Severin Investments, LLC

UNDERSTANDING ANNUITIES

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INTRODUCTION

An annuity is a complex contract between an individual and an insurance company. Annuities can be beneficial for some individuals as a component of their investment strategy. However, they are not suitable for every investor, and there are aspects to them that your sales representative may not disclose. Annuities have many pros and cons associated with them, and this publication is not intended to be an exhaustive list. However, it is intended to outline some basic facts about the most common types of annuities you can purchase.

As you read this book, remember that you and your family are unique. The book is not intended to serve as investment advice and is generic in nature. Please contact a licensed representative if you want specific advice for your unique situation.

If you'd like to learn more from us, you can reach a representative from Severin Investments by calling our toll-free line at 866-983-2707 or emailing info@severininvestments.com.

ANNUITY BASICS

WHAT IS A RIDER?

Riders are amendments to the annuity that either expand or restrict its benefits.

For example, a Death Benefit is one of the most common riders to add to an annuity, which allows you to name a beneficiary.

There are many different types of riders that can be added onto an annuity contract. Each rider is an additional fee. The more riders you add, the more expensive your contract will be.

Annuities are designed to provide an individual or couple with an income stream for life. They are one of the most poorly understood but widely used investment vehicles available. This is because there are so many different types of annuities with contracts that vary according to the additional riders that are added. Sometimes, the contract can be so complicated that it can feel like it was designed just to confuse you. Furthermore, insurance agents are not held to the fiduciary standard, so they are not required to help you choose a product that is actually in your best interests. This is why working with someone who is knowledgeable and who you feel truly cares about your best interests is critical when considering one.

Some financial advisors and insurance agents like to sell annuities as guaranteed investments. Don't be fooled; there are no guarantees on any investment. Annuity contracts are not FDIC insured, and therefore have risk and may lose value—just like every other investment product. If the insurance company goes out of business or files for bankruptcy, you could lose a portion or all of your money.

Additionally, insurance companies are not in the business of giving money away. If you are receiving an income stream from the annuity, the insurance company is receiving money from you in return. Many people have no idea how expensive their annuities are because the contracts are so complex and confusing.

Furthermore, when the annuitant passes away, all annuities are set up so that beneficiaries pay ordinary income taxes on their inheritance, if any. On other types of investments, however, beneficiaries in non-retirement accounts aren't subject to ordinary income taxes. In fact, they can receive stepped up cost base to the date of death. This means the cost basis on the investment resets as if it was purchased the day the account holder passed away. Often, this helps reduce capital gains liability for the beneficiaries.

If you are dead-set on entering the world of annuities, always ask about commissions and fees. It is best to assume that everything you can customize in the contract is an additional fee, and you should make sure you understand all the fees involved with your annuity.

Over the next few pages, we will discuss fees in more detail as well as outline some generic examples of how annuities work.

Because annuities vary so much depending on the type you buy, the rest of the information in this book is split up according to four basic annuity types: Immediate, Fixed, Indexed, and Variable.

Immediate Annuities

Immediate annuities are like pensions. Any annuity can be turned into an immediate annuity by annuitizing, which turns on the annuity's income stream. Once annuitized, the insurance company will usually invest the mon treasury bills and mortgage backed securities. When you start the immediate annuity, you will be offered several payout options, and once chosen, it can never be changed. Some of these payout options are:

- Life Income Cash Refund- provides income on one individual for life and refunds remaining cash value to surviving beneficiaries. The insurance company does not promise any remaining cash value after 10 years, so if you live longer, your beneficiaries may not receive anything.
- Life Income, No Refund- provides income on one individual for life; insurance company keeps any cash value when annuitant passes.
- 5, 10, 15 Year Certain- provides income for the specified time only. If the annuitant passes away before 5, 10, or 15 years,

IMMEDIATE VS. DEFERRED

All annuities are either immediate annuities or deferred annuities. You can buy an immediate annuity with an income stream that starts right away. More commonly, people buy deferred annuities and annuitize them at a later date. Deferred annuities are in the accumulation stage, and may have a higher interest rate or growth potential than an immediate annuity. There is no current income stream on a deferred annuity, and you can surrender the annuity at any time. However, there may be a surrender penalty if you haven't owned the annuity long enough for the penalty to expire.

monthly payments are made to the beneficiary for the remaining time period. Leftover cash value is kept by the insurance company.

- Life Income with Joint Survivor- provides income based on two individuals lives. Once the first individual passes away, the surviving spouse may continue to receive part or all of the payment. Once the second spouse passes, the insurance company keeps any remaining cash value.

Once you annuitize the annuity, you have given up all rights to the money in the annuity. The money you earned now belongs to the insurance company. If you have an emergency, you will not be able to access the money.

When income is calculated on an immediate annuity, the insurance company uses your life expectancy to determine the percentage of principal and earnings paid out to you each month. This is done by taking your life expectancy, and paying out a percentage of principal and interest. This means that a percentage of your income is tax free, because your deposit is being paid out to you. On life income and 5, 10, 15-year certain, there will not be any money left to your beneficiaries. You take the risk that you will pass away before you deplete the cash value in the account.

If the annuity is not an IRA, any interest earned will be taxed at your ordinary income rate. If it is an IRA, just like with any other investment, the entire amount is taxed at your ordinary rate. We do not recommend using annuities for IRAs.

When your beneficiaries inherit the annuity, they will pay ordinary income tax on the earnings only, unless the annuity is an IRA—then ordinary income taxes must be paid on the entire amount.

Fixed Annuities

There are other investments for non-retirement accounts that may be more tax-advantageous to you and to your beneficiaries when you pass away. There are also other investments that will provide you with better liquidity if you need to access your funds.

Fixed annuities are the simplest type of deferred annuity.

They have surrender penalties that can go out 7 years, but you can take out up to10% per year penalty free. Fixed annuities guarantee a fixed interest rate until the contract is annuitized. The contracts usually start with a higher rate, called a bounce rate, to entice you. After a year or two, the interest rate drops down to the fixed rate, which is usually around1% or 2%. Like all annuities the money grows tax deferred, and if you want to surrender before you're 59 1/2, you'll pay a tax penalty of 10% on top of the surrender fee. When you take the money out, you'll pay your ordinary income tax rate, not the capital gains rate, which is usually lower. And when your beneficiaries inherit the money, they will pay ordinary income taxes as well.

SURRENDER PENALTIES

Most deferred annuities have surrender penalties, and the few that don't charge an ongoing fee to remove that feature (another example of a rider). Surrender penalties are put in place to deter the investor from taking money out of the annuity for several years. Annuities with longer surrender penalties usually pay higher commissions to the agent than comparable annuities with short surrender penalties.

Indexed Annuities

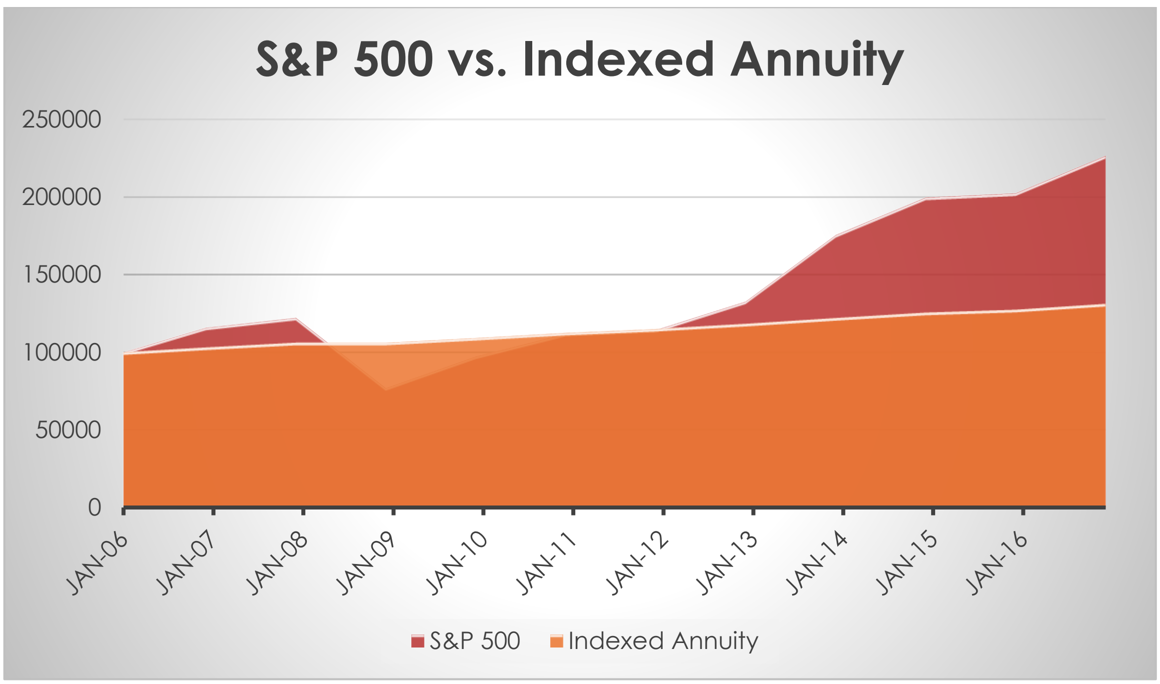
Indexed annuities, also known as "fixed indexed annuities" have the same tax consequences and penalties as all other annuities, and beneficiaries still pay ordinary income taxes regardless of the type of account. Unlike other annuities, indexed annuities can have surrender penalties that go out 10 or even 15 years. Insurance agents and some financial advisers like these types of annuities because of the high commissions.

They have two buckets: a fixed bucket and an indexed bucket. Part of your money can be in the fixed bucket and part in the indexed, but each dollar must go in one or the other. The fixed bucket will give you a fixed return of about 1% to 2%. The indexed bucket has a participation rate, which allows you to participate in a percentage of an index you choose to track. Most participation rates are 3%. This means if the index increases 8%, you go up 3%, but you're guaranteed not to lose money.

ELIMINATE DOWNSIDE RISK?

Most indexed buckets have a minimum return of 0%, so if the index loses money, your account value will not decrease. An insurance agent or advisor may tell you there is "no downside risk" or "no market risk". While this is technically true, you are sacrificing most of your upside potential and the ability to easily access your money.

The best way to illustrate all of the upside potential you sacrifice when investing in an indexed annuity is through an example. Let's say you have a 10-year indexed annuity (this means you have to leave your money in that annuity for 10 years) and you are benched to the S&P 500 with a 3% participation rate (3% cap). If the S&P is down, your account stays stagnant, but you can only participate up to 3% per year in growth. If you purchased the annuity in January 2006, two years before one of the largest recessions in history, how would your account have done compared to the S&P 500 over ten years? Let's take a look. If you invested $100,000, your indexed annuity would have been worth $131,135 at the end of 2016. Had you actually invested your money in the S&P, you would have had $226,579. That's $95,444 difference—almost the entire amount you invested.



Past performance is no guarantee of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance levels, or be suitable for your portfolio.

That being said, the S&P 500 has more risk than most people want to tolerate, but you don't have to choose one or the other. You can invest in a risk-based portfolio that has no surrender penalties, and actually gives you the opportunity for growth at a measured risk that you are comfortable with taking.

VARIABLE ANNUITIES

Like fixed annuities, variable annuities (VAs) usually have surrender penalties that go out 5-7 years, grow tax deferred, and are taxed at your ordinary income rate with tax penalties if you are under 59 1/2. Rather than give you a fixed interest rate, variable annuities bring market risk into the equation.

VAs have a list of sub-account options for you to choose, which are similar to mutual funds. Unlike mutual funds, which purchase shares, VAs purchase units. You have a fixed number of units, no matter how much the account value grows. The only way you can purchase more units is by adding more money to the annuity.

You always want to buy an investment that can build more shares without you coming out of pocket, especially if you are taking income in an IRA. In a VA, when you sell units to create income, you start to deplete your units. If you start with 1000 units and you sell 50 to make income, you now have 950. When the market pulls back, you have to sell more units to get the same amount of income, maybe 75 instead of 50, and you aren't able to replace them through reinvestment. Now you have 875 units, and when the market starts going up again, you have fewer units

SHOW ME THE FEES

Variable annuities can be the costliest and most complicated annuities available, especially when they are loaded with riders, which usually run .5% to 1% per amendment. This is because the sub-accounts also have fees, and those cost .9% to 2% and higher! Tack that onto the Mortality and Expense fee that every annuity has (around 1.5%) and you could be paying as much as 6% inside without even knowing it!

working for you. This increases the risk of depleting your money. Ideally, in order to help prevent depletion, you would allow dividends to build up in your investment account and use them to invest when the market dips so you can buy more shares at a lower price. Dividends give you the ability to buy more shares without taking money out of your own pocket, which gives you more opportunity for growth and a higher likelihood of sustaining your account.

If each investment were to have the same returns over the same time period, you are much less likely to deplete your money using dividend reinvestment over a variable annuity.

Alternatively, you can still annuitize a variable annuity. When it becomes an immediate annuity, unlike a fixed annuity, your income will fluctuate with the market, although you are guaranteed an income stream over a period of time (even for life). However, as mentioned in the immediate annuity section, the money now belongs to the insurance company, and you are only entitled to the specified payout amount.

AFTERWORD

I generally do not advocate for the purchase of annuities because I believe that there are better ways to provide you and your spouse with a good income and help you reach your goals. If you would like to learn more about how we help our clients without charging exorbitant or hidden fees, and without any penalties or commissions please call my office today at 866-983-2707 to speak with a licensed financial advisor.

Disclosures:

The purpose of this booklet is to provide generic information about annuities and some of their most common features. It is not meant to offer legal, financial, or tax advice. If you would like advice specific to you, you may want to consult a professional that specializes in one of these areas. This booklet is not about any particular annuity product, and an annuity may have different features than described herein.

All investment products involve risk of loss.