GUIDE TO UNDERSTANDING ANNUITIES

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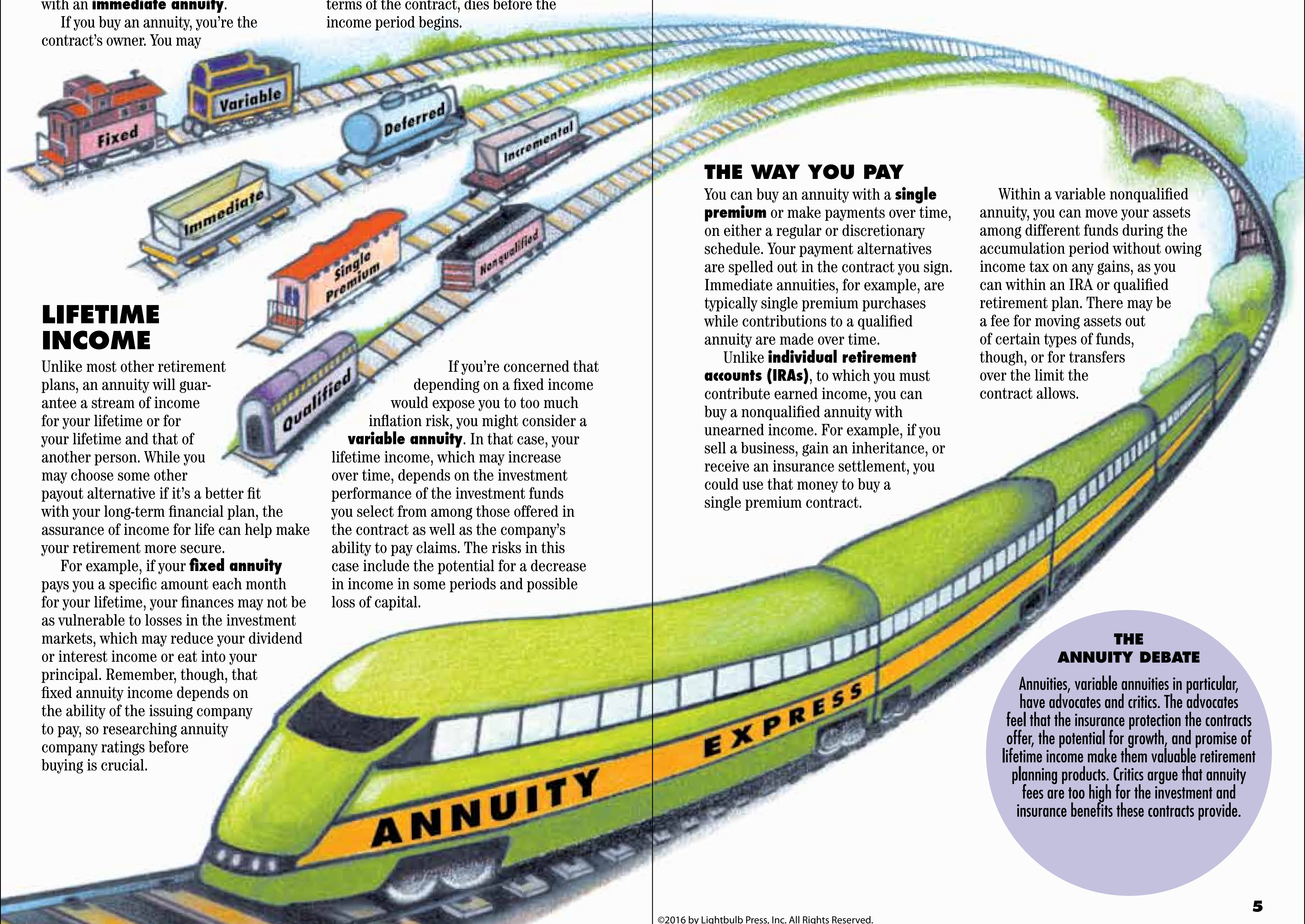
ANNUITIES

The Possibilities of Annuities

You decide on the annuity features that put you on the right track.

Annuities are insurance company contracts. The premiums you pay and tax-deferred earnings on those premiums are designed to be a source of retirement income, either in the future if you choose a **deferred annuity**, longer in the future with a **longevity annuity**, or right away with an **immediate annuity**.

If you buy an annuity, you're the contract's owner. You may also be the **annuitant**, or the person who will receive income from the contract, though you may name a different annuitant. As owner, you also name the **beneficiary** who will receive the death benefit or a portion of the annuity contract's value if the annuitant or owner, depending on the terms of the contract, dies before the income period begins.



LIFETIME INCOME

Unlike most other retirement plans, an annuity will guarantee a stream of income for your lifetime or for your lifetime and that of another person. While you may choose some other payout alternative if it's a better fit with your long-term financial plan, the assurance of income for life can help make your retirement more secure.

For example, if your **fixed annuity** pays you a specific amount each month for your lifetime, your finances may not be as vulnerable to losses in the investment markets, which may reduce your dividend or interest income or eat into your principal. Remember, though, that fixed annuity income depends on the ability of the issuing company to pay, so researching annuity company ratings before buying is crucial.

If you're concerned that depending on a fixed income would expose you to too much inflation risk, you might consider a **variable annuity**. In that case, your lifetime income, which may increase over time, depends on the investment performance of the investment funds you select from among those offered in the contract as well as the company's ability to pay claims. The risks in this case include the potential for a decrease in income in some periods and possible loss of capital.

DEFERRED OR IMMEDIATE

All annuities have the same objective: to provide retirement income. The income an annuity provides depends on:

- The contract value, which is determined by the **premium**, or purchase price to buy the annuity, plus the earnings that accumulate, minus fees and other costs
- The **payout options** you choose
- Whether the annuity is fixed or variable
- Your age when payments begin and the age of the joint annuitant if there is one

With a **deferred annuity** you build your retirement savings over a number of years. You pay the premium with a lump sum, a series of payments, or a combination of these methods, depending on the terms of the contract. With an **immediate annuity**, you make a single lump-sum payment and income payments begin within 13 months.

THE WAY YOU PAY

You can buy an annuity with a **single premium** or make payments over time, on either a regular or discretionary schedule. Your payment alternatives are spelled out in the contract you sign. Immediate annuities, for example, are typically single premium purchases while contributions to a qualified annuity are made over time.

Unlike **individual retirement accounts (IRAs)**, to which you must contribute earned income, you can buy a nonqualified annuity with unearned income. For example, if you sell a business, gain an inheritance, or receive an insurance settlement, you could use that money to buy a single premium contract.

Within a variable nonqualified annuity, you can move your assets among different funds during the accumulation period without owing income tax on any gains, as you can within an IRA or qualified retirement plan. There may be a fee for moving assets out of certain types of funds, though, or for transfers over the limit the contract allows.

THE ANNUITY DEBATE

Annuities, variable annuities in particular, have advocates and critics. The advocates feel that the insurance protection the contracts offer, the potential for growth, and promise of lifetime income make them valuable retirement planning products. Critics argue that annuity fees are too high for the investment and insurance benefits these contracts provide.

Annuity Income

Annuities exist to provide income in retirement.

You can get annuity income in two ways. You can purchase a **deferred annuity**, typically while you are still working, as a way to help you save for retirement. You determine the amount and frequency of your premiums and when the income will begin, typically in retirement.

Or, you can purchase an **immediate annuity** with a single premium, such as a lump-sum payment from a retirement savings plan or the profits from selling your business. As the name implies, immediate annuities begin paying income soon after you purchase the contract.

GROWING MORE FLEXIBLE

The earliest deferred variable annuities offered two choices when you were ready to start receiving income. You could convert your contract to the payout phase, a process called **annuitization**. That generally provided income for as long as you lived but left nothing for your beneficiaries when you died. Or, rather than annuitizing, you could surrender your contract, which meant getting your premiums and earnings back in a lump sum, minus expenses, and owing tax on the earnings. Once you chose, you couldn't change your mind.

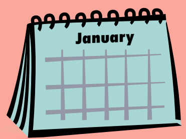
Since then, many different annuity payout options have been added that offer greater liquidity and flexibility, even though the basic purpose continues to be to provide retirement income. A variety of payout options is also available with immediate annuities.

For example, many annuity policies now offer a life annuity with a term certain that guarantees payments until the end of the term even if you die before then. And many contracts offer income that continues for a fixed period rather than as long as you live. With some **commutable** contracts, you may be able to accelerate your payments under certain circumstances. That means you can withdraw a lump-sum amount after annuitization begins rather than continue to receive regular payments. Though changing your mind may be possible only with certain types of payout plans, the flexibility has real advantages if your life situation changes.

Income Choices

When you're ready to take income, annuity contracts typically offer a number of choices:

- **Lifetime income**



- **Income for a fixed term or period**

- **Systematic withdrawals**

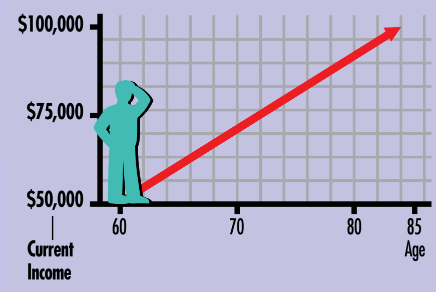
- **Lump-sum withdrawals**

FIGHTING INFLATION

Inflation isn't a new topic, and it certainly isn't a pleasant one. If you're living on $50,000 this year, 24 years from now it will cost you $100,000 to live the same way, assuming that the annual inflation rate averages the historical 3%. If the rate is higher, the cost of living will double faster.

There are two ways to handle the effects of inflation: You can live a less comfortable lifestyle or generate additional income. If you are retired and no longer being paid for work you do, the only way to increase your income is to be able to draw on the earnings in your investment portfolio. Ideally the earnings rate will exceed the rate of inflation.

Inflation Reality Check



USING VARIABLE ANNUITIES

Having variable annuity income to supplement the money you need in retirement can help make long-term planning easier. Even though the amount of each payment may fluctuate, you can count on receiving income consistently.

Perhaps more important, though, is that you can choose an option that will guarantee income for as long as you live, based on the issuing company's ability to pay.

And, with a variable annuity, you can spread your money around in a number of investment funds. That protects you from a major downturn in one market sector, and lets you share the benefit if investments in those funds grow in value or produce strong earnings, or both.

Making Your Money Last

One of the biggest challenges you'll face in retirement is managing your money so that it will last for the rest of your life. Here are some questions to consider as you make your plans:

1. What effect will taking money out of your various retirement accounts have on their continued ability to grow and provide income for as long as you live?

2. What part of your income can you count on and what part is less predictable?

3. How diversified are your income sources? Are you too vulnerable to major changes in the economy, including declining interest rates?