OCTOBER 2013

Why Would Anyone Buy This?

Once upon a time there was an invention in the financial world. Someone got the idea that investments should be sold as an insurance product designed to guarantee retirement income.

On the surface, this seemed like a good idea. Then someone asked the question: 'what if the market goes down and the owner can't get his value out of the plan?' The wise men thought about it, and said: 'we'll guarantee a refund of principal if the policy isn't worth anything when the person needs it, and we'll charge a big fee for this.'

Then someone asked the question: 'well if there was an increase, then the market crashed, and the family was relying on this money, what can we do then?' The wise men thought about it, and said 'we will create a death benefit rider, and charge a big fee for it'.

Then another person asked: 'what if they get to a certain age and need income, and the plan either has not performed, or lost money? The wise

Why would anyone buy this? (cont)

men conferred again, and replied: 'we will make a rider guaranteeing the owner that he can get his principal back at a certain percent until the principal is gone. We can charge a big fee for this.' The skeptic asked one more question: 'what happens when the principal is paid back and the policy was underwater when they started their income?' The wise men smiled. 'Their policy and income ends, and we charged a big fee for that'.

The skeptic paused. He thought about what he had just heard. Why would someone pay a FEE to get their money back, a FEE to have income based on just their principal, and a FEE for a death benefit? Why would they do that when they can get *lifetime* income guarantees, *increasing death benefits*, market participation with no risk to principal, and *nursing home income protections and ever increasing additions to income accounts with little or no fees?* The skeptic concluded: I don't know!

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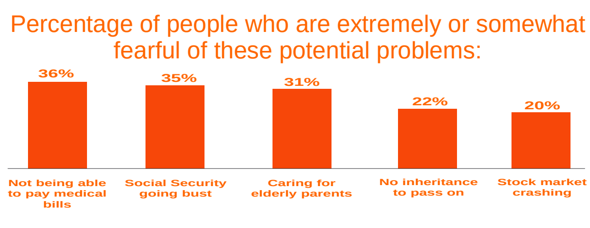


Phillip M. Scheiber, FICF
(952) 649-0504
www.srins.com

Every time a lawyer writes something, he is not writing for posterity. He's writing so endless others of his craft can make a living out of trying to figure out what he said. It is probably he hadn't really said anything, that's what makes it so hard to explain.

--Ronald Reagan by way of Will Rogers.

Will Social Security Be There?

According to the Trustees' Report, the following facts are known:

(1) By 2033, Social Security trust fund is expected to be depleted[1]

(2) Revenue in system will be adequate to pay about 75% of accrued benefits, declining to <u>73%</u> by 2086[1]

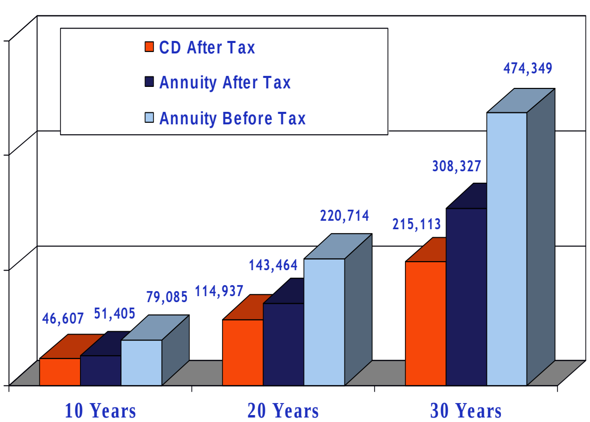
(3)Congress will have to make changes:
Reduction of future benefits?
Increase taxes?
Combination?

This alone stresses the need for income planning with guarantees. Since, in my opinion, we cannot count on the politicians to adroitly address this fact in an adult fashion that secures us all, I believe we must do our own planning as if this promise is just that, a promise, and not a fulfilled commitment. S&R Insurance Services works to make sure that if this comes to pass, <u>OUR</u> clients will not suffer a 25-27% DECREASE in their standard of living.

The Power of Tax Deferral

Many people rely on taxable accounts to enhance their retirement income. Because CDs are popular instruments, the chard below illustrates the advantage of placing income producing assets in to an annuity. As you can see, given interest rate and tax rate assumptions, the annuity outperforms the CD (or other instrument) in an accumulation model. This illustration does not show the difference in INCOME production, especially lifetime income. However, it does display the long term effects of tax deferral.

Example illustrates the difference in gain on $100,000 premium between a taxable CD and a <u>tax-deferred annuity</u> (before and after taxes). Assumes a 6% interest rate and a 35% tax rate.



If one were to analyze the income difference at the 20 year mark, given these assumptions, the annuity would generate a gross income of **<u>$13,250</u>** a year **<u>FOR LIFE</u>**. The CD has no such contractual arrangement.

ANNUITY ›

What Guaranteed Income *Really* Means

Annuity riders can guarantee income for life, but just how much income must be made absolutely clear.

By Bill Kanter

Annuities are great for tax-free accumulation without stock market risk. However, given low interest rates, the interest rate caps on IAs are not very exciting.

Fortunately, an added income rider to an annuity contract (also called a guaranteed withdrawal benefit rider or GWBR or a lifetime income benefit rider or LIBR) can be a godsend when it comes to guaranteeing great income that will last if the client lives to 87, 97 or 127.

The problem is that producers must do an honest job of explaining what these riders do – and what they do not do.

To illustrate, consider the following discussion that I, Bill Kanter, (BK) often have with a Prospective Client (PC) while discussing retirement planning and longevity:

PC: "I have an annuity and I am making 6.5 percent annually compounded on my money, guaranteed!"

BK: "No, you are not making a guaranteed annual rate of 6.5 percent on your money. In this market that is impossible. The insurance company is only making 2-3 percent on the money you give them, how can they pay you 6.5 percent every year?"

PC: "Yes I am! My agent told me that as long as I defer taking out the money I am guaranteed to make 6.5 percent every year."

BK: "No, the financial advisor who told you that was either misleading you or more likely does not fully understand how the product works. What you purchased was a rider to an annuity contract. The rider, which you pay for at the rate of about $650-$950 per $100,000 of annuity premium, guarantees that you will make 6.5 percent per year credited not to your money in the annuity (i.e., money that you can take out lump sum or that will go to your beneficiaries).

Rather, the rider says that the insurance company will credit that 6.5 percent to a separate income-only account from which you can only use to take out annual income for life (no matter how long you live). Not only that, but the insurance company tells you what percentage of that account you can take out. The amount credited to your money in the annuity (what they call the contract value) is more like 3-4 percent if the market goes up and nothing if the market goes down, so you cannot lose your principal due to market losses."

PC: "So why exactly isn't that considered 6.5 percent on my money?"

BK: "Let me give you an example. If you put $100,000 into an indexed annuity and you really did earn 6.5 percent each year compounded, then after 10 years you would have $215,892 to take out of your annuity (assuming a 10-year

Tom's $250,000 401(k)
8% Bonus Annuity with 6.5% Income Rider*
Premium $250,000 (Day 1 Value $270,000)

Age	S&P 500 1999-2010	Annuity Value Cap 3% Floor 0%	Real Account Value*	6.5% Income Only Account Value	Payout % & LIFETIME Payout Amount
65	19.50%	3.00%	$278,100	$287,550	4.5% = $12,939
66	-10.10%	0.00%	$278,100	$306,241	4.5% = $13,780
67	-13.00%	0.00%	$278,100	$326,146	4.5% = $14,676
68	-23.40%	0.00%	$278,100	$347,346	4.5% = $15,630
69	26.40%	3.00%	$286,443	$369,923	4.5% = $16,646
70	9.00%	3.00%	$295,036	$393,968	5% = $19,698
71	3.00%	3.00%	$303,887	$419,576	5% = $20,978
72	13.60%	3.00%	$313,003	$446,849	5% = $22,342
73	3.53%	3.00%	$322,394	$475,894	5% = $23,794
74	-38.50%	0.00%	$322,394	$506,827	5% = $25,341
75	23.50%	3.00%	$332,065	$539,771	5.5% = $29,687

*Cost of Rider about 95 basis points = $950 per $100,000

Note: $250,000 @2% CD after 6 years=$281,540. Withdraw $19,698 per year = 0 in 14 years
Also, CD interest is taxed every year, the annuity is tax free during deferral.

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CLEAN OUT THE CLOSETS OF YOUR LIFE
by Patricia Fripp, CSP, CPAE

Clean out the closets of your life. Have you ever looked at the clothes in your closet with a critical eye: the bargain shoes in the wrong color; the expensive suit you got on sale that never fit; the "great" shirt that was a gift from someone you love?

I had all of those items in my closet. Then a wardrobe consultant friend came over and made me clean out the clothes that didn't fit or that no longer represented my self-image. It was an exhilarating feeling. Now the clothes I wear make me feel and look great, and project the image I like.

Your clothes closet isn't the only hiding place for negative things in your life. You have a self-image closet too. Take a serious look at what you find there. Try cleaning it out. Throw out ideas that no longer fit your lifestyle or your experiences.

Clean your closet of certain old friends as well -- the ones who have become acquaintances. Too often we spend our energies with people whose interests have grown apart from ours. Clean the negative people out of your life's closet. Some folks cannot accept your achievements, insisting it's only a "fluke" when you finally attain a great goal. Their own insecurities require them to shoot other people down. It is time to let them know you are proud of your achievements, and then move on to someone who will support you in your endeavors.

Closets may be hiding places for our outmoded clothes and ideas, but they are also where we store the building blocks for our daily lives. Don't let them get cluttered with outdated ideas.

Separating Fiction from Fact

While few people are prepared to handle the financial burden of long-term health care, many people have a false sense of security when it comes to long-term care.

FICTION FACT

"Medicare and my Medicare supplement policy will cover it."

In fact, Medicare and "Medigap" insurance were never intended to pay for ongoing, long-term care:

- Medicare will pay for up to 100 days in a skilled nursing facility, **but only after a 3-day minimum inpatient hospital stay for a related illness or injury**. Medicare will pay all of the costs for the first 20 days, but you must pay a co-payment amount for days 21 – 100 during each benefit period. Medicare doesn't cover long term care or custodial care in a skilled nursing facility. (Source: Medicare & You 2013, Centers for Medicare & Medicaid Services)
- Only about 12% of nursing home costs are paid by Medicare, for short-term skilled nursing home care following hospitalization. (Source: National Care Planning Council, 2010)
- Medicare and most health insurance plans, including Medicare supplement policies, do not pay for long-term custodial care. (Source: Medicare & You 2013, Centers for Medicare & Medicaid Services)

"I can afford it."

- As a national average, a year in a nursing home is currently estimated to cost $90,520. In some areas, it can easily cost well over $100,000! (Source: 2012 MetLife Survey of Nursing Home, Assisted Living, Adult Day Services, and Home Care Costs)
- The average length of a nursing home stay is 835 days. (Source: CDC Vital and Health Statistics, Series 13, No. 167, June 2009)
- The national average cost of an assisted living facility in the U.S. was $42,600 per year in 2012. The average monthly rate for assisted living facilities that provide Alzheimer's and dementia care was $4,807, or $57,684 annually (Source: 2012 MetLife Survey of Nursing Home, Assisted Living, Adult Day Services, and Home Care Costs)

Upcoming Events.

1. Medicare Open Enrollment, Oct 15th-Dec 7th.
2. Social Security Information Meeting, October 17th, Buckham Library, Faribault
3. Social Security Information Meetings
   October 19th, Red Wing Library,
   October 22nd, Country Inn and Suites, Red Wing

To Register for the Social Security Meetings, Please call (800) 848 4029.

Tools for Thought

❖ *The skeptic in the first article was asking about the structure of variable annuities. Since their inception in the early 1990s, they have been a product that has invited both promotion and skepticism. What the skeptic uncovered were the 'fixes' companies put in to these products to make them superficially provide the safety and security of fixed and indexed annuities. Because the underlying mechanism of a variable insurance product is market risk, the only way to drive out the risk is to add rider upon rider and cost upon cost. Each layer of feature designed to drive out risk adds ballast to what would seem to be a product designed to gain value and provide a larger value upon which to draw income. As one experienced advisor I know once said 'why take on the cost and tax inefficiencies of a variable annuity when you can just invest in mutual funds with your at-risk money?' It seems counterintuitive to take stock market risk, and then burden increases and saddle losses with massive fees and expenses? The skeptic was trying to point out that all of those risk issues are already resolved in the body and chassis of Fixed and Fixed Indexed annuities.*

This remains the focal point of retirement income discussion. Why NOT place those funds planned for income in an instrument DESIGNED to provide protection, enhance income, participate in the market and be guaranteed to be there in its full capacity when it is called upon to do its job? There are many varieties of these products and many types of riders that accomplish ACCUMULATION. That's what we offer here at S & R. 'Providing certainty and reliability in a world that fosters neither'.

"Each man had only one genuine vocation -- to find the way to himself...His task was to discover his own destiny -- not an arbitrary one -- and live it out wholly and resolutely within himself. Everything else was only a would be existence, an attempt at evasion, a flight back to the ideals of the masses, conformity, and fear of one's own inwardness."
-- Herman Hesse

Long-Term Care Insurance Checklist

In purchasing long-term care insurance, it is important to select coverage that matches your needs and preferences. As you evaluate various policy features and benefits, however, keep in mind that the choices you make can affect the premiums you pay and the benefits you are entitled to receive.

Covered Services
What services are covered by the policy? Does the policy offer "shared care," where two people can share the pool of benefits provided by the policy?

Benefit Amount
What is the daily benefit amount? Is it payable only while you are confined to a nursing home, or is a benefit also payable for home health care and other care alternatives? Does the policy have a maximum lifetime benefit?

Benefit Period
For how long are benefits payable? In a nursing home? At home? For an assisted living facility?

Elimination Period
When do benefits begin? For nursing home care? Home health care? An assisted living facility?

Maximum Lifetime Benefit
Does the policy have a maximum lifetime benefit? If so, what is it?

Pre-Existing Conditions
Are pre-existing conditions covered the same as any other conditions? If not, how long must you wait before they are covered?

Excluded Conditions
Are any conditions, such as Alzheimer's Disease, senility or dementia, excluded from coverage?

Inflation
Are benefit amounts adjusted to reflect increasing long-term care costs? How?

Prior Hospital Stay
Is a prior hospital stay required in order to receive benefits? Are medical certifications required in order to receive benefits?

Spousal Discount
Does the insurance company offer a discount when both spouses purchase long-term care insurance policies?

Premiums Waived Are premiums waived after you begin receiving benefits? When?

Guaranteed Renewable
Can you renew the coverage for life, so long as you pay the premiums when due?

Premium Increases
Can your premiums be increased? How often? Under what circumstances?

Long-Term Care Insurance Benefits

The benefits from qualified long-term care insurance, for the most part, are not taxable income to the recipient, up to a per diem limit. The per diem limit, which is adjusted annually for inflation, is $320 for 2013.

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1008 LEXINGTON AVE N.
NEW PRAGUE, MN 56071

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