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Answers to Questions About Retirement Annuities

*A Straightforward Question-and-Answer Guide
To Help You Understand
How Annuities Fit Into
Your Retirement Planning*

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Introduction

Unlike past generations of Americans, people today are more likely to view retirement as a time of fun, of adventure, and of discovery – a time when they realize their dreams rather than simply “relax” and take it easy.

Indeed, retirement is often viewed today as a unique opportunity for a fresh start or a new beginning – perhaps as the crowning reward for a long career in the workplace.

Of course, today’s more ambitious views of retirement – to travel, own a summer home, even a boat perhaps – come with a higher price tag.

For growing numbers of people, including yourself conceivably, simply “getting by” in retirement may no longer be adequate or even acceptable. The goal today is more likely to be genuine financial independence, with enough retirement income to fulfill your vision of doing the things you’ve always wanted to do, but couldn’t do during your working life.

This is why saving and investing for your retirement years is a vital activity which can help you realize the lifestyle you foresee for yourself, whether it’s financially modest or quite ambitious.

Among the many options for retirement funding, one of the best is tax-deferred savings and investments. Annuities accomplish both of these objectives, offering you tax-deferred savings and a steady stream of income in your retirement years ... an income you cannot outlive. More and more people are including annuities in their financial planning simply because *annuities offer many attractive advantages for building retirement funds.*

Annuities come in many types and options, which is why it’s easy to become confused about them. The purpose of this Guide is to help familiarize you with annuities and to show you how they can fit into your own retirement planning.

What Annuities Are, and How They're Used

What are annuities?

Annuities are contracts between financial services companies and buyers which enable the buyer to make “investments,” or payments to the company, which grow tax-deferred through an “accumulation period.” This type of annuity is called a *deferred* or *tax-deferred* annuity. There are also “immediate” annuities which are discussed later.

How do annuities work?

The buyer can purchase annuities with a single contribution or with a series of contributions. Once the accumulation period ends, the contract provides for payout to the buyer (or another designee) to occur either as a lump sum or in a series of payments.

Among the most popular payout options are:

1. Income for life with nothing remaining upon death;
2. Income for life with 10 to 20 years of guaranteed payments to a beneficiary;
3. Income for life with a lump-sum payment at death;
4. Income for life with payments at a reduced level for the life of the survivor; and
5. Income for a specified period, or income of a specified amount.

What are annuities used for?

Tax-deferred annuities are generally regarded as long-term investments intended to fund retirement or other financial goals such as children's education.

What makes tax-deferred annuities particularly attractive for retirement income planning?

Tax-deferred annuities may be particularly attractive to people familiar with Individual Retirement Accounts, or IRAs. Tax-deferred annuities offer the same benefits as non-deductible IRAs but there is no \$2000 contribution limit, no mandatory withdrawal at age 70 ½, and no record keeping and recording requirements like those required for IRAs.

What are the different types of annuities?

There are three types of tax-deferred annuities: fixed, variable, and market value adjusted, which is a hybrid.

1. **A fixed annuity**, according to the American Association of Individual Investors, “credits interest based on the earnings of the general account. Both investment and mortality risks are borne by the company.” The annuity contract specifies a guaranteed minimum rate of return (usually from 3% to 6%) which is reset periodically. The duration of the guarantee varies from one to 10 years. A variation of the fixed annuity is the *equity-indexed annuity*, through which your account accumulates at an annual fixed rate of return. Additional interest may be added to your account depending on the performance of an equity index (often Standard & Poore’s Composite Stock Price Index).
2. **Variable annuities** “allow the annuitant to select from several investment options, and their corresponding returns are credited to the annuitant.”¹ Variable annuity investments are made in stock, bond, and money market funds. Because the purchaser is responsible for selection and allocation (how much of which funds make up the variable annuity investment), the purchaser may pick funds in taxable investments. However, during the accumulation period the investor in variable annuities “incurs no income tax liability for reinvested dividends,

¹ American Association of Individual Investors, <http://www.aaii.com/otherinv/faqs/>

interest, or realized capital gains. The insurance company [which issues the variable annuity] pays a corporate capital gains tax on realized capital gains,” and the investor’s share of those taxes may be deducted from benefits in the annuitant’s account. Variable annuities typically offer the option to also place money in fixed-income accounts, which can help diversify the portfolio.

- 3. Market-value adjusted annuities**, a hybrid of both types noted above, deliver a guaranteed interest rate for a fixed period, usually 10 years. If the contract is surrendered before the guarantee period expires, the cash value is adjusted to reflect the market value of the underlying investments.

What’s a single premium immediate annuity?

With “Single Premium Immediate Annuities” you contribute a lump sum and immediately begin receiving a payout. Taxes on the amount you invest are deferred until payout begins.

Annuity Financing and Payout Options

What financing options are there?

Both “**single premium**” immediate and deferred annuities are purchased with a single contribution. Retirees often purchase single premium immediate annuities with funds received from an employer-sponsored retirement plan, the proceeds from a savings account, the cash value or death proceeds from a life insurance policy, or the proceeds from the sale of a home.

Individuals may purchase “**periodic level premium annuities**” by paying equal premium amounts at regular intervals, such as monthly or annually, until the date the benefit payouts are scheduled to begin. These are always deferred annuities; benefit payouts begin at some future date.

To buy “**periodic flexible premium annuities,**” premiums are paid over time, but the buyer has the option to both vary the premium amount and to skip making deposits. These too are always deferred annuities.

How are the benefits from annuities paid out?

There are a number of options. The major ones are:

1. **Straight life annuity**, which pays income for the rest of your life even if the amount you receive exceeds what you paid in. On the other hand, straight life annuity payouts stop altogether when you die even if you’ve not received the full value of what you paid into the annuity during the accumulation period. Moreover, on your death, any excess funds in your account are not paid out to anyone, not even your dependents. This type of annuity is generally recommended for those who seek maximum income and either have no dependents or have provided for them through other means.

2. **Joint and survivor annuity**, which is paid to you as long as you live and, after you die, to your designated beneficiary as long as he or she lives. You can choose the benefit your beneficiary will receive but bear in mind that this choice affects the payout amount *you* will receive.

3. **Life income with refund annuity**, which provides income for life. If you die before all funds in your account have been paid out, your beneficiary gets what's left.

4. **Life annuity with period certain**, which also provides payments to you for life. It includes a guarantee provision which ensures that if you die within a "period certain" after you start receiving benefits – usually 10 or 20 years – your beneficiary receives regular payouts for the balance of that period.

5. **Other available options** include lump sum distribution, which pays you everything in your account at one time, and **systematic distribution**, under which you receive your account proceeds over a period of years in a series of payments.

How much "payout" will I get?

The payouts you receive depend on which type of annuity you buy and how you configure your payout plan. A number of factors affect how much you will receive, among them:

- Your life expectancy, if you select a lifetime payout plan;
- How much you pay in in premiums, plus any earnings;

- The rate of return the company credits to your account, if you purchased a fixed annuity; and/or
- The investment performance of the funds you've chosen, if you selected a variable annuity.

Different companies offer different contract provisions, including an assortment of sales charges, fees, and interest rates, so it's always best to compare contracts before buying.

Are there any other charges?

By law, all charges and fees are specifically detailed in the annuity contract. If you decide not to keep your annuity contract or take a partial withdrawal, that represents a cost to the company which it recovers through a "surrender charge." Usually, such charges diminish in size the longer you have the annuity contract.

Regardless of which type of annuity you choose, find out what fees are involved and how they will affect your returns. Over time, the advantages of tax-deferred growth can mitigate any negative effect of sales charges and fees on your annuity contribution(s).

Advantages of Annuities

How do current owners of annuities perceive them?

In a 1997 Gallup survey², annuity purchasers said that annuities:

- Have a good rate of return;
- Provide a long-term savings plan;
- Are an important source of retirement security;
- Are an easy way to save for retirement;
- Can ensure a surviving spouse has a continuing income; and
- Provide flexibility in how payouts are received.

What are some of the major benefits of annuities?

There are many, among them:

1. **Tax deferral:** You pay no taxes during the “accumulation period”; taxes are deferred until payouts begin.
2. **Investment flexibility:** Variable annuity assets can be moved from one fund to another without current taxation, which enables you to respond to changes in market conditions or in your personal investment objectives. Fees may apply, however.
3. **Guarantees for beneficiaries:** Most annuities guarantee that if you die before payouts begin, your heirs will receive either what you paid in plus interest, or the market value of the funds in your account, whichever is greater.³

² From “Annuities: The Key To A Secure Retirement,” *American Council of Life Insurance*, www.acli.com, September 21, 1999

³ American Council of Life Insurance

4. **Payout flexibility:** You choose the method by which your annuity payouts are made. You can receive a lump sum, a regular monthly payout until you've received the full value of your account, or a steady stream of income for as long as you live.

5. **Unlimited contributions:** Tax codes do not restrict how much you can contribute to your annuity, which is an advantage not offered by either 401 (k) plans or IRAs.

6. **Payout timing flexibility:** Unlike either IRAs or 401 (k) plans, you do not have to begin receiving annuity payouts at age 70 ½ with annuities. You can receive payouts before age 59 ½, but there may be a 10% penalty in addition to the requirement that you pay ordinary income tax on payouts.

What Annuity is Best For You?

What are the biggest differences between fixed and variable annuities in terms of how they're used?

The “fixed” return of fixed annuities, described earlier, provides little protection against inflation but guarantees a minimum rate of return. The insurer chooses the investment strategy, generally placing assets into bonds and mortgages.

Variable annuities enable investors to select from a spectrum of investment options. However, rates of return, other than any portion of contribution allocated to a “fixed account,” are not guaranteed.

The type of fund you select “depends on the level of risk you want to assume,” says the American Council of Life Insurance. “Over the long term, variable annuities invested in equities generally reflect the growth and performance of the economy and can serve as a hedge against inflation. . . Fixed income accounts can help diversify a portfolio, and their stability may be appropriate if you are nearing retirement.”

How do I know where to begin when analyzing prospective retirement investment options?

There are a number of questions you can ask yourself about your current objectives to determine which annuity products are best suited to helping you reach your goals:

- **How do you want to spend your retirement?** There may be a profound difference in the income required for a quiet, simple retirement versus an active one where you travel frequently, continue to acquire assets, etc.
- **To reach your goal, how much monthly income is required?** The more closely you can quantify your income objectives, the more effectively you'll be able to

develop a program to accomplish them. Many financial professionals recommend you create a monthly income and expense budget now, to get a handle on how much you'll need to live your desired retirement lifestyle.

- **Do you want to receive income immediately, or do you want your savings to grow, tax-deferred, until you need it in the future?** This will determine whether you want an “immediate” or a “deferred” payout.
- **Are you willing to tolerate fluctuations in the value of your assets?** If so, you might well want to consider “variable” annuities.
- **Do you want to finance an annuity through a series of payments over time or in one lump sum – or both?**
- **Are you concerned about outliving your income?**
- **Do you want to receive payouts for a specified period or for life?**
- **Do you need to ensure that your spouse or other dependants will have an income when you pass away?**
- **Does your employer offer a retirement plan?** Company retirement plans are often subsidized, which means the employer may contribute to your retirement funds, potentially enhancing the ultimate bottom-line payout. You should take advantage of such plans to the fullest possible extent.
- **How much will you receive from Social Security?** You can receive “Your Personal Social Security and Benefit Estimate Statement” by requesting a copy of Social Security Administration form SC 7004 from your local Social Security office. Complete and return form SC 7004 and you will receive an estimate of your Social Security at retirement.

Once you set clear goals, you can consider the financial products discussed in this Guide and other options. Social Security, your company retirement plan, your personal savings, prospective annuity investments, and other investments should be planned in such a way that they will all work together to help you achieve the lifestyle you're after. Ultimately you'll want to see a financial professional who can show you alternative strategies to help you accomplish your goals, using different types of annuities and/or other products.

Shopping for an Annuity

Who sells annuities?

Annuities are sold by a variety of financial services companies including banks, brokerage firms, and life insurance companies. However, only life insurance companies actually *issue* the annuities sold by other types of financial institutions.

How do I check the stability of the life insurance company issuing my annuity?

You need not research thousands of life insurance companies to compare their relative merits. Instead, you can consult one of the five top insurance rating companies. Of these, perhaps the two best known are A. M. Best Company, Inc., and Moody's Investors Service, Inc. In materials which life insurance companies send to you, they often print their ratings. Best's ratings are: Superior: A++, A+; Excellent: A and A-; Very Good: B++, B+; Good: B and B-; Fairly Good: C++, C+; Fair: C and C-; Below minimum standards: D; Under state supervision: E; and In liquidation: F. Moody's ratings are: Aaa – Exceptional; Aa – Excellent ; A - Good; Baa – Adequate; Ba – Questionable; B – Poor; Caa - Very Poor; Ca - Extremely Poor; and C – Lowest.

How are ratings determined?

Ratings are based on many factors, including overall financial resources and stability, and other factors. A. M. Best charges for "Risk Profile" reports of companies. You can reach Best at Ambest Road, Oldwick, N. J., 08858, or call them at 908-439-2200. Moody's is at 99 Church Street, New York, New York 10007, or call them at (212) 553-1658. Moody's publishes many ratings directly on its Web site at www.moody.com under "Insurance." In materials which life insurance companies send to you, they often print their ratings. It's always advisable to do business with top-rated companies.

Of course, the insurance company you pick should be reputable, service-oriented, and financially strong. You can also check with your state's insurance department to be sure the company is licensed to do business in your state.

What questions should I ask of the company representative when we discuss annuities?

When buying a fixed annuity, find out the current interest rate being credited under the annuity, how often it changes, and the minimum interest rate guaranteed in the annuity contract.

If you are purchasing a variable annuity, find out what kind of fund options are offered.

Am I supposed to get a prospectus?

A prospectus *must* be given to all purchasers of variable annuity contracts registered with the Securities and Exchange Commission (SEC) and it must be delivered before the purchase or no later than the statement confirming the purchase. Read the prospectus thoroughly; it discloses essential information such as fund objectives, operating expenses, financial statements, and investment risks.

How stable are returns from variable annuities?

Returns from variable annuities fluctuate with the performance of the funds backing the contract. You assume the investment risk that account values may go up -- or down -- on a daily basis. Returns of variable annuity investment accounts are published monthly in *The Wall Street Journal*.

What if I change my mind after I buy?

Review your objectives, options, and expectations thoroughly before buying. After you buy, you may still be entitled to a “free look” of at least 10 days after you receive your annuity contract, during which you can change your mind. Read your contract carefully during the “free look” period. If you decide not to keep it, the company will cancel it and give you a refund calculated by the terms of the contract or by state law. Not all states require a free look, so be sure to ask the representative with whom you speak if it applies in your state.

When do I have to pay taxes on my annuity earnings?

Once you start receiving payouts, the Federal government begins to tax a portion of your accumulated earnings. If the payout option you select calls for a stream of payouts, part of each payout will be considered a return of earnings and will be taxed as ordinary income; the other part represents your contributions and is not taxable. Your annuity earnings also may be subject to state taxes. Different types of payouts may have different tax consequences. You should consult your tax advisor to help determine what type of payout both meets your objectives and minimizes taxes.

What if the insurance company gets into financial trouble after I buy an annuity? Do I have any protection?

A state guaranty association protects you in the unlikely event the insurance company has financial trouble. Such associations are created by state law to ensure that claims of policyholders of insolvent insurance companies who live in the state will be paid, *subject to the limits of the law*. All life and health insurers are required to belong to their state’s association.

Annuities purchased from banks do not have added protection from the Federal Deposit Insurance Corporation (FDIC). Also, annuities purchased from brokerage houses do not have added protection from the Securities Investor Protection Corporation (SIPC).

What if I have more questions?

Your financial professional is well equipped to answer any annuity-related question. Annuities can be key to a secure retirement; it's important that you clearly understand them.

A Word About AXA Advisors

AXA Advisors provides financial strategies, investment, and insurance solutions for consumers and businesses throughout the United States.

AXA Advisors is a member of the global AXA Group, a financial services powerhouse operating in 50 countries with \$655 billion in assets under management (as of 12-31-98) ... and one of the largest insurance providers in terms of premiums, worldwide.

Through its network of 7,000 financial professionals, AXA Advisors works closely with clients to help define their financial goals ... then provides access to an extensive portfolio of investment and insurance products from leading companies ... including its affiliates, The Equitable Life Assurance Company of the United States, and the investment firms of Alliance Capital Management L.P. and Donaldson, Lufkin & Jenrette, Inc.

What sets AXA Advisors apart from other financial services organizations is its people.

AXA Advisors financial professionals are among the best in the business, many with backgrounds in law, accounting, financial planning, estate planning, or investments ... all professionals dedicated to achieving success for their clients.

In fact, AXA Advisors has more associates with both the Chartered Life Underwriter (CLU) and Chartered Financial Consultant (ChFC) designations* than any other financial services firm.

Your financial professional from AXA Advisors can work closely with you to identify your needs and goals, assess your current plan, and implement an individual strategy designed to meet your financial objectives.

For more information on how to put AXA Advisors to work for you, your family and your business, you are invited to call 000-000-0000, or visit us at our Web Site (www.axa-advisors.com).

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*Professional designations of The Society of Financial Service Professionals of Chartered Life Underwriter (CLU) and Chartered Financial Counselor (ChFC)

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Annuity Glossary of Terms

Accumulation phase:

The period during annuity contract holders are “accumulating” savings for retirement or another objective. If funds are not withdrawn during this period, taxes on accumulating funds are deferred.

Anniversary and issue dates:

The date the annuity contract is issued is its “issue date,” which is usually when the issuing company has received the completed application and initial contribution and has processed them. The contract is effective on the issue date. The anniversary date is exactly one year following the issue date.

Annuitant:

The annuitant is the person who receives annuity payouts from the company during the annuity contract’s payout period. Usually, the annuitant is designated by the annuity contract’s owner. In most cases, the owner and the annuitant are the same person.

Annuitization:

The process by which the owner of an annuity elects to receive its value in periodic payments.

Annuity:

Annuities are contracts between financial services companies and buyers which enable the buyer to make “investments,” or payments to the company, which grow tax-deferred through an “accumulation period.” Annuities are usually regarded as retirement savings vehicles but can be used to save for children’s education or for other purposes.

Annuity maturity date:

The date on which an annuity automatically annuitizes, or the date on which the accumulation phase ends and the payout phase begins.

Asset allocation:

The manner in which you divide your investment into various classes of assets.

Asset classes:

There are three asset classes: *cash and equivalents to cash*; *fixed income* instruments such as bonds and bond funds; and *equities*, such as stocks and stock funds.

Beneficiary:

The beneficiary is the person elected by the contract owner to receive the death benefit when the contract owner passes away; there is not always a death benefit. See *death benefit*.

Contract owner:

The person who makes contributions into the annuity and who usually receives its payouts, or who designates someone else to receive them.

Death benefit:

The beneficiary receives the value of the account as a death benefit if the contract owner dies either during the annuity's accumulation period or when payouts are underway. Frequently the death benefit is the amount invested in the annuity.

Diversification:

Placing investments in a broad range of assets to reduce risk. Among assets generally used in diversified investment portfolios are real estate, bonds and stocks, and securities, often involving a spectrum of industries in a number of countries.

Fixed annuitization:

A fixed annuity's payout phase, during which all payments are equal.

Fixed annuity:

An annuity offering either a guaranteed interest rate during accumulation, usually for a certain period of time, or a preset payment amount during the payout phase.

Free look:

A period of time during which an annuity contract owner can examine his or her annuity contract and return it to the company. The duration of the “free look” varies by state from 10-20 days, during which the owner can receive either the amount of the investment or the account’s current value if the owner decides *within the free-look period* not to continue the contract.

Guaranteed period / fixed period:

In a fixed annuity, the period of time during which the interest rate is guaranteed.

Income options / payout options:

Choices for annuity payouts, including lump sum payment, systematic withdrawals (usually equal in amount), partial withdrawals, or annuitization.

Initial purchase:

The contribution that opens an annuity account. Subsequent payments are frequently less.

Mortality and expense risk charge, or M&E:

Variable Annuities have two annual fees, one of which is the M&E or asset charge which is for the annuity itself. The other charge is for expenses and funds management.

Payout:

Funds paid to the annuitant during annuitization. The “payout phase” is when this occurs.

Premium taxes:

A few states charge a tax on monies paid into annuities. The companies that issue the annuities pay the taxes, then usually charge the annuity owner the amount of the tax. If you have specific questions concerning tax consequences of investments, consult your tax advisor.

Rebalancing:

Because the various investments in “asset allocation” accounts grow at different rates, “rebalancing” is occasionally required to ensure that the desired asset allocation percentages are maintained.

Surrender value:

When an annuity contract owner cancels an annuity contract and withdraws all the money in it, he or she receives its surrender value. Surrender charges and early withdrawal penalties are deducted before the actual surrender value is determined.

Systematic withdrawal:

Instead of “annuitizing,” contract owners can withdraw a percentage of the value of their annuity on a regular basis. There are two disadvantages: surrender charges may apply, and the account could be exhausted before death.

Tax deferral:

No taxes are collected on annuity earnings until funds are withdrawn.

Tax-deferred compounding:

Investment earnings that would have been paid in taxes in a non-tax-deferred investment remain in the annuity investment, earning a compounded “interest on interest” investment return.

Tax-free transfers:

Annuities allow the movement of invested funds between various investment choices without any tax liability provided no funds are withdrawn.

Total return:

This is a measure of investment performance which takes into account the appreciation of or loss on investments and assumes that dividends or investment income or interest are reinvested in the account.

Variable annuitization:

An annuitized variable annuity yields payments of variable amounts depending on the performance of its investments.

Variable annuity:

A retirement savings product on which taxes on earnings are deferred during the accumulation period. Payouts may be annuitized to last for the annuitant's lifetime. The value of variable annuities changes according to the performance of its investments.

Variable investment options:

Investment choices applicable to owners of variable annuity contracts.

Surrender (or withdrawal) charges:

Fees charged upon surrender of a variable annuity contract, or upon withdrawal of funds from a variable annuity contract. Not all contracts have surrender charges and for many that do, they are not applied if the annuity contract has been in force a specified number of years.

(End)

January 10, 2000