Understanding Annuities:
A Lesson in Fixed Interest and Indexed Annuities

Did you know that an annuity can be used to systematically accumulate money for retirement purposes, as well as to guarantee a retirement income that you cannot outlive?

Prepared for: **Valued Clients**

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Brought to you by:

Wayne McCullough, LUTCF
Regional Brokerage Manager
5865 Ridgeway Center Pkwy.
Suite 300
Memphis, TN 38120
Office: (901) 758-8886
Wayne@PC4Producers.com
www.PC4Producers.com

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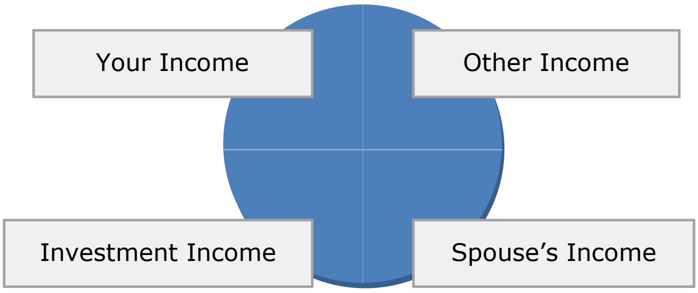
Your Earning Power

Your earning power – *your ability to earn an income* – is your most valuable asset.

Few people realize that a 30-year-old couple will earn 3.5 million dollars by age 65 if their total family income averages $100,000 for their entire careers, without any raises.

Earning Power:



How Much Will You Earn in a Lifetime?

Years to Age 65	Your Future Earning Power If Your Family Income Averages:			
	$50,000	**$100,000**	**$250,000**	**$500,000**
40	$2,000,000	$4,000,000	$10,000,000	$20,000,000
35	1,750,000	3,500,000	8,750,000	17,500,000
30	1,500,000	3,000,000	7,500,000	15,000,000
25	1,250,000	2,500,000	6,250,000	12,500,000
20	1,000,000	2,000,000	5,000,000	10,000,000
15	750,000	1,500,000	3,750,000	7,500,000
10	500,000	1,000,000	2,500,000	5,000,000
5	250,000	500,000	1,250,000	2,500,000

How much of this money will be available to you when you retire?
How can you systematically accumulate money for retirement?
How can you guarantee a retirement income that you cannot outlive?

Annuity Objectives

In planning for financial security in retirement, an annuity can help satisfy two basic objectives:

To accumulate retirement assets on a tax-deferred basis.

If you're already contributing the maximum to IRAs and any employer-sponsored retirement plans and need to save more for retirement, a deferred annuity may be the answer to your retirement savings need.

To convert retirement assets into an income that you cannot outlive.

On the other hand, if you're near or at retirement, an immediate income annuity can be used to convert existing retirement assets into a lifetime income.

What Is an Annuity?

An annuity is a long-term savings plan that can be used to accumulate assets on a tax-deferred basis for retirement and/or to convert retirement assets into a stream of income.

While both are insurance contracts, an annuity is the opposite of life insurance:

- **Life insurance** provides financial protection against the risk of dying prematurely.
- **An annuity** provides financial protection against the risk of living too long and being without income during retirement.

Annuities are classified in several different ways, including:

- **When annuity payments begin**
- **How premiums are paid**
- **How annuity premiums are invested**

If you are already contributing the maximum to an IRA and/or an employer-sponsored retirement plan, an annuity can be an excellent way to save for financial security in retirement.

Deferred Annuities vs. Immediate Annuities

When Annuity Payments Begin…

Deferred Annuities vs. Immediate Annuities

1. Deferred Annuities

- A deferred annuity has two distinct phases: the **accumulation or savings phase** and the **income phase**.
- During the **accumulation or savings phase**, annuity premiums, less any applicable charges, accumulate in the contract on a tax-deferred basis until the annuity starting date. Deferral of tax on annuity earnings is a major advantage that other non-qualified financial products cannot provide.
- On the annuity starting date, a deferred annuity enters the **income phase**, at which time the value of the annuity is converted into a stream of income.

2. Immediate Annuities

- An immediate annuity has only one phase: the **income phase**.
- The single premium used to purchase an immediate annuity is converted into a stream of income **immediately** or shortly after the date the annuity is purchased.

Installment Premium Annuities vs. Single Premium Annuities

How Premiums Are Paid…

Installment Premium Annuities vs. Single Premium Annuities

1. Installment Premium Annuities

- The annuity premium is paid in installments to the insurance company over a period of time.
- The installment premiums can be either a **fixed**, scheduled amount or can be **flexible**, meaning that the amount paid can vary (within set contract limits).
- During the **accumulation or savings period** prior to retirement, installment premiums, less any applicable charges, accumulate in the contract on a tax-deferred basis until the annuity starting date
- On the **annuity starting date**, the value of the annuity can be converted into a stream of income.

2. Single Premium Annuities

- The annuity is purchased with a single premium payment.
- A **single premium deferred annuity** has an accumulation period prior to retirement, during which the single premium, less any applicable charges, accumulates in the contract on a tax-deferred basis until the annuity starting date, when the annuity value can be converted into a stream of income.
- In the case of a **single premium immediate annuity**, the single premium, less any applicable charges, is converted into a stream of income immediately or shortly after the date of purchase.

Fixed Interest Annuities vs. Indexed Annuities

How Annuity Premiums Are Invested…

Fixed Interest Annuities vs. Indexed Annuities

1. Fixed Interest Annuities

A fixed interest annuity pays a **fixed rate of interest** on the premiums invested in the contract, less any applicable charges. The insurance company guarantees* that it will pay a **minimum interest rate** for the life of the annuity contract. A company may also pay an "excess" or bonus interest rate, which is guaranteed* for a shorter period, such as one year. Be aware, however, that an annuity offering a bonus interest rate may also be subject to higher fees which will reduce or even eliminate the value of the bonus interest rate.

2. Indexed Annuities

An indexed annuity has characteristics of both a fixed interest annuity and a variable annuity. Similar to a **variable annuity**, the insurance company pays a rate of return on annuity premiums that is linked to a stock market index, such as the Standard & Poor's 500 Composite Stock Price Index. Similar to **fixed interest annuities**, indexed annuities also provide a minimum guaranteed interest rate*, meaning that they have less risk of loss of principal than variable annuities. An investment in an indexed annuity is not a stock market investment. Instead, the rate of return is linked to the performance of a market index that tracks the performance of a specific group of stocks. Since the minimum guaranteed interest rate is combined with this interest rate linked to a market index, indexed annuities have the potential to earn returns better than fixed interest annuities when the stock market is rising. **You could, however, lose money on your investment if the issuing company does not guarantee 100% of the principal and you receive no index-linked interest due to a decline in the market index linked to your annuity, or if you surrender your indexed annuity while a surrender charge is in effect.** Indexed annuities typically have lengthy surrender periods with a surrender charge equal to a percentage of the amount withdrawn or a reduction in the index-linked interest credited to the contract. In addition, any withdrawals before age 59-1/2 may also be subject to a 10% penalty tax.

** All guarantees are based on the claims-paying ability of the issuing insurance company.*

A Closer Look at Fixed Interest Annuities

Deferred Fixed Interest Annuities:

Premium Payments: A deferred fixed interest annuity can be purchased either with a single premium or through a series of installment premiums.

Accumulation Phase: During the accumulation phase, the insurance company pays a fixed rate of interest on the premiums invested in the contract, less any applicable charges. The fixed interest rate paid is determined by the insurance company and is spelled out in the annuity contract. While the insurance company guarantees* that it will pay a minimum interest rate for the life of the annuity contract, a company may also pay an "excess" or bonus interest rate, which is guaranteed* for a shorter period, such as one year. Be aware, however, that an annuity offering a bonus interest rate may also be subject to higher fees which will reduce or even eliminate the value of the bonus interest rate.

Income Phase: On the annuity starting date, you can elect to receive the value of the annuity in a single lump sum or you can select from a variety of annuity income options, some of which guarantee* you a fixed, level income that you cannot outlive.

Immediate Fixed Annuities:

Premium Payments: An immediate fixed annuity can be purchased with a single premium only.

Income Phase: The single premium less any applicable charges is converted into a guaranteed* fixed, level income that begins immediately or shortly after the premium is paid.

** All guarantees are based on the claims-paying ability of the issuing insurance company.*

A Hybrid Annuity…Equity-Indexed or Indexed Annuities

The indexed annuity has features of both a fixed interest annuity and a variable annuity:

- The insurance company pays a rate of return on your annuity premiums (less any applicable charges) that is tied to a stock market index, such as the Standard & Poor's 500 Composite Stock Price Index.
- Similar to a **fixed interest annuity**, an indexed annuity also provides a minimum guaranteed* interest rate. Unlike a fixed interest annuity, many indexed annuities only guarantee that you'll receive 87.5% of the premiums you paid. In addition, early surrender of any annuity can result in loss of some principal and/or interest earnings.

An indexed annuity is an insurance contract and not an investment in the stock market. Indexed annuities credit interest using a formula based on changes in the index to which the annuity is linked. Any index-linked interest payable in excess of the minimum guaranteed* interest rate is determined by a formula contained in the annuity contract. **There is, however, a limit or cap placed on the index-linked interest paid. As a result, it is important for you to review the annuity contract carefully in order to understand how these indexed annuity features work together, since they can have a substantial impact on the return on your investment:**

- **Indexing Method:** There are different methods used to determine the change in the relevant index over the period of the annuity. The indexing method used will impact the amount of interest credited to the contract.
- **Participation Rates:** How much of the gain in the index will be credited to the indexed annuity? If, for example, an indexed annuity has an 80% participation rate, the annuity will be credited with only 80% of any gain experienced by the index.
- **Spread/Margin/Asset Fee:** An indexed annuity may contain a spread/ margin/asset fee instead of, or in addition to, a participation rate. If, for example, an indexed annuity has a 3% spread/margin/asset fee and the index gains 9%, the interest credited to the annuity will be 6%.
- **Interest Rate Caps:** Some indexed annuities contain a cap or upper limit on the amount of interest the annuity will earn. For example, if the cap rate is 10% and the index linked to the annuity gains 12%, only 10% will be credited to the annuity.

* *All guarantees are based on the claims-paying ability of the issuing insurance company.*

Fixed Annuity Suitability

First of all, an annuity should be considered as a longer-term investment. If, for example, your objective is to save for retirement and you are already contributing the maximum to an IRA and/or employer-sponsored retirement plan, an annuity might be right for you. But which type of annuity? The answer to that question depends primarily on your investment objectives and risk tolerance.

Fixed interest 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 risks to the insurance company
- Understand that a fixed rate of return may not provide a good hedge against inflation

Indexed annuities may be best suited for individuals who:

- Are adverse to risk
- Understand that a rate of return linked to stock market performance provides the potential for higher returns than fixed interest investments, together with the risk of losing money if the issuing company does not guarantee 100% of the principal and no index-linked interest is credited, or if the indexed annuity is surrendered while a surrender charge is in effect
- Prefer to delegate investment decisions to others
- Want less market risk than with a variable annuity

Annuity Comparisons

Fixed Interest Annuities vs. Indexed Annuities

	Fixed Interest Annuities	Indexed Annuities
Minimum guaranteed return?	Yes [1]	Yes [1]
Choice of investment options?	No	No
Opportunity to earn a higher return?	No	Yes
Possibility of losing principal?	No [1]	Maybe [2]
Tax-deferred growth?	Yes	Yes
Minimum death benefit?	Yes [1]	Yes [1]

[1] Subject to the claims-paying ability of the issuing insurance company.

[2] It is possible to lose principal in an indexed annuity if, for example, the issuing insurance company does not guarantee 100% of the principal and no index-linked interest is credited to the contract because the index linked to the annuity declines, or if an indexed annuity is surrendered while a surrender charge is in effect.

Immediate Annuities vs. Deferred Annuities

	Immediate Annuities	Deferred Annuities
Premium payments?	Single premium only.	Either a single premium or a series of installment premiums.
Annuity payout?	Begins immediately or shortly after premium is paid.	Begins at a future annuity payout date, providing time for annuity accumulation.
Partial withdrawals?	Possibly; review the features of the contract you are considering to determine if withdrawals may be made and under what conditions.	Yes, subject to the terms of the contract and possible charges, partial withdrawals can be made from a deferred annuity; partial withdrawals may be subject to a premature withdrawal tax if made prior to age 59-1/2. Withdrawals will reduce the value of the death benefit and any optional benefits.
Surrender value?	None; the contract cannot be surrendered.	Yes, a deferred annuity can be surrendered for its value, subject to surrender charges and a possible premature withdrawal tax if surrendered prior to age 59-1/2.

Annuity Income Phase

When you are ready to begin receiving income from a deferred annuity, you can select from a variety of options, including:

Lump Sum Distribution

You can surrender your deferred annuity and receive the entire value in a lump sum payment. This option requires that income tax be paid on the annuity earnings in the year you receive them. In addition, a lump sum distribution does not solve the problem of outliving your retirement income.

Systematic Withdrawals

You can set up a systematic withdrawal plan, through which you receive a specified amount of money at regular intervals, such as $1,000 per month, until all assets have been withdrawn. With this option, you have the flexibility to change the payment schedule in the future. Since, for income tax purposes, earnings are considered withdrawn before principal, the likelihood is that the earlier withdrawals will be fully taxed at ordinary income tax rates. In addition, with this option there is no guarantee that you will not outlive your retirement income.

NOTE: A lump sum distribution or systematic withdrawals made prior to age 59-1/2 may be subject to a 10% federal tax penalty on the taxable amount of earnings withdrawn, unless one of the exceptions is met.

Annuitization

You convert the value of your deferred annuity into a lifetime income or into a stream of payments for a fixed period of time. Alternatively, you use other retirement assets to purchase an immediate income annuity. As reviewed on page 13, there are a variety of annuity income options from which to select.

Other Options

Talk to your licensed financial adviser about other options that may be available in the annuity contract you are considering.

Annuity Income Options

At retirement, annuity income can be structured in a variety of ways, enabling you to select the income option that best satisfies your unique needs. While you can surrender a deferred annuity and receive a **lump-sum payment** equal to the annuity value, many people elect to convert the annuity value into a stream of retirement income using one of these income options:

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 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 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.

Period Certain Option

(no guarantee of lifetime income)

- Payments are made for a specified number of years, such as 10 years or 20 years.
- Payments cease at the end of the period certain.
- If annuitant dies before receiving all guaranteed* payments, the beneficiary will receive the remaining payments.

* All guarantees are based on the claims-paying ability of the issuing company.

Flexibility

While these are the five basic annuity income options, some annuity contracts offer additional flexibility…ask your licensed financial adviser about contract features that may add flexibility to your use of an annuity to provide retirement income.

Non-Qualified Annuity Taxation

During the Accumulation Phase:

- Earnings credited on the funds in a deferred annuity are tax deferred, meaning that the earnings are not taxed while they remain in the annuity.
- Withdrawals from a deferred annuity during the accumulation phase are treated as withdrawals of earnings to the extent that the cash value of the annuity exceeds the total premiums paid and are taxed as income in the year withdrawn. To the extent that a withdrawal exceeds any earnings, that portion of the withdrawal is considered a non-taxable return of principal.
- In addition, a 10% penalty tax may be imposed on withdrawals made before age 59-1/2, unless certain conditions are met. The penalty tax is in addition to the regular income tax on the withdrawal.
- If the annuitant dies during the accumulation phase, the value of the deferred annuity is generally included in the annuitant's estate, to the extent of the deceased annuitant's proportional contribution to the annuity purchase price.

During the Income Phase:

- 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 and the balance is taxable as received.
- At the annuitant's death, the present value of any remaining annuity payments due is generally included in the annuitant's estate, to the extent of the deceased annuitant's proportional contribution to the annuity purchase price.

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

Fixed Annuity Advantages and Disadvantages

An annuity can be a great way to save for retirement on a tax-deferred basis, in effect creating your own personal "pension" plan. As with any investment, however, there are also potential disadvantages that should be evaluated before purchasing an annuity.

Advantages:

- A fixed annuity protects against a decline in asset value during market downturns.
- Earnings on your annuity premiums are tax deferred so long as they remain in the annuity. When compared to an investment whose earnings are taxed each year, tax deferral offers the potential for accumulating significantly higher amounts of money over time.
- An annuity can be used to provide a steady source of retirement income that you cannot outlive.
- Unlike an IRA or employer-sponsored retirement plan, there are no annual contribution limits to an annuity…you can contribute as much as you want.
- Subject to the terms of the contract, there is no required date by which you must begin receiving annuity income payments, providing you with the flexibility to defer payments until you need the income.
- If you die while your annuity still has value, the annuity death benefit passes directly to your beneficiary without probate.
- In most states, an annuity is free from the claims of a creditor.

Disadvantages:

- The growth of a fixed annuity may not keep pace with inflation.
- Premiums for a non-qualified annuity are not tax deductible, meaning that they are made with after-tax dollars.
- While you can surrender or make withdrawals from a deferred annuity before you begin receiving income payments, the surrender or withdrawal may be subject to a charge if made within a stated number of years after the annuity is initially purchased.
- If made prior to age 59-1/2, a surrender or withdrawal will be subject to a 10% federal penalty tax unless one of the exceptions to this tax is met.
- When received, investment gains are subject to ordinary income tax rates and not the lower capital gains tax rate.
- Once annuity income payments begin, annuity contracts vary in regard to whether the payment amount can be changed and/or whether amounts can be withdrawn from the contract. Ask your licensed financial adviser to explain whether the contract you are considering allows for annuity payments to be increased or decreased and whether withdrawals are available.

Fixed Annuity Checklist

Once you decide that an 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 premiums are paid;
- An **annual maintenance fee** (e.g., $30);
- **Mortality or insurance charges** for death benefit features; and/or
- **Surrender charges** assessed when the annuity is surrendered or withdrawals are made in the early years of the contract.

Carefully evaluate fees and expenses, since they will impact the amount of money ultimately available in the annuity.

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 annuity. Ask for company rating information from respected sources, such as A.M. Best, Moody's or Standard & Poor's, before purchasing an annuity.

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 interest annuity**, the current interest rate being credited, how often it changes and the minimum interest rate guaranteed by the contract;
- in the case of an **indexed annuity**, how amounts credited to the annuity contract are determined;
- the withdrawal and surrender options;
- how the death benefit is determined and paid;
- the income payout options available.

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, VSA, L.P. is not engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

Annuity contracts contain exclusions, limitations, reductions of benefits and terms for keeping them in force. All contract guarantees are based on the claims-paying ability of the issuing insurance company. Consult with your licensed financial representative on how specific annuity contracts may work for you in your particular situation. Your licensed financial representative will also provide you with costs and complete details about specific annuity contracts recommended to meet your specific needs and financial objectives.

NOTE: This annuity discussion is intended primarily to provide information on personal, non-qualified annuities that are not purchased to fund an IRA or qualified employer-sponsored retirement plan. An annuity purchased to fund an IRA or qualified employer-sponsored retirement plan does not provide any additional tax deferral, since tax deferral is provided by the IRA or qualified plan itself. If an annuity is purchased to fund an IRA or qualified employer-sponsored retirement plan, it should be done for the annuity features and benefits other than tax deferral.

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