Learning about fixed annuities

MAKE FINANCIAL CHOICES BASED ON KNOWLEDGE

Live retirement on your terms

Achieving financial security so you can live comfortably during retirement depends on how well you plan and save while working — and how effectively you conserve your assets during retirement. To help ensure you make fixed annuity choices based on knowledge, we've prepared this primer, which we hope will serve as a helpful resource as you plan for your future.

What is a fixed annuity?

A fixed annuity is a contract between you and an insurance company that offers you a fixed rate of interest on your money. You may either:

+ Purchase an annuity outright with a lump-sum payment (a single-premium annuity), or
+ Make an initial purchase payment and subsequent contributions (a flexible-premium annuity).

When you receive income is up to you.

When purchasing an annuity contract, you may wish to consider when you will want to receive income from your contract.

+ An immediate annuity allows you to receive income right away.
+ A deferred annuity allows you to build your account value over time and convert it to income in the future.

The tax-deferred advantage.

Over time, the money in a fixed annuity account compounds at a faster rate than it would in a taxable account. Here's why:

+ Unlike investments in a taxable account, you will not have to pay current taxes on any interest or earnings until money is withdrawn.
+ Money that otherwise would have gone toward federal income taxes stays in the account, earning interest. Keep in mind, if you take money out of your account prior to age 59½, the IRS considers the withdrawal a premature distribution, in which case you may be subject to a 10% federal income tax penalty.

How does an annuity work?

+ There are three parties to every annuity contract.
+ The owner purchases the annuity.
+ The annuitant receives income payments from the contract upon annuitization.
+ The beneficiary receives the assets if the annuitant (and/or owner in some contracts) dies.

Guarantees

While it's possible for you to be both the owner and the annuitant, the beneficiary must be different. When you purchase a fixed annuity, your account earns a fixed rate of interest that accumulates on a tax-deferred basis. The principal and interest are usually backed by the financial strength of the insurance company that issues the annuity.

Along with this guarantee, some insurance companies also may provide a return-of-principal guarantee that safeguards beneficiaries against loss of principal. Since the death benefit is usually paid directly to your beneficiary(ies), the annuity proceeds are not generally subject to probate.

Build-up phase (or accumulation phase)

During the build-up phase, interest compounds three ways: on your principal, on your interest and on the tax dollars you would normally pay. The company that issues the annuity sets the current rate of interest that is paid. This rate can be adjusted from time to time. Fixed annuities, however, have a guaranteed minimum interest rate that issuers will pay, regardless of market fluctuations.

Early withdrawals

There are usually withdrawal privileges during the accumulation phase of an annuity, although there may also be federal income tax penalties for withdrawals taken before age 59½. Withdrawals in excess of permitted amounts are also generally subject to early withdrawal charges.

Income options

Tax-deferred annuities provide the opportunity to build income for the future. When you are ready to start receiving income, which is called the payout phase, you can receive a steady flow of income for life or a stated number of years. Annuities can also be styled to cover the lifetimes of one or two people, usually a husband and wife. Alternatively, you may take the build-up of assets as a lump sum, or a single sum can be paid directly to your beneficiary(ies), usually free of probate.

Pay-out phase (or annuitization phase)

Tax-deferred annuities let you build income for the future. Then, when you are ready, annuities offer a number of ways for you or another designated payee to receive income.

+ **Life income** allows the annuitant to receive income for life; when the annuitant dies, the payments cease.
+ **Life income with period certain** provides for payments over the lifetime of the annuitant or a set number of years, whichever is longer. If the annuitant dies before the "period certain" ends, the remaining assets are paid to the beneficiary(ies), as scheduled.
+ **Period certain** only provides for payments to be made for a specific time, usually five to 20 years.
+ **Joint and survivor income** provides payments as long as either of the annuitants is alive.

Features of a fixed annuity

A fixed annuity is a relatively conservative choice that offers many benefits.

Safety of principal

Fixed annuities are backed by the financial strength of the issuing insurance company. Independent rating services rank annuity providers on their overall financial condition, which underlies their ability to meet their obligations to policyholders. Generally, the higher the ratings of the insurance company, the stronger the insurer.

Tax deferral

Taxes due on the income earned on the principal and interest of a fixed annuity are deferred until withdrawals are taken. Remember the IRS rule. Withdrawals taken prior to age 59½ may be subject to a 10% federal income tax penalty.

+ Nonqualified annuities do not require a minimum distribution at age 70½, unlike tax-qualified retirement plans, such as traditional IRA and 401(k) plans.

+ Tax-qualified annuities, which include IRA funds in an annuity, are subject to minimum distribution requirements.

Liquidity

With a fixed annuity, you can continue to have access to your money during the accumulation phase. While it's possible to make withdrawals, fixed annuities have penalties for withdrawals taken within a certain time period specified in the contract. These are referred to as either surrender fees or early withdrawal charges. The fee or charge is usually a percentage of the amount withdrawn and the charge decreases to zero over a set number of years.

Avoids probate

Fixed annuities usually provide for a death benefit payable directly to the beneficiary(ies), which in most situations, eliminates probate.

The safety of fixed annuities

Deciding to purchase a fixed annuity reflects a conservative and thoughtful approach to meeting your financial goals. The following measures are in place as safeguards.

The legal reserve system

The life insurance industry has been able to keep its financial commitments partially because of the strength and dependability of the legal reserve system.

+ Though not an insurance or guaranty fund, the legal reserve system is a strict, regulatory framework to which all life insurance companies must adhere in order to offer products to the public.
+ As a legal reserve life insurance company, Western National Life Insurance Company is required by statute to establish financial reserves to support policyholder benefits, such as withdrawal privileges, annuity income payments, and payments to beneficiaries.

To be licensed to do business in your state, Western National must satisfy this reserve requirement as set forth by the insurance department. Western National is also required to file periodic financial statements with each state insurance department where licensed, to assure that it is meeting departmental standards.

Insurance industry regulations

The insurance industry is one of the most stringently regulated businesses, overseen by the Department of Insurance in each state. An insurance product must first be filed with your state insurance department prior to its sale in your state.

+ All legal reserve companies must submit annual and quarterly financial statements to each state in which they are licensed to conduct business.

+ All companies, including Western National, operating in more than one state must also periodically undergo a thorough home-office examination of their financial position by state insurance department examiners.

How insurance companies invest assets

The investment of insurance company assets must comply with state statutes. These guidelines require that appropriate levels of quality be maintained. And, for diversification, only a small portion of an insurance company's assets may be invested in a single issuer, except for government-backed securities. Permissible types of investments include government and corporate bonds, government-insured mortgages, commercial paper and CDs.

Western National Life Insurance Company

Western National Life Insurance Company has helped Americans achieve financial security with innovative fixed annuity products for more than 50 years.

Today, we are the nation's number one provider of tax-deferred fixed annuities in this market. Licensed in 49 states and the District of Columbia, Western National products are built upon deep market knowledge and supported by the financial strength of Western National.

Glossary of terms

Accumulation phase. The period during which contributions are made to an annuity.

Annuitant. The person who receives income payments under an annuity contract upon annuitization.

Annuitize. To begin a series of payments based on funds accumulated in the annuity.

Annuity. A contract between an insurance company and an individual. It generally guarantees an income to the individual in exchange for a lump-sum payment or periodic payments.

Beneficiary(ies). In an annuity contract, the party(ies) who will receive the annuity death benefit if the annuitant (and/or owner in some contracts) dies.

Contract owner. The purchaser of the annuity contract.

Deferred annuity. An annuity contract that defers or delays income payments until the contract owner elects to receive them.

Fixed annuity. An annuity in which the insurance company pays a fixed rate of interest on the funds placed in the contract. The insurance company guarantees both principal and interest.

Flexible-premium deferred annuity.
An annuity that can be purchased with a series of payments over a period of time. The contract owner is not required to make any specific amount or number of payments.

Guaranteed interest rate. In a fixed annuity, the minimum rate of interest the insurance company agrees to credit each period (usually a year). The actual crediting rate is equal to or greater than the guaranteed rate.

Immediate annuity. An annuity contract purchased with a single premium that begins paying the annuitant immediately following purchase.

Interest-out-first rule. A federal tax law that specifies any money withdrawn from an annuity (not paid out as regular annuity income) is considered to come first from the earnings in the account and is considered taxable income to the contract owner, up to the amount of the earnings. If there are no earnings in the account, then the withdrawal is not taxable income. For tax-qualified plans, the entire withdrawal amount may be subject to income tax.

Joint and survivor income. An annuity payout option that covers two or more people. The annuity payments continue as long as one of the annuitants remains alive.

Life income. An annuity payout option that pays during the lifetime of the annuitant. Payments cease upon the annuitant's death.

Life income with period certain. An annuity payout option that pays during the lifetime of the annuitant. If the annuitant dies before the time period expires, the scheduled payments will be made to the annuitant's beneficiary(ies) for the remainder of the period certain.

New money rate. The initial rate of interest the insurance company agrees to pay on new premium payments.

Period certain. An annuity payout option that guarantees payments will be made over a certain period of time, usually between five and 20 years.

Premature distribution. Taking a withdrawal from an annuity before the contract owner reaches the age of 59½ (unless he or she is disabled or dies). Withdrawals taken prior to age 59½ are generally subject to a 10% federal income tax penalty.

Renewal rate. The rate of interest the insurance company pays after the current rate period expires.

Single-premium annuity. An annuity purchased with one lump sum of money rather than with a series of periodic payments.

Surrender or early withdrawal charge. A fee charged by many insurance companies for withdrawing all or part of the funds in an annuity. Surrender or early withdrawal charges usually decrease to zero after each premium in the annuity has been in force for a period of years.

Tax deferred. In an annuity contract, income taxes are delayed or postponed on annuity earnings until withdrawn.

Western National Life Insurance Company was one of the first insurance companies to develop fixed annuity products specifically for sale through banks. We are a leading provider of fixed annuities in this market, and have maintained our position by offering innovative products and valued services to help Americans achieve their financial goals.

Our products can help your customers live retirement on their terms.

Tax-qualified contracts such as IRAs, 401(k)s, etc., are tax deferred regardless of whether or not they are funded with an annuity. If you are considering funding a tax-qualified retirement plan with an annuity, you should know that an annuity does not provide any additional tax-deferred treatment of earnings beyond the treatment by the tax-qualified retirement plan itself. However, annuities do provide other features and benefits such as income options.

Neither Western National Life Insurance Company nor its agents or representatives are authorized to give legal, tax or accounting advice. Please consult your attorney, accountant or tax advisor on specific points of interest.

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In determining if a fixed annuity is the right product for you, speak frankly with your licensed financial representative about your financial situation and your retirement goals.

Fixed annuities offer a retirement income solution to suitable customers, but as with all financial products, there are certain risks to consider. An open discussion about your finances and goals will help you and your financial professional decide if fixed annuities are a suitable fit for your portfolio.

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