Learn about the strengths and limitations of annuities

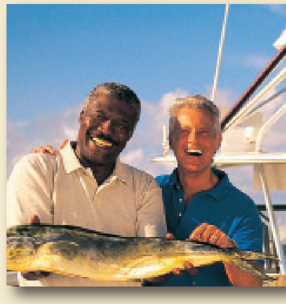
Understand how to leverage annuities and avoid mistakes

Discover the solutions annuities offer for retirement

Using Annuities to Help Reach Your Retirement Goals

A guide to common concerns that can help you maximize your annuity's potential

Introduction



Annuities are designed to meet long-term needs for retirement income. They provide guarantees against loss of principal and credited interest, along with the reassurance of a death benefit for beneficiaries. These guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company.

Annuities are not guaranteed by the FDIC or any other governmental agency, and they are not deposits or other obligations of, or guaranteed or endorsed by, any bank or savings association. Early withdrawals may impact contract values and death benefits. Taxes are payable upon withdrawal of funds. An additional 10% IRS penalty may apply to withdrawals prior to age 59½.

The information contained in this booklet is not intended to provide tax or legal advice. It reflects tax and legal rules and regulations in effect at the time of publication.

Annuities may be either tax-qualified or non-qualified. Qualified means that an annuity is part of a tax-deferred arrangement, such as a traditional or Roth individual retirement arrangement. Depending on the specific arrangement and other factors, contributions to tax-qualified annuities may be tax-deductible. When distributions are received the entire amount will be subject to ordinary income taxes unless there have been after-tax contributions. Non-qualified means that the annuity is not part of a tax-deferred arrangement and is funded with after-tax dollars. Only the portion of the distribution that comes from earnings is taxed upon distribution, not the entire amount.

The information herein refers only to non-qualified, fixed annuities.

- This guide was created by the financial professionals at American Financial.
- [Add "Securities offered by" disclosure as mandated by Compliance.]

Using Annuities to Help Reach Your Retirement Goals

In simple terms, an annuity is a contract between you and an insurance company. You pay a sum of money to the insurance company, and it promises to make payments to you at some point in the future. Depending upon the annuity you select, this payment may be a single lump sum or a stream of payments over a predetermined period of time. This income stream can be an important supplement to your Social Security payments.

Modern annuities, however, can be complex. They can offer a range of choices that can affect how potential interest will be credited, when – and how – you can receive your annuity's values, and how your beneficiaries may receive the contract's death benefit.

Consider your annuity purchase carefully. The time you invest in learning about annuities can help you avoid costly errors and get the most benefit from the annuity you select.

Start by reviewing the information in this booklet. If you see a term you don't understand, circle or highlight it. Then schedule an appointment with your financial professional to go over what you've learned – and get answers to all your questions.

Look inside for these helpful strategies:

Define your goals

Annuities are created to meet your long-term financial goals. In order to receive your annuity's highest value, you may be required to leave the bulk of your money in the contract for five, seven, ten years – or longer.

Although you may be able to access a portion of your contract's value sooner, don't consider an annuity to be an alternative to a savings or checking account. If you're looking for a transaction account you can tap whenever the need arises, look elsewhere.

If, on the other hand, you're looking for a way to assure yourself retirement income you cannot outlive, take a closer look at annuities. They can play an important role as part of your diversified retirement savings strategy.

Annuities are one of the only financial vehicles that can provide a lifetime stream of retirement income. And since that income will be based on how much money you place in the product, an annuity may be the only option for lifetime income payments you can control.

Because of their death benefit, annuities can also be an effective way to pass on a legacy to your loved ones. They may receive a single payment or a series of payments that can reduce possible tax burdens. Ask your financial professional about this important benefit.

Understand premium bonuses

Some annuities offer a premium bonus. This can be a worthwhile feature, but make sure you understand how the bonus works and any restrictions that may be involved.

A premium bonus is an amount of interest that is credited to your annuity in a lump sum. Because premium bonuses are often credited when the contract is purchased, the value of the bonus can benefit from potential interest through the life of the contract. In other cases, a premium bonus can be paid later, while the contract is in force.

In exchange for the premium bonus, the insurance company may require you to keep your money in the contract for a longer period of time. Since we have already stated that annuities are long-term commitments, this may not be a problem for you. Or you may discover that you must take scheduled payments in order to receive the annuity's full value – including the premium bonus. Again, that may be your intention from the start.

Do your homework, though. Bonus annuities may include higher surrender charges, longer surrender charge periods, lower caps, or other restrictions that are not included in other annuities that don't offer a bonus feature.

So be sure to carefully consider any restrictions the bonus requires. Compare the bonus product's potential interest (including any renewal interest rates) to a similar annuity that does not offer a premium bonus. Then make an informed decision.

Keep an eye on renewal rates.

As you compare annuities, you may find products that promise seductively high interest for the first contract year. That's a great way to grow the value of your annuity, but it may carry a price tag down the road.

In many cases, annuities that offer exceptionally high first-year rates make up the difference by paying less competitive interest in later years. Additionally, annuities with high first-year rates can tie you down with longer surrender charge periods, limiting your ability to cash out or transfer your contract.

This doesn't mean every annuity with an attractive first-year rate is not suitable for your portfolio. Like any other industry, insurance is a competitive marketplace, and companies work hard to create new products that offer more.

Just be sure you look beyond that first-year rate and evaluate the annuity's long-term potential. Ask questions like:

- Is the interest rate guarantee period (the length of time during which the rate is guaranteed) as long as the contract's surrender period (the period during which charges are assessed for canceling the contract)?
- Can I lock in a higher rate for more than one year?
- When can I receive the annuity's full value – and how will it be paid out?
- Can I cancel my contract if the renewal rate drops below a minimum amount specified in the contract?
- Can I access part of my money while the contract is in force?

Your financial professional will answer all of your questions and help you make sure the annuity you select suits your needs – including your need for potential growth of your money.

Take care when naming beneficiaries

For many annuity owners, choosing a beneficiary is simple: They want the kids to get the money. But how you achieve that goal may take some careful thought.

You should generally not, for example, take what looks like a simple path and name your estate as beneficiary. Doing so could result in your annuity's value being included in your probate settlement, and made part of the public record.

With a properly named beneficiary (other than your estate, in other words) your annuity's proceeds would be distributed without the costs and delays of probate. The transfer would be handled confidentially as well, avoiding its inclusion in records that are accessible to the public.

You should also think twice before simply naming your young children as beneficiaries. Check your state laws. Can minors authorize withdrawals or exercise other contract ownership rights? Can they legally decide whether they wish to receive contract proceeds in a single payment or in scheduled payments over time? Quite likely, the answer is no.

Ask your financial professional whether a UGMA (Uniform Gifts for Minors Act) or UTMA (Uniform Transfer to Minors Act) account could be the solution. Just like their acronyms, these options are very similar. Both involve naming a trusted individual (the custodian) to oversee and manage the UGMA/UTMA account. The chosen custodian is responsible for distributing any funds placed in the UGMA/UTMA account.

Once the minor reaches the age of majority, he or she can assume total control over the account, despite the wishes of the custodian.

Put your trust in a trust...

Although it may come with a hefty price tag, setting up a formal trust may be the most cost-efficient way to make sure the kids – or whomever you choose – really do "get the money."

Talk to your family attorney about your intentions and your concerns. The answer may involve establishing a formal trust, especially if your estate is sizeable.

A properly executed trust agreement will allow you to name a trustee to receive and handle your annuity's death benefit. It will also instruct the carrier about how you want the proceeds distributed. But that doesn't mean a formal trust agreement will be the best solution for you.

... Or don't

Should you name a trust to own your annuity, its proceeds become taxable at your death. Assuming your spouse is named as the trust's beneficiary, he or she could be forced to immediately pay taxes on the contract's gains.

Absent a trust agreement, if your surviving spouse was named the primary beneficiary, he or she could assume ownership of the annuity at your passing. Your spouse could benefit from up to five additional years of tax-deferred potential growth, and make decisions about the contract as though he or she were the original owner.

The question of how to effectively pass on the proceeds from your annuity cannot be resolved casually in a booklet like this. It deserves careful deliberation and invaluable input from professionals like your attorney and accountant.

One final thought: Regardless of whom you choose as your contract's primary beneficiary, give careful thought to naming a contingent beneficiary as well. Many contract owners are caught completely off-guard when their primary beneficiary dies unexpectedly. Simply having a contingent beneficiary in place can protect you from this unnecessary concern should the unthinkable occur.

Don’t let your annuity “retire early”

Like many financial products, annuity contracts are often filed away with other important papers, and ignored. True, you will conscientiously open your annual statements when they arrive, but they may present a dizzying combination of numbers, values, and insurance terms that have lost their definitions over time. It’s easy to just tuck them in with your contract and promise to look them over when you get a chance.

Those annual statements (or online updates, if available) are important tools. Use the information they provide to monitor your annuity’s current values.

Check the interest renewal rate information contained in each annual statement. Compare the new rate to the one it replaces. Are you headed in the right direction? Then track how much your contract’s value has changed over time. Has the annuity continued to meet your expectations?

It will also be important to talk to your financial professional when you approach the end of your annuity’s surrender charge period. As the years have passed, your long-term objectives may have changed. It’s possible your annuity is still suitable for your current financial situation and future goals.

Ask about whether a newer annuity with other benefits may be a better fit for you. If it is, a new annuity may be purchased with the proceeds from your old contact through a transaction called a 1035 exchange. Be aware, the IRS has restrictions that must be followed carefully. But you may be able to wake up your sleeping assets and transfer them to a new annuity to keep your money growing – while deferring taxes on that growth. Learn more on the next page.

Consider exchanging your annuity – or part of it

As we mentioned on the previous page, a 1035 exchange can permit you to purchase a new annuity with the proceeds from an old one. This could allow you to benefit from attractive features offered by the new product – like a premium bonus or stronger guaranteed interest rate.

Unfortunately, many annuity owners don't take advantage of this capability because they fear they will be required to pay taxes on their contract's gains. Perhaps they've heard a "horror story" about an annuity owner who received a lump-sum payout of an annuity, then used those proceeds to purchase a new one. This will indeed create a taxable event, but only because the proceeds passed through the contract's owner, rather than directly from the old carrier to the new one.

A taxable event could also occur if the owner and annuitant named on the old contract differed from those named on the replacement. One solution could be to make sure the owner and annuitant remain the same during the transfer, and then modify the new contract after the exchange has taken place (if permitted by the contract).

Please note: The IRS has a variety of restrictions and rules governing 1035 exchanges. Consider consulting with a Certified Public Accountant to make sure an exchange is suitable for your current situation and future goals.

Review your beneficiary designations periodically

Earlier we cautioned about the need to take care in naming a beneficiary. That caution should be extended to include the naming of the contract's annuitant, and even its owner.

To do otherwise can result in unforeseen problems, such as creating a taxable event, when you attempt to transfer the annuity. Furthermore, you could jeopardize your annuity's ability to generate tax-deferred interest. You could even create an unnecessary income- or estate-tax burden on yourself or your loved ones.

The proactive attitude you should have when naming a beneficiary should continue throughout the life of the contract. Talk to your financial professional about periodic reviews of your beneficiary designation(s). And make whatever changes may become necessary to keep your designations up-to-date.

It seems obvious, but people and relationships can change dramatically over an annuity's lifetime. Think about the changes your family has seen over the past seven, ten, or even twelve years. Who could have predicted them?

Fortunately, you don't have to. Just remember to review your contract's beneficiary designations periodically. Then rest easy.

Be aware of these possible "side effects"

One of the benefits offered by annuities is their tax-deferred growth potential throughout their accumulation phase. That benefit may not be maximized, though, if you overlook other possible tax implications.

During the annuitization phase, when you are receiving income payments of your initial premium and credited interest, those payments may be taxable. Only gains from non-qualified annuities will be taxed as ordinary income, which will likely be higher than capital gains tax rates in effect when you receive your annuity's values. Keep in mind that payouts of your annuity's value will also trigger a 10% IRS tax penalty if the money is received prior to age 59½.

Another "side effect" to consider is an annuity's possible impact on estate planning. Creating an income stream from the assets placed in an annuity potentially reduces the value of your estate. Depending upon your estate planning strategy, annuities can be a tool to help you liquidate part of your estate to help you achieve your long-term goals. Seek the advice of an estate planning professional to learn ways to make sure your annuity aids your estate planning efforts.

You may be surprised to discover your deferred annuity can help you lower taxes on your Social Security benefits. The money you place in a deferred fixed annuity can reduce your taxable income. This can help you remain below IRS thresholds for taxation of your Social Security benefits. However, any withdrawals from your annuity will be included for determining thresholds for taxation of social security benefits.

Make annuitization work for you

Through most of the past century, annuitization was the only payment option. Back then, insurance companies required you – and your beneficiaries, most likely – to receive an annuity's value in payments over time (also known as annuitization).

Recently, however, annuities have become increasingly flexible. Although annuitization remains a popular option with many contracts, yours may permit you to take your contract's full value in a lump sum once the surrender charge period expires.

It would be impossible to explain all the advantages and disadvantages of annuitization here. There may, for example, be valuable tax advantages to taking your contract's value in installments over several years, rather than in a single check.

Be aware that once you create an income stream through annuitization, your decision will likely be final. The amount of money you receive each year will be locked in. So we strongly urge you to talk to your financial professional to see whether annuitization can help you achieve your personal retirement goals.

One alternative to annuitization which we mentioned earlier is the ability to systematically withdraw money from your annuity – often at any time while the contract is in force – without triggering a surrender charge or penalty. This is often done via optional income riders. If you were younger than 59½ when these payments are received, you may face a 10% IRS penalty in addition to ordinary income tax.

Take the next step

By now, we trust you have a better understanding about some of the key features and benefits fixed annuities can provide. We hope you have gained valuable insights regarding:

- How annuities work
- Which features and benefits may be important to you
- How annuities can provide you with reliable retirement income
- Steps you can take to maximize the value of your annuity

Your decision to purchase an annuity should only be made after a thorough discussion of your current financial situation and your future retirement (and legacy) goals. It's a conversation that should include someone who works with annuities every day, like the financial professional who made this booklet available to you. For your convenience, you'll find their contact information on the next page.

As we've mentioned previously, this booklet was created to enhance your understanding of annuities in general. It cannot provide insight as to whether an annuity is a suitable choice for you. So you should include your tax advisor, accountant, lawyer, or estate planning specialist in the discussion prior to making your purchase.

Only then can you be comfortable in your decision to make an annuity part of your retirement finance strategy.

Your financial professional will answer all of your questions and help ensure the annuity you select suits your needs – including your need for potential growth of your money.

This booklet is designed to provide general information on the subjects covered. Pursuant to IRS Circular 230, it is not, however, intended to provide specific legal or tax advice and cannot be used to avoid tax penalties or to promote, market or recommend any tax plan or arrangement. Please note that American Financial, its affiliated companies, and their representatives do not give legal or tax advice. Please consult your tax advisor or attorney.

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