another valuable benefit over other similar investments.

Considerations to Keep in Mind:

1. *As with all annuities, a long-term investing horizon is key to avoiding hefty surrender charges, fees, or tax penalties if taken too early, particularly before age 59½.*
2. *FIAs may be very complex with caps and restrictions that may be hard to understand. Your financial professional should make you aware of what the contract entails before recommending the investment.*

CHAPTER FIVE

Variable Annuities

Variable annuities are known for being higher risk with the highest potential return, but it's important to remember that there is no guarantee that returns will be higher than any other investment. These are best suited for those who have a higher risk tolerance and therefore a desire to participate in the growth of their money at a rate exceeding inflation. Variable annuities have various fees and offer the ability to purchase riders that may not be available to the other types of annuities discussed. To be able to purchase a variable annuity, you must work with an advisor who has certain securities licenses and abides by federal securities regulations, as well as state insurance regulations.

Unlike both the fixed indexed and fixed annuities, variable annuities are directly invested in the market in a separate account from the insurance company's general assets, meaning these annuities are exposed to the market's ups and downs, with the risk taken on by the annuity owner instead of the insurance company. Annuities are directly invested in the market in a separate account from the insurance company's general assets, meaning these annuities are exposed to the market's ups and downs with the risk taken on by the annuity owner instead of the insurance company. You may however purchase a variable annuity that allows for a payment that is part fixed and part variable, known as combined or balanced annuities.

Within a variable annuity, contract owners are able to invest in a dozen or more professionally managed subaccounts comprised of varying asset classes like stocks, bonds, or money market funds. Much like a mutual fund, the separate account is professionally managed and aims to diversify your portfolio to spread out the risk among many securities.

A more well-known investment that variable annuities have been compared to are mutual funds. One distinct benefit variable annuities offer over mutual funds is their tax treatment in the sense that variable annuities allow for tax deferral while mutual funds require gains to be taxed on a yearly basis. The tax efficiency is twofold just as it is with the other annuities: One is the fact that you aren't taxed on earnings each year like you would have been had the money been in the taxable world with regular mutual funds. Two, when you annuitize, the portion of the money that represents your basis (the money they contributed) is not taxable.

The investment return that a separate account receives is based on four factors:

1. **Dividend income** - This is income received from stocks within the portfolio that pay dividends.
2. **Interest income** - This is received from the bonds or money market accounts within the portfolio
3. **Realized capital gains and losses** -These occur when a security within the portfolio is sold for more (gain) or less (loss) than what it was worth.
4. **Unrealized appreciation or depreciation** - This is accounted for when a security that is held within the account rises or falls in value.

As an annuity contract owner, you're not paid out income or realized capital gains, but these remain in the separate account to help offset losses from another source or increase the account's value. When the overall separate account value increases, annuity owners benefit because your interest received will increase by a proportional amount.

Each account is run by a particular investment policy that should match the investment objective of the annuity owner.

1. *If your investment objective is growth, as opposed to income, you'd be less concerned with stocks in your account that offered dividends, and place a higher value on purchasing stocks that are thought to see an increase in value.*
2. *Those with an investment objective of growth would have a greater percentage of stocks with dividends and those asset classes that would earn interest, like bonds.*
3. *Growth and income is often achieved with investments in stocks of "blue chip" companies, or those with a history of paying solid dividends. They typically experience growth, but not the explosive growth that you may see in riskier, start-up types of companies.*
4. *Some separate accounts may be invested with a specialized objective — meaning they'll have a higher concentration in a particular industry, economic sector, or geographic region.*

You're not limited to the number of subaccounts or portfolios into which your annuity funds may be invested. If you so choose, you may actually manage your investments with a variable annuity. If instead you'd like an asset allocation service, there may be fees for this service. Some find these management fees worthwhile, because of their own lack of financial expertise and desire to save time. It's important to be aware of these fees and ensure that your advisor is always acting in your best interest.

Distribution Phase:

When it comes time to annuitize (start your income payments), you receive a varying amount of payments based on the investment performance of the separate account and the annuity units, meaning that you'll receive a different payment every month.

Fees & Riders:

One major aspect to be aware of regarding a variable annuity are the fees associated with the policy you purchase, as they can diminish the value of your contract. Understanding some of the most common fees can help you assess your suitability and know what questions to ask when going through with a purchase decision. The four most common types of fees are:

1. **Insurance Charges**: *These may be known as Mortality and Expense (M&E) and administrative fees. These are used to pay for the insurance-like features of the contract, like the death benefit, or any selling and administrative expenses. The M&E could be as much as 1.35% per year.*

2. **Surrender charges**: *As with other annuities, surrender charges pertain to the amount of money you can withdraw*

in a given year, typically, a preset limit by the insurance company. These can be hefty and may be imposed over a particular period of time. It's important to understand these charges to ensure that the contract will be flexible enough for you.

3. **Investment Management**: *The underlying account may be invested for you by your financial advisor, similar to a mutual fund. These can range from 0% to more than 2% of your assets under management.*

4. **Rider Charges**: *Because the investment return you receive is no guarantee, it may be beneficial to add on additional benefits to your variable annuity product. As an investor, you may purchase optional features that can offer a range of guarantees and optional benefits. With the purchase of any additional–cost riders, the contract's value will be reduced by the cost of the rider. This may result in a reduction of your principal in any year in which the contract does not earn interest or earns interest in an amount less than the rider charge.*

- **Guaranteed Minimum Income Benefit (GMIB)**

  This rider helps to increase the monthly payout to keep pace with inflation. Since variable annuities have no guarantee of a positive subaccount value and are subject to market risk, the GMIB rider will guarantee a minimum annuity payment level, regardless of how the subaccount performs.

- **Guaranteed Minimum Accumulation Benefit (GMAB)**

This rider is available for the first 5-10 years of a variable annuity contract, and is appropriate for those who may be nervous that the value they put in the account will be less than what they originally invested. If your account were to reflect a lower amount in this time period than what you paid into it, your account would be restored.

- **Guaranteed Minimum Withdrawal Benefit (GMWB)**

This rider acts as a money back guarantee that allows you to withdraw a particular percentage from your annuity until the value that you paid in is withdrawn. It offers another way to make sure that you receive your premiums paid even if your account did not perform well, but it does not guarantee that you'll receive income for the rest of your life.

- **Guaranteed for Lifetime Income Benefit (GLIB)**

This rider may be available for both variable and fixed indexed annuities and guarantees that you'll have an income for life without annuitizing your contract. This is helpful if you'd like to receive gains on your premium while receiving your monthly payments, and acts like a GMWB, but ensures that you'll still receive a monthly benefit for life. This may be appropriate for those who are in particularly good health and have a family history of longevity to guarantee income no matter how long you live.

Considerations to Keep in Mind:

1. As *with all annuities, a long-term investing horizon is key to avoiding hefty surrender charges, fees, or tax penalties if taken too early, particularly before age 59½.*
2. *With a variable annuity, the investment risk is reserved for the contract owner instead of the insurance company meaning your annuity could lose value in a given year.*
3. *Compared to other annuities, there are additional fees, charges, and expenses associated with variable annuities that need to be taken into account with the purchase decision. Your advisor should provide full disclosure on these fees.*

OVERVIEW

Conclusion

All in all, annuities can act as a valuable tax-preferred component to your overall financial plan. They can help combat the retirement realities facing retirees today: lack of pensions, rising health care costs, and the need for supplemental income beyond Social Security and other retirement accounts. Unlike your IRA or 401k, there are no contribution limits, and unlike their taxable investment counterparts — like CDs or mutual funds — taxes are deferred on the growth until you receive the income.

Each type of annuity — fixed, fixed indexed, and variable — is associated with varying features, guarantees, and risks. Fixed are the simplest form, yet have the lowest potential return, while fixed indexed may allow you to participate in the gains of indexes without being directly invested in the market. Variable annuities have the highest potential for return, but the investment risk is completely borne by the annuity owner with the underlying investment directly invested in the market. It's important that with whichever annuity you choose, that you fully understand the fees, potential interest you could receive, and the provisions regarding withdrawals.

Keep in mind that not all annuities are created equal, and not all annuities could be right for each person. You could be subject to lower returns than you may find elsewhere in a riskier investment, like directly in the stock market. Management fees could be high and diminish the value of your annuity. Finally, annuities are not as liquid as other investments in the sense that your capital could be tied up after you decide to annuitize. A financial professional can help you assess how each of these risks impacts you and your individual situation.

Despite any negative press on particular types of annuities, there are good annuities just as there are bad annuities. It's also important to note that an annuity would likely never be your only source of retirement income. An annuity should work together with your other retirement assets as part of an overall, comprehensive financial plan. The key to finding the right way to guarantee income for the rest of your life is by consulting with the right financial professional and understanding the basics of what your investment entails. With full disclosure and an assessment of your individual goals, needs, and financial situation, an annuity could provide a solution you desire to ensure that your nest egg lasts at least as long as you do.

DISCLOSURES

1. This material is intended for educational purposes only and is not intended to serve as the basis for any investment or purchasing decisions.
2. Bonus annuities may include higher surrender charges, longer surrender periods, lower caps, higher spreads, or other restrictions that are not included in similar annuities that don't offer a bonus.
3. Bank CDs are insured by the Federal Deposit Insurance Corporation and offer a fixed rate of return, whereas both the principal and yield of variable products will fluctuate with market conditions and are not guaranteed.
4. Securities are not guaranteed by the FDIC or any other government agency, fluctuate in value, and may be worth more or less when redeemed.
5. Interest, if any, will vary depending upon the allocation option you choose for your annuity. Choosing several allocation options ("diversifying") does not ensure that interest will be credited. No allocation option provides the most interest in all market scenarios.
6. Dollar-cost averaging does not ensure a profit or protect against loss. This type of plan involves continuous investment in securities, regardless of fluctuating price levels. Investors should consider

their ability to continue purchases through periods of low price levels.

7. Guarantees are backed by the financial strength and claims-paying ability of issuing insurance company and do not apply to the performance of the variable subaccounts, which will fluctuate with market conditions.
8. All annuity contract and rider guarantees, or annuity payout rates, are backed by the claims-paying ability of the issuing insurance company. They are not backed by the broker/dealer from which this annuity is purchased, by the insurance agency from which this annuity is purchased, or any affiliates of those entities, and none makes any representations or guarantees regarding the claims-paying ability of the life insurance company. Guarantees do not apply to the performance of the variable subaccounts, which will fluctuate with market conditions.
9. Although an external index may affect your interest credited with in a Fixed indexeded Annuity, the contract does not directly participate in any equity or fixed income investments. You are not buying shares in an index. The index value does not include the dividends paid on the equity investments underlying any equity index or the interest paid on the fixed income investments underlying any bond index. These dividends and interest are not reflected in the interest credited to your contract.
10. Any transaction that involves a recommendation to liquidate a securities product, including those within an IRA, 401(k), or other retirement plan, for the purchase of an annuity or for other similar

purposes, can be conducted only by individuals currently affiliated with a properly registered broker/dealer or registered investment advisor. If your financial professional does not hold the appropriate registration, please consult with your own broker/dealer representative or registered investment advisor for guidance on your securities holdings.

11. Any distributions may be subject to ordinary income tax and, if taken prior to age 59 ½, an additional 10% federal tax.
12. Fixed indexed Annuities are designed to meet long-term needs for retirement income, and they provide guarantees against the loss of principal and credited interest, and offer the reassurance of a death benefit for your beneficiaries.
13. No one crediting method credits the most interest in all market scenarios.
14. This hypothetical example is shown for illustrative purposes only and is not guaranteed. The characters in this example are fictional only. Your actual experience will vary.

TABLE OF CONTENTS:

About Dave Lopez

Dave Lopez is the founder of ILG Financial, LLC. Dave has been working with individuals and businesses in the Northern Virginia area since 1986. Dave specializes in strategies that enable his clients to potentially build a retirement nest egg that they can rely on and can never outlive.

Dave has his Bachelors of Science degree from James Madison University with a major in Mathematics and Computer Science. Dave is an Investment Advisor Representative with AlphaStar Capital Management.

In addition, Dave is a licensed Life, Health, and Annuity Agent. In partnership with Financial Independence Group, Dave has access to an extensive team of experts to assist in building the best plan for each client utilizing the appropriate combination of Market Investments/Life Insurance/Annuity/Long Term Care Insurance/ and Disability Insurance options. Through The Financial Independence Group Dave brings extensive resources and experience allowing them to match the best possible plans to their clients' needs.

The Little Red Book of Retirement
The Basics Of Annuities