

Understanding Annuities: A Lesson in 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:

Table of Contents	Page
Annuity Objectives	2 - 3
What Is an Annuity?	3
How Are Annuity Premiums Invested?	3
A Closer Look at Equity-Indexed or Indexed Annuities	3 - 4
Why Choose an Indexed Annuity?	4
Indexed Annuity Contract Features	5 - 6
Indexing Methods	6 - 7
Indexed Annuity Riders	7 - 8
Indexed Annuity Income Phase	8
Annuity Income Options	9
How Are Indexed Annuities Taxed?	10
Indexed Annuity Advantages and Disadvantages	11
Indexed Annuity Checklist	12
Important Information	13

Brought to you by:



Bill Clark, Ph.D., CLU, ChFC

Clark Financial Group, Inc.
6898 Lebanon Rd, Ste 101
Frisco, TX 75034
Office: (469) 287-5657
bill@wrclark.com

Advisory services offered through CFG Advisors LLC, insurance products sold through Clark Financial Group, Inc. CFG Advisors LLC and Clark Financial Group, Inc. are affiliated companies.

October 25, 2012

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.

There are two basic types of annuities, depending on whether you need to accumulate assets for retirement or whether you're at or near retirement and interested in creating a lifetime retirement income:

Deferred Annuities A deferred annuity has two distinct phases: the accumulation phase and the income phase.

- **During the accumulation phase**, you contribute premiums to the annuity, where they accumulate on a tax-deferred basis until needed for income purposes.
- **During the income phase**, the value of the annuity is converted into income payments.

Immediate Income Annuities An immediate income annuity is purchased with a single premium and **income payments begin immediately** or shortly after the premium is paid.

How Are Annuity Premiums Invested?

Depending on your investment objectives and risk tolerance, there are a variety of ways that you can choose to invest your annuity premiums:

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.

Variable Annuities

During the **accumulation phase** of a variable annuity, premiums less any applicable charges are placed in a separate account of the insurance company, where the annuity owner can invest them in one or more stock and bond subaccounts. During the **income phase** of a variable annuity, the amount of each income payment may be fixed and guaranteed*, or it may be variable, changing with the value of the investments in the separate account.

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 tied 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 market risk than variable annuities. Since the minimum guaranteed interest rate is, however, combined with the 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.

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

A Closer Look at Equity-Indexed or Indexed Annuities

The indexed annuity is a hybrid of the fixed interest annuity and the 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, meaning that it has less market risk than does a variable annuity.

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 interest payable in excess of the minimum guaranteed* interest rate is determined by a formula contained in the annuity contract. This formula is determined by a variety of indexed annuity contract features, including:

- **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.

Why Choose an Indexed Annuity?

An indexed annuity provides the opportunity to benefit from potential gains in the equity markets, while paying a stated minimum interest rate during market downturns. An indexed annuity is a compromise between a fixed interest annuity and a variable annuity. The return on an indexed annuity varies more than a fixed interest annuity, but not as much as a variable annuity. As a result, an indexed annuity has more risk and more potential return than a fixed interest annuity, but less risk and less potential return than a variable annuity.

An indexed annuity may be right for you if you want to participate in the potential gains from the equity markets, while limiting your potential losses during market downturns. As a result, 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

Indexed Annuity Contract Features

Before purchasing an indexed annuity, it is important to understand various contract features and their potential impact on annuity performance.

The Index	Indexed annuities credit interest based on the movement of the stock market index to which the annuity is linked. A market index tracks the performance of a group of stocks representing a specific market segment or the entire stock market. The S&P 500 is the index most commonly used for this purpose. Another index, however, may be used, such as the Dow Jones Industrial Average, NASDAQ 100 or Russell 2000. It is important to understand that when you buy an indexed annuity, you are purchasing an insurance contract and not shares of any stock or index.
Indexing Method	An indexed annuity earns a minimum rate of interest and then offers the potential for excess interest earnings based on the performance of the index to which the annuity is linked. The indexing method is the approach used to measure the amount of change in the index and, as a result, has a direct impact on the potential growth of an indexed annuity. Additional information is available on page 8.
Participation Rate	The participation rate determines how much of the increase in the index will be credited to the indexed annuity. The participation rate is usually less than 100%. For example, if the S&P 500 increases by 10% and the participation rate is 80%, the indexed annuity would be credited with 8%. The insurance company may have the right to change the participation rate from year to year or when the annuity is renewed for a new term.
Margin/ Spread/ Administrative Fee	Some indexed annuities subtract a specific percentage from the calculated change in the index before crediting interest to the contract. This "margin," "spread" or "administrative fee," which may be charged instead of, or in addition to, a participation rate, is subtracted only if the change in the index produces a positive interest rate.
Index Term	This is the period over which index-linked interest is calculated and/or the length of time during which withdrawals or surrenders are subject to a charge.
Cap Rate	Some indexed annuities put a cap or maximum on the index-linked interest that will be credited to the annuity. For example, if the market index increases 20% and the annuity has a 15% cap rate, only 15% will be credited to the annuity. Not all annuities have a cap rate.
Floor	This is the minimum guaranteed interest that will be credited to the annuity. This guarantee is based on the claims-paying ability of the issuing insurance company.
Averaging	Some indexed annuities use an average of the changes in the index's value rather than the actual value of the index on a specified date.

Interest Compounding	Some indexed annuities pay simple interest during the index term, while others pay compound interest, meaning that index-linked interest that has already been credited to the contract during the term also earns interest in the future.
Exclusion of Dividends	In measuring index gains, most indexed annuities count only equity index gains from market price changes and exclude any gains from dividends.
Vesting	In some indexed annuities, none or only part of the index-linked interest is credited to the contract if the annuity is surrendered before the end of the term.

The combination of these policy features found in any particular indexed annuity will make a difference in the amount of money your annuity investment will earn and in the amount of money you will receive if you surrender the annuity early. As a result, before you purchase an indexed annuity, it is important that you fully understand the various features in the contract you are considering.

Indexing Methods

Each indexing method generally contains preset combinations of features, which impact the potential growth of your annuity investment.

Indexing Method	Advantages	Disadvantages
<p>Annual Reset (or Ratchet)</p> <p>Index-linked interest is determined each year by comparing the index value at the end of the contract year with the index value at the start of the contract year. Interest is added to your annuity each year during the term. Any declines are ignored.</p>	<ul style="list-style-type: none"> ■ Future decreases in the index will not affect interest already earned. ■ May credit more interest than other indexing methods when the index fluctuates up and down often during the term. ■ Any gain is locked in each year. 	<ul style="list-style-type: none"> ■ May be combined with other features, such as averaging and lower cap rates, that work to limit the amount of interest credited each year. ■ The participation rate may change each year and generally be lower than that of other indexing methods.
<p>High Water Mark</p> <p>Looks at the index value at various points during the term, usually annual anniversaries. Interest is then based on the difference between the highest index value and the index value at the start of the term. Interest is credited at the end of the term.</p>	<ul style="list-style-type: none"> ■ May credit higher interest than other indexing methods if the index reaches a high point early or in the middle of the term and then drops off at the end of the term. ■ Provides some protection against declines in the index. 	<ul style="list-style-type: none"> ■ Since interest is not credited until the end of the term, index-linked interest may not be paid if the annuity is surrendered before the end of the term. ■ May be combined with other features, such as lower cap and participation rates, that limit the amount of interest earned.

Indexing Method	Advantages	Disadvantages
<p>Point-to-Point</p> <p>Compares the change in the index at two distinct times, such as the beginning and ending dates of the contract term.</p>	<ul style="list-style-type: none"> ■ May be combined with other features, such as a higher cap rate or higher participation rate, which may result in a higher rate of interest being credited. 	<ul style="list-style-type: none"> ■ Relies on a single point in time to determine interest, meaning that an earlier gain can be lost if the index decreases dramatically at or near the end of the term. ■ Since interest is not credited until the end of the term, index-linked interest may not be paid if the annuity is surrendered before the end of the term.

Indexed Annuity Riders

Indexed annuities may offer several riders, all designed to provide guarantees and additional flexibility. These include:

Guaranteed Lifetime Withdrawal Benefit (GLWB Rider)

Provides a guaranteed annual withdrawal throughout your lifetime, without the need to annuitize the contract. With the GLWB rider, withdrawals continue even if the annuity's account value decreases or is exhausted. The annuity owner can elect to stop taking withdrawals and still have access to any principal remaining in the contract. Withdrawals are subject to ordinary income tax and, if made prior to age 59-1/2, may be subject to a 10% penalty tax.

Enhanced Death Benefit

An enhanced death benefit rider should be considered if you want to pass on a legacy to your heirs. Some enhanced death benefit riders guarantee that the death benefit will increase by a specified amount each year, regardless of the annuity's underlying performance. Other enhanced death benefit riders combine an income stream with an enhanced death benefit.

Long-Term Care Rider (LTC Rider)

An LTC rider offers the flexibility of having access to a portion of the annuity's principal to pay for long-term care expenses without any applicable annuity withdrawal or surrender charges. In addition, the cost of any long-term care benefits paid from the annuity contract will not be included in income for income tax purposes.

Indexed annuity riders are optional, require payment of an additional fee, and the guarantees provided by these riders are based on the claims-paying ability of the issuing insurance company. Be sure you understand the benefits and costs before purchasing an indexed annuity rider.

Indexed Annuity Income Phase

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

Lump Sum Distribution

You can surrender your indexed annuity and receive the entire value in a lump sum payment. This option requires that income tax be paid on the indexed 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 indexed annuity into a lifetime income or into a stream of payments for a fixed period of time. As reviewed on page 9, 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 indexed 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	<ul style="list-style-type: none"> ■ 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	<ul style="list-style-type: none"> ■ 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	<ul style="list-style-type: none"> ■ 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	<ul style="list-style-type: none"> ■ 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)	<ul style="list-style-type: none"> ■ 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. <p>* All guarantees are based on the claims-paying ability of the issuing company.</p>
Flexibility	<p>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.</p>

How Are Indexed Annuities Taxed?

During the Accumulation Phase:

- Earnings credited on the funds in an indexed annuity are tax deferred, meaning that the earnings are not taxed while they remain in the annuity.
- Withdrawals from an indexed 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 death benefit of the indexed 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.

Indexed Annuity Advantages and Disadvantages

An indexed 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 indexed annuity.

Advantages:

- An indexed annuity provides the opportunity to benefit from a rising stock market with an interest rate linked to a market index, while also offering a minimum guaranteed interest rate.
- Indexed annuity earnings 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:

- 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 an 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. Withdrawals will reduce the value of the death benefit and any optional benefits.
- There is a 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.
- 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, the payment amount cannot be changed and withdrawals above the payment amount generally are not available.

Indexed Annuity Checklist

Once you decide that an indexed 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	<p>The indexed annuity fees and expenses an insurance company charges can include:</p> <ul style="list-style-type: none">■ Premium charges deducted when premiums are paid;■ A margin, spread or administrative fee, which is subtracted from any gain in the index before interest is credited to the annuity;■ An annual maintenance fee (e.g., \$30); and/or■ Surrender charges assessed if the annuity is surrendered or withdrawals are made. <p>Carefully evaluate fees and expenses, since they will impact the amount of money ultimately available in the annuity.</p>
Insurance Company Ratings	<p>Since an indexed 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.</p>
Annuity Features	<p>Make sure you understand the terms and limitations of an indexed annuity contract before you purchase it, including:</p> <ul style="list-style-type: none">■ the indexing method used and the term of the contract;■ the minimum guaranteed interest rate;■ the participation rate and for how long it is guaranteed;■ policy features such as a cap, whether averaging is used and if interest is compounded during a term;■ any vesting provisions and withdrawal and surrender options;■ how the death benefit is determined and the payout options available;■ 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, neither VSA, L.P. nor The National Underwriter Company is 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.

U.S. Treasury Circular 230 may require us to advise you that "any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed and you should seek advice based on your particular circumstances from an independent tax advisor."

© VSA, LP All rights reserved (VSA 1a2-17 ed. 06-12)