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what you need to know about your indexed annuity

What Should I Do With My Indexed Annuity?

Prepared for: Client

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Report date: March 15, 2007

Projection date: March 15, 2007

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Your information and our assumptions

We have relied on this information to prepare this report.

Life insurance company	
Product trade name	
Contract number	
Issue date	*March 15, 2005*
Tax status	*Qualified*
Owner	*Client (in IRA)*
Annuitant	*Client*
Beneficiary	*Spouse*
Guaranteed minimum values	*3% interest on 90% of premiums*
Indexing method	*S&P 500 index. Annual point-to-point with reset. Gain is measured from beginning to end of contract year, subject to declared participation rate (100% minimum), cap (3% minimum) and floor (0% minimum).*
Surrender charge	*10-year surrender charge. Percentage of indexed account value, reduced by penalty-free withdrawal. Accrued indexed gains are forfeited upon surrender during contract year. Surrender charge is waived if owner dies, or if (after five years) owner elects to receive annuity payments over at least five years, or if annuitant is confined to long-term care facility or hospital for at least 30 days.*
Surrender value	*Greater of guaranteed minimum value or indexed account value minus surrender charge.*
Penalty-free withdrawal	*10% of indexed account value each year. Not cumulative.*
Death benefit	*Greater of indexed account value or minimum guaranteed value. Payable upon owner's death.*

Other assumptions

Calendar year	Surrender charge	Participation rate	Cap	Floor	Tax rate on gains	Tax rate on losses
2007-08	9%	100%	6.0%	0%	0%	0%
2008-09	9%	100%	6.0%	0%	0%	0%
2009-10	8%	100%	6.0%	0%	0%	0%
2010-11	8%	100%	6.0%	0%	0%	0%
2011-12	7%	100%	6.0%	0%	0%	0%
2012-13	6%	100%	6.0%	0%	0%	0%
2013-14	4%	100%	6.0%	0%	0%	0%
2014-15	2%	100%	6.0%	0%	0%	0%
2015-16	0%	100%	6.0%	0%	0%	0%
2016-17	0%	100%	6.0%	0%	0%	0%
2017-18	0%	100%	6.0%	0%	0%	0%
2018-19	0%	100%	6.0%	0%	0%	0%
2019-20	0%	100%	6.0%	0%	0%	0%
2020-21	0%	100%	6.0%	0%	0%	0%
2021-22	0%	100%	6.0%	0%	0%	0%
2022-23	0%	100%	6.0%	0%	0%	0%

Contract values at last anniversary

Date	March 15, 2007
Indexed account value	$113,422
Surrender value	$104,235
Minimum guaranteed value	$113,422
Death benefit	$95,481

Contract values at projection date

Date	March 15, 2007
Indexed account value	$113,422
Surrender value	$104,235
Minimum guaranteed value	$113,422
Death benefit	$95,841
Tax basis	$0

Projected annuity values versus benchmarks

In this section, we help you answer two questions:

- Should I keep my annuity or should I get out and invest my money elsewhere, even if I have to pay a surrender charge?
- If I decide to keep my annuity, should I take a penalty-free withdrawal?

We show the projected values for your annuity versus two benchmarks. The benchmarks represent alternative investments growing at a constant rate of return. The projected values are computed using Monte Carlo simulation, a mathematical technique that is widely used for science, business and personal finance problems that involve uncertainty. See the appendix for details.

Our starting point for the comparison is the projection date. If you do not provide contract values as of the projection date, we estimate the values based on the provisions of the contract and the index performance since the last contract anniversary.

If your annuity contract is held in a tax-deferred retirement plan (such as an Individual Retirement Account) or if you plan to replace your indexed annuity with another annuity, we use a 0% tax rate for both gains and losses.

Should I keep my annuity?

To help you answer this question, we compare the projected after-tax surrender value of your annuity versus two after-tax benchmarks.

This is what you would receive if you cashed out your annuity at the projection date:

Before-tax surrender value	$104,235
less: Income tax	$0
After-tax surrender value	**$104,235**

If you invest this money elsewhere, we assume that it would grow at an after-tax rate of return that is between 4.50% and 6.00%.

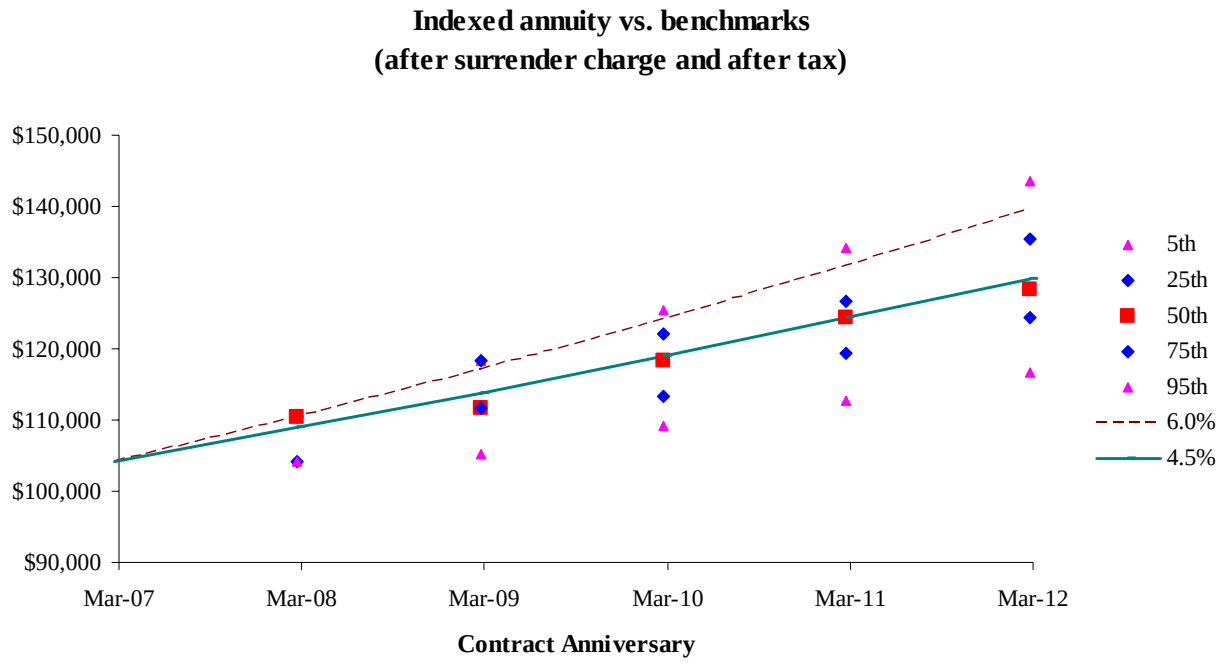
We do two Monte Carlo simulations using different sets of assumptions, so that you can see if the results vary significantly as the assumptions change.

Simulation #1

Here are additional assumptions for the Monte Carlo simulation:

Probability distribution	*Lognormal*
Parameters (annualized):	
Arithmetic mean	*9.17%*
Standard deviation	*15.00%*
Source: Historical data for S&P 500 index for 1950-2006	
Number of trials	*50,000*
Benchmark rates of return:	
High	*6.00%*
Low	*4.50%*

This chart summarizes the simulation results of the projected after-tax surrender value of your annuity contract versus the projected after-tax value of two alternative investments that earn the benchmark after-tax rates of return. We show the 5th, 25th, 50th (median), 75th and 95th percentiles of the simulated annuity values for the next five years.



This table shows the annuity and benchmark values that are displayed in the chart. We also show the mean (average) values for the annuity at each contract anniversary.

After-tax surrender value at projection date: $104,235

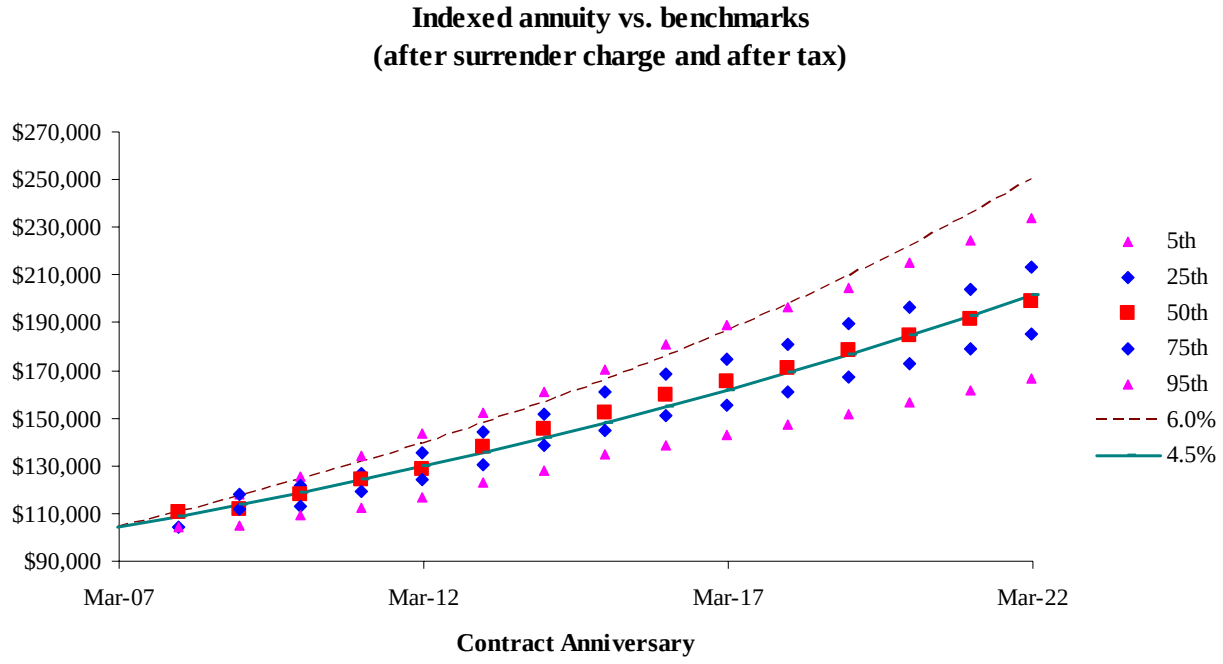
Projected annuity values
(after surrender charge and after tax)

	Contract anniversary				
Percentile	Mar-08	Mar-09	Mar-09	Mar-11	Mar-12
5th	$110,489	$118,265	$125,361	$134,172	$143,588
25th	110,489	118,265	122,054	126,577	135,460
50th	110,489	111,613	118,265	124,444	128,376
75th	104,235	111,571	113,327	119,412	124,294
95th	104,235	105,256	109,115	112,653	116,575
Mean	108,231	113,481	117,832	123,546	129,517
Benchmarks					
6.0%	110,489	117,118	124,145	131,594	139,490
4.5%	108,925	113,827	118,949	124,302	129,896

You can use the chart and table to help you decide if the annuity is worth keeping. If the projected annuity values will probably be greater than the benchmark values during the next few years, you should consider keeping the annuity.

If the projected annuity values will probably be lower than the benchmark values during the next few years, you have a harder decision to make. Should you drop the annuity, even if you have to pay a surrender charge?

Not necessarily. If your annuity has a surrender charge that declines over time, you are effectively receiving a bonus each year by waiting to surrender. A five-year projection period may be too short to capture the full effect of a declining surrender charge. To give you a longer-term view, the chart on the next page shows projected values for the next 15 years.

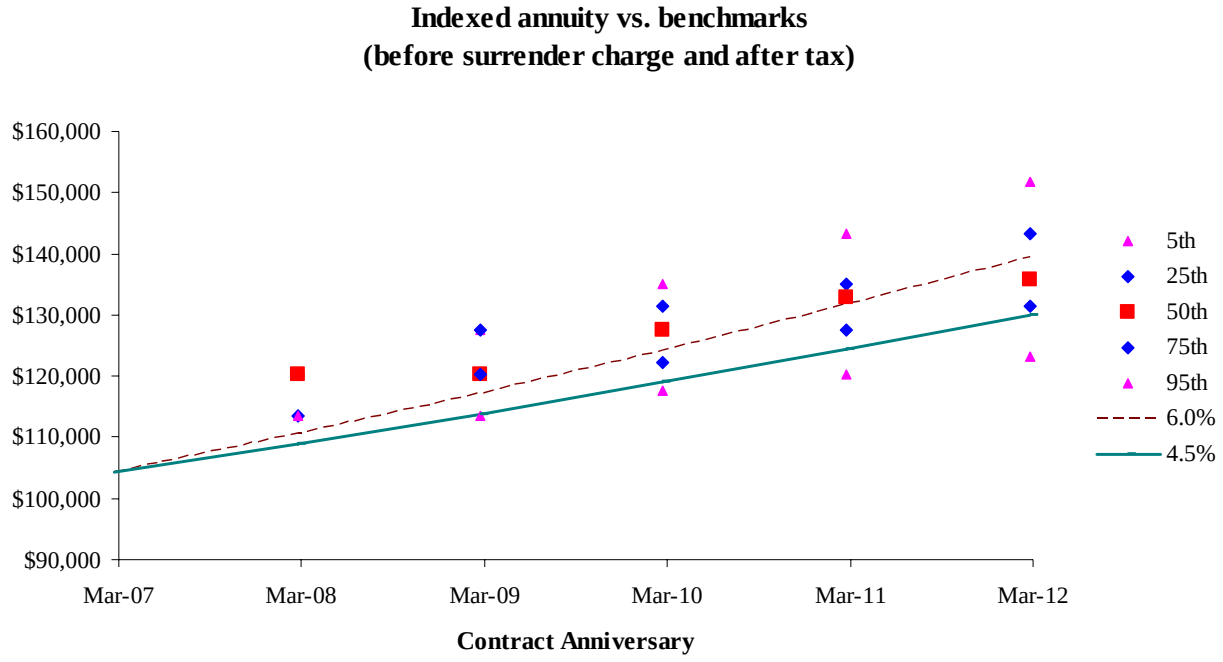


This table shows the annuity and benchmark values at five-year intervals.

Projected annuity values
(after surrender charge and after tax)

	Contract anniversary		
Percentile	Mar-12	Mar-17	Mar-22
5th	$143,588	$188,897	$233,723
25th	135,460	174,465	213,348
50th	128,376	165,093	199,056
75th	124,294	155,578	185,280
95th	116,575	143,193	166,901
Mean	129,517	165,240	199,453
Benchmarks			
6.0%	139,490	186,669	249,805
4.5%	129,896	161,873	201,724

The surrender charge on your annuity may be waived under certain conditions (see the relevant sections of your contract and the summary of contract features on page 2 of this report). You should take this possibility into account in deciding whether to keep the annuity. For example, if the surrender charge is waived upon the death of the annuitant and you know that the annuitant is in poor health, it may be useful to look at the projected annuity values without the surrender charge, as shown in this five-year chart.



Your annuity may also provide these benefits:

- Guaranteed annuity options
- Guaranteed living benefits (such as minimum withdrawals for life)
- Avoidance of probate
- Protection from creditors

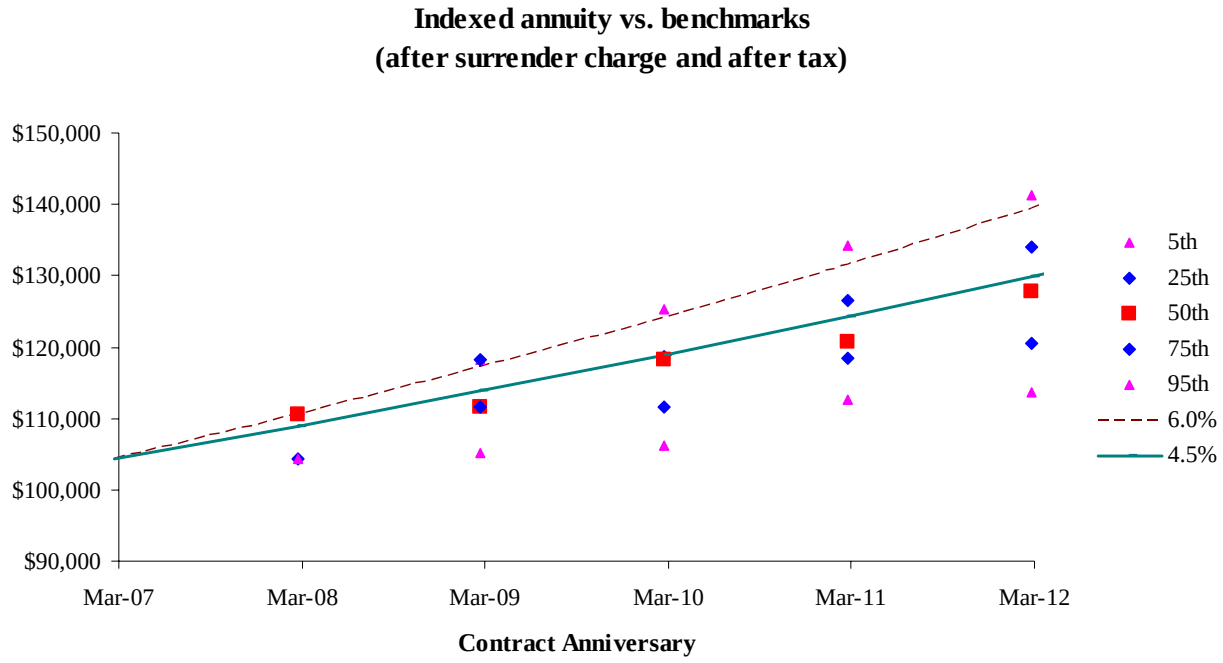
See the appendix for more information.

Simulation #2

Here are additional assumptions for the Monte Carlo simulation:

Probability distribution	*Lognormal*
Parameters (annualized):	
Arithmetic mean	*8.00%*
Standard deviation	*18.00%*
Source: Client's forecast	
Number of trials	*50,000*
Benchmark rates of return:	
High	*6.00%*
Low	*4.50%*

This chart summarizes the simulation results for a five-year period.

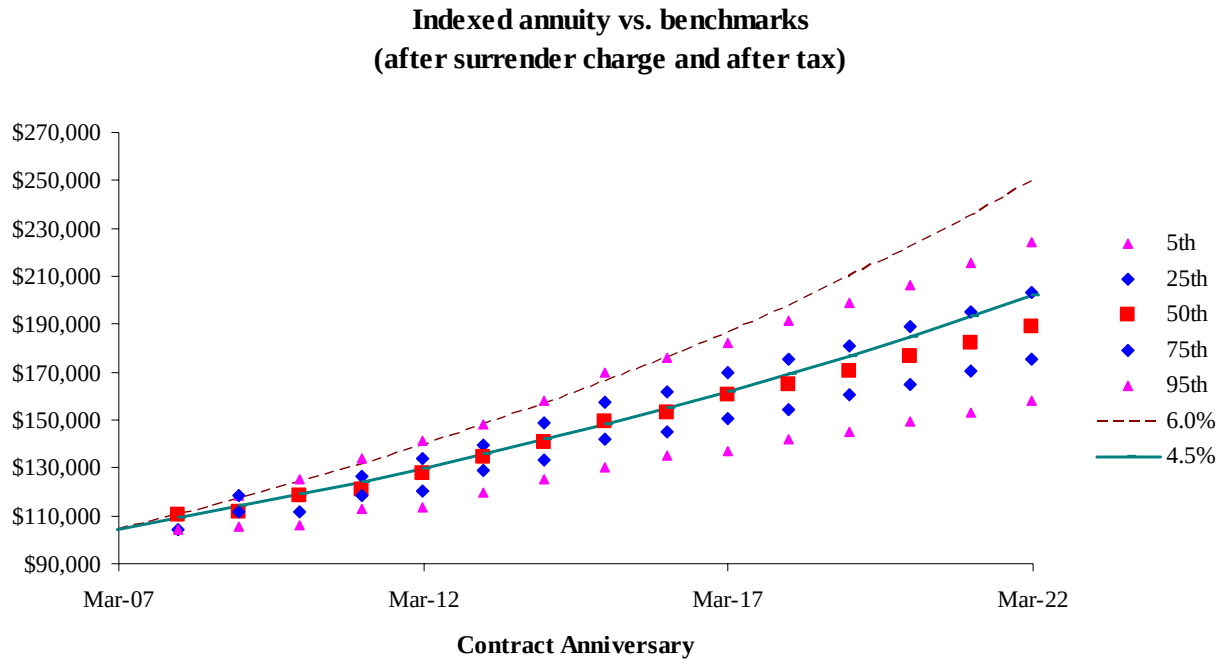


This table shows the annuity and benchmark values that are displayed in the chart.

Projected annuity values
(after surrender charge and after tax)

	Contract anniversary				
Percentile	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
5th	$110,489	$118,265	$125,361	$134,172	$141,243
25th	110,489	118,265	118,631	126,577	133,970
50th	110,489	111,571	118,265	120,827	127,793
75th	104,235	111,571	111,571	118,484	120,559
95th	104,235	105,256	106,096	112,653	113,735
Mean	107,867	112,718	116,646	121,904	127,369
Benchmarks					
6.0%	110,489	117,118	124,145	131,594	139,490
4.5%	108,925	113,827	118,949	124,302	129,896

This chart shows projected values for the next 15 years.

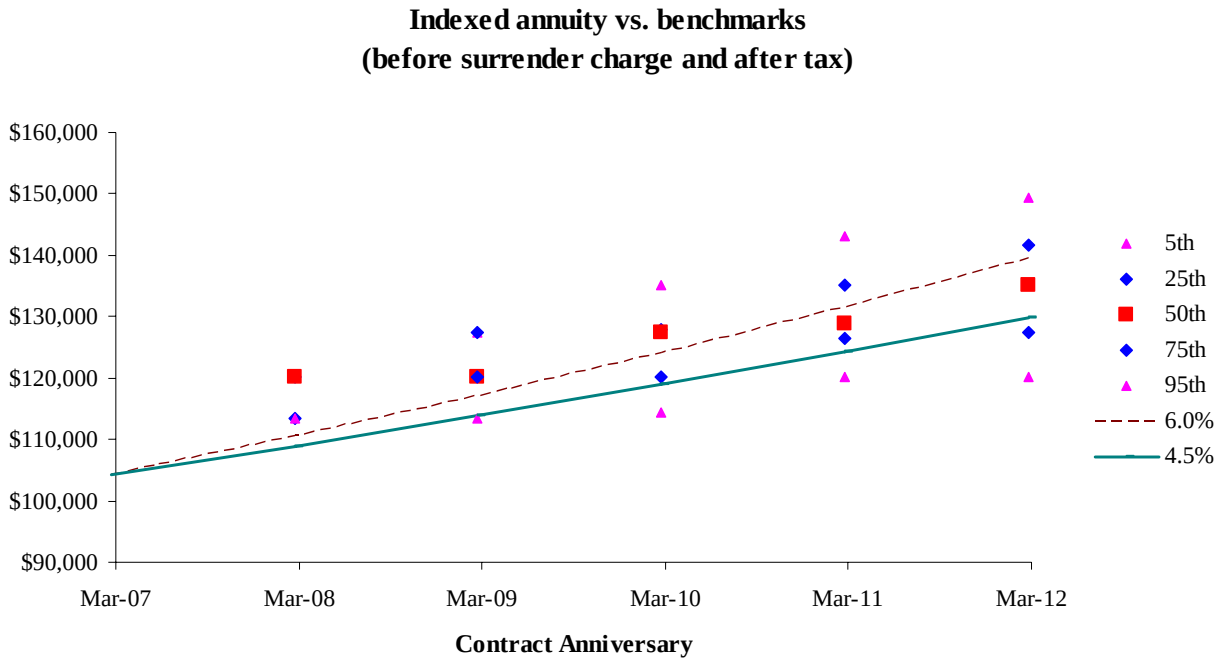


This table shows the annuity and benchmark values at five-year intervals.

Projected annuity values
(after surrender charge and after tax)

	Contract anniversary		
Percentile	Mar-12	Mar-17	Mar-22
5th	$141,243	$181,914	$224,451
25th	133,970	170,040	203,122
50th	127,793	160,251	189,170
75th	120,559	150,717	175,400
95th	113,735	137,207	158,127
Mean	127,369	159,776	189,663
Benchmarks			
6.0%	139,490	186,669	249,805
4.5%	129,896	161,873	201,724

This chart shows the after-tax annuity values if the surrender charge is waived.



Should I take a penalty-free withdrawal?

If you decide to keep your annuity, and if your annuity lets you take a penalty-free withdrawal, you have a second decision to make. You do not have to pay a surrender charge on penalty-free withdrawals, so your starting point is different than if you surrender the entire annuity.

To help you make a decision about taking a penalty-free withdrawal, we ask the question this way: Should I take a penalty-free withdrawal now or later?

You have the option of taking a withdrawal now and investing it elsewhere or leaving the money in the annuity and taking a withdrawal later. To shed some light on this choice, we compare the projected after-tax amounts that you will have if you leave money in the annuity versus taking a withdrawal and investing it outside. For convenience, we assume that you take a one-time withdrawal on the projection date.

This is what you would receive if you took the maximum allowable penalty-free withdrawal from your annuity:

Before-tax withdrawal amount	$11,342
less: Income tax	$0
After-tax withdrawal amount	**$11,342**

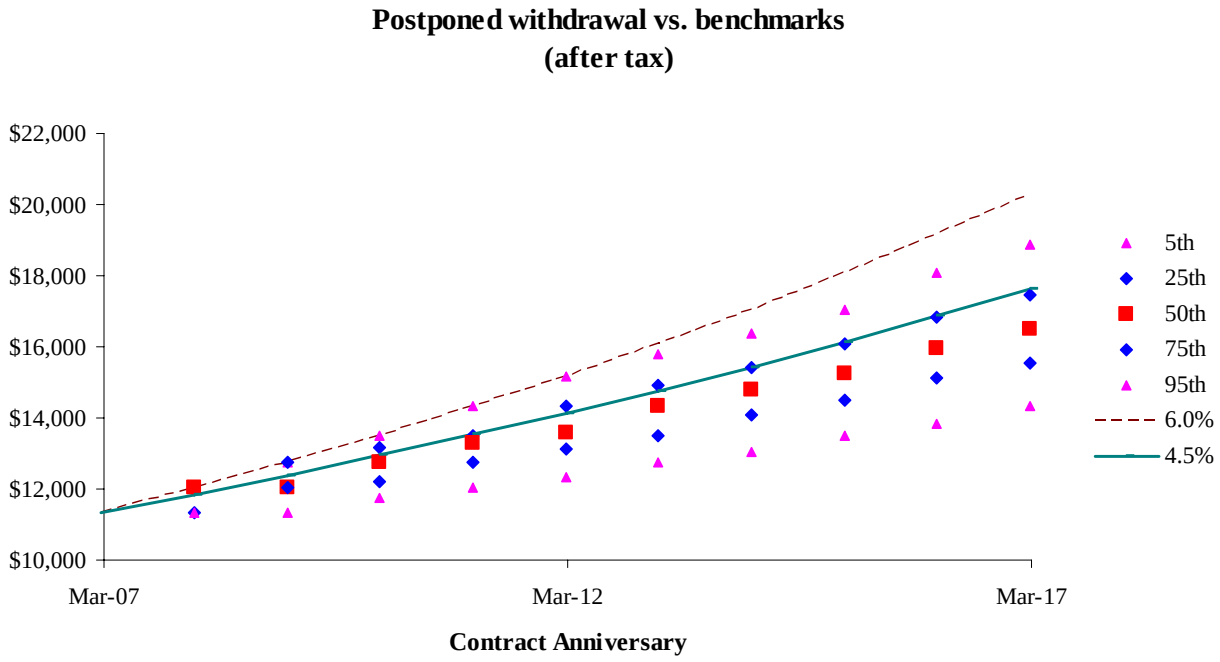
If you invest this money elsewhere, we assume that it would grow at an after-tax rate of return that is between 4.5% and 6.0%.

We use before-tax values in Simulation #1 and Simulation #2 to calculate the before-tax values of the penalty-free withdrawal for a 10-year period, and then we compute the after-tax values of the penalty-free withdrawal based upon the tax basis and assumed tax rates.

Simulation #3

The Monte Carlo simulation assumptions are the same as for Simulation #1.

The chart and table show the simulation results for the postponed penalty-free withdrawal versus the projected value of an immediate withdrawal that earns the benchmark after-tax rates of return.



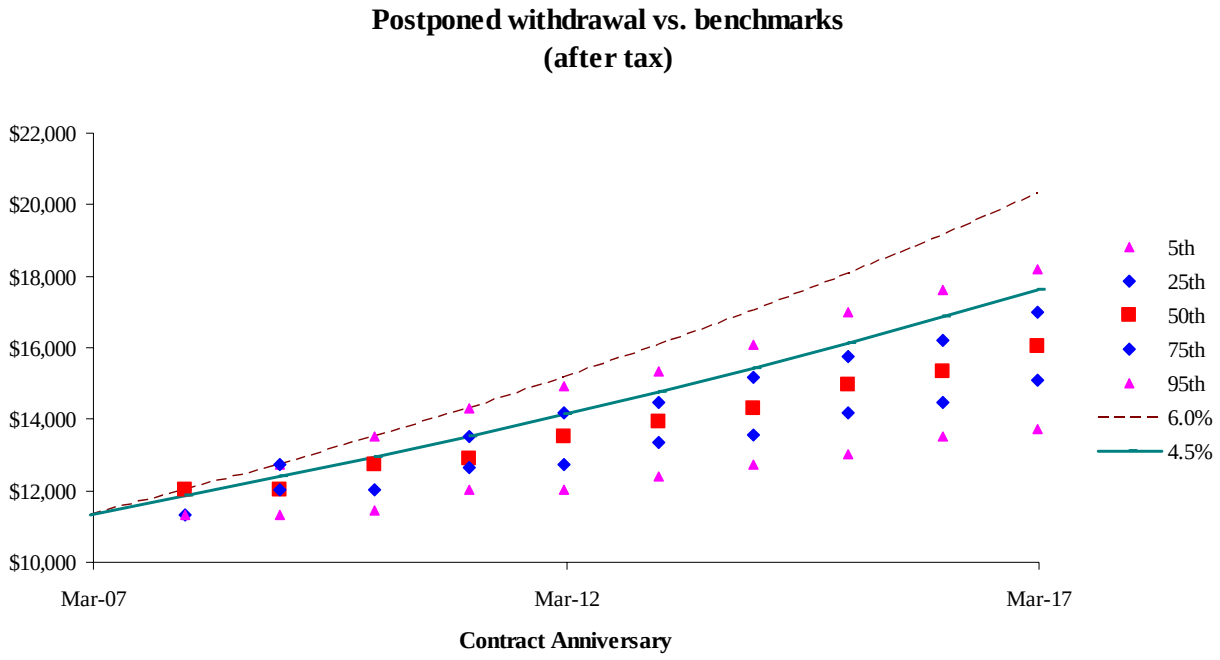
After-tax values of postponed withdrawal

	Contract anniversary		
Percentile	Mar-08	Mar-12	Mar-17
5th	$12,023	$15,178	$18,890
25th	12,023	14,319	17,446
50th	12,023	13,570	16,509
75th	11,342	13,139	15,558
95th	11,342	12,323	14,319
Mean	11,777	13,690	16,523
Benchmarks			
6.0%	12,023	15,178	20,312
4.5%	11,853	14,134	17,614

Simulation #4

The Monte Carlo simulation assumptions are the same as for Simulation #2.

The chart and table show the simulation results for the postponed penalty-free withdrawal versus the projected value of an immediate withdrawal that earns the benchmark after-tax rates of return.



After-tax values of postponed withdrawal

	Contract anniversary		
Percentile	Mar-08	Mar-12	Mar-17
5th	$12,023	$14,931	$18,191
25th	12,023	14,162	17,004
50th	12,023	13,509	16,025
75th	11,342	12,744	15,072
95th	11,342	12,023	13,721
Mean	11,737	13,461	15,975
Benchmarks			
6.0%	12,023	15,178	20,312
4.5%	11,853	14,134	17,614

Preparer's comments

Contract features:

The contract is vague about how the insurance company determines the cap each year. The cap was lowered from 6.5% in 2006-07 to 6.0% in 2007-08, without explanation. The minimum cap is 3.0%.

Projection date:

We are starting at the beginning of the 2007-8 contract year.

Benchmark rates of return:

You provided the two benchmarks. The low benchmark reflects current yields on fixed-income investments, such as bank certificates of deposit, Treasury securities and bond mutual funds. The high benchmark matches the cap and represents an achievable return with a diversified portfolio.

Simulation results:

The mediocre long-term results are partly due to the cap and annual reset features of this contract. Even though the assumed mean return is greater than the 6% cap, it is not likely that the S&P 500 index return will exceed 6% each year, just as it is not likely that a coin toss will be heads 15 times in a row.

About the preparer

Glenn S. Daily is one of the few fee-only life insurance consultants in the U.S. He provides consulting services to individuals, businesses, trustees and other advisers. Compensation is strictly on a fee basis. Mr. Daily is a Certified Financial Planner™ certificant, a Chartered Financial Consultant, a Chartered Life Underwriter, a New York-licensed Life Insurance Consultant and a graduate of Princeton University. His website is www.glenndaily.com.

Appendix: Technical issues

We had to deal with many technical issues in order to prepare this report. This appendix describes the major issues and the choices that we made as of the report date.

1. Simulation methodology

Simulation involves constructing a mathematical model of a situation as an aid in deciding what actions to take. The designer of a simulation process faces these choices:

a. Which simulation method should you use?

Many simulation techniques are available. We use Monte Carlo simulation. Here are the steps:

1. Build a mathematical model of the indexed annuity contract. Some of the required inputs (such as tax rates) will be specified values; other required inputs (such as the future index values) will be random variables.

2. Decide how to model each of the random variables. For the future index values, here are the choices:

   - Use historical data. For example, you could use the 600 monthly index changes for the past 50 years as your universe of possible future monthly changes.

   - Choose a probability distribution and parameters. For example, you could assume that the index changes are lognormally distributed, with an annualized mean of x% and a standard deviation of y%.

   - Create an economic model that relates the future index values to fundamental factors such as inflation, interest rates, corporate earnings and consumption. For indexed annuities, you could extend this to forecasting the price of derivatives used in hedging.

   We choose a probability distribution and parameters.

3. Obtain a series of uniformly-distributed random numbers from zero to one from a reliable source.

4. For each random variable in the model, pick a random number and then translate it into an input value. Run the model and save the outputs. Repeat this step many times, and then tabulate the results.

For more information, see:

Ibbotson Associates, *Stocks, Bonds, Bills, and Inflation 2006 Yearbook.*

John H. Cochran, *Asset Pricing (Revised Edition)*, Princeton University Press, 2005.

A.D. Wilkie, M.P. Owen and H.R. Waters, "Notes on Options, Hedging, Prudential Reserves and Fair Values," *British Actuarial Journal*, Vol. 11, No. 2 (2005).

Thomas N. Herzog, "Monte Carlo in the Game," *Contingencies*, May/June 2004.

Joseph H. Davis, Nelson W. Wicas and Francis M. Kinniry, "The Strengths and Weaknesses of Various Financial Simulation Methods," *Journal of Wealth Management*, Spring 2004.

Glenn Kautt and Fred Wieland, "Modeling the Future: The Full Monte, the Latin Hypercube and Other Curiosities," *Journal of Financial Planning*, December 2001.

David Nawrocki, "The Problems with Monte Carlo Simulation," *Journal of Financial Planning*, November 2001.

John Mulvey, Robert Rush and John Sweeney, "Generating scenarios for global financial planning systems," *International Journal of Forecasting*, June 1998.

David Vose, *Quantitative Risk Analysis: A Guide to Monte Carlo Simulation Modeling*, John Wiley & Sons, 1996.

b. What is the probability distribution of index changes?

Many models have been proposed for generating future asset values. We use the common assumption that equity returns are lognormally distributed.

For more information, see:

Mary R. Hardy, R. Keith Freeland and Matthew C. Till, "Validation of Long-Term Equity Return Models for Equity-Linked Guarantees," *North American Actuarial Journal*, October 2006.

Frank J. Fabozzi, Sergio M. Focardi and Peter N. Kolm, *Financial Modeling of the Equity Market: From CAPM to Cointegration*, John Wiley & Sons, Inc., 2006.

Y. Malevergne, V. Pisarenko and D. Sornette, "Empirical distributions of stock returns: between the stretched exponential and the power law?", *Quantitative Finance*, August 2005.

Mary Hardy, *Investment Guarantees: Modeling and Risk Management for Equity-Linked Life Insurance*, John Wiley & Sons, Inc., 2003.

John Y. Campbell, Andrew W. Lo and A. Craig MacKinlay, *The Econometrics of Financial Markets*, Princeton University Press, 1997.

c. What are the parameters of the probability distribution?

If you assume a lognormal distribution, you have to specify two parameters: mean and standard deviation. You also have to decide if you are going to use the arithmetic mean, the geometric mean or something else.

Many researchers have studied the problem of forecasting future stock market returns. We use the assumptions that you give us, or we use other assumptions that we have obtained from published sources.

For more information, see:

Charles P. Jones and Jack W. Wilson, "Using the Supply-Side Approach to Understand and Estimate Equity Returns," *Journal of Portfolio Management*, Fall 2006.

Ibbotson Associates, *Stocks, Bonds, Bills, and Inflation 2006 Yearbook.*

Oluwatobi Oyefeso, "Would There Ever Be Consensus Value and Source of the Equity Risk Premium? A Review of the Extant Literature," *International Journal of Theoretical and Applied Finance*, March 2006.

Jeremy J. Siegel, "Perspectives on the Equity Risk Premium," *Financial Analysts Journal*, November/December 2005.

James Poterba, "The Impact of Population Aging on Financial Markets," NBER Working Paper No. 10851, October 2004.

Eric Jacquier, Alex Kane and Alan J. Marcus, "Geometric or Arithmetic Mean: A Reconsideration," *Financial Analysts Journal*, November/December 2003.

Rajnish Mehra, "The Equity Premium: Why Is It a Puzzle?", *Financial Analysts Journal*, January/February 2003.

Roger G. Ibbotson and Peng Chen, "Long-Run Stock Returns: Participating in the Real Economy," *Financial Analysts Journal*, January/February 2003.

Robert D. Arnott and Peter L. Bernstein, "What Risk Premium is 'Normal'?", *Financial Analysts Journal*, January/February 2003.

John Y. Campbell, Peter A. Diamond and John B. Shoven, "Estimating the Real Rate of Return on Stocks Over the Long Term," Social Security Advisory Board, August 2001 (available at www.ssab.gov/publications.htm).

d. How many trials will you do?

A trial represents one possible future out of an infinite number of possible futures. It is one pairing of inputs and outputs from the mathematical model used in the simulation. You should do enough trials to get results that do not change significantly from one simulation to another. We do at least 10,000 trials.

e. How will random numbers be generated?

A Monte Carlo simulation requires random numbers for each trial, and some random number generators are better than others. We use the random numbers produced by the RAND function in Microsoft Excel 2003.

For more information, see:

"Description of the RAND function in Excel 2007 and in Excel 2003", Microsoft, January 16, 2007 (available at http://support.microsoft.com/kb/828795).

Pierre L'Ecuyer, "Software for Uniform Random Number Generation: Distinguishing the Good and the Bad," Proceedings of the 2001 Winter Simulation Conference, IEEE Press, December 2001 (available at http://www.informs-cs.org/wsc01papers/012.PDF).

2. Nonguaranteed factors

Most indexed annuities give the insurance company the right to change the participation rate, spread, cap or floor after the contract is issued. Insurance companies are not required to explain their pricing practices, and we have no insider information about what they plan to do. Our default assumption is that the current factors will remain unchanged, but we will use any other assumption that you give us.

3. Income taxes

Annuity gains are taxed as ordinary income, and there may be a 10% penalty tax if the taxpayer is under age 59 1/2. The tax treatment of losses on nonqualified annuities is more complicated. There are three possibilities:

- The loss is allowed as a miscellaneous itemized deduction, subject to the 2% of adjusted gross income limit. Therefore, you benefit only if you itemize your deductions and if you satisfy the 2% threshold. This is the IRS's position for losses upon surrender.

- The loss is allowed as a miscellaneous itemized deduction, but it is not subject to the 2% threshold. This is the IRS's position for losses at death.

- The loss is fully deductible against other ordinary income. This is an aggressive position that is advocated by some tax practitioners but is not supported by the IRS.

See IRS Publication 575 and your tax adviser for more information. We use the tax rates that you give us for each contract year.

4. Benchmark rates of return

We show the compounded growth of two investment alternatives. You can specify the two benchmark rates of return, or we will choose high and low rates of return that seem useful for decision-making.

5. Other features

Indexed annuities offer benefits in addition to asset growth, and you should take them into account in deciding what to do with your annuity. The most common benefits are:

a. Waiver of surrender charge

Some indexed annuities waive the surrender charge upon the owner's or annuitant's death or upon other specified events. We show the impact of a waiver on the value of the annuity, but we do not estimate the probability that a specified event might occur.

b. Guaranteed annuity options

All deferred annuities, including indexed annuities, give you the right to receive annuity payments at guaranteed rates. These payments may be for a fixed period or for life, and the guaranteed rates may be better or worse than what you can obtain by shopping around at the appropriate time in the future. From an economic perspective, the value of guaranteed annuity rates depends on future interest rates and future mortality rates. Insurance companies and regulators pay little attention to guaranteed annuity rates, which implies that they do not think that this feature has much value.

We do not take this feature into account in the simulations.

For more information, see:

Chi Chiu Chu and Yue Kuen Kwok, "Valuation of Guaranteed Annuity Options in Affine Term Structure Models," *International Journal of Theoretical and Applied Finance*, March 2007.

Andrew J.G. Cairns, David Blake and Kevin Dowd, "Pricing Death: Frameworks for the Valuation and Securitization of Mortality Risk," *ASTIN Bulletin*, May 2006.

Laura Ballotta and Steven Haberman, "The fair valuation problem of guaranteed annuity options: The stochastic mortality environment case," *Insurance: Mathematics and Economics*, Vol. 38, Issue 1 (February 24, 2006).

Enrico Biffis and Pietro Millossovich, "The fair value of guaranteed annuity options," *Scandinavian Actuarial Journal*, 2006(1).

Phelim Boyle and Mary Hardy, "Guaranteed Annuity Options," *ASTIN Bulletin*, November 2003.

A.D. Wilkie, H.R. Waters and S. Yang, "Reserving, Pricing and Hedging for Policies with Guaranteed Annuity Options," *British Actuarial Journal*, Vol. 9, No. 2 (2003).

Moshe A. Milevsky and S. David Promislow, "Mortality Derivatives and the Option to Annuitize," *Insurance: Mathematics and Economics*, Vol. 29, Issue 3 (December 20, 2001).

c. Guaranteed living benefits

Some indexed annuities provide minimum lifetime withdrawals or other living benefits in addition to the surrender value and the guaranteed annuity rates. Indexed annuities already protect principal through the interest-crediting method, so the value of guaranteed living benefits for indexed annuities should be less than for variable annuities.

We do not take this feature into account in the simulations.

d. Avoidance of probate

Annuity values outside of qualified retirement plans pass directly to named beneficiaries, avoiding the expense, delays and lack of privacy of the probate process. However, the probate process can be avoided with other techniques, such as revocable living trusts, so this benefit of annuities has value only to the extent that it may be more convenient than other techniques.

e. Protection from creditors

Annuity values outside of qualified retirement plans are protected from creditors to some degree in most states. However, the specific protections vary from state to state, so you should consult an attorney to discuss your situation. One way to quantify the value of protection from creditors is to estimate the cost of liability insurance and add that amount to the projected annuity values (or subtract it from the benchmark rate of return). We make that adjustment upon request.

For more information, see:

Alexander A. Bove, Jr., "Protecting Assets Through Insurance and Annuities," *Estate Planning*, June 2004.

Peter Spero, "Using Life Insurance and Annuities for Asset Protection," *Estate Planning*, January 2001.

Gideon Rothschild and Daniel S. Rubin, "Creditor Protection for Life Insurance and Annuities," *Journal of Asset Protection*, May 1999 (available at www.mosessinger.com).