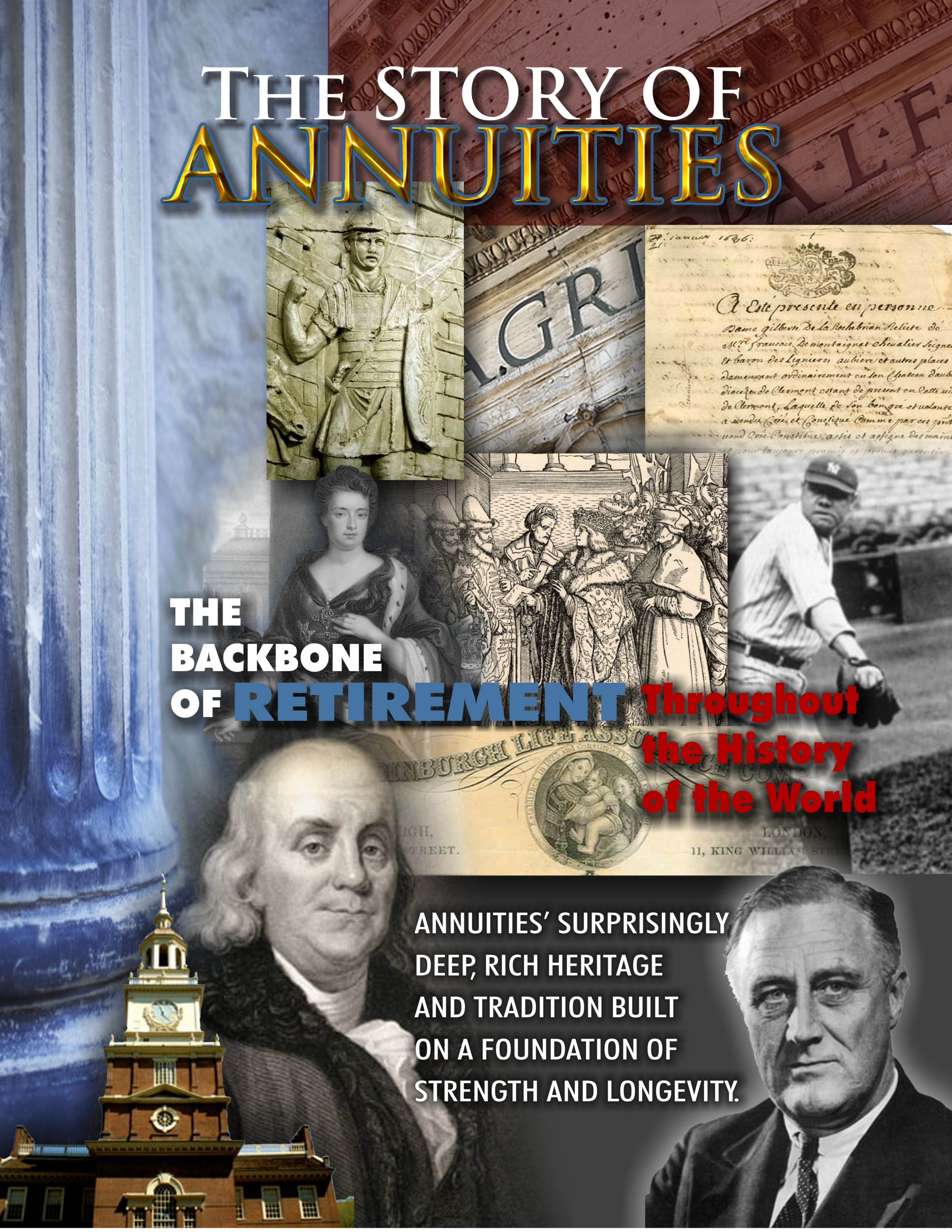
THE STORY OF ANNUITIES



THE BACKBONE OF RETIREMENT Throughout the History of the World

ANNUITIES' SURPRISINGLY DEEP, RICH HERITAGE AND TRADITION BUILT ON A FOUNDATION OF STRENGTH AND LONGEVITY.

The History of Annuities

How many financial instruments can claim the awesome, time-tested power of the annuity? Available for more than 2,000 years, the annuity has proven itself to be one of the oldest, most enduring and historically dependable financial tools on earth.

Yet the annuity has meant so much more to the ongoing development of humankind. Throughout the centuries, the annuity has been the financial key to the development of our modern world.

An historic builder of monuments, defender of nations and citizens across the globe, the annuity of today is widely acknowledged as the fundamental financial cornerstone for everything from the large estates to the modest retirement portfolios.

Yet, few are aware of the contribution the annuity has made to the history of the world. Few appreciate the role of the annuity in forming the political and economic shape of the planet as we know it today.

In ancient Rome, speculators sold financial instruments commonly known as “annua.” Translated from the jargon of the times, annua meant “annual stipend,” or annual payout, which still applies to the annuity today. Like so many other incredible innovations coming out of ancient Rome – the aqueducts, the Roman arch, the infrastructure of the Roman Coliseum – the Roman ‘annua,’ or annuity remains a fundamental building block for the financial security of industrial and government retirement programs, families, estates and individuals alike.

Annuities in Roman times work fundamentally the same as today's more sophisticated annuity. An Roman annuity buyer made a lump sum payment. In return, the buyer received a contract that promised a fixed payment every year for his natural life. In ensuing years, annuities were modified to allow for enhanced payments for a specific period of years, called a term.

Historians believe an ancient Roman named Domitius Ulpianus was the first annuity dealer on earth. We know that Ulpianus helped create the first version of today's actuarial table, which tried to calculate the probability of human life expectancy at the time. Records show that Ulpianus and his life table calculated the eventual value of an estate, on behalf of the beneficiaries of the decedent who purchased the annuity for his survivors.

For those in the annuity industry, imagine Ulpianus' life table in action. He very likely would have used his life table to make annuity sales presentations, similar to annuity and life insurance presentations today. Ulpianus and his staff would have used basically the same computations to ensure a safe, dependable level of income for his clients!

We often mistake the "Dark Ages," or Middle Ages, as a barbaric period of war and pestilence, a time devoid of progress and innovation. Yet there were exceptions to that perception. While the Middle Ages were marred by near-constant war, revolution and civil conflict, rulers of the time could remain in power only through the financing of armies to protect the people they ruled.

During the Middle Ages, the expense of war led to the widespread adoption of creative financing vehicles, one of the most popular being the annuity. Yes, the annuity was used by kings, queens and governments throughout the history of the world to finance armies and build arsenals for war. The annuity was the financial powerhouse enabling England and other nations to defend their borders, and to expand and colonize the world.

After many exhaustive and costly years of war against France, England reportedly created a financial instrument similar to the annuity. Called the State Tontine of 1693, historians still debate the creation of the first tontine, but this instrument was one of the first types of group annuity. It essentially acted like today's single-premium life annuity.

Detailed records show individual citizens buying into tontines, or special annuity pools. In exchange for an initial, lump sum payment of say, 100 pounds (a considerable sum at the time), purchasers received an annuity – an annual stipend – for a lifetime. They could also give their annuities to others, by will or deed, for the lifetime of a nominated survivor.

The amount of the annual stipend, or annuity, increased each year for the purchaser's survivor, as he or she received annuity-pool payouts that otherwise would have gone to the deceased. As each nominee/survivor died, the remaining pool of cash was evenly distributed to an ever-shrinking number of nominees. As a result, annuities for remaining survivors grew larger and larger, until the last survivor received the entire amount of remaining principle.

Since sole-survivor annuity payouts could be quite large, word of these wondrous windfalls spread far and wide. The tontine/annuity grew in popularity because it had all the aspects of insurance with a hint of lotto-style speculation – for the possibility of become the sole surviving nominee who won an impressive jackpot of cash.

The tontine soon gave way to more sophisticated forms of annuity programs. Throughout the 16th century, governments in Holland, England and other European nations chose to issue annuities in place of government bonds. While such annuity contracts still promised a lifetime of payouts to their annuitants, the annuity contract proceeds also began to fund a variety of government programs and construction projects. Annuity proceeds virtually built many of the ancient, enduring buildings and monuments we see today, structures that have withstood the centuries all over Europe! And they still stand today, while the annuity itself is stronger than ever before, securing modern financial portfolios worldwide.

During the 18th century, growing numbers of European governments sold annuities, which gave individual citizens a lifetime of state-guaranteed income. From the 1600s through the 1800s, annuities financed government projects, administrative operations and the retirement income of select government officials. Some of the earlier versions of annuities were sold at the same, fixed price, regardless of the buyer's sex or age. Obvious problems arose with fixed-price annuities for both annuity buyers and providers, leading to more refined computations for payouts and pricing structures, and a growing array of rules, regulations and laws governing annuities.

In 18th century England, for example, Parliament enacted an intricate grid of virtually hundreds of annuity-related laws, which further defined the sale of annuities and the efforts they would help fund. Wars were one obvious recipient, yet annuities went on to do much more, even helping to provide an annual allowance for England's royal family.

Through a series of Acts of Parliament, annuities became the interwoven fiber of English financial law, part of the founding statutes of the royal realm. From the Middle Ages of Anglo-Saxon England to modern-day living in London, annuities have thus been an ongoing component in English life and the law.

Detailed recordings of annuities and related Acts of Parliament first appeared in published form as early as 1483. These were bound in Parliamentary volumes of legislative sessions, dating back to the reign of King Richard the III and the first sitting of Parliament. While historians note the extreme rarity of such session recordings, prior to 1713, eight such early volumes do exist today in the Library of the House of Lords. The volumes attest to the existence and vital importance of annuities, the scarcity of volumes due to the high cost print and the proprietary nature of content. These volumes were meant for the exclusive use of judges, members of Parliament and other high-level government officers. Yet a precious few have survived, and in these volumes – now carefully maintained in certain libraries and museums – details of annuities and related law abound, in considerable detail.

Historic documents show Acts of Parliament relating to the issuance of annuities dating back to 1702. Granting the government's right to fund ongoing war through the sale of annuities, such records illustrate the fundamental role of annuities throughout history.

Acts of Parliament relating to annuities occur frequently, and again in copious detail, throughout the reign of Queen Ann, specifically during the period from1702 – 1714, and through reigns of King George I, King George II, King George III and King George IV.

Parliament continued to define and regulate the sale of annuities through the successive reigns of King William IV, from 1830 to 1837, and throughout the reign of Queen Victoria, from 1837 to 1901.

Even the great Bank of England owes a debt of gratitude to the annuity. In 1693, when the English Parliament created the first charter for the Bank of England, the bank would be funded, in part, by the sale of certain shares, which promised a fixed rate of return each year. Sound familiar? Putting it another way, what stock or security would promise a fixed annual return? While historic records use the term 'share' or 'stock,' these 'shares' acted much like the 'immediate annuity' of today. Early Bank of England certificates indeed use the word “Annuity” at the top of each document issued to the purchaser.

In later years, Bank of England certificates replaced the term ‘shares’ with the more familiar term ‘annuity,’ further refining annuity products and features, as providers do today. And because interest rates changed routinely with economic conditions, annuities changed repeatedly with the times. Yet, four basic periods mark the evolution of the annuity during the 100-year period between 1780 and 1880. During that era, the English created Consolidated Annuities, Navy Annuities, Reduced Annuities and the notorious, albeit short-lived, New Annuities.

During the aforementioned 100-year period of change, the British national debt continued to grow. Colonies were added and related conflict continued to escalate as the British Empire spread to all corners of the globe. The promotion and sale of annuities flourished as a result, with Parliament ever dependent upon such a win-win money raising instrument. Yet the ever-growing variety of annuities, and variable rates of interest, caused a good deal of confusion. Something had to be done.

As early as 1751, Parliament enacted a radical consolidation of securities into one, single issue. This instrument carried a fixed, 3 percent annual rate, which lawmakers dubbed the “Consolidated Annuity.” Others dubbed it the ‘perpetual bond’ or ‘consol,’ which had no maturity date and was redeemable at any time deemed appropriate by the British government.

Consolidated annuities caught on and were widely respected as a solid retirement instrument, providing guaranteed income for elderly citizens of the realm. The Consolidated annuity became so popular, in fact, that during the late 19th century, and well into the early 20th century, this instrument represented more than half of England's national debt!

During the latter half of the 19th century, the British government introduced the "Three Percent Reduced Annuity," or simply the "Reduced Annuity," which allowed the government to borrow money at lower interest rates in other markets. These annuities were so popular and pervasive in their heyday that criminals attempted to forge their own names on Reduced Annuity certificates. Most unfortunately for culprits, English law in that era carried the death sentence for Reduced Annuity forgery. As a result, many a criminal met the hangman's noose in Old Bailey and Newgate Prison.

In the midst of it all, for an 11-year period from 1810 to 1821, the indebted English Navy issued annuities of its own to balance the ledger. These were hot commodities, indeed, because the Navy Annuity carried relatively high interest rates – up to five percent - fostering a ready popularity for this short-lived instrument.. Naval commanders and others used the proceeds to buy needed materials and the so-called The "Navy Five Per Cent" became so pervasively popular, it even found its way into English literary novels. In one chronicle, a crew member for the famed Captain Cook is shown to will a portion of "Navy Five Per Cents" to his survivors.

Another annuity of the period, and by far the most controversial, came in the form of the British “New Annuity,” which attempted to carry a lower rate of return paid on the former Navy Annuity. In 1823, probably hoping to correct a deal to good to be true, the British government lowered the New Annuity return from 5 percent to 4 percent. The resulting public outcry probably rattled the windows of Westminster Abby.

Avid readers of Charles Dickens and other period authors know the popularity of annuities in upper tiers of English society of the day. Annuities were de facto *de rigueur* for high society all over Europe in the 18th and 19th centuries. Aristocrats and wealthy merchants knew annuities could protect them from a humiliating descent into poverty, which was common among investors in other markets, and equally common among high born ‘wagerers’ willing to gamble away family fortunes at the ever fashionable gaming table. Without the protective power of annuities, even the lofty echelons of royal gentry were at financial risk.

Peeking into the exclusive, curtained salons of European high society, we spy the simple truth of the times: family honor, individual reputations, legendary royal lifestyles…all were quietly preserved with the help of annuities.

Yet, despite the traditional British-Continental love affair with annuities, early Americans were slow to adopt the time-honored savings tool. Founded as early as 1759, on the eve of the American Revolution, one of the first known American annuity producers began as the Corporation for the Relief of Poor and Distressed Presbyterian Ministers and Distressed Widows and Children of Ministers. The company provided annuity payouts for the survivors of deceased ministers.

As the War of 1812 began to rage, a Pennsylvania company opened its doors to offer annuities and life insurance policies: The Pennsylvania Company for Insurance on Lives and Granting Annuities. For the first time in American history, anyone could purchase annuities through PCIIGA but a relative few seized the opportunity.

Although annuities have been sold and managed in the United States for more than 200 years, life insurance policies would outpace annuities through the remainder of the 19th century, and both instruments would be slow to gain acceptance. Given the agrarian nature of American society at the time, large, extended families lived in widespread isolation on family farms and ranches. Such extended American families cared for their elders in retirement, making the annuity's guaranteed income seem less important than today.

As times changed, beginning around the turn of the last century from the 1890s through the 1920s, American families became less multi-generationally focused. They might not live near one another, in a centralized geographic area. As families began to drift and spread into a more modern, mobile society, annuities accordingly began to appear in growing numbers of financial portfolios.

During the early part of the 20th century, the concept of the group annuity took hold, requiring both employee and employer to contribute to employee retirement plans. This type of annuity would add to future retirement income provided through company pension plans, with an overall goal of reaching roughly 50% to 60% a retired worker's former salary.

Yet, the annuity's true popularity would have to wait for an explosive catalyst, one of the greatest economic disasters in global history: The Great Depression.

During the Great Depression, Americans were suddenly clamoring for stability, asset safety and security. The by-word of the era, during the administration of President Franklin D. Roosevelt, was "save for a rainy day." The annuity served that purpose more than any other savings tool at the time, at a time when banks began to collapse at a catastrophic rate.

One lucky celebrity, baseball legend Babe Ruth, survived the infamous stock market crash of 1929 – thanks to annuities. Urged by business mentor and sports cartoonist Christy Walsh, Ruth put his money into annuities before the crash. As a result, Babe Ruth lived well through the Great Depression, while other celebrities went for the bread lines.

Suddenly everyone followed suit, running to the staunch bastions of well known insurance companies, which offered self-retirement plan alternatives in the form of annuities and life insurance. At the same time, companies and corporations began to see the value of safeguarding employee pension plans through annuities.

Annuities in the late 1930s and early 1940s were comparatively simple, offering a fixed return during accumulation periods, and guaranteed safety and return on principle. Tax-deferral would become a major feature of the annuity, making compounded accumulation all the more attractive. And if those annuities had few of the features available today, they did offer a fixed, lifetime income when annuitants were eligible to make withdrawals. Or the annuitant could choose to receive payments over a set number of years.

Then came the advent of the variable annuity. Created in 1952, the variable annuity allowed interest-type earnings based on more speculative financial vehicles in separate accounts. While variable annuities offered certain guarantees of principal, they also posed greater levels of risk for purchasers. In short, variable annuities placed some of a purchaser's earnings at risk through the issuer's involvement in securities and other investments. The variable annuity accordingly acted like an early version of the contemporary mutual fund, which began to mushroom in popularity through the 1960s, and through several catastrophic recessions, to the present day.

Today, after millions of consumer-level investors have lost trillions in recent markets, annuities have again begun to gain widespread popularity. As fund managers anxiously listen to the rising call for safe-haven, asset preservation in annuities, some have created separate accounts for the annuity premiums of insurance companies. Designed to cater to tax-deferred variable annuities, such accounts may be managed in a different fashion than mainstream mutual fund operations. They may offer the opportunity of higher returns, but they are essentially prone to greater risk than fixed annuities.

Regardless of the bedrock security of fixed annuities, or the more risk-oriented nature of the variable annuity, both offer tax-deferred growth and safety of principal. As a result, annuities have been growing steadily in popularity as the American mindset dwells on the post-9/11 effect on Wall Street. Also post-9/11 terrorism, catastrophic market corrections, adjustment, borderline market panic and the ever-present threat of a softening, recession-prone economy.

The combined sale of fixed and variable annuities reached $98.5 billion in 1985, a paltry figure prior to 1999, when annuity sales soared to $155 billion. Today, annual annuity sales top $200 billion.

Annuities continue to garner larger portions of American savings, as an ever cautious generation of Baby Boomers round the last turn into their retirement years. Part of the growth came from other factors, including the Tax Reform Act of 1986, which reduced the ability of Individual Retirement Accounts to defer tax liabilities for investors. IRAs became somewhat less attractive as a result, strengthening the tax-deferred appeal of the annuity.

Annuity product features and design innovations have meanwhile given investors new options, particularly for variable annuities. Premiums for variable annuities have increased dramatically in the past 10 years, competing with the upsurge of health insurance premiums. Yet the realities of annuities remain, posing basic choices for investors in the years to come.

While annuities offer a sort of insurance policy for principal, some carry hefty surrender charges and transaction costs. And while the well-publicized controversy over annuities has sometimes mistakenly included fixed annuities, the real target of recent criticism has fallen on the variable annuity.

Fixed annuities are indeed monitored by insurance regulators and rightfully treated as insurance products. Critics argue, however, that the variable annuity is essentially a security, while some in annuity and insurance sales counter that the variable annuity should be regulated as an insurance product.

If the variable annuity acts like a security in the way premiums are exposed to securities markets, variable annuity providers are required to maintain separate “reserves,” or asset pools designed to preserve principal. Critics contend, however, that the variable’s line of demarcation is thin when gauging the difference between the variable annuity’s securities features, versus those of insurance products. Thus, debate over variable annuities will continue, providing yet another chapter to the uniquely ancient history of the annuity.

Regardless, by 2006 major *fixed*-annuity wholesalers and other companies formed industry coalitions to counter a then-rampant promotion of high-risk securities in the stock market.

The modern annuity was by then considered a solid tool for tax and guaranteed-income planning. It allowed for capital appreciation and preservation, and asset protection, making it an ideal estate planning instrument, with the value-added aspect of providing creditor protection in many states.

Since the FDR adminstration, through Congressional introduction in 2007 of an annuity-related retirement act, Congress has always favored annuities – as have governments through the centuries.

In 2007, the U.S. government again proposed to put annuities to work for retirement planning through introduction of bi-partisan House Bill, HR 2205, sponsored by Rep. Stephanie Tubbs Jones (D-Texas) and Rep Phil English (R-Pennsylvania), and bi-partisan Senate Bill, SB 1010, introduced by Sen Gordon Smith (R-Oregon) and Kent Conrad (D-North Dakota).

Collectively known as The Retirement Security for Life Act, HR 2205 and SB 1010 responded to projections that Social Security reserves would likely run out by 2017. The Congressional measure thus proposed a new federal tax exclusion for half of the payout of a non-qualified annuity, for a tax-free sum of up to $20,000 per year. The same tax break would go to similar types of life insurance proceeds.

In perspective for most American taxpayers, The Retirement Security for Life Act would essentially give annuity payouts up to $5,000 in annual tax savings for someone in the 25 percent tax bracket.

Essentially endorsed as the prime vehucle for an economically tumultuous era – the early part of the 21st century – the annuity stood strong with historically proven attributes: safety, liquidity, competitive returns without risk, tax advantages, probate avoidance, Medicaid protection in many states, recession/depression-proof planning, creditor protection in most states, freedom from 1099 reporting, simplicity, flexibility, guaranteed lifetime income, beneficiary benefits, and freedom from overall market risk.

As in ages past, annuities still insure against the outliving of personal resources and overspending. Annuities continue to provide a financial cushion for survivors of a pre-mature death. Newer annuities allow for investment-level adjustment without incurring tax liabilities. And the bottom line being most favorable to Congress: annuities promote private savings, which will become more critical in the years to come.

In the ensuing years, the words of a former Congressional committee member will find new relevance. In March 1980, during another historically traumatic period on Wall Street, John E. Chopoton, then Assistant Secretary for Tax Policy, testified about the power of the annuity before the US Senate Finance Committee. Chopoton said, “To the extent that annuities can be fashioned to offer interest rates that are competitive with rates paid by other financial instruments, there is little reason why a potential investor would purchase anything but a deferred annuity.”

Yet even in the tumultuous, post-9/11 economy, the centuries old value of the fixed annuity placed it in the asset savings arena, which meant it was destined to run against the interests of some securities promoters.

Pro-annuities coalitions ran a steady stream of informational campaigns to defend the historic, asset preserving qualities of the annuity. Certain elements in the securities industry meanwhile launched a subversive campaign of disinformation aimed at life insurance companies and annuity providers.

As growing numbers of annuity providers called for increased professionalism, accountability and ethical standards in the annuity industry itself - this to ensure against any isolated allegations of consumer abuse involving the annuity – annuities became an increasingly important component for investor portfolios. Which, in turn, made the annuity appear – to certain interests - ever more threatening to risk-prone speculation.

Yet, even some of the more strident securities advocates softened about annuities. Best selling author and financial wizard Suze Orman wrote favorably (circa 2007) about certain aspects of specific types of annuities, including well-structured index annuities:

“In its effort to keep up with mutual funds,” Ormand wrote, “the insurance industry introduced yet another kind of annuity in the mid-1990s – the index annuity. It was created to compete with the very popular index funds, mutual funds that track a stock market index. I have to admit,” concluded Orman, “I like the concept (of the index annuity) – for the right investors.”

As index annuity sales rose from nothing in 1995 to $13.8 billion in 2005, they still represented only about 8 percent of total annuity sales, including $42 billion in 2005 sales for traditional, fixed annuities.

While some lamented the increased popularity of annuities during that period, a more conventional wisdom saw obvious stiumlants: a recent collapse in the technology sector, increasing caution among baby boomers nearing retirement, and the lackluster perfomance of the market through 2003.

Would this mean a market takeover by annuities? O course not. It simply means, as stated in a 2006 newsletter by the National Association of Fixed Annuities, that “annuities are a safe place for money when a safe place makes sense.” A balanced portfolio continues to rule the roost, yet we are constantly challenged to re-define the term “balance.” Investors and their advisors have yet to find a magic bullet for every kind of risk.

Life and annuity producers meanwhile continue to heighten self-regulatory efforts across the U.S., having forged a nationwide movement to broadcast the truth about annuities - versus any disinformation generated by risk-promoting securities consultants.

Yet one reality remains with us thus far: with the help of one market decline after another, from 2000 through 2007, more than $50 billion went out of securities and into annuities…from 2005 to 2007, alone.

By then, millions of investors had had enough. It was time to return to the by-word of the FDR era. It was time to "save for a rainy day."

Historic truth will always remain the best defense for the time-proven, resoundingly honored annuity.

From the height of ancient Roman society to the technological marvels of 21st Century America, the annuity has changed little over a period of two thousand years. It is, and always will be, the first and last defense for hard-wrought estates and the hard-bought life savings of working people around the globe.

Ever since the financially chaotic, post-9/11 global economy began to gather momentum, circa 2001, we all might agree on at least one, final postscript: winds of time and human hands may carve away stone monuments, but the timeless annuity will remain, so long as investors continue to covet the most rare and special commodity of all.

And what would that commodity be? Written into the Iliad and the Odyssey as the Elysian Fields, translated through time as a place called Heaven, humans continue to yearn for that one, precious place in a timeless universe. No matter how we define the name of the place, we would all agree that it would have once essential quality. We call that quality "Peace of Mind."

With the help of rational thinking, asset preservation and instruments like the annuity, some of us just might find it.

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