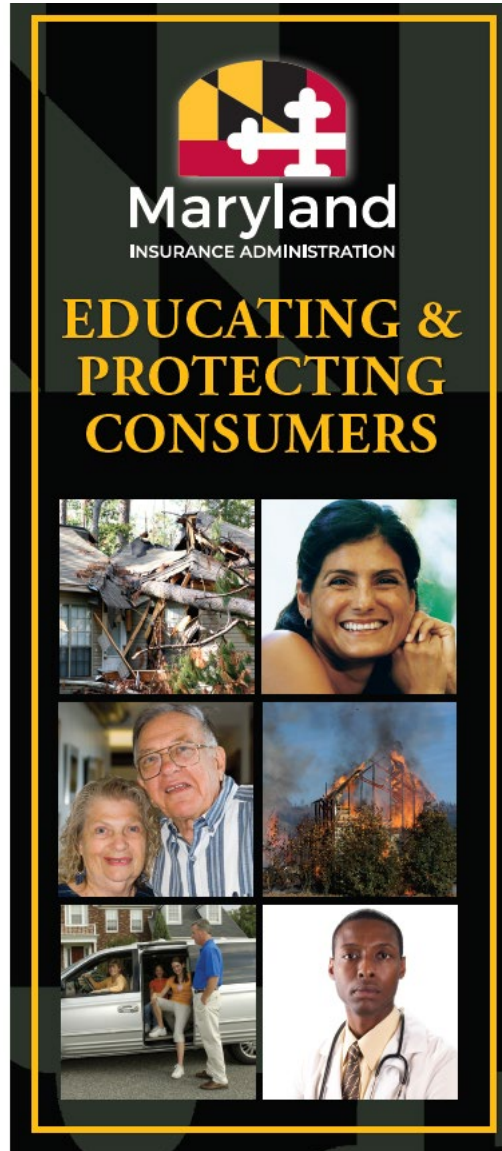




Annuities 101

Patricia Dorn
Consumer Education and Advocacy Unit
patricia.dorn@maryland.gov

What is the Maryland Insurance Administration



The Maryland Insurance Administration (MIA) is the state agency that regulates insurance in Maryland. The MIA:

Licenses insurers and insurance producers (agents or brokers).

Examines the business practices of licensees to ensure compliance.

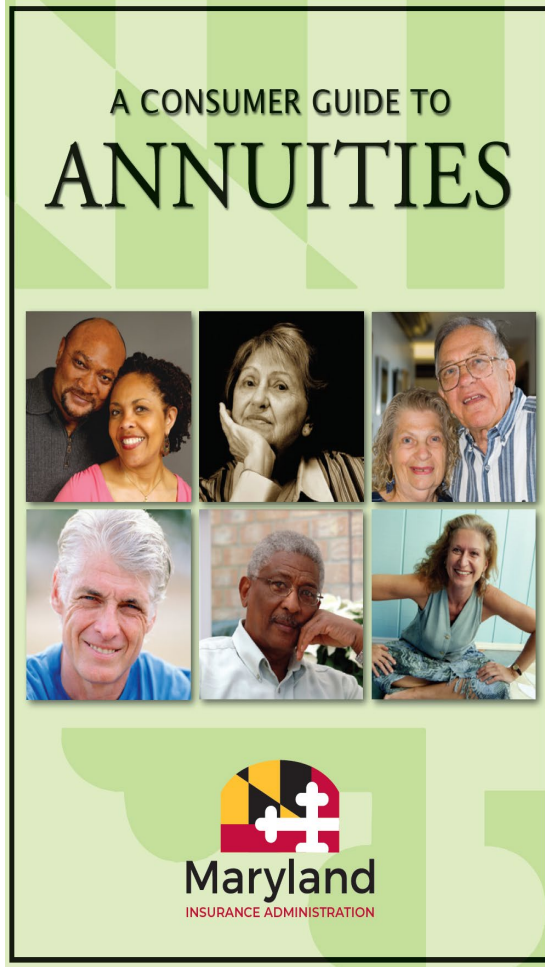
Monitors solvency of insurers.

Reviews/approves insurance policy forms. Reviews insurance rates to ensure rates are not inadequate, excessive or unfairly discriminatory.

Investigates consumer and provider complaints and allegations of fraud.



What is an Annuity?



- **An annuity is a contract** between you and an insurance company under which you make either a lump sum payment or a series of payments, and in exchange, the insurance company agrees to make payment to you in the future.
- **The amount of this payment** is determined according to the terms of the contract and the market environment. It typically varies depending upon the amount of the original payment, the length of the investment, and any withdrawals, among other factors.
- Although **annuities are not life insurance**, most include death benefits.
- Annuities are frequently used as an **investment tool**; however, they may not be the best investment option for you.



Tips for Understanding Annuities

An annuity can have a number of features, requirements, and options. The details can be difficult to understand, even for an experienced investor, and it is strongly recommended you consult with a trusted advisor when considering an annuity. You can gain a better understanding of an annuity by knowing the answers to these questions:

- How does the annuity earn interest, is it fixed or variable?
- How do you pay premiums into the annuity fund?
- When does the annuity start paying you?
- How does the annuity pay you?
- What administrative fees and charges does the annuity have? Is there a surrender fee?

These answers can help provide an overall sense of the annuity's main characteristics.

How does the annuity earn interest, is it fixed or variable?



There are two basic types of annuities – fixed and variable.

In a **fixed** annuity, the insurance company guarantees that you will earn a minimum rate of interest during the time your account is growing. The interest rate may fluctuate. Fixed annuities tend to be more conservative. The guaranteed rate may be higher or lower than the interest rate you would earn in a bank savings account.

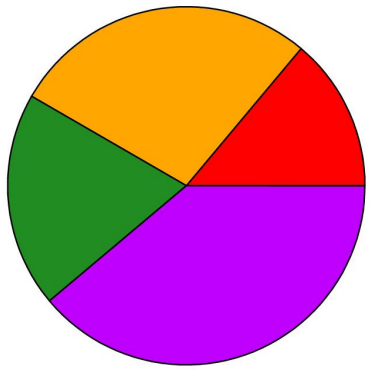
An equity index or fixed index annuity is a variation of the fixed annuity.

In an **indexed** annuity, you choose how you want to invest your premiums. Your premiums can go into a fixed account or to an indexed account you select that is offered by the contract.

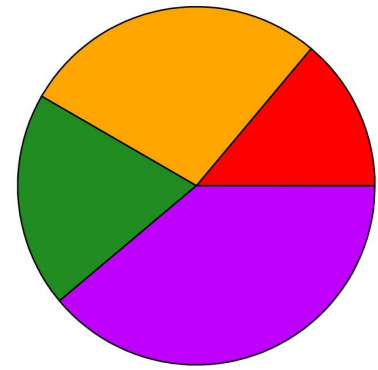
How does the annuity earn interest, is it fixed or variable?

Variable annuities offer the chance to earn greater **returns** (profit on your investment) than the typical fixed annuity, but also have greater risk and require more **active involvement** by the contract holder. Active involvement means you may have to make decisions on a regular basis about your investment, often annually. These annuities are highly dependent on the performance of the stock market and generally make no guarantees about earnings. If the annuity fund performs poorly, you could lose some or all of your original investment.





How does the annuity earn interest, is it fixed or variable?



For example, if you own a **variable annuity**, in one year, you could choose to put 40 percent of your total value into the annuity's bond fund, 40 percent into its stock mutual fund, and 20 percent into its money market account. Meanwhile, another purchaser of the same annuity could allocate his or her accumulated value in a completely different way.

You choose how you want to invest your premiums. **You select the funds based on your risk tolerance.**

This means that investors who purchase the same variable annuity will have different rates of return, depending upon the decisions you have made about how you invest your premiums.

Please discuss with your financial advisor.



How do you pay premiums into the annuity fund?

Single premium annuities are contracts where you pay the entire premium up front in one lump sum. An advantage of a single premium annuity is that the full amount of your premium begins earning interest from day one.

Flexible premium annuities allow you to pay however much you want, when you want, within certain limits. Most flexible premiums will require certain **minimum** premium payments, at least in the early years. In some cases, companies also may place a cap on the maximum amount you can contribute. This is the **accumulation period** – the period of time when contributions are being made to the annuity and the value of the annuity account is building.



FYI: Annuitization and Withdrawals

Annuitization is the process of converting your annuity into a series of periodic payments. When the contract owner is ready to begin receiving payments, the insurer computes a payment based on several factors – such as the value of the contract, the projected longevity of the beneficiary and the type of payout chosen.

Each annuitized payment includes part of the principal, while the rest is made up of earnings.

A lump sum **withdrawal** is generally allowed, but can be a costly move. You need to review your plan's rules, and you may be required to pay taxes, penalties and a surrender charge. We will cover this in a bit more depth in a few more slides.



When does the Annuity start paying you?

Immediate annuities begin the payout phase within a very short period of time, from 1 to 13 months, for example. For this reason, immediate annuities are typically paid for in a single premium, since the entire premium amount must accumulate before the payout phase begins. The purpose of an immediate annuity typically is to convert a large sum of cash into a steady stream of income for an extended period of time.

Deferred annuities begin the payout phase some time after purchase. The time when the payout begins is dependent on the contract. The majority of annuities sold today are deferred annuities. Instead of receiving a payout, you also have the option of rolling the amount over into another annuity or to extend your existing annuity.

Most deferred annuities include an **accumulation period** – the period of time when contributions are being made to the annuity and the value of the annuity account is building.



How does the Annuity pay you?

Life only. The company makes payments for as long as the recipient lives. Payment amount is largely determined by life expectancy – the longer the recipient can be expected to live, the smaller the payment amount will be. There is no guarantee that the total amount invested will be returned. On the other hand, the recipient is guaranteed the income for the remainder of his or her lifetime. If the recipient lives a long time, more than the amount paid into the annuity could be received.

Fixed period. The recipient receives a payment for a specific number of years. Payments after the recipient's death may be made to a designated beneficiary.

Life with period certain. Payments are made during the lifetime of the recipient with a guaranteed minimum payment. That means if the recipient dies without receiving the minimum payment, a balance is paid to the named beneficiary.

Joint and survivor life. The company pays the annuitant or survivor for as long as either is alive.

Not all annuities offer these options, and some may offer others. Be sure to read the actual annuity contract, in addition to any brochures the insurance producer may give you, to learn about the features of the annuity and how the payout is structured.

What administrative fees and charges does the annuity have? Is there a surrender fee?

It's important to ask your financial advisor questions about what happens to your annuity contract if you die, or decide to purchase another annuity. If you are considering replacing one annuity for another, carefully compare your old product with the new one.



Are the death benefits the same?

What about the surrender value?

Is there a surrender charge to get out of the old annuity?

Are the annual fees and new surrender charges higher for the new product?

Will there be a new surrender charge period for the new product?

What administrative fees and charges does the annuity have? Is there a surrender fee?

Most annuities will charge you a substantial penalty for a withdrawal from your accumulated value during the surrender period . This penalty, called a **surrender charge**, is typically highest in the early years of the annuity, and may be reduced or eliminated over time.

- Surrender charges commonly range from 5 to 15 percent of the amount withdrawn.
- High surrender charges can erase any earnings you may have gained. These penalties are the primary reason an annuity generally is preferred as a long-term investment, and therefore, may be unsuitable for individuals who may have immediate needs to access their funds.
- Discuss the tax consequences of early withdrawal with a tax advisor.
- Also – ask your financial advisory if the annuity contract includes a death benefit and a surrender value,
- and make sure you clearly understand the taxes you may pay on any benefits received.

Shopping Tips

- **Consider consulting an accountant, financial adviser, or a trusted family member or friend.** If you purchase an annuity that you don't fully understand, you could be in store for surprises down the road.
- **Shop around.** Compare the guaranteed interest rate, fees, and surrender charges of multiple annuity contracts. Also, compare an annuity's projected return with other types of investments. Even with an annuity's tax advantages, other investments may provide an equal or better return while providing less restrictive access to your money.





Shopping Tips

- **Make sure the time frame for payout is right for your needs.** Remember that annuities are not short-term investments. They frequently take at least several years to become profitable. Income in an annuity is not taxed until it is paid out, so talk to a tax advisor before buying an annuity within a retirement plan such as a 401(k) or IRA.
- **Know how much risk you are willing to take on.** It's important to decide the level of risk you're willing to accept before you purchase an annuity. Weigh that against the risk posed by the type of annuity you're considering. Fixed annuities guarantee a minimum rate of return. Variable annuities have the potential to earn significantly more, but you also could lose money.

Shopping Tips

- **Verify that the producer and insurer are licensed.** Insurance producers and insurers must have a Maryland insurance license to legally sell annuities in the state. In addition, insurance producers who sell variable annuities must have a federal securities license. Although it won't avoid every potential problem, verifying the insurance producer or insurer's license is a good first step toward ensuring that an annuity is legitimate and meets minimum state requirements. You can quickly verify licensing status by calling the MIA at 410-468-2000 or 800-492-6116.
- **Consider the insurer's financial condition.** Annuities are a long-term investment. A company that's in solid financial shape is more likely to be around when it's time for you to collect on your investment. You can learn an insurer's financial rating from an independent rating organization.
- **Take your time to consider.** It's probably not a good idea to purchase an investment as complex as an annuity on a first visit with an insurance producer. Take all the time you need to make a decision. If you feel you are being pressured to make a decision quickly, you may want to go elsewhere. It's a good idea to ask a trusted family member or friend to accompany you when you meet with the insurance producer.



Shopping Tips

- **Maryland has a legally mandated free-look period.** All annuities sold in Maryland come with a minimum of a 10-day free-look period. During this period, you can cancel the contract for any reason. If you have a fixed annuity and cancel within the free-look period, you may be entitled to a full refund. If you have a variable annuity, you may not receive a refund for any loss in the investment. Use this time to reread the contract and make sure it meets your financial needs. If the annuity doesn't offer a free-look period, be careful. If you have already purchased an annuity, and it does not have a free-look period, you may file a complaint with the MIA.

- **Be wary of annuities sold door-to-door or over the telephone.** While most annuities sold door-to-door or over the telephone are legitimate, these sales techniques can lend themselves to fraud operations. If you do buy an annuity in this manner, obtain the insurer's physical address and make sure you have a way to contact the insurance producer or insurer.



Additional Resources

A Consumer Guide to Annuities

<https://insurance.maryland.gov/Consumer/Documents/publications/consumerguidetoannuities.pdf>

Maryland Life and Health Insurance Guaranty Corporation

<https://www.mdlifega.org/>

Consumer Advisory – Trading Your Annuity for a New One

<https://insurance.maryland.gov/Consumer/Documents/publicnew/Consumer-Advisory-Trading-Your-Annuity.pdf>

Contact Information

Maryland Insurance Administration

800-492-6116 or 410-468-2000

www.insurance.maryland.gov



Questions?

patricia.dorn@maryland.gov