ANNUITIES GUIDE

The Pennsylvania Insurance Department is here to help you understand annuities. Annuities are sometimes used as retirement investments. There are many different kinds of annuities and each carries a different level of risk and guarantees. This is one reason it is important to look closely at what you are considering, and take your time making a decision. Since there are various types of annuities, it can be difficult to understand the differences and whether they are right for you.

pennsylvania
INSURANCE DEPARTMENT

What Is an Annuity?

An **annuity** is a contract under which an insurance company pays you income at regular intervals, during the **payout phase**, in return for a **premium** or **premiums** you have paid. Some **annuities** can pay an income guaranteed as long as you live. Many people buy **annuities** to help manage their income in retirement.

The amount of an annuity benefit depends upon the annuity settlement option selected.

There Are Three Different Types of Annuities.

The amount of an **annuity** benefit depends upon the **annuity** settlement option selected. The accumulation amount may be **fixed, variable,** or **equity indexed.**

1. A **fixed annuity** provides a guaranteed accumulation amount that could be increased if the company credits interest at a rate greater than the minimum guarantee.

2. A **variable annuity** provides earnings and/or benefits that vary, depending on the gains and losses experienced on investments underlying the contract. The owner of a **variable annuity** contract has the option of selecting the investments and making periodic changes to the selections. Investments may include stocks, bonds, money market funds, and combinations of these. Since **variable annuities** have an investment component, they must be registered with the Securities and Exchange Commission and may be sold only by individuals licensed to sell securities, as well as **annuities.**

3. In an **equity indexed annuity** the money earns interest based on changes in an **index.** Some **indexes** are measures of how the overall financial market performs like the Standard and Poor's 500. Other **indexes** measure how a specific financial market performs, like the Nasdaq, during a term.

The insurance company uses a formula to determine how a change in the **index** affects the amount of interest to add to your **annuity** at the end of each **index** term. The interest credits usually are less than the full amount of change in the stock market **index** and are subject to both a minimum and maximum. In addition, the company guarantees that the **accumulation value** will not be less than an amount set forth in the contract. The **equity indexed annuity** may also be referred to as a **fixed indexed annuity** or an **indexed annuity,** where the latter terms also include alternative or innovative **indexes.**

When Do Annuity Payments Start?

An **annuity** is either an **immediate annuity** or a **deferred annuity** depending on when the **annuity** payments begin.

Immediate annuities generally are purchased by people of retirement age. These **annuity** contracts provide a periodic payment beginning soon after purchase. For example, if the **annuity payment period** is monthly, the first **annuity** payment will be made one month after issuance of the contract. An **immediate annuity** is purchased with a single **premium** payment.

Deferred annuities are purchased by people who want to accumulate money during their working years so they can receive periodic payments in the future, or who just want to save money for future use. A **deferred annuity** may be either a single

Please refer to the Glossary found on page 7 for definitions of the terms in bold face.

premium contract, a contract with **premium** payments accepted for a limited period of time, or a contract with **flexible premium** amounts.

If you do not continue **premium** payments as you originally planned, you will receive reduced **annuity** benefit payments.

During the **accumulation phase,** interest and/or earnings will be credited to the **accumulation value.** No taxes are owed on the credited interest until **annuity** payments begin.

For more information about **deferred annuities,** visit the National Association of Insurance Commissioners (NAIC) at *www.naic.org* and type "Deferred Annuities Guide" in their search engine.

If you do not continue premium payments as you originally planned, you will receive reduced annuity benefit payments.

For Fixed Annuities, How Is the Credited Interest Rate Determined?

Interest rates on a **deferred annuity** are determined by the company and depend on the investment results experienced by the company. The interest rates an **annuity** earns always are subject to a guaranteed minimum set by the company and disclosed in the policy. The typical **guaranteed minimum interest rate** is 1 percent. Some contracts provide for a limited time guaranteed interest rate that exceeds the **guaranteed minimum interest rate.** For example, a limited time guaranteed interest rate of 2 percent may be in effect for the first three years of the contract. After the initial three-year period, a new limited time guaranteed interest rate may be set by the company or discontinued altogether. Either way, your contract always will provide for a **guaranteed minimum interest rate.**

How Can You Receive the Accumulation Value of Your Contract?

You can receive the **accumulation value** of your **deferred annuity** contract, net of any charges and adjustments, by contacting your agent or company. During the **accumulation phase,** an **annuity** contract may be totally **surrendered** for its **accumulation value,** including the credited interest. Some contracts also may allow you to **surrender** a portion of the **accumulation value.** A **surrender charge** usually is applied upon total or partial **surrender.**

Surrender Charges

To recoup expenses involved in issuing an **annuity** contract, most companies apply a **surrender charge** during the early years whenever a **deferred annuity** contract is **surrendered** for its total or partial **accumulation value.** Typical **surrender charges** are 10 percent in the first year decreasing to zero after a five- to 10-year period following issuance of the contract.

Contracts frequently provide that applicable **surrender charges** will not be applied if a **surrender** is made during a certain window period, such as the last 30 days of each contract year. **Surrender charges** also may be waived under specified conditions, such as chronic illness of the **annuitant** or owner.

Market Value Adjustment

Some **annuities** have a market value adjustment (MVA). An MVA may increase or decrease the amount payable upon **surrender,** depending on how market interest rates have changed since you bought the contract. Every MVA calculation is different, so make sure it is adequately explained to you.

Living Benefits

Some **annuities**, often **equity indexed annuities** or **variable annuities**, offer a guaranteed living benefits feature at an extra cost. Subject to specific conditions and limits, periodic withdrawals can be guaranteed to continue for a period of time (or for life in some cases) even if the **accumulation value** has been reduced to zero as a result of the periodic withdrawals or poor market performance. Conditions and limitations vary substantially from contract to contract, so make sure any living benefits feature is adequately explained to you.

Tax Deferral Features of Annuities

You should always consult a tax professional for advice *before* deciding to purchase an **annuity** and *after* you do because the tax rules surrounding **annuities** are complex.

If all or any portion of an **annuity** contract is **surrendered**, there are tax consequences. **Premiums** paid for an **annuity** contract are not tax deductible unless the product is purchased under a specific section of the Internal Revenue Code (IRC). Increases in the value of the contract during the **accumulation phase** (due to interest income or dividends) grow untaxed until the time of **surrender** or until benefits begin. Once **annuity** benefits begin, the interest part of each **annuity** payment will be taxed as ordinary income for federal income tax purposes.

For Pennsylvania state income tax purposes, once **annuity** benefits begin, no tax is due while the sum of the **annuity** payments is less than the **premiums** paid during the **accumulation phase** of the **annuity** contract. Once the sum of the **annuity** payments is greater than the **premiums** paid during the **accumulation phase**, all future payments are subject to the Pennsylvania income tax.

You should contact a tax advisor for further tax information. Also, the Internal Revenue Service has several brochures on **annuities.**

You should always consult a tax professional for advice before deciding to purchase an annuity and after.

Annuity Interest Bonus or Premium Bonus

Some **annuity** contracts provide that the company will credit the first **premium** paid with an amount in addition to the interest rate. For example, an interest rate of 2 percent plus a bonus of 2 percent may be credited to the first **premium** payment. The expense charges of the contract may be increased and could over time exceed the bonus.

How Long Do Annuity Benefits Continue?

The length of time during which **annuity** benefits are paid depends on the settlement option selected. You may select payment for a fixed period of time such as 20 years or for as long as the **annuitant** is living.

When you select a settlement option, you lose access to the **accumulation value** in exchange for the maximum periodic payment available from the company for the option you have chosen.

Other settlement options guarantee a certain number of **annuity** benefits or a certain total dollar amount to a designated person, even if the original **annuitant** dies. **Annuities** also may be issued on a joint and survivor basis, which means that **annuity** benefits will continue as long as any of the named joint **annuitants** are living.

When you are ready to select a specific settlement option, you will want to consider the available options and the specific needs of you and your family.

Money put in an annuity is typically "locked up" for a period of time specified in the annuity.

Where to Buy an Annuity

Now that you know more about what to look for when choosing an **annuity,** let's talk about where you can go to buy.

To buy an **annuity,** talk to an agent who is licensed to sell **annuities** in Pennsylvania. Shop around to compare the various **annuity** products and insurance companies. Consult insurance company rating services such as A.M. Best (www.ambest.com), Moody's Investors Service (www.moodys.com), and Standard & Poor's (www.standardandpoors.com). The ratings provided by these services are opinions as to the relative financial strength and performance of insurance companies.

Here are some questions from the National Association of Insurance Commissioners (NAIC) you should ask before purchasing an **annuity.**

- Do I understand the risks of an **annuity?** Am I comfortable with them?
- How will this **annuity** help me meet my overall financial objectives and time horizon?
- Will I use the **annuity** for a long-term goal such as retirement? If so, how could I achieve that goal if the income from the **annuity** isn't as much as I expected it to be?
- What features and benefits in the **annuity,** other than tax deferral, make it appropriate for me?
- Does my **annuity** offer a **guaranteed minimum interest rate?** If so, what is it?
- If the **annuity** includes riders, do I understand how they work?
- Am I taking full advantage of all of my other tax-deferred opportunities, such as 401(k)s, 403(b)s, and IRAs?
- Do I understand all of the **annuity**'s fees, charges, and adjustments?
- Is there a limit on how much I can take out of my **annuity** each year without paying a **surrender charge?** Is there a limit on the total amount I can withdraw during the **surrender charge** period?
- Do I intend to keep my money in the **annuity** long enough to avoid paying any **surrender charges?**
- Have I consulted a tax advisor and/or considered how buying an **annuity** will affect my tax liability?
- How do I make sure my chosen survivors (beneficiaries) will receive any payment from my **annuity** if I die?

If you don't know the answers or have other questions, ask your **annuity** salesperson for help.

The Do's and Don'ts of Annuities

•••••DO•••••

- Read the materials. If you don't understand something, find someone you trust and ask.
- Understand that money put in an **annuity** is typically "locked up" for a period of time specified in the **annuity,** often five to 10 years. If you withdraw some or all of your money during the specified time period, you will have to pay a penalty called a **surrender charge. Annuities** are not for short-term goals.

- Ask about these **surrender charges.** Do you intend to keep the **annuity** *for the entire* ***surrender charge*** *period?* Usually, the closer you are to the end of the time the money must be "locked up," the smaller the **surrender charge.**

- Pay attention to optional features offered with **annuities,** and get information about additional fees associated with adding benefits.
- Use the free-look period all **annuities** have. *Read and understand* the terms of the contract. If you decide the terms are not favorable, you can cancel the contract and receive all of your money back. **This only applies during the free-look period, so make sure you know when this period ends.**

••••• DON'T •••••

- Don't be pressured into thinking you need to buy an **annuity** today or right now. Don't feel obligated to buy because someone gave you a free lunch, dinner, or gift.
- Don't make your check out to the agent or producer, only to the company issuing the **annuity.**
- Don't accept verbal assurances; always verify policy terms in writing.
- Don't work with an agent unable or unwilling to provide credentials.

An agent should be willing to listen to you and look for ways to find the right type of **annuity** for you. At the time of purchase, after you have read and are sure you understand everything you are signing, **make your check payable to the insurance company,** not to the agent. Be sure the agent gives you a receipt.

Never pay cash. This will reduce the possibility that the salesperson could mishandle your funds.

Illustrations

A salesperson may present computer printouts showing payouts of an **annuity** contract in the future. In reviewing the numbers on the illustration,

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be sure you understand whether the figures are "guaranteed" or "illustrated."

Guaranteed amounts mean the company must pay the amount shown. Even if the company's investments do not make as much money as anticipated, the company still must pay at the rate that it guaranteed.

Illustrated values are one view of how the contract might perform given certain assumptions about future returns on the investments that support the **annuity.** The insurance company is not contractually bound to pay illustrative figures.

One thing you can count on is that the contract's actual performance will be different from any illustrations that are not guaranteed. The payout may be higher and it may be lower. Read all the illustrations, especially the explanatory notes. If the illustration refers to explanatory notes, but does not include them, ask that you be given a copy.

Is It OK for a Salesperson or Company to Sell Me a New Annuity in Replacement of an Existing Contract?

It is not illegal for a salesperson or company to sell new contracts in replacement of existing contracts. It *is* illegal to use unfair and deceptive sales practices to convince the **annuitant** to accept a replacement. **Churning** usually benefits the salesperson, not the consumer.

Be extremely cautious when replacing an **annuity** contract. Do not change your existing contract unless you are convinced that the new contract is in your best interest.

Whenever a salesperson recommends that you replace an existing contract, obtain a written explanation of why doing so would be beneficial for you. Then review this explanation with an independent advisor, such as a certified public accountant, attorney, or financial planner, before you act.

Replacement of an **annuity** contract may be legitimately in your best interest if you fully understand what you are giving up and what you are purchasing. If you do decide to make a change, never cancel your existing contract until your new contract is in place.

Free-Look Period

If you buy an **annuity** contract and are not satisfied with the contract for any reason, you may return it directly to the agent or company within 10 days after receipt of the contract for a full return of the **premium** paid. Your **annuity** contract will provide at least 20 days if your new contract replaces an existing contract. In the case of a **variable annuity,** your contract may provide for an amount other than a return of the **premium** paid.

As a safeguard, you are encouraged to use certified mail to establish the date the contract was mailed back to the agent or company.

Even if you find an **annuity** that seems to fit your investment risk level, you still have to ask whether any **annuity** is right for you. Keep in mind that **annuities** are to provide income for the long term and should not be bought to reach a short-term financial goal.

Sound advice when considering any financial transaction is to avoid high pressure sales tactics and to take your time in deciding upon the appropriateness of the transaction. You don't need to buy anything today or right now. If a deal seems too good to be true, it probably is.

More information on **annuities** is available through the *National Association of Insurance Commissioners* at www.NAIC.org or www.insureuonline.org.

The Pennsylvania Insurance Department

The mission of the Insurance Department is to provide a premier regulatory environment that promotes a competitive marketplace and serves the best interest of insurance consumers. Whether you have a general question about annuities, or want to file a complaint against a company or agent, you can get help at Consumer Services online at www.insurance.pa.gov or contact us toll-free at 1-877-881-6388.

Annuity Glossary—a Supplement to the Annuity Guide

These definitions are offered to give you a general understanding of the terms you may hear that are associated with **annuities.** Please note, your individual company may define similar terms differently.

Accumulation Phase

The period of time prior to the start of annuity payments where the premiums paid under an annuity contract are accumulated with interest.

Accumulation Value

The amount of money, consisting of premiums paid, any expense charge deductions and interest credited, that accumulates under an annuity contract during the accumulation phase.

Annuitant

The person who receives periodic payments under an annuity contract. This person is not necessarily the same person who made the original purchase payment.

Annuity

A contract that provides for the periodic payment of money. It is designed to pay benefits while a person is living.

Annuity Payment Period
The length of time annuity benefits are paid under an annuity contract.

Churning
The improper activity of an agent replacing one policy with another policy issued by the same or different company through misrepresentation of the new or existing policy. Such activity is undertaken repeatedly to generate new business commissions that are substantially higher than renewal commissions. Transactions of this type generally are not in the best interest of the policyholder.

Deferred Annuities
An annuity contract where money accumulated is designed to provide annuity payments to begin at some future date.

Equity Indexed Annuity
A type of annuity that earns interest based on the changes in the established stock market index, such as Standard and Poor's 500.

Flexible Premium
A premium that can be varied as to the amount and time of payment at the option of the premium payor.

Fixed Annuity
Provides a guaranteed accumulation amount that may be increased if the company credits interest at a rate greater than the minimum guarantee.

Guaranteed Minimum Interest Rate
During the contract accumulation phase, it is the minimum interest rate that a company guarantees to credit to the accumulation value of an annuity contract.

Immediate Annuities
An annuity contract that provides a periodic payment to begin soon after purchase.

Index
A measure of how an overall or specific market performs, like the Standard and Poor's 500 and Nasdaq, during a set period of time.

Joint and Survivor Annuity
A contract that pays annuity benefits to one or more named annuitants until the death of the last surviving named annuitant.

Payout Phase
The period of time after the accumulation phase where payments are made to the annuitant at regular intervals.

Premium
Purchase payments made to an annuity contract to accrue earnings and/or benefits.

Surrender
The return of an annuity contract to the insurance company for a refund of the accumulation value of the contract less any applicable surrender charges.

Surrender Charge
A deduction made from an annuity contract's accumulation value when the annuity contract is cash surrendered within a stated period.

Variable Annuity
An annuity contract providing for earnings and/or benefits that vary up or down in value depending on the experience of the underlying investments of the annuity contract.

Questions? For more information on annuities, visit: www.insurance.pa.gov and click "Seniors" under the Consumer Corner or call the department at 1-877-881-6388

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