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Defining Annuities

An annuity is an investment that is made through an insurance company. It is defined as the liquidation of a principal sum to be distributed on a periodic payment basis to commence at a specific time and to continue throughout a specified period of time or for the duration of a designated life or lives. It is a contractual relationship between the contract owner the particular insurance company. It is and actual agreement between the customer and the insurance company that stipulates the guidelines by which each must operate. The features of the annuity are outlined in detail in the contract. Retirement Annuity Contracts are “old style” individual pension plans, which were on sale prior to 1988. They were similar in nature to personal pension plans, they allowed an individual to take a greater amount of his pension fund at retirement as a tax free lump sum, but they insisted that the individual should normally be at least 60 years old before gaining the benefits.

An annuity is a contract, usually sold by an insurance company that makes periodic payments to the holder at a future date, usually beginning at retirement. A fixed annuity pays a guaranteed rate and guarantees principal. A variable annuity produces investment returns based on the performance of the investments made through the annuity. All annuities are tax-deferred, meaning that the income resulting from the growth of the assets within the annuity is deferred until withdrawals are made from the annuity. Both the amounts that build up within the annuity (during the accumulation phase) and the amounts that are received as annuity payments (during the distribution phase) can qualify for favorable federal income-tax treatment. Thus, purchasing an annuity can become a tax-deferred method of saving for retirement. Annuities can be sold through insurance agencies, banks, savings and loans institutions, brokerage firms, investment advisors, and financial planners. Although annuities are sold only by the insurance industry, they do not have anything to do with life insurance or insurance coverage.

Annuity Types According To When Benefits Are Paid Out

There are two main annuity types – Immediate and Deferred. The difference between deferred and immediate annuities is the following. With an immediate annuity, the income payments start right away. The individual chooses whether he or she wants income guaranteed for a specific number of years or for a lifetime. The insurance company calculates the amount of each income payment based on the purchase amount and the life expectancy. A deferred annuity has two phases: the accumulation phase, where the money grows for a while, and the payout phase. During accumulation, the money grows tax-deferred until it is taken out, either as a lump sum or as a series of payments. The individual decides when to take income from the annuity and therefore, when to pay the taxes. Gaining increased control over taxes is one of the key benefits of annuities. The payout phase begins when one decides to take income from the annuity. For most people, this is during retirement. As one’s needs dictate, the individual can take partial withdrawals, completely cash-out (surrender) the annuity, or convert the deferred annuity into a stream of income payments (annuitization). This last option is essentially the same as buying an immediate annuity.

Define Immediate Annuity

An immediate annuity is guaranteed and can spread out the tax liability of a deferred annuity over time. An immediate annuity is one bought with a lump sum, with the annuity payments to commence immediately. If a deferred annuity contains non-qualified funds and a person chooses to annuitize, the income payments will be treated as part return of principal and part interest. Only the interest portion will be taxable. In contrast, systematic withdrawals from a deferred annuity may be fully taxable until all of the earnings have been withdrawn. An immediate annuity begins making payments right away, rather than several years from now.

An immediate annuity can be purchased with funds from a variety of possible sources, such as: a maturing Certificate of Deposit (CD); monies which have accumulated in a deferred annuity account; or funds from a tax-qualified defined benefit or profit-sharing plan, or from an IRA account. Immediate annuities provide many advantages to the buyer, such as: (1) Security—the annuity provides stable lifetime income which can never be outlived or which may be guaranteed for a specified period; Simplicity; High Returns; Preferred Tax Treatment; and Simplicity.

- ***Immediate Annuity*** - *Fixed:* An individual locks in an earnings rate, and receives monthly payments that include a return of investment plus taxable earnings. The amount of the monthly payment will depend on the options chosen and age. In some cases, these are effectively used by people who want the assurance of payments that they cannot outlive.
- ***Immediate Annuity*** - *Variable:* Monthly payments will vary according to how investments in the stock market perform. There is no guaranteed monthly payment amount. Comment: Has greater risk than an Immediate Annuity - Fixed.

An immediate annuity can solve many income needs. The unique guarantee, security and flexibility offered by an immediate annuity make the product an ideal financial solution for many situations. For example, if searching for an easy way to manage retirement income, an immediate annuity can relieve financial concerns with a simple one-time premium. Or, if an individual has a qualified plan and wants to retire early, an immediate annuity can help avoid early withdrawal penalties. An immediate annuity provides protection against outliving assets. Advances in technology and healthier lifestyles are allowing Americans to live longer than ever. According to the National Center for Health Statistics (1996), if an individual is planning to retire at age 65, he or she can anticipate managing assets for income 20-30 more years. Immediate annuity payments are guaranteed for life (or the certain period of time chosen). An individual can never outlive lifetime benefit payments and they will never fluctuate. With the guaranteed income offered by an immediate annuity, it is important to worry about managing retirement spending. Receiving retirement income from an immediate annuity offers significant tax advantages. Not only is income guaranteed, but tax liability is also spread out over time.

- ***Mechanics of Immediate Annuities*** -- Immediate annuities provide current income. An immediate annuity can provide dependable security that will continue for the rest of one's life or for a period selected. If an individual is about to retire, an immediate annuity may be a good place to put a large lump sum of money accumulated through a deferred annuity, a retirement plan, or other savings vehicle. If the annuity is "life-based," the insurance company guarantees payments for as long as the annuitant lives. The amount of the payments is determined not only by the initial investment and investment returns, but also by the actuarial life expectancy of the annuitant. Generally, immediate annuities are irrevocable, and the annuitant may never alter the payment schedule. From a tax perspective, the periodic payments are comprised of both principal and interest. Many immediate annuities are not "life-based" but contain guarantee provisions in case the annuitant dies "too early." If the annuitant dies before the specified number of years is reached, a person named as beneficiary by the annuitant will receive the remaining payments.
- ***Purchasing An Immediate Annuity*** -- To purchase an immediate annuity, a one-time payment is made, and distributions typically begin within a month. Immediate annuities can be fixed or variable, just like deferred annuities. The income payments received from fixed immediate annuities are based on the amount contributed, age, and the interest rate environment at the time of purchase. The payments will not change. The payments from variable immediate annuities fluctuate based on the performance of the investment options chosen. Although payments may go up or down, variable annuities are designed to provide income that can rise over time to help keep pace with inflation. The principal in an immediate annuity is not readily accessible. If choosing an income for life option with no refund guarantee, and an individual should die before the principal is all paid out, the balance of the principal and any earnings will go to the insurance company rather than to one's heirs. Annuities offer several guaranteed payout options.

- ***Features and Options of the Immediate Annuity*** -- To purchase an immediate annuity, a one-time payment is made, and distributions typically begin within a month. Immediate annuities can be fixed or variable, just like deferred annuities. The income payments received from fixed immediate annuities are based on the amount contributed and the interest-rate environment at the time of purchase and will not change. The payments from variable immediate annuities fluctuate based on the performance of the investment options chosen. Although payments may go up and down, variable annuities are designed to provide income that hopefully will rise over time to help keep pace with inflation. A number of options can be chosen from for receiving income from an immediate annuity. A life option guarantees a specified income for as long as the annuity owner lives. A period certain annuity guarantees an income for a specific period of time, such as 15 years. Perhaps the most popular choice is known as a joint and survivor option, which guarantees that income payments will continue for the life of the primary owner and a second person. The guarantee is made by the insurance company issuing the annuity.
- ***Benefits of The Immediate Annuity*** -- With immediate annuities, there is no accumulation phase and an individual will start receiving annuity payments right after purchasing the annuity. Some of the benefits to consider in an immediate annuity are as follows:
    - Guaranteed income for life is provided.
    - Frequency to receive income payments -- monthly, quarterly, semi- annually or annually; there's a payout plan to fit particular needs.
    - Lessens financial worries. Financial management can be a burden in retirement years.
    - Income taxes are paid only as payments are received.

Types of Immediate Annuities

There are several kinds of immediate annuities, not all of which make payments for life. Immediate annuities are usually irrevocable contracts. All immediate annuities provide for periodic payments that are predetermined and specified when the contract is negotiated. Once the annuity has been purchased, the owner does not have the right to revoke the contract and obtain a refund. An immediate annuity will provide income right away. Immediate annuity payments may be made monthly, quarterly, or annually. When buying an immediate annuity, a person is transferring a lump sum to an insurance company in return for their promise to pay a monthly income. The amount of income that will be paid by the insurance company is subject to 1) the interest rate they credit, and 2) the type of immediate annuity purchased. There are three different types of immediate annuities payouts:

- Life
- Period Certain;
- Life with Period Certain.

Life Time Payments are made as long as the annuitant lives. This option pays the highest income per dollar applied because there is no payment obligation at the death of the annuitant. Lifetime with a period certain: If the annuitant dies before a specified number of years have elapsed (10 or 20, for example), payments will continue to the beneficiary for the balance of the specified period. If the annuitant lives beyond the specified period, payments continue until death of the annuitant.

Period Certain Annuities **–** With "Period Certain" annuity, the insurance company will pay monthly benefits for the period of time that was applied for. The period of the annuity payments is predetermined and does not depend on the survival of the annuitant. The payment is guaranteed and will be made either to the original beneficiary or, in the event of the original beneficiary's death, to contingent beneficiaries named in the policy. Unlike the Life with Period Certain choice, this option merely guarantees a monthly income to the annuity owner and to the beneficiary for whatever Period Certain select. Once the Period Certain ends, payments cease, even if an individual is still living.

Life With Period Certain -- A Life with Period Certain annuity combines these two different types of annuities into one. With a Life and Period Certain annuity, the insurance company will pay benefits for all of the individual's life. However, if he or she dies before the expiration of the Period Certain specified, then benefits will continue to be paid until the expiration of the Period Certain. Immediate annuities should be considered by anyone who wants to turn available cash into a predictable, guaranteed income. It guarantees a monthly income for life, regardless of how long one might live, but also guarantees that in the event of one's death *before* the Period Certain is selected, the beneficiary named will receive the balance of the monthly payments until the payments have been made to the individual and his beneficiary combined for the Period Certain. With most companies the Period Certain can be five, 10, 15 or 20 years. The trade off is the longer the Period Certain, the smaller the monthly income.

Define Deferred Annuity

A deferred annuity is one in which purchase payments are made in a lump sum or installments, and annuity payments are to commence sometime in the future. Tax-deferred means postponing taxes on interest earnings until a future point in time. In the meantime, an individual earns interest on the money that he or she is not paying in taxes. It is possible to accumulate more money over a shorter period of time, which ultimately will provide with a greater income. Many people today are using tax-deferred annuities as the foundation of their overall financial plan instead of certificates of deposit or savings accounts. Although CD's and annuities are very similar, there are significant differences between the two. The most important difference is that annuities allow for the deferral of the taxes due on the interest earned until the interest is withdrawn. Later, if an individual decides to take a monthly income, taxes can be less because they will be spread out over a period of years. Like Certificates of Deposits, annuities have a penalty for early surrender, however most annuity contracts have a liberal "free withdrawal" provision.

- ***Deferred Annuity*** - *Fixed:* Locks in a fixed-rate investment approach (although guarantee periods vary), with delayed pay-out. Comments: In addition to the underlying investment risk, the risk is that the return will not beat inflation.
- ***Deferred Annuity*** - *Variable:* Provides tax-deferral and potential for growth in value. Comments: Can be suitable for those who have "out-maximized" their annual contributions to other tax-deferral tools [e.g., IRAs and 401(k)s] and can wait for stocks to outperform other types of investments over the long-term.

A deferred annuity is a contract issued by an insurance company that allows a person to accumulate money on a tax-deferred basis for long term goals like retirement. Unlike an IRA or company sponsored plan, there are virtually no limits on contributions to a deferred annuity. There are two phases to a deferred annuity. The first is the "accumulation phase" during which assets grow tax deferred. If an individual withdraws money from his annuity during the "accumulation phase" of the contract, the insurance company may assess a charge to cover the cost of issuing the contract (commonly known as a withdrawal charge). An individual may also incur tax penalties as a result of withdrawals prior to age 59 ½. The second is the "payout phase" which begins when the annuitant is ready to receive income from the annuity. At that time, there are a number of options from which one can choose, according to his or her needs. The annuitant can withdraw his or her money in a lump sum or in a regular stream of income payments guaranteed to last as long as one lives.

The word "fixed" refers to fixed interest rates. There is a different product called a "variable annuity" that is sold predominantly by stock-brokers. It contains an insurance element, but basically consists of market-risk "securities." Whereas a fixed annuity steadily increases in value, a variable annuity can decrease in value, although some variable annuities do offer a low, but important, guaranteed interest. Just as banks have rules pertaining to the savings-account deposits they hold, life-insurance companies have rules pertaining to the monies that they hold in the form of fixed annuities, one of which is a guaranteed interest rate. Interest rates declared for various time periods (1-10 years) are generally substantially higher than those obtainable in bank CD's. Growth takes place in a tax-deferred environment. The word "deferred," when combined with "annuity," has two separate meanings also. Because the company ardently hopes that the accumulated funds will, at a future date, be annuitized, they rather presumptuously call the account a "deferred annuity". The account is also referred to as tax-deferred, due to the privileged status legislatively awarded to it under tax law. Whereas income tax credited to bank CD's must be reported and paid, whether it is left in and "rolled over" into a new CD at maturity or taken as income, taxes on interest credited to annuities are deferred. We see, therefore, that both the words "annuity" and "deferred" must be defined in the context in which they are useful if one is to accurately understand or intelligently discuss the remarkable financial product called the "deferred annuity."

Advantages of Deferred Annuities

- Based on the contract value, an individual can choose a pay-out option that guarantees income for life to help meet retirement income needs;
- Earnings grow tax-deferred;
- If provided in the contract, a death benefit that guarantees beneficiaries will never receive less than the original investment (less withdrawals);
- No annual tax reporting until annuity earnings are withdrawn;
- No forced distribution at age 70 ½;
- Unlimited contributions;
- Undistributed earnings will not reduce Social Security benefits;
- Usually avoids the delays and costs associated with probate.

A deferred annuity is designed to help set aside funds for retirement. When retirement begins, it may be time to use those funds. An immediate annuity can help receive income from the assets that have been accumulated in a deferred annuity. The option to receive income from a deferred annuity is called annuitization.

Distinguishing Between Immediate Annuity and Deferred Annuity

The two types of annuity contracts that determine when benefit payments will begin are the Immediate Annuity and Deferred Annuities. With an **immediate annuity**, the insurer agrees to start making payments soon after the contract is signed. With a **deferred annuity**, payments by the insurer are postponed until a later time. An **immediate annuity** is one in which the distribution period begins immediately. Normally, these annuities are funded with a single lump-sum payment. With a **deferred annuity** there is a time delay between when beginning to add to the annuity and when the distribution period begins. **Deferred annuities** are the most common by far, and are particularly attractive if wishing to save for retirement. **Immediate annuities** are generally purchased by people of retirement age. Such plans provide income payments at once or soon after purchase.

Annuity Type According To How And When Premiums Are Paid

One of these Single Premium Immediate Annuities allows an individual to make a single premium payment, and then begin receiving a monthly income, starting one month later and continuing for the rest of one's life or for a certain number of years guaranteed. This policy may be considered if an individual wishes to convert a tax-qualified rollover, a CD that has matured, or an inheritance into an immediate income. For certain income options, monthly incomes will vary depending on the age and gender of the annuitant, single premium payment amount, income option, state of issue, and policy provisions.

Define Single Premium Annuities

Single premium annuities require a single up-front lump sum payment to cover the entire cost of the annuity. The Single Premium Retirement Annuity is a fixed annuity and provides a guarantee of principal and interest. When an individual is ready to receive income, a variety of options are available. Interest rates are guaranteed for one or three years. For a single payment, defined benefit plan sponsors can guarantee annuity payments in a non-participating contract for a specified group of plan participants upon plan termination or for settlement purposes. Multiple plans can be accommodated in a single contract, and most common plan provisions, such as early retirement, optional forms of annuity, and pre- and post-retirement death benefits, can be included.

Define Flexible Premium Annuities

Flexible premium annuities allow a series of deposits over a period of time. A tax-deferred variable annuity is designed to provide the flexibility to control the future of a retirement income. There are both flexible premium deferred annuities, into which one can make flexible payments to fit needs, and single premium deferred annuities, into which a person makes one single lump-sum payment. The primary purpose of an annuity is to pay an income benefit an individual cannot outlive or pay a benefit for a specified period of time. The income from an annuity can:

- Help pay for everyday living expenses;
- Supplement other retirement income sources; or
- Help manage taxable retirement income.

Distinguish Between The Characteristics Of Single Premium Annuity vs. Flexible Premium Annuity

A single premium annuity is purchased in one single lump sum payment and usually does not allow the contract owner to make additional deposits into the annuity. In lieu of a large lump sum, annuities can be purchased by periodic payments which can be either level (equal amounts at regularly scheduled intervals) or flexible, in which contributions can fluctuate between a set minimum amount and a maximum amount over a stated period of time. A single premium annuity is purchased by the payment of a one-lump-sum premium or by the payment of monthly or annual premiums over an extended period of time. The premium then accumulates interest until the contract owner is ready to receive payments. Most purchase such an annuity during their working years to provide retirement income later.

Annuity Type According To Investment Options Offered

Define Variable Annuities

Variable annuities offer various options to switch among stock, bond, and money market funds. Some funds are actively managed to beat the benchmark indexes, while others, known as index annuities, are tied to popular indexes like the Standard & Poor's 500. Variable annuities are deferred investments that have the same tax benefits of deferred fixed annuities, but their rate of return varies according to the returns of investment sub-accounts. An individual selects the sub-accounts he wants to invest in and decides how much risk he wants to take. By allocating portions of an investment to different asset classes, it is possible to achieve a balance between risk and potential reward that is suitable for a particular circumstance. A variable annuity allows one to direct his investment among several types of investment funds while enjoying the tax-deferred benefits of the annuity product. Variable annuities have additional insurance-related expenses, may be subject to surrender charges, and are generally a longer-term investment than a mutual fund. With variable annuities, one bears the investment risk.

Types of Variable Annuities -- The investor has total control of his investment choices with a mutual fund or a variable annuity. The insurance company plays no part in directing the investments of a variable annuity. The insurance company does not share in any profits earned on the annuity, nor will it absorb any losses. If an annuity earns 50 % in one year, the contract owner keeps the entire amount. Conversely, if an annuity suffers a 60 % loss in one year, there is no recourse. Investing in a variable annuity can be compared to investing in a mutual fund. Not every investor seeks a guaranteed rate of return.

Variable Deferred Annuities

Variable deferred annuities are often said to combine the best advantages of mutual funds with the tax-deferred growth of an annuity. These annuities usually offer a choice of several types of investments that purchase shares of stock, bond, money market, and specialty funds. The owner may select how to allocate the policy's cash value and is able to transfer money among these investment options. A variable annuity may offer investors opportunities for higher potential growth than is usually available with a fixed-interest investment. For investors who seek the professional fund management and asset diversification that is available with a mutual fund, but who prefer always to defer immediate income tax on their gains, a variable annuity may be the perfect solution. An unusual feature found only in variable annuities is the guaranteed death benefit. The value of a variable annuity death benefit is guaranteed never to be less than the total of the premiums paid, less any withdrawals that have occurred.

Features and Options of Variable Annuities -- A variable annuity provides investment flexibility and the ability to participate in market returns. Variable annuities offer fixed-rate sub-accounts as well as sub-accounts tied to stocks, bonds and money market securities. A variable annuity offers a much wider range of investment options than regular fixed annuities. The value of a variable annuity contract will vary due to the performance of the investment options selected by the contract holder. The investment options commonly available in variable annuities are similar to mutual funds. Variable annuities offer:

- ***Professional money management*** - Professional money managers invest money in stocks, bonds and other securities and their investments determine the return rate the investment receives while in the annuity.
- ***Tax-free reallocations*** - An individual can easily adjust a strategy by switching from one investment to another as the investment objectives change, or as market conditions dictate,

Define Fixed Annuities

A fixed annuity is one designed to assure the buyer of a lifetime (or other fixed period) of payments of a guaranteed fixed amount. The amount of these payments is based on the age of the annuitant (the person whose life the annuity is computed on) at the time the payments are to commence, the sex of the annuitant, and the rate of interest that the insurer will assume will be made from the purchase funds paid by the annuitant. An annuity is a contract issued by an insurance company to set aside money to have it grow on a tax-deferred basis for future use. When an individual is ready to retire, he or she can withdraw money as needed, or turn the value of an annuity into a regular income stream that is guaranteed by the insurance company to last the rest of an individual's life, regardless of how long he or she lives. A fixed annuity is a deferred investment, which pays a stated rate of return for a stated period and provides the added security of a stated minimum interest rate. These annuities are best at helping meet long-term goals. A fixed annuity may allow an individual to achieve potentially higher returns because taxes are generally deferred, a feature that allows benefits from the effects of compounding in three ways:

- Earn a return on the investment;
- Earn on earnings; and
- Earn on the money otherwise paid in taxes.

Fixed annuities guarantee a fixed rate of return for a specific period of time, usually one to five years. The insurance company invests money in a fixed rate vehicle like a bond or mortgage to provide this return. When an individual begins to withdraw the money from the annuity, he or she is guaranteed a specific minimum amount each pay period.

Options Of Fixed Annuities -- Not all fixed annuities are created equal. Most have similar features and benefits, but a few go above and beyond the average annuity. Others may look like the opportunity of the century, but are riddled with disclaimers and contingencies underneath. To get the fixed annuity that is best, an individual must be sure of what he or she is buying by reading the fine print. The following are some valuable features:

- ***Easy access to earnings*** -- An individual should be able to take 100% of accumulated interest earnings from a policy without a surrender charge through one of two methods:
- ***Extended care waiver --*** Gives the ability to access money when it is needed.
- ***Five-Year Rate Guarantee Option --*** Allows one to earn a competitive rate for five years on an initial premium.
- ***Interest Enhancement --*** Some fixed annuities have a 1% interest enhancement guaranteed on the initial premium for the first policy year or a 2% interest enhancement.
- *Surrender charges* **--** Range from 5% to 8% for the first year or two and decline by approximately one percentage point each year. Disappears after five or more years.
- ***Characteristics of The Fixed Annuities*** -- A fixed annuity is an insurance product that provides tax-deferred growth at a fixed rate over a fixed period of time. An investor purchases an annuity with a lump payment, usually from after-tax dollars, and then receives scheduled payments. Depending on the type of annuity chosen, withdrawals — which are taxable as ordinary income — can begin immediately or at some point in the future.
- ***Types of Fixed Annuities*** -- With a fixed annuity, a person selects from several guaranteed interest rate periods. During this time period, money accumulates, tax-deferred, at the declared rate. After this period, the company will offer a new interest rate for a specified number of years (usually one to ten years). While money accumulates, the insurance company issuing the contract guarantees the interest and principal against loss**.** These guarantees are based on the insurance company's ability to meet its financial obligations. Investors need to be aware that there may be a surrender charge if the annuity is cashed in before the end of the interest rate guarantee period. Both fixed and variable annuities offer the opportunity for money to grow tax-deferred. Some fixed annuities are designed to have a market value adjustment (MVA) feature. MVA is an adjustment made to the value of a withdrawal or surrender based upon changes in interest rates. The MVA may have a positive effect (increasing the value of the withdrawal), a negative effect (decreasing the value of the withdrawal), or no effect at all.
- ***Risks of Fixed Annuities*** -- When interest rates are low, a person might wish to avoid locking up money for too long. Similar to other fixed-income products, a "laddering" strategy with fixed annuities can be an effective way to mitigate interest-rate risk. If rates go up in the future, an individual can use the money from expiring annuities to invest in higher-yielding products. On the other hand, if rates fall, an individual will have locked in higher yields with longer-maturity annuities. A fixed annuity may be available with no upfront fees or charges, which means that 100% of the premium can go to work immediately. Annuities are not insured by the FDIC, nor are they insured by any other government agency. They are not deposits or obligations of a bank or any other affiliated entity and are not guaranteed by the bank. Annuities involve investment risks, including the possible loss of principal amount invested.

Define Indexed Annuities

The indexed annuities are a special class of annuities that yields returns on your contributions based on a specified equity-based index. These annuities can be purchased from an insurance company, and similar to other types of annuities, the terms and conditions associated with payouts will depend on what is stated in the original annuity contract. In recent years, a new type of fixed annuity called an equity-indexed annuity has emerged. Equity-indexed annuities are one of the hottest products going these days. They offer a guaranteed minimum return in the stock market in exchange for a limit of maximum return. In short: An annuity owner may get less upside but much less downside. The interest rate on an equity indexed annuity is tied to the return of an external index, such as Standard and Poor's 500 (without dividends). Generally, only a portion of the index's return is credited to the annuity, and an interest rate cap may apply. If the index's return is negative, however, no loss is posted to the account, in effect giving equity indexed annuity owners upside potential with downside protection.

Equity-indexed annuities, a hybrid product, provide the potential high returns available in the stock market, the security of a guaranteed rate, and an income for life. Equity-indexed annuities link an investment to a stock or equity index. Indexes, such as the Standard and Poor's 500, measure the market's performance. Life insurance companies determine a rate of return based on changes in the index. The issuing company offers a percentage of the index's gain, called a participation rate. For example, if the participation rate is 85% and the index changes by 7%, the interest rate will become 5.95% (7% x 85%). Participation rates and their calculation methods vary greatly, but most companies offer a rate between 70% and 90%. The insurance company guarantees the participation rate for a specified time period, after which a new rate is issued.

Equity-indexed annuities involve little risk. Insurance companies guarantee a minimum interest rate, sometimes as high as 3%, in case the market declines. This allows a person to take advantage of a booming market without the risk of losing his or her retirement savings. Similar to variable annuities, the amount of equity-indexed annuity payouts is not predictable. However, an individual is guaranteed a minimum interest rate so he or she can find comfort in knowing that payouts will always be equal to or higher than the minimum rate of return. Indexed annuities guarantee a minimum return combined with the growth potential of the stock and bond market. Indexed annuities are tied to the performance of a stated index and are tax deferred until withdrawals begin.

Features and Benefits of The Equity-Indexed Annuity -- An equity-indexed annuity is a type of fixed annuity. It's different from a traditional fixed annuity because earnings are linked to the performance of an index, like the S&P 500®. But there is also a guarantee. When the market is up, the annuity owner benefits from averaged gains and if it drops, nothing is lost. Two features that have the greatest effect on the amount of additional interest that may be credited to an equity-indexed annuity are the indexing method and the participation rate. It is important to understand the features and how they work together. The following describes some other equity-indexed annuity features that affect the index-linked formula. Features and benefits of the EIA are Safety of principal; Guaranteed earnings; Gains are tax-deferred; Access to funds through free withdrawals; and Death benefits by-pass probate.

- ***Interest Rate Feature*** -- Equity-indexed annuities, like other fixed annuities, also promise to pay a minimum interest rate. The rate that will be applied will not be less than this minimum guaranteed rate even if the index-linked interest rate is lower. The value of the annuity also will not drop below a guaranteed minimum. The insurance company will adjust the value of the annuity at the end of each term to reflect any index increases.
- ***Equity-indexed annuities*** -- guarantee customers a minimum interest rate, while offering the potential of higher rates by tying the return to an index like the Standard and Poor's 500. While it is a lot like investing directly in the stock market, clients do not get the full boost of a rising market.
- ***Beneficiary Protection --*** Annuities guarantee that if the annuity owner dies before beginning to receive income from an annuity, the family or heirs would receive the value of the annuity less any withdrawals. The EIA credits interest to the policyholder based on the performance of an index of equities such as the S&P 500. The company hedges the index by purchasing options on the market to fund the future obligations to its EIA policyholders. The company pays a fee for the right to profit from a rise in the market, and shares a portion of that profit to fund interest credited to its EIA policyholders. If the market goes up,

the EIA owner benefits from the higher interest rates credited and if the market remains level or goes down, the EIA owner is credited with a guaranteed rate of interest.

- ***Averaging*** -- In some annuities, the average of an index's value is used, rather than the actual value of the index on a specified date. The index averaging may occur at the beginning, the end, or throughout the entire term of the annuity. Averaging at the beginning of a term protects an individual from buying his annuity at a high point, which would reduce the amount of interest he might earn. Averaging at the end of the term protects him against severe declines in the index and losing index-linked interest as a result. On the other hand, averaging may reduce the amount of index-linked interest he earns when the index rises either near the start or at the end of the term.

Mechanics of Indexing -- With equity-indexed annuities, the money put down by purchasers is not invested directly in the stock market. Instead, customers are offered a percentage of how much the index gains over a period of time (not including dividends, which accounted for about 30% of the total return of the S&P 500 for the last 20 years), and a guaranteed minimum return if the stock market declines. At predetermined times during the annuity's life, customers are credited with a percentage of the gain of the index. The schedule varies with each annuity. Some offer annual "indexing," while others use various averages taken over the life of the annuity. The percentage of the index's gain that a customer receives is called the "participation rate." These rates vary, with some companies offering 50% and others offering 100% or more.

Distinguish Between The Characteristics of Fixed, Indexed, And Variable Annuities

Fixed Annuity vs. Variable Annuity -- **Fixed annuities** are designed to limit the contract owner's risk by providing a guaranteed return. Fixed annuities are generally appropriate for individuals with a low risk investment tolerance who want to know exactly how much they will be earning. **A variable annuity** is one in which the insurer invests the premiums in a portfolio of securities. **Fixed annuities** are invested primarily in bonds, bond funds, or the insurer's general account. **Variable annuities** are invested primarily in stocks, stock funds, or stock index funds. With variable annuities, an individual has the ability to put money in a wide range of professionally managed options. If an annuity is right, then the choice between fixed and variable annuities will depend on particular situations and preferences. Both fixed and variable annuities provide many advantages, including tax-deferred earnings, unlimited contributions, and guaranteed payments for life. With a **fixed annuity**, there is little risk. The growth potential of a **fixed annuity** is limited. A **variable annuity**, on the other hand, has a much greater potential for growth. Depending on the performance of the investments chosen, an annuity could grow a great deal or very little. Understanding motivations and knowing how much risk an individual can comfortably accept will help to make the choice between a fixed and a variable annuity.

Variable Annuity vs. Variable Immediate Annuity

When purchasing a variable annuity, there are few guarantees. The annuity issuer offers a choice of investment options, which may include general equity stock funds, balanced funds, bond funds, and other specialty investments, such as international stock funds. The issuer of a variable annuity does not guarantee or project any rate of return on the underlying investment portfolio. Instead, the return on the annuity investment depends entirely on the performance of the investments selected.

If an individual annuitizes and starts receiving distributions from a variable annuity, he or she can choose the type of payout. The choices are a fixed payout, a variable payout, or a combination of the two. If a fixed payout is selected, a series of equal payments will be received. The payment amount will not vary, but it will depend on the amount of money in the annuity. If a variable payout is selected, then the amount of each payment will depend on the performance of an investment portfolio. If the portfolio increases in value, then payments will increase as well. Most annuity issuers offer a third option, allowing a minimum fixed payment to be locked in every month, with the possibility of an additional variable payment based on the performance of the investment portfolio.

Equity-Indexed Annuities vs, Other Fixed Annuities

An equity-indexed annuity is different from other fixed annuities because of the way it credits interest to the value of an annuity. Some fixed annuities only credit interest calculated at a rate set in the contract. Other fixed annuities also credit interest at rates set from time to time by the insurance company. Equity-indexed annuities credit interest using a formula based on changes in the index to which the annuity is linked. The formula decides how the additional interest, if any, is calculated and credited. How much additional interest an individual gets and when he or she gets it depends on the features of the particular annuity. An equity-indexed annuity, like other fixed annuities, also promises to pay a minimum interest rate. The rate that will be applied will not be less than this minimum guaranteed rate even if the index-linked interest rate is lower. The value of an annuity also will not drop below a guaranteed minimum. For example, many single premium contracts guarantee the minimum value will never be less than 90% of the premium paid, plus at least 3% in annual interest (less any partial withdrawals). The guaranteed value is the minimum amount available during a term for withdrawals, as well as for some annuitizations and death benefits. The insurance company will adjust the value of the annuity at the end of each term to reflect any index increases.

Section II
The Affect Of Fixed, Variable, and Index Annuity Contract Provisions on Consumers

Contract Provisions Common to Annuities
Along with analyzing clients' situations, examining the provisions of the annuity contracts you sell will help you evaluate whether you are recommending the best products for your clients. Understanding the provisions of annuity products you sell, can only be done by reading the contracts themselves. Each contract may vary considerably, so merely reading the contracts summaries or subheadings of each contract will usually not be enough to grasp the features and nuances of each contract. Differences in wording can lead to substantially different outcomes for your clients.

Interest Rates and Compensation
During the accumulation period, an individual's money (less any applicable charges) earns interest at rates that change from time to time**.** Usually, what these rates will be is entirely up to the insurance company. A real interest rate is the compensation, over and above inflation, that a lender demands to lend his money. Earning $100 today is preferable to earning $100 a year from now. If a person earns $100 today, it can be spent or invested now. The use of $100 earned a year from now must be deferred until that time. This is an example of the time value of money, a fundamental principle of budgeting and investing. The economy determines a general time value of money through the level of interest rates.

- ***Defining Rates*** -- The current rate is the rate the company decides to credit to a contract at a particular time. The company will guarantee it will not change for some time period. The *initial rate* is an interest rate the insurance company may credit for a set period of time after first buying an annuity. The initial rate in some contracts may be higher than it will be later. This is often called a bonus rate. The *renewal rate* is the rate credited by the company after the end of the set time period. The contract tells how the company will set the renewal rate, which may be tied to an external reference or index.
- ***Minimum Guaranteed Rate*** -- The minimum guaranteed interest rate is the lowest rate an annuity will earn. This rate is stated in the contract.
- ***Multiple Interest Rates --*** Some annuity contracts apply different interest rates to each premium paid or to premiums paid during different time periods. Other annuity contracts may have two or more accumulated values that fund different benefit options. These accumulated values may use different interest rates. An individual gets only one of the accumulated values depending on which benefit is chosen.

Fixed annuity interest rates can be higher than those of other fixed-interest, long-term savings vehicles. Moreover, since annuity interest not withdrawn is not subject to current taxation, the effective yield may be even more favorable. But, the current interest rate is not the most important consideration in selecting an annuity. Because an annuity is a long-term financial instrument, the initial interest rate is not nearly as important as the long-term rate of return. Of course, that's not easy to predict, as the rate will fluctuate overtime with changes in economic conditions. In order to anticipate what might happen in the future, it's worth looking at what has happened in the past. It is often not revealed that during a low interest rate environment, an immediate annuity with an equal installment payout period may not return the entire principal.

First Year Bonus "Teaser" Rates -- This is additional interest granted to new purchasers of annuities that is paid on top of the normal stated current interest rate. Investors must think of annuities as long-term investments with limited liquidity. Agents should not use "teaser" or "bonus" rates that are good for only a year or two and are then reset at the discretion of the insurance company. Normally, a minimum rate of 3% is usually guaranteed. A fixed deferred annuity is one that grows by interest alone. The underwriting insurance company offers the annuitant a guaranteed rate of return. Many deferred fixed annuities do not have a fixed rate of return for the entire life of the contract, but rather, a guaranteed minimum rate for a short duration, often coupled with a "bonus" or "enhancement". These features are used by insurance companies as a teaser to attract investors. In a typical deferred fixed annuity, the annuity contract will contain a 3% minimum guaranteed interest rate, a 1% bonus rate to be credited in year-one, and an adjustable rate after a specific period of time. Deferred annuities usually have an initial interest rate guarantee period of one to five years. During the guarantee period, the insurance company guarantees the interest rate and thereafter it fluctuates subject to the minimum guarantee. Bonus annuities can bear much higher surrender charges than those annuities found without the feature.

Issue Ages
§10112 of the California Insurance Code states that Subject to Section 2459 of the Probate Code, in respect to life or disability insurance, or annuity contracts (except as provided in Sections 2500 to 2507, inclusive, of the Probate Code and Section 3500 of the Probate Code and Chapter 4 (commencing with Section 3600) of Part 8 of Division 4 of the Probate Code), heretofore or hereafter issued to or upon the life of any person not of the full age of 18 years for the benefit of such minor or for the benefit of the father, mother, husband, wife, child, brother, or sister, of such minor, or issued to such minor, subject to written consent of a parent or guardian, upon the life of any person in whom such minor has an insurable interest for the benefit of himself or such minor's father, mother, husband, wife, child, brother or sister, such minor shall not, by reason only of such minority, be deemed incompetent to contract for such insurance or annuity, or for the surrender thereof, or to exercise all contractual rights thereunder, or, subject to approval of a parent or guardian, to give a valid discharge for any benefit accruing or for any money payable.

This is provided, that all such contracts made by a minor under the age of 16 years, as determined by the nearest birthday, shall have the written consent of a parent or guardian, and that the exercise of all contractual rights under such contracts, or the surrender thereof, or the giving of a valid discharge for any benefit accruing or money payable thereunder, in the case of a minor under the age of 16 years, as determined by the nearest birthday, shall have the written consent of a parent or guardian. All such contracts made by a minor not of the full age of 18 years which may result in any personal liability for assessment shall have the written assumption of any such liability by a parent or guardian in consideration of the issuance of the contract. Such assumption shall be in a form approved by the commissioner, reasonably designed to inform the parent or guardian of the liability thus assumed. Such assumption of liability may be made a part of and included with any written consent of such parent or guardian required under other provisions of this section and it may be provided therein that such assumption shall cover only up to the anniversary date of the policy nearest to the member's birthday at which he or she attains age 18.

Maximum Ages For Benefits to Begin
Non-Qualified Annuities- Annuities are based on life expectancy. Being non-qualified, the tax code specifies no maximum age limitation for contributions or withdrawals. It is at the issuer's discretion as to age at which payments must begin. Once annuitization occurs, payments must be spread evenly over the life expectancy of the annuitant. **Qualified Plans-** To make sure that most of the retirement benefits are paid to the plan participant during his or her lifetime, rather than to subsequent beneficiaries after an individual's death, the payments that are received from qualified retirement plans must begin no later than the plan participant's ***required beginning date*** (defined later). The payments each year cannot be less than the ***minimum required distribution***. If the actual distributions to an individual in any year are less than the minimum required distribution for that year, he or she is subject to an additional tax. The tax equals 50% of the part of the required minimum distribution that was not distributed. A qualified retirement plan includes a qualified employee annuity plan and a tax-sheltered annuity plan (403(b) plan) (for benefits accruing after 1986).

Required beginning date -- Unless the rule for 5% owners and IRAs applies, the plan participant must begin to receive distributions from the qualified retirement plan by April 1 of the year that follows the later of:

- The calendar year in which the subject individual reaches age 70½, or
- The calendar year in which the person retires.

5% owner -- If a person is a 5% owner of the employer maintaining the qualified retirement plan, the plan participant must begin to receive distributions from the plan by April 1 of the year that follows the calendar year in which he or she reaches age 70½. This rule does not apply if the retirement plan is a government or church plan. A person is a 5% owner if, for the plan year ending in the calendar year in which he or she reaches age 70½, the person in question owns (or is considered to own under section 318 of the Internal Revenue Code) more than 5% of the outstanding stock (or more than 5% of the total voting power of all stock) of the employer, or more than 5% of the capital or profits interest in the employer.

Age 70½ -- A person reaches age 70½ on the date that is 6 calendar months after the date of their 70th birthday. For example, if your 70th birthday was on June 30, 2004, you reached age 70½ on December 30, 2004. If your 70th birthday was on July 1, 2004, you reached age 70½ on January 1, 2005.

Required distributions -- By the required beginning date, as explained above, the plan participant must either:

- Receive his or her entire interest in the plan (for a tax-sheltered annuity, the entire benefit accruing after 1986), or
- Begin receiving periodic distributions in annual amounts calculated to distribute the entire interest over a person's life or life expectancy or over the joint lives or joint life expectancies of the plan participant and his or her designated beneficiary (or over a shorter period).

Crisis Waivers
With a waiver, access can be provided to an annuity before retirement. Some annuities contain a waiver that triggers payments not subject to the usual surrender fees. It has been reported that 161 variable annuity contracts offer some type of waiver. An annuity-tracking service surveyed 282 fixed annuities and found that 35 % have a death waiver; 18.5 % contain nursing home waivers; 7.4 % have hospital waivers; and 2.3 % carry disability waivers. While a death waiver is most common in the fixed annuities survey, the most popular waiver found in variable annuities is the nursing home waiver, with 103 variable annuity contracts containing that provision; 83 provide death waivers; 69 have terminal illness waivers; and 42 carry disability waivers. Situations that trigger the waiver and allow early annuity withdrawals vary from company to company. Waivers are granted for specific conditions, and the contract waiver provisions may differ between policies and companies.

Nursing Home – Some new products are including long-term care provisions as part of the contract. If there is a nursing home waiver that allows withdrawal of funds for such care, explain if nursing home waiver only applies to nursing homes, not assisted-living or other rehabilitative facilities, and how many consecutive days in the nursing home are necessary to trigger this provision. One insurer might require a 90-day nursing home confinement before benefits are activated, while another might call for 60 days. With a nursing home waiver, surrender fees will not be charged and access is granted to some or the entire annuity if an individual is put in a nursing facility. A 90-day confinement period before benefits begin may be typical, however, longer periods could apply. A doctor will usually be asked to submit an attending physician's statement, along with a completed claim form.
Terminal Illness – Allows one free partial or full distribution of an annuity if the policy holder is diagnosed with a terminal medical condition effective the day a policy is issued. The same can hold true if a policyholder becomes terminally ill, thus allowing access to money when it may be needed most. The definition of terminally ill may vary from company to company, it's generally a condition that will result in death within six months to a year.
Unemployment – This is another condition for which a waiver of surrender charges could be added.
Disability – With this type of waiver, one company may consider an individual disabled if he or she is unable to work in any occupation, while another may require only that a person is unable to work in their current vocation The risk of disability is greater than the risk of death at all ages between 20 and 65. It is prudent to protect oneself financially if disability does occur, and that includes annuity considerations.

Charges and fees-- Insurers may charge additional premium for a waiver. Liquidity is always an issue during a financial emergency. Purchasers of annuity contracts must be made aware that without a waiver additional charges and fees can apply when access to funds in the annuity contract is necessary

Riders Vs. Crisis Waivers
Long-term care insurance riders are different than crisis waivers in that an annuity containing a long-term care insurance rider provides insurance benefits across the long-term care continuum - including nursing home care, assisted living facility care, home and community-based care. A nursing home crisis waiver eliminates surrender charges upon withdrawal in the event a nursing home admission occurs after the annuity was purchased. No insurance benefit is provided, nor does the crisis waiver apply to all aspects of the long-term care continuum such as home care, assisted living or adult day care. In California, agents who sell long-term

care insurance, including life insurance and annuity contracts containing long-term care insurance riders, are required to complete additional training as a pre-requisite. Agents selling policies with LTC waivers would not be required to undergo this special training.

Premium Payments

§10540 of the California Insurance Code states that an incorporated life insurer issuing life insurance policies on the reserve basis may collect premiums in advance. Such insurers may also accept moneys for the payment of future premiums related to any policies issued by it. No such insurer may accept such moneys in an amount to exceed (1) the sum of future unpaid premiums on any such policy or (2) the sum of 10 such future unpaid annual premiums on any such policy if such sum is less than the sum of future unpaid premiums on any such policy. This section shall not limit the right of such insurers to accept funds under an agreement which provides for an accumulation of such funds for the purpose of purchasing annuities at future dates.

Settlement Options Upon The Death of The Owner or Annuitant

A settlement option offering payments after the death of the owner or annuitant offers a hedge against the loss of value of the annuity in the event of an early death. Various types of settlement options include;

Life with period certain guarantee- Payment is made for the longer of the annuitant's lifetime or a certain period of years. If the annuitant dies, payments continue to the beneficiary.

Refund Life Annuity- At the annuitant's death, if the accumulation amount applied to the annuitization of the contract is more than the total of payments made to the annuitant, the difference is paid to the beneficiary in a lump sum.

Joint and Survivor Life Annuity- This annuity pays out over the lifetime of two individuals. They must be natural persons. This type of annuity can be modified to allow a primary beneficiary to receive the full annuity payment while the secondary beneficiary would receive some fractional (half, two-thirds) payment.

Tax-Qualified Plan -- Remember, with a tax-qualified plan, owner and annuitant are the same person. Any annuity payment that continues on with a beneficiary will be taxable. A death benefit, may be purchased as a life insurance feature. The benefit was purchased with the policy and no tax is due. Otherwise payments to a beneficiary are payments of the tax deferred accumulated value of the annuity and as such, tax is due. This term refers to the tax status of the source of funds used for purchasing the annuity. Qualified annuities may either come from corporate-sponsored retirement plans, lump-sum distributions from such retirement plans, or from such individual retirement arrangements as IRAs, SEPs, and Section 403(b) tax-sheltered annuities, or Section 1035 annuity or life insurance exchanges. Generally speaking, insurance companies use male/female rates to price qualified annuities in situations where the purchaser and/or owner is a corporation. When an individual is purchasing the annuity, annuity rates are generally unisex.

Stretch— The stretch annuity option is based on IRS Private Letter Ruling PLR 20015103 8. This ruling allows the beneficiaries to continue the annuity, lets it keep growing tax deferred over their lifetime as an option. The beneficiaries take distributions each year based on their life expectancy, which in turn allows the majority of the money to keep growing tax deferred and minimizes the taxes that are paid each year.

Tax-Non-qualified Plan-- Non-qualified immediate annuities are purchased with monies which have not enjoyed any tax-sheltered status and for which taxes have already been paid. Non-qualified annuities may be purchased by employers for situations such as deferred compensation or supplemental income programs, or by individuals investing their after-tax savings accounts or money market accounts, CD's, proceeds from the sale of a house, business, mutual funds, other investments, or from an inheritance or proceeds from a life insurance settlement. While most insurance companies apply their male/female tables to non-qualified annuities, some states require the use of unisex rates for both males and females.

Stretch-- The stretch annuity option is based on IRS Private Letter Ruling PLR 20015103 8 issued on December 21, 2001 by the IRS. Not long after the ruling on qualified annuities, the insurance industry challenged the IRS to allow non-qualified annuity distributions upon death to be stretched using the same method. With some exceptions, Internal Revenue Code allows the death benefit from a nonqualified annuity to be extended over the beneficiary's life expectancy as calculated by the "uniform table." By electing a "non-qualified annuity stretch":

- The income will be less than the income using life only annuitization settlement as the life expectancies of the "uniform table" are longer than standard mortality tables.
- The beneficiary maintains the tax-deferred status on the unpaid death benefit because under an annuitization option, funds no longer benefit from tax-deferral.

The private letter ruling goes on to state the following;

> The Companies have requested a ruling where payments are made to a designated beneficiary under the procedures set forth in Requested Rulings 1, 2, and 3. No amount will be constructively received by the beneficiary prior to its actual payment under the specified payment procedure. An annuity contract consists of an accumulation phase and a phase subsequent to the ASD commonly referred to as annuitization. During the accumulation phase, all amounts received by the holder are “amounts not received as an annuity.” During the annuitization phase, if the requirements of Treas. Reg. §1.72-2(b)(2) and (3) are met, amounts received by the holder may be characterized as “amounts received as an annuity.” During the annuitization phase, amounts received by the holder may possibly be characterized as “amounts not received as an annuity.” (See IRC § 72(e)(1)(A)(ii) and (e)(2)(A)). This ruling expresses no opinion on whether amounts paid to the designated beneficiary under the procedures set forth in Requested Rulings 1, 2, and 3, are “amounts received as an annuity” or “amounts not received as an annuity.” Under either conclusion, no amount will be constructively received by the beneficiary prior to its actual payment under the specified payment procedure.
>
> Section 72 of the IRC provides a comprehensive scheme for the taxation of life insurance, endowment, and annuity contracts. Section 72(a) and (b) provide, in general, for the taxation of “amounts received as an annuity.” Section 72(e), in general, taxes amounts received under life, endowment, and annuity contracts that are “not received as annuities.” Both § 72(a) and (e) literally require that amounts be “received” by the holder before they are included in gross income.

Not everyone or every company can ‘stretch.’ A private letter ruling cannot be used or cited as precedent by another taxpayer. The annuity contracts must be set up properly and executed within a certain time frame to take advantage of stretching. An example is Beth Finch, a widow who passes away and leaves an annuity to her 54-year-old daughter, Ruth. If the distributions to Ruth are spread out over her remaining life expectancy of 30.5 years, this could prove to be a substantial amount.

Surrender Charges

§10127.10 of the California Insurance Code is recorded in *Chapter 3, Rights and Obligations of The Insurance Company.* §10127.12 of the California Insurance Code states that whenever an insurer provides an annual statement to a senior citizen policyowner of an individual life insurance policy or an individual annuity contract issued after January 1, 1995, the insurer shall also provide the current accumulation value and the current cash surrender value. 10127.13 of the California Insurance Code states that all individual life insurance policies and individual annuity contracts for senior citizens that contain a surrender charge period shall either disclose the surrender period and all associated penalties in 12-point bold print on the cover sheet of the policy or disclose the location of the surrender information in bold 12-point print on the cover page of the policy, or printed on a sticker that is affixed to the cover page or to the policy jacket. The notice required by this section may appear on a cover sheet that also contains the disclosure required by subdivision (d) of Section

Market Value Adjustment – Market value adjustments are features added to some deferred annuities to discourage surrenders prior to their contractual maturity date. The market value adjustment works in the annuity contract in a manner similar to the way individual bond prices fluctuate. If, during the contract period and before the maturity date, money in excess of any free-corridor amount is withdrawn, it is subject to a market value adjustment. The market value adjustment is an increase or decrease in the annuity’s value, depending on the level of the general economy’s interest rates relative to the interest rates of the contract from which the withdrawal is taken. Annuities with market value adjustment features may offer a slightly higher interest rate than a comparable fixed annuity without such features. If a contract owner has an annuity with a contractual interest rate of 8% with 5 years left prior to its maturity date, and similar contracts are being issued with 4% interest rates, the contract owner can expect some gain upon early surrender. This is because the surrender will relieve the insurance company from its 8% obligation in a market where interest rates have decreased to 4%. On the other hand, if the opposite occurred and the old contractual obligation was for 4% in a current interest rate market of 8%, the contract owner can expect a negative MVA and therefore will receive a smaller

Policy Administration Charges and Fees

Every insurer that sells annuities charges fees which are connected to the contract. These fees cover the company's costs of administering the annuity. Annuities may charge a nominal annual contract maintenance fee such as one percent of the cash value not to exceed $20–$50. These fees are usually deducted from the annuity cash values, and they will often expire when the contract accrues a certain amount of cash value such as $5,000 or $10,000. This contract provision less has become less common in newly issued annuity contracts.

Withdrawal Privilege Options

In the event the policy-owner needs to access funds prior to maturity, the owner has the option of requesting a withdrawal, also called a partial surrender. It is important to remember that withdrawals are subject to tax and withdrawals prior to age 591/2 are subject to an additional 10% tax penalty. Having access to the annuity contract value is important for anyone with a long-term investment. If you additional income is needed or if one is faced with the unexpected, he or she will be glad to know that a portion of annuity contract will be available. The withdrawal privilege enables you to withdraw, free of surrender charges, per contract year: 10% of payments per contract year that remain and are subject to surrender charges2 Withdrawal provisions in deferred annuity contracts allow the policy-owner limited withdrawal of funds prior to maturity of the contract. The surrender or withdrawal, if made during the surrender charge period, is normally subject to a surrender charge. If the withdrawal is requested after the policy is beyond its surrender charge period, the policy-owner should be able to access the withdrawal without any charges imposed by the insurance company. Withdrawals are not expected to be repaid to the annuity contract. With flexible premium policies, the withdrawal can later be paid into the annuity policy as new premiums. Annuity policies do not generally have loan provisions available to the policy-owner due to tax consequences.

Free-Corridor Amount -- A free corridor is some maximum amount of money that a contract owner can withdraw from the contract each year without incurring a surrender charge. If a contract owner elects to make an early withdrawal of just part of the funds in an annuity contract before the end of the surrender charge period, there is likely to be a free-corridor amount that he or she can withdraw without any charge. Normally, this amount is about 10% of the last year's accumulation value or 10% of the initial premium paid. However, some contracts do not allow any withdrawals without charge; the most generous allow withdrawals of up to 15% per contract year without charge. Amounts in excess of the free corridor amount are subject to proportional surrender charges.

Annuitization Options

With people today living longer than ever, careful planning is essential to determine whether or not there will be enough assets to last throughout the years of retirement. The annuitization phase starts with the first scheduled payment to the annuitant. Upon retirement, an individual can elect to receive payments, an option known as annuitization, which are guaranteed to last for a specific period of time or for as long as the annuitant(s) life. The simplest form of annuity is the life annuity, where the annuitant receives scheduled payments for the remainder of his or her lifetime. Annuities can be immediate or deferred, variable or fixed. The opposite of any sort of annuitization would be some method of systematic withdrawal. The advantage of annuitization is its hedge against longevity. Systematic withdrawal has the advantage of immediate access to principal and the availability of better interest rates for the principal. Some of the options are: income guaranteed for a certain period; lifetime income guaranteed for a certain period; and lifetime income.

Annuity Contract Provisions Common To Fixed Annuities

A fixed annuity is a contract between an individual and an insurance company. Fixed annuities have five key features: Safety, Tax Control, Liquidity, Estate Planning Benefits. The contract between the insurer and the client describes what happens during the accumulation and distribution phases of the contract. The client agrees to be a purchaser and to place money into an annuity contract in order to have the rights offered under the contract. The insurance company agrees to the obligations because it has the capacity to meet those obligations and is in the business of doing so as a for-profit enterprise.

Death Benefits

All deferred annuity contracts provide for a death benefit prior to the annuity starting date. Death payments after the annuity starting date would be a form of settlement option. Tax code changes in 1985 provide that a death benefit is payable if any owner of the annuity dies before the maturity date. Some annuities provide that a death benefit is payable only if the owner dies, so long as the contract provides for a new annuitant to take the place of the deceased annuitant. The amount of the death benefit payable under a deferred fixed annuity will normally be the accumulated value of the contract, possibly reduced by any applicable surrender charge. Variable annuities also provide a death benefit, based on total premiums paid or the annuity's account value.

Lump Sum vs. 5-year pay out – Federal tax law calls for the distribution within five years of a contract's entire cash value if the 'holder' (owner) dies before the maturity date. However, there is an exception to the five-year rule, if the death benefit is paid as an annuity over the life, or a period not longer than the life expectancy, of the beneficiary and the payments start within one year of the owner's date of death.

Provisions – If an annuity contract has joint owners, the distributions at death rules are applied upon the first death. Under a special exception to the distribution at death rules, if the beneficiary is the surviving spouse of the owner, the annuity contract may be continued with the surviving spouse as the owner. If the owner of the annuity is a non-natural owner, then the annuitant's death triggers the distribution at death rules.

Charges and Fees

Annuity contracts will designate a minimum premium that the policy-owner must pay to purchase an annuity. When investing in a fixed annuity, one's money is placed in the general account of the insurance company. When setting the rate of return credited to the annuity contract, the company considers prevailing market rates and also the costs of issuing and maintaining the annuity contracts. In addition to the surrender charges, some contracts may charge an annual maintenance fee, which can range from $25 to $30. Normally these amounts are in the $5,000–$10,000 range for single-premium policies and $25–$50 per month for flexible-premium policies. Insurance companies may designate a different minimum amount, depending on the type of funds the client places in the annuity. Deferred annuities may charge a nominal annual contract maintenance fee such as one percent of the cash value not to exceed $20–$50. These fees are usually deducted from the annuity cash values, and they will often expire when the contract accrues a certain amount of cash value such as $5,000 or $10,000.

Interest Rate Strategies

The amount of interest the annuity product earns is of primary importance to the owner of the policy. In addition, because the initial interest rate is guaranteed for some period of time in the terms of the contract, the length of the guarantee period is critical. A potential annuity purchaser needs to know how the insurance carrier has typically treated its policyholders in terms of renewal interest rates. These are the interest rates declared once the initial guaranteed interest rate period has expired. Two questions a person should ask when considering the purchase of an annuity are;

- What is the current interest rate being paid?
- For what length of time is that interest rate guaranteed? Will it be one year, two years, five years, or longer?

The length of time the annuity will pay the initial interest rate is important. Purchasers need to know how long they can count on the insurance company paying the higher initial interest rate. Often, the interest rate guarantee period is tied to the length of the annuity's surrender charge period. Fixed-interest deferred annuity contracts will also provide a minimum interest rate, and the insurance company guarantees that it will never credit an interest rate less than this percentage to the annuity. This rate has typically been 3 %. Interest rates in the economy fell towards 1% in the first half-decade of the 21st Century. Although a boon for contract holders, the 3% guaranteed rates caused insurers to see more money go out the window than was coming in the front door. The result has been a movement to tie minimum interest rates to economy-wide rates, not set them in stone.

Annual – Interest rates are guaranteed for one or three years. An initial effective rate is guaranteed by the issuing insurance company for a fixed term, usually one year from the contract date. Thereafter, the interest rate is reset for one-year intervals and will not be less than the minimum guaranteed rate in the insurance contract.

Multi-Year **–**The multi-year guarantee annuity offers the choice of several different guarantee periods. During each interest-crediting period, whether a single year or a multi-year period, a minimum level of credited interest is guaranteed. Commonly, this is a 0% guaranteed interest rate over a one-year period. For multi-year interest crediting approaches, this is commonly expressed as the greater of 0% and a greater guarantee that is derived from compliance.

Crediting Methods
Companies use several methods to establish the current interest rate to be credited to their accumulation accounts.

Portfolio Rates **–** The portfolio average method credits all policyholders with a composite rate of interest that reflects the company's earnings on its entire portfolio of investments during the year in question. During periods of rising interest rates, the interest credited to the "new" contributions received during the year will be heavily influenced by the interest earned on investments attributable to "old" contributions, (received and invested 5, 10, 15 or more years earlier). The interest credited will therefore be stabilized. When interest rates are rising, contributions made in the year 199X earn 4%, funds placed in the accounts (old or new) in year 199Y earn 4.5%, and all funds in year 199Z earn 5%. When interest rates are falling, contributions made in the year 200X earn 4%, funds placed in the accounts in year 200Y earn 3.5%, and all funds in year 200Z earn 3%.

New Money Rates **–** With new money rates (sometimes referred to as the 'banding'), the contributions made by all policyholders in any given period are banded together and credited with a rate of interest consistent with the actual yield that such funds obtained during that period. If a company's average return on all money is 4% in a given period, the contributions made by all participants during the current period may be credited with 5% if the company was able to make new investments that, on average, returned in excess of 5% interest. Additionally, the interest rate credited on those contributions should continue to earn 5% until the monies are reinvested. After reinvestment, the interest on these contributions will change and the rate credited to contributions banded in the following period could be higher or lower. With increasing interest rates and reinvestment of assets every year, an investment in year 199x might earns 5% and then earn 5.25% in the second year and 5.5% in the third year. An investment in year 2 earns 10% and then earns 10.25% in the second year and 10.5% in the third year. Finally, an investment in year 3 earns 11%.

Minimum Guaranteed Interest Rates
§10168.25 (a) of the California Insurance Code states that this applies to contracts issued on and after January 1, 2006, and may be applied by a company, on a contract-form-by-contract-form basis, to any contract issued on or after January 1, 2004, and before January 1, 2006. §10168.25 (b) of the California Insurance Code states that the minimum values as specified in Sections §10168.3, §10168.4, §10168.5, §10168.6, and §10168.8 of any paid-up annuity, cash surrender, or death benefits available under an annuity contract shall be based upon minimum nonforfeiture amounts as defined in this section. §10168.25 (c) of the California Insurance Code states that The minimum nonforfeiture amount at any time at or prior to the commencement of any annuity payments shall be equal to an accumulation up to that time, at the rates of interest indicated in subdivision (d), of the net considerations (as hereinafter defined) paid prior to that time, decreased by the sum of all of the following:

- Any prior withdrawals from or partial surrenders of the contract, accumulated at the rates of interest indicated in subdivision (d).
- An annual contract charge of fifty dollars ($50), accumulated at the rates of interest indicated in subdivision (d).
- Any state premium tax paid by the company for the contract, accumulated at the rates of interest indicated in subdivision (d). However, the minimum nonforfeiture amount may not be decreased by this amount if the premium tax is subsequently credited back to the company.
- The amount of any indebtedness to the company on the contract, including interest due and accrued.

The net considerations for a given contract year used to define the minimum nonforfeiture amount shall be an amount equal to 87.5% of the gross considerations credited to the contract during that contract year. §10168.25 (d) of the California Insurance Code states that the interest rate used in determining minimum nonforfeiture amounts shall be an annual rate of interest determined as the lesser of 3% per annum and the following, which shall be specified in the contract if the interest rate will be reset:

- The five-year Constant Maturity Treasury Rate reported by the Federal Reserve as of a date, or averaged over a period, rounded to the nearest one-twentieth of 1%, specified in the contract no longer than 15 months prior to the contract issue date or redetermination date under paragraph (2), reduced by 125 basis points, where the resulting rate is not less than 1%.
- The interest rate shall apply for an initial period and may be redetermined for additional periods. The redetermination date, basis, and period, if any, shall be stated in the contract. The basis is the date or average over a specified period that produces the value of the five-year Constant Maturity Treasury Rate to be used at each redetermination date.

§10168.25 (e) of the California Insurance Code states that during the period or term that a contract provides substantive participation in an equity indexed benefit, it may increase the reduction described in paragraph (2) of subdivision (d) by up to an additional 100 basis points to reflect the value of the equity index benefit. The present value at the contract issue date and at each redetermination date thereafter, of the additional reduction shall not exceed the market value of the benefit. The commissioner may require a demonstration that the present value of the additional reduction does not exceed the market value of the benefit. Lacking a demonstration that is acceptable to the commissioner, the commissioner may disallow or limit the additional reduction. §10168.25 (f) of the California Insurance Code states that the commissioner may adopt regulations to implement the provisions of subdivision (e) and to provide for further adjustments to the calculation of minimum non-forfeiture amounts for contracts that provide substantive participation in an equity index benefit and for other contracts with respect to which the commissioner determines adjustments are justified.

Low Interest Rate Environment Impact on Interest Rates

Interest rates declared for various time periods (1-10 years) are generally substantially higher than those obtainable in bank CD's. Growth takes place in a tax-deferred environment. Available interest rates and time periods vary according to market conditions, the annuity product, and the issuing company.

Annuity Contract Provisions Common To Variable Annuities

There are a number of key contract provisions that a buyer of a variable annuity. The contract should be aware of a *Guaranteed death benefit* which is a contract that will pay the named beneficiary the greater of the investment in the contract or the contract value on the date of death. Enhanced death benefit provides for some variable annuities to offer an enhanced death benefit option. This feature provides that upon the death of the annuitant, the beneficiary will receive the greater of the accounts value on the date of death, or the highest contract value ever reached during the accumulation years. Prospectus: Variable annuities are considered by the Securities and Exchange Commission (SEC) to be a security. The SEC requires that the purchase of a variable annuity be given a prospectus, which provides detailed information on how the annuity contract works, and the sub-accounts available.

Variable Options

There are several contract provisions common to variable annuities. Not all annuities will contain all provisions. It is important that the purchaser understands the several options available and makes an informed decision about which features he or she wants.

Equity-Based – The outstanding advantage is higher long-term return on average. Since the end of World War II, equity-based investments have outperformed debt-based investments (bonds) for long-term investors. Assuming this historical data holds true into the future, a variable annuity held for a number of years can outperform a conventional deferred annuity, on average. The negative rates of return are the greatest disadvantage. Unlike fixed annuities, which guarantee a minimum rate of return, variable annuity returns can be negative in any given year.

Risk-based-- This feature refers to interest rate risk. An interest rate guarantee based on bond or interest rate indexing is designed to guarantee the minimum value of the variable accounts in the variable annuity. When the annuity is purchased, even though inflation is uncertain it can reduce the real value of the annuity payout. The absence of markets for purchasing power-adjusted annuities has been pointed out as one of the important rationales for government-provided retirement income programs.

Fixed Options
§10127.10 of the California Insurance Code is recorded in *Chapter 3, Rights and Obligations of The Insurance Company.*

Charges and Fees
An annuity owner will pay several charges when investing in a variable annuity. It is of utmost importance to understand all the charges before investing. These charges will reduce the value of an account and the return on an investment. Relatively high expenses that reduce the rate of return have always been a major consideration with variable annuities.

Variable Annuity Living and Death Benefits Costs -- There is a charge for the benefits previously discussed and they do vary between companies. A careful examination of the company's prospectus for explanations and costs of these benefits is needed.
Surrender Charges -- Variable annuities offer liquidity and access to the account value unlike Certificates of Deposit. Generally, the surrender charge is stated as a percentage of the amount that is withdrawn over the free amount that is allowable from contract. Surrender charges vary in amount and period from one company to the next. Companies allow either free withdrawals of 10% of the contract value per year without penalty or cumulative free withdrawals for greater liquidity. A typical charge might be 7% in the first year, 6% in the second, 5% in the third, and so on, phasing out completely after seven years. Surrender charges may kick in again under certain conditions***.***
Mortality and Expense Charges -- Mortality and expense risk charges are usually stated as a percentage of the account value and typically cover the cost of selling the variable annuity risks that the company assumes under the annuity contract. All variable annuities have a mortality or expense fee commonly referred to as guaranteed death benefit. This fee is levied against the account balance each year. This figure also represents one source of the insurance company's profit which covers the insurance company's payments of overhead, commissions, set up fees, and death benefit claims. Profit from the mortality and expense risk charge is sometimes used to pay the insurer's costs of selling the variable annuity, such as a commission. This fee can range from 1.1% to 1.5%. The variable annuity contract specifies that this fee is "frozen" and it can never be increased. The mortality charge is used to pay commissions and overhead costs that the contract owner would normally have to pay in an up-front or continuing sales charge.
Administrative Charges -- Most variable annuities have administrative fees that are deducted from the account value, either on a flat annual basis or expressed as a percentage of the account value. Fund and or investment management expenses are often assessed by the money managers that professionally manage the investment sub-accounts.

Annual Account Maintenance Charge -- Annual account maintenance charges minor when compared to the mortality fee. The annual contract maintenance charge will range from $25 to $50. This charge will be noted on the fourth- quarter statement issued by the insurance company, and will be deducted from the then-current value of the annuity. This fee can never be increased during the life of the contract.

Dollar Cost Averaging

The Dollar Cost Averaging strategy lets an individual invest money systematically over a period of time into a combination of investments. This strategy takes the worry out of guessing the “best” time to invest, ultimately reducing volatility and risk. Investors should consider their ability to continue purchases through periods of fluctuating prices. Strategies like Dollar Cost Averaging control the purchase price of investments. Dollar cost averaging can save money in the short term. And like most investment strategies, the effect of regular investing multiplies over the long term. If an individual is looking for an investment strategy that offers simplicity, with a long-term approach, this technique may be right. Choosing an investment strategy that suits is never easy. There are a myriad of tough questions, including:

- How much money should I invest?
- How often should I invest?
- Where should I invest my money?

Fortunately, there’s a venerable investment strategy that could be the answer to many concerns. It's called dollar cost averaging, and it can simplify investment planning. The name may sound complicated but, simply put, dollar cost averaging is nothing more than the systematic investment of a fixed dollar amount at regular time intervals. The amount and frequency of investments depends upon one’s financial means and long-term goals. However, once a person initiates the plan, the key to success is sticking with it and ignoring market fluctuations.

- ***The Mechanics of Dollar Cost Averaging*** -- Dollar cost averaging does not assure a profit and does not protect against loss in a declining market. After all, an individual could choose an investment that didn’t perform as well as others, or the market as a whole could have a run of poor years. There’s no guarantee that an individual could not make a large lump-sum purchase at the lowest price so that his investment costs less than it would if he had paid the average price over a period of time.
- ***Dollar Cost Averaging in Turbulent Times*** -- Let's assume an individual decides to put $100 every month in an investment that is currently selling for $10 per share. For this hypothetical example, let’s assume that there are no additional charges. The first month he invests $100 and receives 10 shares. Then, in an extreme but easy to follow example, the market falls and the price drops to $5 per share. In the second month, the $100 buys 20 shares. The market rebounds in the following month, the price jumps to $10 per share, and for the $100 investment receives 10 shares.
- **Dollar Cost Averaging and Stocks** -- Dollar cost averaging is used most often with mutual funds and the investment portfolios in variable annuities, but the principle applies to stock investing as well, if using a dividend reinvestment plan or a direct purchase plan to make regular additional investments. Though there may be a limit to the total amount one can invest, it’s usually in the range of several thousand dollars.

Annualized Interest Rate Calculations On Bonuses That Apply To Fixed Accounts

Bonus interest rates are extra amounts of interest granted to new purchasers that are paid in addition to the normal stated current interest rate. Based on the total dollars contained in the contract during its first year, these rates are designed to attract money from existing annuity contracts. The agent and the potential purchaser should be well informed regarding any bonus interest rates. Bonus rates are enticements. Bigger enticements usually mean bigger constraints down the road when that bonus will be applied or earned. Forfeiture or withdrawal prior to the end of the surrender charge period could void the bonus

Death Benefit Guarantees

If an individual dies before the annuity payments begins, the heirs are guaranteed by the issuing insurance company to receive at least the original investment less withdrawals at the time of death. §10168.4 of the California Insurance Code states that for contracts which provide cash surrender benefits, such cash surrender benefits available prior to maturity shall not be less than the present value as of the date of surrender of that portion of the maturity value of the paid-up annuity benefit which would be provided under the contract at maturity arising from considerations paid prior to the time of cash surrender reduced by the amount appropriate to reflect any prior withdrawals from or partial surrenders of the contract, such present value being calculated on the basis of an interest rate not more than 1% higher than the interest rate specified in the contract for accumulating the net considerations to determine such maturity value, decreased by the amount of any indebtedness to the company on the contract, including interest due and accrued, and increased by any existing additional amounts credited by the company to the contract. In no event shall any cash surrender benefit be less than the minimum nonforfeiture amount at that time. The death benefit under such contracts shall be at least equal to the cash surrender benefit.

Living-Benefit Guarantees.

Guaranteed Monthly Income Benefit (GMIB) is a living benefit offered by some insurers as a way to protect contract value against potential market losses. This feature guarantees a guaranteed minimum of annuity payments, regardless of how the market performs while the annuity contract is in force. The value of this feature is usually stated as a specific interest rate compounded annually on the initial investment or series of payments.

Contract Provisions Common To Indexed Annuities

An equity-indexed annuity is an annuity that earns interest that is linked to a stock or other equity index. An equity-indexed annuity is different from other fixed annuities because of the way it credits interest to the annuity's value. An equity-indexed annuity allows an annuity owner to benefit from potential gains when the stock market is up, but also prevents penalties when it’s down. The Equity Indexed Annuity offers the potential of higher performance without exposing principal to market risk.

Primary Interest Crediting Strategies

The index-based return depends on the particular combination of indexing features specified in the contract. The return of equity index annuities is typically based on the S&P 500 Index, but other domestic and international indices are also used. Some products permit the contract owner to select one or more indices from a specified group of indices. Index growth generally is computed without regard to dividends. There are several methods for determining the change in the relevant index over the period of the contract. The most common indexing features are described below The "point-to-point" method compares the level of the index at two discrete points in time, such as the beginning and ending dates of the contract term. The "high water mark" or "look-back" method compares the highest index level reached on specified dates throughout the term of the contract (e.g., contract anniversaries) to the index level at the beginning of the contract term. The "annual reset," "cliquet," or "lock-in" method compares the index level at the end of each contract year to the index level at the beginning of that year, with the gain for each year "locked in" even if the index declines in the following year. Averaging techniques may be used with these formulas to dampen the volatility of index changes.

- ***Monthly Averaging***—Monthly Averaging uses the monthly closing market levels to determine the index level at the end of the contract term. The interest rate provides a return equal to the monthly average S&P of the previous year, times a participation rate which is then adjusted, as dictated under the contract, to be not less than zero- or other floor- nor higher than the CAP or maximum rate. Suppose in year 1, the S&P goes up 20%- the client would get not 14% but about half that due to averaging. In the second year, the S&P did a -10%, but the client would just show no return at all due to the zero floor. In year 3, the S&P went up 20%- the client would get about 7%.
- ***Point To Point***— The index-linked interest is based on the difference between the index value at the end of the term and the index value at the start of the term adding interest to the annuity at the end of the term. The European, or Point-To-Point, Method divides the index on the maturity date by the index on the issue date and subtracts one from the result. The method's name comes from European stock markets, where options can be exercised only on their expiration date. **Advantages** -- Since interest cannot be calculated before the end of the term, use of this design may permit a higher participation rate than annuities using other designs. **Disadvantages** -- Since interest is not credited until the end of the term, typically six or seven years, he may not be able to get the index-linked interest until the end of the term.
- ***Long Term Point to Point***—The long-term point-to-point method compares the level of the index at two discrete points in time, such as the beginning and ending dates of the contract term in the point-to-point method, the ending index value could be computed by averaging index values on each of the final 90 days of the contract term. Long term averaging may be used at the end of a multi-year point-to-point benefit determination, that is, when the index benefit is determined solely upon the change in the index from the beginning of the index term period to the end of the index term period, which could be up to ten years. Such averaging might be over a period of 2 to 24 months and commonly might use the average of monthly indices, Index-based interest is credited to the contract value either when it is calculated or at the end of the term. Interest in point-to-point contracts invariably is credited at the end of the term because its amount is unknown until then.
- ***High Water Mark*** -- The index-linked interest is decided by looking at the index value at various points during the term. The interest is based on the difference between the highest index value and the index value at the start of the term with the interest added to the annuity at the end of the term. **Advantages** ~ Since interest is calculated using the highest value of the index on a contract anniversary during the term, this design may credit higher interest than some other designs if the index reaches a high point early or in the middle of the term, then drops off at the end of the term. **Disadvantages** ~ Interest is not credited until the end of the term. In some annuities, if an individual surrenders his annuity before the end of the term, he may not get index-linked interest for that term. In other annuities, he may receive index-linked interest, based on the highest anniversary value to date and the annuity's vesting schedule.
- ***Annual Resets*** -- The Annual Reset, or Cliquet or Ratchet, Method calculates the increase in the index each policy year by comparing the indices on the beginning and ending. Most equity-indexed annuities offer participation rates between 70% and 90%, and some place a cap on how much one can gain. **Advantages** ~ Since the interest earned is "locked in" annually and the index value is "reset" at the end of each year, future decreases in the index will not affect the interest the investor has already earned. Therefore, the annuity using the annual reset method may credit more interest than annuities using other methods when the index fluctuates up and down often during the term.

Disadvantages ~ His annuity's participation rate may change each year and generally will be lower than that of other indexing methods. Also, an annual reset design may use a cap or averaging to limit the total amount of interest he might earn each year.

Combination Methods

The following variations of the design are used for the reset/ratchet method. The discussion above pointed out other combinations.

Annual Averaging Of Index Values Within Each Year- This is used for ratchet designs to reduce the volatility in the interest credited to the contract. Another result is that a nominally higher portion of the calculated index increase rate is reflected in the interest rate. Daily averaging, monthly averaging, and quarterly averaging methods reflect on average half to slightly more than half of the annual index increase percentage. The portion will vary considerably from year to year depending upon the profile of the index volatility during the year. Ratchet Payment guaranties provide an increase over the most recent annuity payment if equity index based interest exceeds the assumed interest rate.

Length Of Guaranty Of Index Change Recognition-The current participation rate, spread charge, or cap can be guarantied for the entire term, only for the current interest crediting period, or for some intermediate period. If the guaranty is only for the current interest-crediting period, a lesser guaranty commonly is provided for the balance of the term and subsequent terms.

Method of Accumulation- A compound ratchet applies the index-based interest rate to the current contract value at the time of the crediting. A simple ratchet applies the index-based interest rate to the premium minus cumulative withdrawals at the time of the crediting.

Spreads

Spreads are not new, and they are not restricted to annuities. Spreads are the difference between the rates at which money is deposited in a financial institution and the higher rates at which the money is lent out. The difference between the bid and ask price for a security. When an individual opens a savings account, he or she is subject to a spread. The bank may be earning 5% on your money, but in a savings account, they're only paying you 1%. In this example, the 4% difference is the spread. In the case of index annuities, the annual spread can range anywhere from 1.5% to 5%, and is clearly reflected both in the initial contract, as well as the statements issued by the insurer. In some annuities, the index-linked interest rate is computed by subtracting a specific percentage from any calculated change in the index. This percentage, sometimes referred to as the "margin," "spread," or "administrative fee," might be instead of, or in addition to, a participation rate. If the calculated change in the index is 10%, the annuity might specify that 2.25% will be subtracted from the rate to determine the interest rate credited. So, the rate would be 7.75% (10% - 2.25% = 7.75%). The company subtracts the percentage only if the change in the index produces a positive interest rate.

Cap Rates

Some annuities may put an upper limit, or cap, on the index-linked interest rate. This is the maximum rate of interest the annuity will earn. Not all annuities have a cap rate. While a cap limits the amount of interest an individual might earn each year, annuities with this feature may have other product features he wants, such as annual interest crediting or the ability to take partial withdrawals. Also, annuities that have a cap may have a higher participation rate.

Participation Rates

The participation rate decides how much of the increase in the index will be used to calculate index-linked interest. The initial participation rate in an annuity will depend on when; it is issued by the company. The company usually guarantees the participation rate for a specific period. When that period is over, the company sets a new participation rate for the next period. Some annuities guarantee that the participation rate will never be set lower than a specified minimum or higher than a specified maximum. The participation rate may vary greatly from one annuity to another and from time to time within a particular annuity. Therefore, it is *Minimum Guaranteed Interest Rate*

important for an individual to know how his annuity's participation rate works with the indexing method.

The minimum guaranteed interest rate is the lowest rate an annuity will earn. This rate is stated in the contract. Equity-indexed annuity contracts provide a minimum guaranteed interest rate of 3% as prescribed by law. This will eventually change to a rate itself tied to an index that more realistically reflects interest rates in the economy.

Impact of Premature Surrender Charges

Surrender charges are required if the contract is given up before a specified period of years. The idea is to make it less tempting for annuity owners to draw funds out of the contract and allow the insurer to recover costs associated with the contract. Surrender charges are commonly deducted from withdrawals, but these charges often are eliminated for a 30 to 45 day window at the end of each index term. There may also be a limited free withdrawal privilege.

Charges and Fees

In some annuities, the index-linked interest rate is computed by subtracting a specific percentage from any calculated change in the index. This percentage is sometimes referred to as the "margin," "spread," or "administrative fee," might be instead of, or in addition to, a participation rate.

Considering Available Riders

A rider is a written agreement attached to an insurance policy or annuity contract that limits or expands the policy's terms or coverage. Riders are endorsements or supplemental benefits which, are attached to an existing annuity contract. Riders may increase the premium paid to the insurance company. Strictly speaking, a rider is documentation attached to an existing policy that augments or deletes from policy provisions. It is generally used to extend coverage for some specific reason. Endorsements are themselves often standardized. Basically, endorsements or riders are the documents used to shape the standardized policy to fit individual needs.

Life Insurance Riders

A life insurance rider is an increased, separate, amount that would be paid for life insurance protection in some amount. Such insurance could feature an accelerated benefit option that allows for the early payment of some portion of the policy's face amount should the insured suffer from a terminal illness or injury.

Tax-qualified term life -- Tem life as a part of an annuity contract is considered incidental life insurance. If all of a person's 403(b) accounts invest only in mutual funds, then he or she has no incidental life insurance. If someone has an annuity contract, a portion of the cost of that contract may be for incidental life insurance. If so, the cost of the insurance is taxable to the individual in the year contributed and is considered part of the basis when distributed. The employer will include the cost of a person's insurance as taxable wages in box 1 of Form W-2. Not all annuity contracts include life insurance.

Figuring the cost of incidental life insurance -- If it is determined that part of the cost of an annuity contract is for an incidental life insurance premium, he or she will need to determine the amount of the premium and subtract it from the includible compensation. To determine the amount of the life insurance premiums the individual will need to know the following information.

- The value of the life insurance contract, the amount payable upon the named insured's death.
- The cash value of the life insurance contract at the end of the tax year.
- The taxpayer's age on his or her birthday nearest the beginning of the policy year.

Taxation of LTC Rider Benefits

The Health Insurance Portability and Accountability Act of 1996 addressed the tax treatment of long-term care insurance benefits and premiums. Specifically, if long-term care insurance contracts are intended in their design to be "tax-qualified" in accordance with the provisions of HIPAA, benefits received from LTC policies and riders are not considered taxable as income. While the benefits of a medically underwritten LTC rider may be considered income tax free if the rider complies with HIPAA, the annuity value (which may be required to be spent down first) receives the tax treatment in accordance with Section 72 of the Internal Revenue Code. For annuity contracts issued on August 14, 1982 or later, interest is withdrawn first and considered income taxable. This method is referred to as LIFO, or Last In, First Out. Additionally, if withdrawals made from the annuity occur prior to the owner being 59½, all interest withdrawn will be subject to a 10% excise penalty tax. After earnings have been withdrawn, the premiums withdrawn are not subject to income tax. Since non-medically underwritten LTC riders do not comply with HIPAA's standards, the benefits may be subject to income tax. It is helpful to understand that some companies deposit the benefit amount from the rider directly into the annuity. In this situation, the deposit is treated as gain and thus, taxable as ordinary income when it is withdrawn. Here again, if the owner is younger than 59½ at the time such withdrawals are made, the 10% excise tax applies.

Terms of Riders

These riders are designed to provide benefits without cutting into the monthly payments received from an annuity. Thus, a long-term care rider on an annuity can provide great coverage in the event of an accident or unplanned illness. As with any added benefit, however, the cost can be a drawback. There can be minimum deposits required, sometimes ranging from $30,000 to $50,000 for the initial product purchase. Many annuities with long-term care riders require that the annuity be held for a certain term, such as 7-10 years.

Differentiate Between Crisis Waivers and Long Term Care Riders

Many annuity contracts now offer accelerated death benefit or long-term care riders that provide benefits if long term care is needed. A rider is documentation attached to an existing policy that augments or deletes from policy provisions. The Long-Term Care (LTC) rider is a favorite because it really highlights what sets annuities apart from other retirement savings options: their flexibility and their security. Many LTC riders are similarly constructed, providing coverage for catastrophic illnesses, which require home health care, like an in-home nurse or aide, or long-term hospitalization, or a nursing home stay. These riders are designed to provide benefits without cutting into the monthly payments you receive from an annuitized annuity. A waiver is an intentional and voluntary surrender of some known right, which generally may either result from an express agreement or can be inferred from circumstances. It is the relinquishment of a known right that may result from either the affirmative acts of the insurer or its authorized agents, or from the insurer's non-action, with knowledge of the applicable facts. In this case, the insured waives ownership rights to the policy in exchange for consideration. Basically, riders are the documents used to shape the standardized policy to fit individual needs. At least one form must be added to the insuring agreement and the terms and conditions in order to structure a complete contract. Concerning riders, these are written modifications of an insurance policy that changes the original, often standardized, contract of insurance.

Suitability Of LTC Riders -- LTC riders on annuity contracts are normally more limited than conventional LTC policies on the market today and may be subject to different, often stricter, coverage triggers. When working with seniors, a number of factors should be considered when evaluating annuities with LTC riders:

- With a non-medically underwritten rider your client's life expectancy should be longer than the waiting period on the rider otherwise the rider may not be suitable since the likelihood of accessing benefits diminishes.
- If your client is considering an annuity with a LTC rider in place of conventional long-term care insurance, take the time to explain the differences between the two.
- These riders do not participate in California's Partnership for Long-Term Care Program. Clients who purchase an annuity with a long-term care rider will not be eligible for expanded asset protection from Medi-Cal, as well as other consumer safeguards in a Partnership Policy.

Loan Provisions

Amount not received as an annuity- If a loan is received under an annuity contract, the amount received is treated as an amount not received as an annuity and included in current income. This is true whether the amount is received directly under the contract from the insurer or indirectly from another source. Any assignment or pledge of an annuity contract used to obtain a loan from a third party is considered to be an amount not received as an annuity. Loans are treated as distributions if a person borrows money from his or her retirement plan unless it qualifies for some type of exception. Further, it applies if a person renegotiates, extends, renews, or revises a loan that qualified for the exception below if the altered loan does not qualify. The taxable part may be subject to the additional tax on early distributions. It is not an eligible rollover distribution and does not qualify for the 10-year tax option.

Though loan provisions usually are found most in qualified annuities, some of the new nonqualified annuities designed over the past few years have incorporated loan provisions. These loans typically are available to contract owners at a low net cost. However, annuity loans are considered distributions from annuity contracts and therefore are taxable. If a loan is taken before the annuitant reaches age 59½, a 10% early withdrawal penalty also applies.

Section III
The Senior Market, Required Disclosures and Sales Practices

The Senior Market and Their Risks
Clients might say things in a way that can mislead the advisor into thinking that the client is very risk tolerant, when in fact they are often uncomfortable with the potential of losing principle and or earnings. Most seniors will readily admit even if they have a substantial estate that they will not have the chance to make up for losses at this time in their life. There will still be those seniors that feel that a certain amount of risk is reasonable. In today's market the advisor who works with not just seniors but anyone, who because of income and assets may be at more risk than someone who might have more, has to pay close attention to establishing the clients risk tolerance. Risk tolerance needs to be discussed with the client whenever the advisor is discussing investments. There are fact finder questions that address the clients risk tolerance. The recommended questions typically revolve around prior investments, investment experience, purpose of the current investment, time horizon, and other liquid assets. All of these areas can help the advisor get a better idea of what will be an appropriate recommendation for the client. An agent should keep notes regarding presentations and client responses. Many times agents will have the client sign a form, which memorializes the responses to these questions because when the market takes a negative turn they will often want to revisit some of the subjects that were discussed prior but may not always remember their response.

When dealing with a valuable product they might rationalize that it is good for everyone because we can customize the investment mix to fit the clients risk tolerance. If it is an indexed annuity they may feel it is right because the contract says the client cannot lose principle. Unfortunately these are rationalizations even though the products that we have today have broad appeal due to the built in flexibility. The reality is that people all have different needs and situations that will dictate how much money they need to be liquid or not. If the client loses sleep because of an investment, then they are probably a prospect for a CD, savings account, money market, fixed annuity, and/or short term government/high quality corporate bond. Another facet for the advisor to consider is that a client's risk tolerance will often change over time. The discussion is not just a one-time event but should come up every few years to make sure that the investment style the client chose is still appropriate. If they do not have short term savings available, or if the money may be needed in the near future, it is not likely to be appropriate for the client to make substantial deposits in an annuity.

Senior Citizens and Surrender Charges
There are many concerns with respect to sales to senior citizens. One of the concerns is that they may not fully understand all the ins and outs of the investment options. Another concern can be that an agent may fail to fully explain, that their access to contract cash values may be subject to surrender charges. To be sure that senior citizens are aware of these limits on liquidity, any individual annuity contract that contains a surrender charge period must also disclose to the senior citizen that there is:

- the applicable surrender charge period;
- a penalty/ies associated with surrender of the contract.

This requirement can be met through a notice in 12-point bold print on the cover page making the mandated disclosures or by indicating the location of this information in the policy. Insurers normally furnish their annuity contract owners with annual statements concerning their contracts. When these annual statements are handed to a senior citizen, they must include the contract's:

- current accumulation value;
- current cash surrender value.

The Senior's Investment Objective
The senior's risk tolerance and return expectations -- By having a choice of fixed, equity-indexed and variable annuities, an agent can usually help satisfy the senior's risk tolerance and reward expectations then having a solid understanding of the products so he or she can make a recommendation of the type of annuity most suitable. Riskier investments usually translate to higher potential for return while conservative investments offer lower reward potential. Seniors, in particular, tend to be especially sensitive to this issue since many of them may rely on their annuity for income at some point in the future.
The senior's investment horizon -- It is important that the surrender period of the proposed annuity coincides with the date the senior wants to access or annuitize the funds. Many annuities on the market today have

surrender periods in excess of 10 years. The senior must know this because if he or she anticipates a five-year horizon, a 10-year surrender may not be suitable due to the surrender charge.
The senior's liquidity needs -- Although most annuities contain some liquidity provisions they are not designed to provide liquidity. If the senior needs more than the contract allows, a costly surrender charge applies. In this event, another investment vehicle may be more suitable than an annuity.

Required Disclosures
Effective July 1, 2001, Chapter 442, Statutes of 2000 (Assembly Bill 2107, Scott), strengthens the Elder Abuse and Dependent Civil Protection Act with respect to selling insurance and financial products to elders and clarifies the definition of financial abuse. The definition of "elders" is any person residing in this state that is 65 years of age or older. At the time of the enactment of this law, a life agent is required to make specified disclosures about the potential consequences of entering into financial transactions related to an elder's potential eligibility for Medi-Cal coverage and prohibits a life agent from negligently misrepresenting a product based on its treatment under Medi-Cal.

Pursuant to Section §789.8 of the California Insurance Code, if a life agent offers to sell to an elder any life insurance or annuity product, the life agent shall advise an elder or elder's agent in writing that the sale or liquidation of any stock, bond, IRA, certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of this product may have tax consequences, early withdrawal penalties, or other costs or penalties as a result of the sale or liquidation, and that the elder or elder's agent may wish to consult independent legal or financial advice before selling or liquidating any assets and prior to the purchase of any life or annuity products being solicited, offered for sale, or sold. This section does not apply to a credit life insurance product. A life agent who offers for sale or sells a financial product to an elder on the basis of the product's treatment under the Medi-Cal program may not negligently misrepresent the treatment of any asset under the rules and regulations of the Medi-Cal program, as it pertains to the determination of the elder's eligibility for any program of public assistance. A life agent who offers for sale or sells any financial product on the basis of its treatment under the Medi-Cal Program shall provide, in writing, the required disclosure.

AB 2107
AB 2107 would impose the duty of honesty, good faith, and fair dealing on insurers, brokers, agents, and others engaged in the business of Medicare supplemental insurance and long-term care insurance with respect to prospective policyholders. The bill would only permit life agents, on or after July 1, 2001, to sell or offer for sale to an elder or his or her agent any financial product on the basis of the product's treatment under Medi-Cal after providing the elder or his or her agent with a specified disclosure, in writing, explaining the resource and income requirements of the Medi-Cal program, including, but not limited to, certain exempt resources, certain protections against spousal impoverishment, and certain circumstances under which an interest in a home may be transferred without affecting Medi-Cal eligibility.

In order to improve the annuity marketplace in California, NAIFA-California has strongly supported efforts to provide appropriate product disclosures, enhance consumer protections, improve agent education, increase fines and penalties and fund enforcement actions. In 2003, NAIFA-California actively participated in numerous policy hearings and meetings that resulted in the protections established by SB 620 (Scott). NAIFA-California worked with Senator Scott and the DOI on SB 618 in 2003 and SB 1273 in 2004 that enhanced the penalties for bad actors and AB 2316 (Chan) in 2004, which provided for a $1 assessment on all life policies and annuities sold in California to enhance the DOI's investigations and enforcement efforts pertaining to the sale of life insurance and annuities. In addition to being unwarranted, SB 192 is premature at this time. In January 2005, all of the provisions of SB 620 were fully implemented and the DOI began collecting a $1 assessment required by AB 2316. In addition, NAIFA-California and the insurers are currently working with the DOI on regulations to further enhance the provisions in SB 620 and SB 2173 from several years ago. It is imperative that the laws and regulations that have already been passed and are currently being developed be fully implemented prior to adding more administrative burdens to the agents and insurers doing business in California. Simply passing laws and promulgating regulations does not remove the bad actors from the business but it is effective when the DOI takes the enforcement actions necessary to remove them from the business.

Specifics of Disclosures

The primary determinant of full disclosure is whether the client has been provided, in an understandable manner, with all of the facts that are material to his or her purchase decision. Regulators say that the three main areas of deficiency in regard to annuity sales disclosure involve the following:

- ***Interest rates*** -- An annuity is a long-term contract so interest rates and market condition changes affect them.
- *Surrender charges* -- Clients must understand the period of time and the conditions under which surrender charges may be assessed as well as any exceptions.
- ***Tax implications*** -- Clients must understand that annuities earn interest on a tax *deferred,* not a *tax-free basis being* due on annuity accumulations when they are paid out of the contract. 10% penalty tax applies to withdrawals which are made on the contract if they are made prior to age 59½, unless certain exceptions apply.

Types of Disclosures

Written Disclosure -- A new disclosure must be delivered prior to meeting in a senior's home that may lead to an annuity sale or sales presentation. The notice must be delivered in writing no less than 24-hours prior to the meeting. If the senior is already a client and requests a meeting the same day, notice must still be furnished before the meeting begins. The new disclosure notifies the senior of their rights, provides information about the attendees, and communicates the type of insurance sales presentation that will be made.

Verbal Disclosures -- In addition to the written disclosure, the agent is also required to follow new guidelines upon arriving in the senior's home. Besides a greeting, three verbal disclosures must be provided before proceeding. These include:

- The meeting's purpose is to discuss insurance; and
- The name and titles of all persons in attendance; and
- The name of the insurer represented, if known

Following the verbal statement, each person attending the meeting must provide the senior with a business card (or other written identification) including name, business address, telephone number and insurance license number. If for any reason, the agent is asked to leave the senior's home, the agent and all attendees must do so without hesitation, immediately.

Disclosures and The Prospectus

Since variable annuities are securities, a prospectus must be delivered to a prospect before, or at the time of, sale. The prospectus provides the client with essential information regarding the variable annuity. Information contained in a prospectus includes:

- Charges and fees;
- Listing of subaccounts;
- Description of what investments can be made in each subaccount;
- Description of the subaccount objective;
- Additional benefits;
- How to determine the death benefit.

Variable annuities are classified as securities so must be registered with the SEC and are required to have a prospectus in the sales materials. The prospectus is a valuable tool, which reveals any hidden charges not defined clearly in the supporting marketing materials. The prospectus outlines all costs and benefits, defines terms, discusses the issuer and gives the potential contract owner information. Recently the SEC has allowed companies to issue brief prospectus "profiles" along with their prospectuses, which provide a summary of the variable annuity's main features in plain English and in a standardized format. The Guidelines for the Variable Annuity Profile describe certain disclosure items that must be included in the profile. The profile describes the annuity contract's terms, payout options, investment options, expenses, tax treatment, performance characteristics, death benefits, purchase terms, and withdrawal provisions. The order in which these items must appear is specified in the guidelines, and the profile's content is limited to the items in the guidelines. The profile must be provided in conjunction with the profile and be be bound together with the prospectus or given to the client along with the prospectus as a separate item.

Fair vs. Unfair Sales Practices

Annuity fraud takes place when the selling agent misrepresents facts when soliciting the purchase of an annuity or fails to properly disclose important facts about the investment. There are as many types of annuity fraud as there are types of annuities - and there are many different annuities. Although most of the recent abuse has involved variable annuities, other forms of annuities, such as fixed or indexed annuities, have also been the subject of abuse. Any violation may be deemed to be an unfair method of competition or an unfair deceptive act and practice. Regulators continue to focus a good deal of time and attention on the prevention and detection of inappropriate sales and marketing practices with respect to variable annuities and variable life insurance policies. Of foremost recent concern are the following:

- unsuitable sales and switching;
- failure to disclose critical information to customers;
- market timing and late trading;
- improper sales contests;
- the failure of some broker-dealers to maintain and enforce adequate written supervisory procedures which might prevent or detect abuses in each of the previously mentioned areas.

Among the abusive and improper sales practices allegedly engaged in by sellers of variable annuities are the following:

- ***Churning and Excessive Fees*** -- The unnecessary replacement of old variable annuities with new ones to create unnecessary commission payments and surrender fees;
- ***False Disclosures*** -- Failure to disclose investment risks or misrepresenting tax deferral benefits that can be achieved through variable annuity investments. Falsely touting variable annuity products of one company over identical products of another in order to generate commissions and surrender fees;
- ***Preferential and Unfair Customer Treatment*** -- Side agreements between the seller and certain large or favored investors to allow "market-timing" and "after hours trading" in which favored customers are allowed to rapidly buy and sell variable annuities;
- ***Unsuitable Sales Into Tax-Deferred Accounts*** -- The unsuitable investment or transfer of funds in tax-deferred accounts such as IRAs, Keoughs, Rollovers, 401(k)s, profit sharing, and other qualified retirement plans, subjecting such investors to higher and additional classes of fees, as well as unnecessary termination costs and restrictions, and lower overall investment returns
- ***Inappropriate Recommendations*** -- The recommendation of any type of annuity that is not appropriate for the client is improper and considered a form of fraud by the broker.

California's seniors have been subjected to very misleading sales practices called *pretext interviews.* §791.02 of the California Insurance Code defines pretext interviews as "an interview whereby a person, in an attempt to obtain information about a natural person, performs one or more of the following acts:

- Pretends to be someone he or she is not;
- Pretends to represent a person he or she is not in fact representing;
- Misrepresents the true purpose of the interview;
- Refuses to identify himself or herself upon request.

Producers should never attempt to dissuade seniors from seeking further assistance from their regular insurance producer, family member, friend, or the types of agencies

Living Trust Mills

Living trust mills are designed for the sole purpose of generating annuity sales, chiefly aimed at seniors. Seniors pay substantial sums of money to sales agents for living trust mills. But through fraud and deceit, the sales agents damage seniors' estate plans, and the security of their investments and life savings. This is a classic example of *Bait & Switch - The* agent *baits* the senior with the living trust and then *switches* the sales pitch to an annuity presentation when the trust is complete. When the agent meets with the senior, they misrepresent themselves as an expert in estate planning. Through the process of developing the living trust the client's assets and investment information is collected. Once the agent has this information (not to mention the trust of the senior), they use it to sell annuities, usually when a *boiler-plate* trust is delivered. The senior believes they are getting valuable legal services from a trusted legal advisor or estate planner.

The California Attorney General recently cracked down on one company that was giving estate planning advice, and selling living trusts to elders in California. The company would find out all about an elder individual's finances and investments as part of the living trust planning process. Then the elder individual would be approached to buy annuities, after selling or exchanging their existing investments. Annuities can generate significant up-front commissions for the seller, and over $200 million of annuities were sold this way. Other groups have seen the financial success of the trust-annuity sales gimmick, and adopted it as their model. Some are using a slightly different approach – they offer advice on long-term care planning, including Medi-Cal. They only give part of the picture, and stress that some annuities do not count as assets under Medi-Cal's eligibility rules. Agents are selling lots of unsuitable annuities this way, and getting paid large commissions.

The tips below help consumers avoid becoming victims of living trust mills and their scams:

- Living trust mills' sales agents are not attorneys and are not experts in estate planning.
- Documents in the trust packages may not comply with California law.
- An annuity is not 100% safe, and only a portion is guaranteed by the state. Insurance companies can and do fail, and their assets may not be enough to pay the full value of their customers' investments.
- Sales agents may not follow procedures set by law for executing or witnessing wills and other documents. T
- Sales agents may fail to disclose possible adverse tax consequences or early withdrawal penalties that may be incurred when transferring stocks, bonds, certificates of deposit or other investments to annuities.
- So-called "promissory notes" are not insured by the FDIC or any other government agency
- and may be very risky. They may not be registered as securities with the state.
- Watch out for companies that sell trusts and also try to sell annuities or other investments.

Warning From Attorney General To Seniors about "Living Trust Mills" and Annuity Scams

February 19, 2003

(SACRAMENTO) – Attorney General Bill Lockyer today warned California consumers to be on the lookout for "living trust mill" con artists who fraudulently sell trusts and annuities to senior citizens. Sales agents for these scam operations often misrepresent the disadvantages of seniors' current investments and the advantages of the investments the agents are selling. ….. To give themselves a cloak of legitimacy, these sales agents pretend to be experts in living trusts. They often work in assisted living centers, churches and other places where seniors gather, hooking elderly victims through free seminars and other sales presentations. Consumers, particularly seniors and their families, should be wary," said Lockyer. "We believe there are living trust mills violating the law -- and the trust placed in them by seniors. ….. Seniors pay substantial sums of money to sales agents for living trust mills. But through fraud and deceit, the sales agents damage seniors' estate plans, and the security of their investments and life savings……

"In their solicitations, sales agents often pose as expert financial or estate planners. They pass themselves off as a "trust advisor," "senior estate planner" or "paralegal," and schedule an initial appointment with seniors in their homes. Under the guise of helping set up or update a living trust, the sales agents find out about seniors' financial assets and investments. Usually, the sales agents then schedule a second visit to deliver a completed trust and have documents signed and notarized, and title of assets transferred to the trust.

Typically, the agents use the review of seniors' investments to scare them into believing their investments are unsafe, and that by "moving" their money, they can earn higher interest with no risk.

“Planning an estate and choosing investments involve important legal, financial and personal decisions. If estate-planning documents are not properly prepared or executed they can be invalid and cause lasting damage. Following are additional tips to help consumers avoid becoming victims of living trust mills and their scams:

- An annuity is not 100% safe, and only a portion is guaranteed by the state. Insurance companies can and do fail, and their assets may not be enough to pay the full value of their customers' investments.
- Documents in the trust packages may not comply with California law.
- Living trust mills' sales agents are not attorneys and are not experts in estate planning.
- Sales agents may not follow procedures set by law for executing or witnessing wills and other documents.
- Sales agents may fail to disclose possible adverse tax consequences or early withdrawal penalties that may be incurred when transferring stocks, bonds, certificates of deposit or other investments to annuities.
- So-called "promissory notes" are not insured by the FDIC or any other government agency and may be very risky. They may not be registered as securities with the state.
- Watch out for companies that sell trusts and also try to sell annuities or other investments.

Understanding SB 620

The California Legislature passed Senate Bill 620 (SB 620) and enacted new insurance producer training statutes at section 1749.8 of the Insurance Code. The new California law requires eight hours of California-specific annuities training for all life and health agents who sell individual annuity products in the state. Beginning Jan. 1, 2005 life agents subject to the requirement must have already completed the training. New agents licensed after that date must complete the training prior to soliciting individual consumers for annuity sales. The law requires training in annuity product history, features and benefits; California law, regulations and requirements related to annuities; prohibited sales practices; and fraudulent and unfair trade practices. These required hours are part of, and not in addition to, the regular continuing education requirement.

SB 620 seeks to address abuses in annuity sales practices, such as selling an annuity product with an excessive surrender penalty to elderly people. The law also imposes restrictions on approaching elderly prospects for annuity sales. Most significant is the requirement for a 24-hour waiting period between first contacting a prospect and meeting with them in their home. With the dramatic growth in the elderly population in California, the legislature decided it was important to protect seniors in this state from overly-aggressive sales tactics and to make financial professionals accountable for the terms and conditions of the products they sell to elderly consumers. Suitability, the duty to the client and selling products to seniors in their homes are all addressed in this legislation. In addition, the need for the education of agents regarding these issues is now required by law.

Fair Sales Practices

We put so much focus on unfair sales that sometimes we forget about the importance of capitalizing on fair sales practices. Communications with the consumer forming the basis for the suitability determination must be documented along with other records including information concerning:

- A breakdown of any fees, costs, features, and surrender or penalty charges associated with partial withdrawals and surrenders, and any limits or conditions for waiving those penalties or charges;
- Age of the person for whom the product will be purchased;
- Information that may reasonably show suitability of the product for the senior.
- Information provided by the senior;
- The senior’s financial status and current assets, including any existing life insurance contracts;
- The senior's risk tolerance;
- The senior’s investment objectives;
- The senior’s monthly financial needs;
- The likely need of the contract owner to access cash values in the near future;
- That the senior was notified that there may be tax implications to the sale or exchange and that he should contact his personal tax advisor;
- The amount of the premium enhancement to be credited;
- The trade-off between bonus credits, if any, and product fees and charges must be explained to the senior;
- Whether the senior decided to enter into the transaction against the advice of the producer;

Section IV
Annuity Sales Practices and Prohibitive Sales Practices

Appropriate Advertising

The new restrictions and other changes in California's insurance code are the result of Senate Bills 620 and 618, signed into law in September 2003. Both bills were sponsored by Senator Jack Scott (D-Pasadena). SB 620 requires agents to adhere to strict guidelines when advertising to senior citizens. These provisions of the Code better protect seniors from misleading, deceptive, or confusing advertising practices. The California State's definition of advertisements include *envelopes, stationary, business cards,* as well as materials designed to describe and encourage the purchase of an annuity. The advertising provisions of SB 620 fall under two categories - requirements and *restrictions.* The new law includes several measures to prevent misleading advertisements, including advertisements that imply incorrectly that a particular insurer or insurance product is endorsed by any governmental agencies, non-profit or charitable organizations.

Advertising For Persons 65 Years and Older

§787 (a) of the California Insurance Code states that no insurer, agent, broker, solicitor, or other person or other entity shall solicit persons age 65 and older in this state for the purchase of disability insurance, life insurance, or annuities through the use of a true or fictitious name which is deceptive or misleading with regard to the status, character, or proprietary or representative capacity of the entity or person, or to the true purpose of the advertisement. 787 (c) of the California Insurance Code states that advertisements shall not employ words, letters, initials, symbols, or other devices which are so similar to those used by governmental agencies, a nonprofit or charitable institution, senior organization, or other insurer that they could have the capacity or tendency to mislead the public. Examples of misleading materials, include, but are not limited to, those which imply any of the following:

- The advertised coverages are somehow provided by or are endorsed by any governmental agencies, nonprofit or charitable institution or senior organizations.
- The advertiser is the same as, is connected with, or is endorsed by governmental agencies, nonprofit or charitable institutions or senior organizations.

§787 (d) of the California Insurance Code states that no advertisement may use the name of a state or political subdivision in a policy name or description. §787 (e) of the California Insurance Code states that no advertisement may use any name, service mark, slogan, symbol, or any device in any manner that implies that the insurer, or the policy or certificate advertised, or that any agency who may call upon the consumer in response to the advertisement, is connected with a governmental agency. §787 (f) of the California Insurance Code states that no advertisement may imply that the reader may lose a right, or privilege, or benefits under federal, state, or local law if he or she fails to respond to the advertisement. §787 (g) of the California Insurance Code states that an insurer, agent, broker, or other entity may not use an address so as to mislead or deceive as to the true identity, location, or licensing status of the insurer, agent, broker, or other entity. §787 (h) of the California Insurance Code states that no insurer may use, in the trade name of its insurance policy or certificate, any terminology or words so similar to the name of a governmental agency or governmental program as to have the capacity or the tendency to confuse, deceive, or mislead a prospective purchaser. §787 (i) of the California Insurance Code states that all advertisements used by agents, producers, brokers, solicitors, or other persons for a policy of an insurer shall have written approval of the insurer before they may be used. §787 (j) of the California Insurance Code states that no insurer, agent, broker, or other entity may solicit a particular class by use of advertisements which state or imply that the occupational or other status as members of the class entitles them to reduced rates on a group or other basis when, in fact, the policy or certificate being advertised is sold on an individual basis at regular rates. 787 (k) of the California Insurance Code states that in addition to any other prohibition on untrue, deceptive, or misleading advertisements, no advertisement for an event where insurance products will be offered for sale may use the terms "seminar," "class," "informational meeting," or substantially equivalent terms to characterize the purpose of the public gathering or event unless it adds the words "and insurance sales presentation" immediately following those terms in the same type size and font as those terms.

- **Definition of Advertisement: envelopes, stationary, business cards**

§787 (b) of the California Insurance Code states that an advertisement includes envelopes, stationery, business cards, or other materials designed to describe and encourage the purchase of a policy or certificate of disability insurance, life insurance, or an annuity.

  - ***Required Information To Be Displayed*** -- If the goal is to generate leads, an advertisement must indicate that an agent will *contact* the prospect if that is the fact. Additionally, when the agent makes initial contact with a prospect generated from a lead, the agent must disclose that the contact is the result of a lead generating device. If the advertisement mentions a specific product, written approval by the insurer must be provided prior to use.
  - ***Use of The Word "Insurance"*** -- Effective January 1, 2005, every licensee shall prominently affix, type, or cause to be printed on business cards, written price quotations for insurance products, and print advertisements, distributed in this state for insurance products, the word "*Insurance*" in type size no smaller than the largest indicated telephone number. A penalty can be levied on *each piece* of printed material that fails to conform to this requirement. (§1725.5 of CIC) The only exception here is if the failure to comply was beyond the control of the agent. In addition, this requirement does not apply to general advertisements of motor clubs that merely list insurance products as one of several services offered by the motor club, and do not provide any details of the insurance products.
  - ***License Number*** -- Every licensee shall prominently affix, type, or cause to be printed on business cards, written price quotations for insurance products, and print advertisements distributed exclusively in California for insurance products its license number in type the same size as any indicated telephone number, address, or fax number. If the licensee maintains more than one organization license, one of the organization license numbers is sufficient for compliance.

- **Seminars, Classes, Informational Meetings**

Seminars as an effective way to sell to seniors are growing. Senate Bill 620 requires specific language in any advertisement for an event where insurance products will be offered for sale. The words *"and insurance sales presentation" has to be added immediately after other information regarding seminars, classes or informational meetings telling about an* event where insurance products will be offered for sale to characterize the purpose of the public gathering or event. Advertising must also comply with requirements to display their license number. Some agents believe the new language is not required if no selling is done at the meeting. However, if a seminar is an eventual means to make annuity presentations or sales, the language is required.

  - ***Required Information To Be Displayed*** -- Seminars include classes, workshops, informational meetings or any other terms referring to a meeting.
  - ***Use of The Word "Insurance"*** -- Immediately following the word "seminar," "class," "informational meeting," or any other words implying a meeting, an agent must include the words in the same type size and font -- "and insurance sales presentation."
  - **License Number** -- Business cards, written price quotations, and print advertisements must contain the agent's license number in the same type and size as any other indicated phone number, address, or fax number.

- **Direct Mailers**

§787 (1st paragraph) of the California Insurance Code states that any advertisement or other device designed to produce leads based on a response from a potential insured which is directed towards persons age 65 or older shall prominently disclose that an agent may contact the applicant if that is the fact. In addition, an agent who makes contact with a person as a result of acquiring that person's name from a lead generating device shall disclose that fact in the initial contact with the person.

  - ***Advertisement May Not Look Like Government Agency, Non-Profit or Senior Organization*** -- An advertisement cannot contain words, letters, initials, symbols or other devices, similar to those used by governmental agencies, senior organizations, charitable and nonprofit institutions or other insurers as they could be confusing or misleading to seniors.
  - ***Coverage Not Provided or Endorsed by Government Agency, Non-Profit or Senior Organization*** -- An advertisement cannot imply that the reader could lose rights, privileges, or benefits provided by a federal, state, or local law if there is a failure to respond.

- ***Advertiser Is Not Connected With Government Agency, Non-Profit or Senior*** -- An advertisement cannot contain any name, service mark, slogan, symbol or other device that would imply the agent, insurer or policy is connected with a governmental agency.
- ***Coverage or Advertiser Is Not Related To Government Agency*** -- A policy or certificate's name cannot mislead, deceive, or confuse a prospective purchaser by using words similar to a governmental program or agency.
- ***Any Person or Entity That is Exempt From Licensure, or Nonresident Agent Representing An Insurer That is A Direct Response Provider*** --The current legislation applies to all life agents who sell annuities to California consumers. In the case of the new training requirements, only non-resident direct response providers are exempt, provided they meet the State's definitions as set forth by Section 1749.8 of the California Insurance Code.
- ***Fines and Penalty*** – **Agents --** Any broker, agent, or other person or other entity engaged in the transactions of insurance, other than an insurer, who violates this article is liable for an administrative penalty of no less than $1,000 for the first violation. Upon a second violation, an agent will be liable for an administrative penalty of no less than $5,000 and no more than $50,000 for each violation. In addition, if the commissioner brings an action against a licensee for the violations above and determines that he may reasonably be expected to cause significant harm to seniors, the commissioner may suspend his or her license pending the outcome of a hearing. **Insurers --** Any insurer who violates this article is liable for an administrative penalty of $10,000 for the first violation. Second violations can bring a $30,000 to $300,000 fine and a rescission of the annuity or policy in violation.

Prohibited Sales Practices
Selling Annuities for Medi-Cal Eligibility
§789.9 (a) of the California Insurance Code states that in addition to any other reasons that a sale of an individual annuity to a senior may violate any provision of law, an annuity shall not be sold to a senior in any of the following circumstances:

- The senior's purpose in purchasing the annuity is to affect Medi-Cal eligibility and either of the following is true:
  - The purchaser's assets are equal to or less than the community spouse resource allowance established annually by the State Department of Health Services pursuant to the Medi-Cal Act (Chapter 7 (commencing with Section 14000) of Part 3 of Division 9 of the Welfare and Institutions Code).
  - The senior would otherwise qualify for Medi-Cal.
- The senior's purpose in purchasing the annuity is to affect Medi-Cal eligibility and, after the purchase of the annuity, the senior or the senior's spouse would not qualify for Medi-Cal.
  - In the event that a fixed annuity specified in subdivision (a) is issued to a senior, the issuer shall rescind the contract and refund to the purchaser all premiums, fees, any interest earned under the terms of the contract, and costs paid for the annuity. This remedy shall be in addition to any other remedy that may be available.
- Selling annuity to persons 65 years and older for purpose of qualifying for Medi-Cal is prohibited if:
  - *Assets are equal to or less than community spouse resource allowance* – the senior's assets are equal to or less than the Medi-Cal community spouse resource allowance ($99,540 as of January 1, 2006)
  - *Senior Otherwise Qualifies* -- the senior would otherwise qualify for Medi-Cal
  - *After Purchase Senior or Spouse Does Not Qualify for Medi-Cal* -- after the purchase of the annuity, the senior or the senior's spouse would not qualify for Medi-Cal.

If a senior purchases an annuity in order to qualify for Medi-Cal, and the senior or the senior's spouse still does not qualify after the purchase, then the senior may cancel the annuity and receive a refund. If the senior has purchased a fixed annuity, then he or she will be refunded all premiums, fees, interest earned, and any other costs that were paid for the annuity. A life agent who offers for sale or sells a financial product to an elder on the basis of the product's treatment under the Medi-Cal program must represent the treatment of any asset under the statutes and rules and regulations of the Medi-Cal program accurately and completely, as it pertains to the determination of the elder's eligibility for any program of public assistance. In addition, the following disclosure is required. The statement shall be printed in at least 12-point type, shall be clearly separate from any other document or writing, and shall be signed by the prospective purchaser and that person's spouse, and legal representative.

"NOTICE REGARDING STANDARDS FOR MEDI-CAL ELIGIBILITY

If you or your spouse are considering purchasing a financial product based on its treatment under the Medi-Cal program, read this important message! You or your spouse do not have to use up all of your savings before applying for Medi-Cal.

UNMARRIED RESIDENT

An unmarried resident may be eligible for Medi-Cal benefits if he or she has less than ___________(amount of individual's resource allowance) in countable resources. The Medi-Cal recipient is allowed to keep from his or her monthly income a personal allowance of ___________(amount of personal needs allowance plus the amount of any health insurance premiums paid). The remainder of the monthly income is paid to the nursing facility as a monthly share of cost.

MARRIED RESIDENT

COMMUNITY SPOUSE RESOURCE ALLOWANCE: If one spouse lives in a nursing facility, and the other spouse does not live in a facility, the Medi-Cal program will pay some or all of the nursing facility costs as long as the couple together does not have more than __________________ (amount of community countable assets).

MINIMUM MONTHLY MAINTENANCE NEEDS ALLOWANCE: If a spouse is eligible for Medi-Cal payment of nursing facility costs, the spouse living at home is allowed to keep a monthly income of at least his or her individual monthly income or ______________(amount of the minimum monthly maintenance needs allowance), whichever is greater.

Fair Hearings And Court Orders -- Under certain circumstances, an at-home spouse can obtain an order from an administrative law judge or court that will allow the at home spouse to retain additional resources or income. The order may allow the couple to retain more than ___________(amount of community spouse resource allowance plus individual's resource allowance) in countable resources. The order also may allow the at-home spouse to retain more than __________(amount of the monthly maintenance needs allowance) in monthly income.

Real And Personal Property Exemptions

Many of your assets may already be exempt. Exempt means that the assets are not counted when determining eligibility for Medi-Cal.

REAL PROPERTY EXEMPTIONS

One Principal Residence -- One property used as a home is exempt. The home will remain exempt in determining eligibility if the applicant intends to return home someday. The home also continues to be exempt if the applicant's spouse or dependent relative continues to live in it. Money received from the sale of a home can be exempt for up to six months if the money is going to be used for the purchase of another home.

Real Property Used In A Business Or Trade -- Real estate used in a trade or business is exempt regardless of its equity value and whether it produces income.

PERSONAL PROPERTY AND OTHER EXEMPT ASSETS

IRA's, Keoghs, And Other Work-Related Pension Plans -- These funds are exempt if the family member whose name it is in does not want Medi-Cal. If held in the name of a person who wants Medi-Cal and payments of principal and interest are being received, the balance is considered unavailable and is not counted. It is not necessary to annuitize, convert to an annuity, or otherwise change the form of the assets in order for them to be unavailable.

Personal Property Used In A Trade Or Business. One Motor Vehicle. Irrevocable Burial Trusts Or Irrevocable Prepaid Burial Contracts. There May Be Other Assets That May Be Exempt.
This is only a brief description of the Medi-Cal eligibility rules. call your county welfare department, for more detailed information. Contact a legal services program for seniors or an attorney who is not connected with the sale of this product. I have read the above notice and have received a copy.

Dated:_______________ Signature: _______________________________

In-Home Solicitations: 24-hour Notice requirement for persons 65 years and older
Misrepresenting The Content Of An In-Home Presentation -- The new regulations prohibit any agent from selling an annuity in the residence of senior (in person or by phone) through the use of any scheme that hides the true status mission of the contact. This is designed to protect seniors from abusive marketing schemes.

- Criteria
  - *For Persons 65 years and older* -- New legislation requires that before an insurance agent visits a senior's home to sell an annuity, the agent must provide written notice in 14-point type that the senior will be given a sales presentation on life insurance, annuities, or other insurance products.

- Content of Written Notice

The notice below must be provided to the senior at least 24 hours before annuity/insurance solicitation takes place in the senior's home. It must have the appropriate information inserted, and be printed in 14 point type providing the following information:

(1) During this visit or a follow-up visit, you will be given a sales presentation on the following ___________________(indicate all that apply):
- Life insurance, including annuities;
- Other insurance products (specify): _________________.

(2) You have the right to have other persons present at the meeting, including family members, financial advisors or attorneys.
(3) You have the right to end the meeting at any time you want.
(4) You have the right to contact the Department of Insurance for information, or to file a complaint. ________________(the consumer assistance numbers at CIC)
(5) The following individuals will be coming to your home: _____________________ (all attendees listed, and insurance license information.

The notice must also:
- List the names of others who will accompany the agent to the meeting, and provide their insurance license information, when applicable.
- Advise the senior that he or she may invite family members, attorneys, or financial advisors to attend the meeting, and may end the meeting at any time.

Can Not Misrepresent True Content of Meeting -- When the meeting in the home begins, the agent must state that the purpose of the meeting is to talk about insurance, or gather information for a follow-up visit to sell insurance.

Sharing Commissions With Attorney
§ 1724 of the California Insurance Code and the Senate Bill 620 clarifies the commission-sharing agreements between attorneys and agents. An agent or broker may not share a commission or other compensation (including a bonus, gift, prize, award or finder's fee) with an active member of the California bar, unless the agent or broker is also an active member of the California bar. The intent of this provision is to discourage marketing schemes like living trust mills and the use of annuities in Medi-Cal planning where an agent would share his commission with the attorney. The bill also clarifies the definition of commission to include a bonus, gift, prize, award, or finder's fee. This section of the new law prevents California attorneys from recommending life insurance or annuities to seniors and then referring them to insurance agents in return for a share of the commission or other compensation. §1724. An agent, broker, or solicitor who is not an active member of the State Bar of California may not share a commission or other compensation with an active member of the State Bar of California. For purposes of this section, "commission or other compensation" means pecuniary or nonpecuniary compensation of any kind relating to the sale or renewal of an insurance policy or certificate or an annuity, including, but not limited to, a bonus, gift, prize, award, or finder's fee.

Unnecessary Replacement
§10509.8 (a) of the California Insurance Code states that a violation shall occur if an agent or insurer recommends the replacement or conservation of an existing policy by use of a materially inaccurate presentation or comparison of an existing contract's premiums and benefits or dividends and values, if any, or recommends that an insured 65 years of age or older purchase an unnecessary replacement annuity. §10509.8 (b) of the California Insurance Code states that "unnecessary replacement" means the sale of an annuity to replace an existing annuity that requires that the insured will pay a surrender charge for the annuity that is being replaced and that does not confer a substantial financial benefit over the life of the policy to the purchaser so that a reasonable person would believe that the purchase is unnecessary. §10509.8 (c) of the California Insurance Code states that patterns of action by policyowners who purchase replacement policies from the same agent after indicating on applications that replacement is not involved, shall constitute a rebuttable presumption of the agent's knowledge that replacement was intended in connection with the sale of those policies, and such patterns of action shall constitute a rebuttable presumption of the agent's intent to violate this article. §10509.8 (d) of the California Insurance Code states that this article does not prohibit the use of additional material other than that which is required that is not in violation of this article or any other statute or regulation.

Agents selling annuities need to be more diligent than ever when the sale involves replacement. Under current legislation, a violation occurs if an agent recommends the replacement of an existing annuity when an inaccurate presentation or comparison of premiums, benefits, dividends and values are made. This requires agents to evaluate replacement on the basis of several aspects.

- **Define "Unnecessary Replacement"**

Unnecessary replacement occurs when an agent replaces an annuity, for which a surrender charge is incurred, without providing a substantial financial benefit over the life of the replacement annuity. In the case of an annuity, an unnecessary replacement is defined as one that:

  - ***Pay a Surrender Charge***— Surrender charge penalties typically apply for at least the first seven years from the date of purchase for most policies. If an individual chooses to cancel or replace a policy, the surrender charge penalty can cost a significant amount of money.
  - ***Define Substantial Financial Benefit***—A replacement does not confer substantial financial benefit over the life of the new annuity to the purchaser.

- **Examples of Unnecessary Replacement**

With other provisions of the situation and the annuity policy, the following define situations that are considered unnecessary replacement:

  - the proposed annuity contains a lower interest rate than the replacement annuity;
  - the existing annuity features a guaranteed interest rate while the replacement annuity does not;
  - the existing annuity has a better settlement option than the replacement immediate annuity;
  - replacing a guaranteed rate annuity with either an equity indexed or a variable annuity could potentially outperform the existing annuity.

Example: Bob Adair agrees to replace a $100,000 deferred annuity earning 5% with a new contract offering a first year bonus of 7%. His surrender charges in the swap will amount to $3,000. So over the life of the contract the replacement, after charges and taxes, he would gain a total of $100. This would be considered an unnecessary replacement because it is not a substantial financial benefit.

Example: Sharon Adair has $50,000 invested in a variable annuity. She has a death benefit equal to the original value or surrender value at time of death but part of the surrender charges still apply. Neil Perry found a new contract with a slightly better return, reduced charges, a short surrender period and an enhanced death benefit that increases the death benefit at surrender by 2% with no underwriting required. As long as Sharon Adair does not need access to the funds before the new surrender charges period is over this replacement is probably legal but not substantial financial benefit.

Bait and Switch

Bait & Switch tactics are marketing schemes that misrepresent the true intent of an insurance sales presentation. If a system is devised to generate long-term care insurance leads, but the true intent is to switch the sale to annuities, the California Department Of Insurance could deem this a violation. "Bait and switch:" it's one of the oldest swindles known to human civilization, and it's key to the defense's strategy in pushing your client into a structured settlement. In this common maneuver, you will be shown a pay-out to a normal life expectancy on an injured client with a very high age rating; let's say a three-year-old client whose proper age rating is 82. So even though your client will probably live only a few years, the proposal projects a full life expectancy. The defense is counting on a passive plaintiff's attorney in order for this outrageous tactic to succeed, an attorney who does not determine an accurate age rating. It is trying to turn human nature to its advantage: guardians or parents who want to believe that an injured minor will live a normal life span... an attorney eager to wrap up a case with a big settlement figure. The tactic works all too often. Then once the papers have been signed, the defense buys a much cheaper annuity using the true age-rating, and pockets the difference.

Suitability Standards

Choosing suitable products for clients is not as easy as drawing numbers out of a hat. It is a precise science, but not a perfect one, and it takes considerable product knowledge and practice. Suitability requirements have existed for securities for decades, and they also apply to variable life insurance and annuity products, which are regulated as securities. Annuities are available in a variety of shapes and sizes. Immediate, deferred, fixed, indexed, variable, single-premium, flexible premium. By matching a client's needs and resources with these variables, an annuity can be designed to fit almost any situation. An annuity can address a distribution need or a savings and accumulation need.

- • to systematically liquidate an existing amount of money.
- • to accumulate money on a tax-deferred basis for use in the future.

Besides government regulations concerning suitability, recent concerns about life insurance and annuity sales practices have become a catalyst for the industry to establish the Insurance Marketplace Standards Association (IMSA) to help maintain high ethical standards in the industry. IMSA standards are stricter than regulatory requirements, however. Suitability requirements apply to variable insurance products so it makes sense to apply them to fixed life insurance and annuity products as well. After receiving training about all the nuances of life insurance and annuity products, one probably realizes that different products were created because people have various types of needs. In order to assure that the annuity product an agent recommends is suitable for any one client, he or she must take several pieces of information into consideration during the interview and application process.

Fact Finding Assessing Annuity Suitability

The more complicated the annuity product, the greater the chance that a client may not understand it fully so the agent must be prepared to explain all facets of the product to the client whether the client is elderly or young or middle-age. Suitability demands that producers recommend only those products with which they are familiar and that they can explain easily. In addition, they should be able to discuss the financial strength and track record of the issuing insurers. The criteria for assessing annuity suitability with seniors is of utmost importance for the agent to consider. Making suitable recommendations requires an educated agent to blend comprehensive knowledge with the needs of the prospective client. Purchasing an annuity should entail looking at a senior's total financial picture, both today and into the future as well. A thorough fact-finding and objective-setting session will take an agent a long way toward finding a suitable product for a client. Agents must continually seek to obtain additional product knowledge so they can match their products to the clients' needs.

- ***Criteria 1*** -- The senior's financial status;
- ***Criteria 2*** -- The senior's tax status;
- ***Criteria 3*** -- The senior's investment objectives;

According to California Insurance Code (§785), agents owe a prospective client aged 65 or older a duty of honesty, good faith and fair dealing. The Department Of Insurance wants agents to assist seniors to make informed buying decisions. To accomplish this, agents have an implied responsibility to provide full disclosure including advantages and disadvantages for the clients situation.

Suitability of Riders
LTC riders on annuity contracts are usually more limited than conventional LTC policies on the market today and may also be subject to different, often stricter, coverage triggers. When working with seniors, a number of factors should be considered when evaluating annuities with LTC riders.

- With a non-medically underwritten rider your client's life expectancy should be longer than the waiting period on the rider otherwise the rider may not be suitable since the likelihood of accessing benefits diminishes.
- If your client is considering an annuity with a LTC rider in place of conventional long-term care insurance, take the time to explain the differences between the two.
- These riders do not participate in California's Partnership for Long-Term Care Program.

Clients who purchase an annuity with a long-term care rider will not be eligible for expanded asset protection from Medi-Cal, as well as other consumer safeguards in a Partnership Policy.

Continuing To Pursue Suitability
Accurately identifying customers' needs, circumstances and objectives will help an agent recommend appropriate products to customers. Over time though their situations may change significantly, and the products that an agent has suggested earlier may no longer match their new condition as well. The agent has professional obligation to periodically review the status of clients and their products, and will thus improve the relationship with them and possibly create opportunities for additional sales. When financial circumstances change for a client, he or she will concentrate on what is most important. That important item may not be an annuity product particularly if he or she has just had a new baby, a new job or a financial windfall. However, as the agent keeps in touch with the client on a regular basis, he or she will be able to provide them with necessary advice when their needs change and possibly gain additional business if they need to purchase additional products.

Even though this may seem a bit obsessive, The suitability of an annuity product must be assessed from the day it is purchased to the time the customer realizes the benefits from the product by reassessing things periodically to make sure circumstances and products continue to match.

Senior Protection In Annuity Transactions Model Act
The purpose of this Act is to promote sales practices in the life insurance industry that result in recommendations to consumers aged 65 years or older on transactions involving annuity products that meet the insurance needs and financial objectives of senior consumers. The provisions of this Act shall apply to all recommendations by an insurer or an insurance producer to a consumer aged 65 years or older on the sale, surrender or other disposition of a fixed or variable annuity, and to recommendations of a series of insurance transactions, including the replacement of a life insurance policy, where at least one of the transactions recommended is the sale, surrender or other disposition of an annuity. Nothing herein shall be construed to create or imply a private cause of action for a violation of this Act.

Section 3 – Recommendations -- Prior to recommending a transaction involving an annuity to a senior consumer, an insurer or an insurance producer shall obtain relevant information from the senior consumer. Recommendations of transactions by insurers and by insurance producers shall assist the senior consumer in meeting the senior consumer's insurance needs and financial objectives. Insurers shall establish and effectuate policies and procedures to carry out the purposes of this Act.

Section 5 --Duties of Insurers and of Insurance Producers -- The following items are the recommendation standards for insurers and insurance producers:

- Prior to recommending a transaction involving an annuity to a senior consumer, an insurer and an insurance producer shall make every effort to obtain relevant information from the senior consumer.

- An insurer and an insurance producer shall make recommendations only of transactions that are appropriate to assist the senior consumer to meet the particular senior consumer's insurance needs and financial objectives.
- An insurer and an insurance producer shall not make a recommendation unless the insurer and the insurance producer comply with the standards, guidelines, procedures and data collection processes established by the insurer under Subsection B(2)(a) to (c) of this section.

Insurer Sales Supervision Standards

- An insurer shall establish and maintain a compliance program.
- An insurer's compliance program shall include at least the following:

  - Data collection processes implemented by the insurer, such as fact-finding tools, consumer information forms, product applications, or other appropriate means that are designed to obtain relevant information concerning a senior consumer's insurance needs and financial objectives;
  - Enforcement of standards for appropriate discipline of insurer employees, insurance producers or vendors who violate, permit the violation of, or fail to report to the insurer violations of this regulation;
  - Guidelines and procedures implemented by the insurer designed to ascertain a senior consumer's insurance needs and financial objectives;
  - Knowledgeable staff responsible for assessing the insurer's and the insurance producer's compliance with the recommendation standards pursuant to Section 5A of this regulation pertaining to the appropriateness of recommendations in light of senior consumers' insurance needs and financial objectives;
  - Review by the insurer of recommendations to senior consumers to determine whether the recommendations comply with the standards developed and implemented by the insurer and comply with this regulation and to decline proposed transactions that would not comply;
  - Procedures that require producers to make reasonable efforts to obtain relevant information to be used in making recommendations to a senior consumer;
  - Procedures for insurance producer training, and documented assurance of producer attendance, on the requirements of this regulation and the guidelines and procedures of the insurer, including the obligation to collect and analyze relevant information to help determine a senior consumer's insurance needs and financial objectives;
  - Standards complying with Section 5A(2) of this regulation for determining whether recommendations meet senior consumers' insurance needs and financial objectives;
  - Systems and controls that are designed to provide assurance that management of the insurer will detect insurer and insurance producer practices that do not comply with the standards, guidelines, procedures and data collection processes established by the insurer in accordance with this regulation;
  - Systems, controls and standards for taking prompt action to correct violations and provide restitution to consumers;
  - Staffing to carry out the functions require here.

Section 7 -- [Optional] Recordkeeping -- Insurers or insurance producers shall maintain records of the relevant information and the recommendations that were the basis for insurance transactions for [insert number] years after the insurance transaction is completed by the insurer. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

Section V
Policy Cancellation and Refunds & Legal and Ethical Obligations

Policy Cancellation
§10127.10 (a) of the California Insurance Code states that every policy of individual life insurance and every individual annuity contract that is initially delivered or issued for delivery to a senior citizen in this state on and after July 1, 2004, shall have printed thereon or attached thereto a notice stating that, after receipt of the policy by the owner, the policy may be returned by the owner for cancellation by delivering it or mailing it to the insurer or agent from whom it was purchased. The period of time set forth by the insurer for return of the policy by the owner shall be clearly stated on the notice and this period shall be not less than 30 days. The owner may return the policy to the insurer by mail or otherwise at any time during the period specified in the notice. During the 30-day cancellation period, the premium for a variable annuity may be invested only in fixed-income investments and money-market funds, unless the investor specifically directs that the premium be invested in the mutual funds underlying the variable annuity contract. Return of the policy within the 30-day cancellation period shall have one of the following effects:

- In the case of individual life insurance policies and variable annuity contracts for which the owner has not directed that the premium be invested in the mutual funds underlying the contract during the cancellation period, return of the policy during the cancellation period shall have the effect of voiding the policy from the beginning, and the parties shall be in the same position as if no policy had been issued. All premiums paid and any policy fee paid for the policy shall be refunded by the insurer to the owner within 30 days from the date that the insurer is notified that the owner has canceled the policy. The premium and policy fee shall be refunded by the insurer to the owner within 30 days from the date that the insurer is notified that the owner has canceled the policy.
- In the case of a variable annuity for which the owner has directed that the premium be invested in the mutual funds underlying the contract during the 30-day cancellation period, cancellation shall entitle the owner to a refund of the account value. The account value shall be refunded by the insurer to the owner within 30 days from the date that the insurer is notified that the owner has canceled the contract.

§10127.10 of the California Insurance Code creates new free-look language affecting variable annuities. By default, all premiums paid for a variable annuity will be allocated to fixed-income investments and money market funds during the free-look. This assures that all premiums paid will be refunded during the free-look period if the senior has a change of mind or circumstances. The only exception to this is that the investor may direct the premium to be invested into the variable annuity's subaccounts immediately.

§10127.10 (b) of the California Insurance Code states that this section applies to all individual policies issued or delivered to senior citizens in California on or after January 1, 2004. All policies subject to this section, which are in effect on January 1, 2003, shall be construed to be in compliance with this section, and any provision in any policy, which is in conflict with this section shall be of no force or effect. §10127.10 (c) of the California Insurance Code states that every individual life insurance policy and every individual annuity contract, other than variable contracts and modified guaranteed contracts, subject to this section, that is delivered or issued for delivery in this state shall have the following notice either printed on the cover page or policy jacket in 12-point bold print with one inch of space on all sides or printed on a sticker that is affixed to the cover page or policy jacket:

IMPORTANT

YOU HAVE PURCHASED A LIFE INSURANCE POLICY OR ANNUITY CONTRACT. CAREFULLY REVIEW IT FOR LIMITATIONS.

THIS POLICY MAY BE RETURNED WITHIN 30 DAYS FROM THE DATE YOU RECEIVED IT FOR A FULL REFUND BY RETURNING IT TO THE INSURANCE COMPANY OR AGENT WHO SOLD YOU THIS POLICY. AFTER 30 DAYS, CANCELLATION MAY RESULT IN A SUBSTANTIAL PENALTY, KNOWN AS A SURRENDER CHARGE."

The phrase "after 30 days, cancellation may result in a substantial penalty, known as a surrender charge" may be deleted if the policy does not contain those charges or penalties. 10127.10 (d) of the California Insurance Code states that every individual variable annuity contract, variable life insurance contract, or modified guaranteed contract subject to this section, that is delivered or issued for delivery in this state, shall have the following notice either printed on the cover page or policy jacket in 12-point bold print with one inch of space on all sides or printed on a sticker that is affixed to the cover page or policy jacket:

IMPORTANT

YOU HAVE PURCHASED A VARIABLE ANNUITY CONTRACT (VARIABLE LIFE INSURANCE CONTRACT, OR MODIFIED GUARANTEED CONTRACT). CAREFULLY REVIEW IT FOR LIMITATIONS.

THIS POLICY MAY BE RETURNED WITHIN 30 DAYS FROM THE DATE YOU RECEIVED IT. DURING THAT 30-DAY PERIOD, YOUR MONEY WILL BE PLACED IN A FIXED ACCOUNT OR MONEY-MARKET FUND, UNLESS YOU DIRECT THAT THE PREMIUM BE INVESTED IN A STOCK OR BOND PORTFOLIO UNDERLYING THE CONTRACT DURING THE 30-DAY PERIOD. IF YOU DO NOT DIRECT THAT THE PREMIUM BE INVESTED IN A STOCK OR BOND PORTFOLIO, AND IF YOU RETURN THE POLICY WITHIN THE 30-DAY PERIOD, YOU WILL BE ENTITLED TO A REFUND OF THE PREMIUM AND POLICY FEES. IF YOU DIRECT THAT THE PREMIUM BE INVESTED IN A STOCK OR BOND PORTFOLIO DURING THE 30-DAY PERIOD, AND IF YOU RETURN THE POLICY DURING THAT PERIOD, YOU WILL BE ENTITLED TO A REFUND OF THE POLICY'S ACCOUNT VALUE ON THE DAY THE POLICY IS RECEIVED BY THE INSURANCE COMPANY OR AGENT WHO SOLD YOU THIS POLICY, WHICH COULD BE LESS THAN THE PREMIUM YOU PAID FOR THE POLICY. A RETURN OF THE POLICY AFTER 30 DAYS MAY RESULT IN A SUBSTANTIAL PENALTY, KNOWN AS A SURRENDER CHARGE."

The words "known as a surrender charge" may be deleted if the contract does not contain those charges. §10127.10 (e) of the California Insurance Code states that this does not apply to life insurance policies issued in connection with a credit transaction or issued under a contractual policy-change or conversion privilege provision contained in a policy. Additionally, this section shall not apply to contributory and noncontributory employer group life insurance, contributory and noncontributory employer group annuity contracts, and group term life insurance, with the exception of subdivision (f). §10127.10 (f) of the California Insurance Code states that when an insurer, its agent, group master policyowner, or association collects more than one month's premium from a senior citizen at the time of application or at the time of delivery of a group term life insurance policy or certificate, the insurer must provide the senior citizen a prorated refund of the premium if the senior citizen delivers a cancellation request to the insurer during the first 30 days of the policy period. §10127.10 (g) of the California Insurance Code states that for purposes of this chapter, a senior citizen means an individual who is 60 years of age or older on the date of purchase of the policy.

§10509.6 of the California Insurance Code states that every life insurer that uses an agent in a life insurance or annuity sale shall do the following:

- §10509.6 (a) of the California Insurance Code requires that with or as part of each completed application for life insurance or annuity, a statement signed by the agent as to whether he or she knows replacement is or may be involved in the transaction.
- §10509.6 (b) of the California Insurance Code states that where a replacement is involved:
    - Require from the agent with the application for life insurance or annuity: (i) a list of all of the applicant's existing life insurance or annuity to be replaced, and (ii) a copy of the replacement notice provided the applicant pursuant to Section §10509.4. The existing life insurance or annuity shall be identified by name of insurer, insured, and contract number. If a number has not been assigned by the existing insurer, alternative identification, such as an application or receipt number shall be listed.
    - Send to each existing life insurer a written communication advising of the replacement or proposed replacement and the identification information obtained pursuant to this section and a policy summary, contract summary, or ledger statement containing policy data on the proposed life insurance or annuity. Cost indices and equivalent level annual dividend figures need not be included in the policy summary or ledger statement. This written communication shall be made within three working days of the date the

application is received in the replacing insurer's home or regional office, or the date the proposed policy or contract is issued, whichever is sooner.

Every existing life insurer or the insurer's agent that undertakes a conservation shall, within 20 days from the date the written communication plus the materials required in subdivisions (1) and (2) are received by the existing insurer, furnish the policyowner with a policy summary for the existing life insurance or ledger statement containing policy data on the existing policy or annuity. Information relating to premiums, cash values, death benefits, and dividends, if any, shall be computed from the current policy year of the existing life insurance. The policy summary or ledger statement shall include the amount of any outstanding indebtedness, the sum of any dividend accumulations or additions, and may include any other information that is not in violation of any regulation or statute. Cost indices and equivalent level annual dividend figures need not be included. When annuities are involved, the disclosure information shall be that in the contract summary.

§10509.6 (c) of the California Insurance Code states that the replacing insurer may request the existing insurer to furnish it with a copy of the summaries or ledger statement, which shall be within five working days of the receipt of the request. The replacing insurer shall maintain evidence of the "notice regarding replacement," the policy summary, the contract summary, and any ledger statements used, and a replacement register, cross-indexed by replacing agent and existing insurer to be replaced. The existing insurer shall maintain evidence of policy summaries, contract summaries, or ledger statements used in any conservation. Evidence that all requirements were met shall be maintained for at least three years.

Free Look For Persons 60 Years and Older

The "Free Look" period is for a policyholder to consider a policy to determine if he or she is satisfied or not satisfied with an annuity policy after they receive it. An individual has 10 days to review the policy and return it if not satisfied. Under the "Free Look" period, policyholders have 20 days to review an individual fixed dollar policy being offered as a replacement for an annuity contract with an insurer or insurer group other than the one which issued the original policy. Under the "Free Look" Period, policyholders have 45 days to review an individual fixed dollar policy being offered as replacement for an existing insurance or annuity contract with the same insurer or insurer group. life insurance, variable life insurance, annuities, variable annuities, and endowments are now included for "Free Look" provisions on replacement. "Free Look" periods are 10 days for a new issue, 20 days when replacing another insurer's policies, and 45 days when the company replaces its own business. The free look provisions (CIC §786) apply to persons 60 years and older and do not apply to contracts sold through group plans.

In California, a senior citizen investor (age 60 and above) in variable contracts receives special consideration during the 30-day free look period. During this 30-days. the premium for a variable annuity may be invested only in fixed-income investments and money-market funds. This assures that upon a cancellation of the contract the owner will be refunded all premiums in full, as though the contract was never purchased. Where the senior investor has specified his funds immediately invested in mutual funds, a cancellation will entitle him to a refund of the account value (which may have gone up or down) within 30 days.

Policy Refunds

The new law makes it easier for seniors to receive a full refund if they cancel an annuity contract within 30 days after purchase. While the old law provided for a 30-day "free look" period, the new law states that the annuity must be invested in fixed-income accounts during this 30-day period, so that a full refund can be made. A senior can waive this provision, but if the provision is waived and the annuity is invested in variable accounts, the senior might receive only a partial refund. For this provision, a "senior" is someone age 60 or older.

§ 789.9 (a) & (b) of the California Insurance Code states that in addition to any other reasons that a sale of an individual annuity to a senior may violate any provision of law, an annuity shall not be sold to a senior in the event that a fixed annuity is issued to a senior, the issuer shall rescind the contract and refund to the purchaser all premiums, fees, any interest earned under the terms of the contract, and costs paid for the annuity. This remedy shall be in addition to any other remedy that may be available.

§10509.6. (d) of the California Insurance Code states that the replacing insurer shall provide in its policy or in a separate written notice which is delivered with the policy that the applicant has a right to an unconditional refund of all premiums paid which right may be exercised within a period of 30 days commencing from the date of delivery of the policy. In the case of variable annuity contracts, variable life insurance contracts, and modified guaranteed contracts, return of the contract during the cancellation period shall entitle the owner to a refund of account value and any policy fee paid for the policy. The account value and policy fee shall be refunded by the insurer to the owner within 30 days from the date that the insurer is notified that the owner has canceled the policy.

Legal and Ethical Obligations

Legislation in California has changed the marketing and safety of annuities since 1993 in an effort to keep up with the increased marketing of annuities especially to seniors. All too common abuses occur over and over again when working with the elderly and their money. The most recent legislation was a reaction to misconduct by a few people who convinced senior using scare tactics to motivate the seniors into purchasing often, unsuitable products. Hundreds of millions of dollars of consumer money was directed into annuities that were typically not suitable or liquid and some of the targeted consumers were not even capable of handling their own affairs due to age and illness. Unfortunately there were organizations training licensed representatives on how to take advantage of seniors and to treat seniors as though they simply were stupid. One of the other scams would get people to complete a trust and then the personal information acquired from establishing the trust would be used to help market unsuitable deferred annuities to the same people.

The California Department of Insurance is aware of a number of unlawful marketing schemes designed to accomplish the sale of annuities principally to senior citizens through the use of misrepresentation of identity and/or purpose. The initial approach to clients may be to solicit senior citizens at “seminars,” purportedly to educate participants about the benefits of living trusts, retirement planning, long term nursing care and explanations of Medicare Part D. The initial approach may be made to senior citizens through mass mailing, telemarketing, door-to-door solicitation, or even while providing entertainment at senior related functions. Sometimes high CD rates or reverse mortgages are offered in newspaper ads or in banks in a classic bait and switch. Seniors characteristically perceive the agent as a legal advisor or estate planner and not as an insurance agent because the representatives misrepresent themselves as experts in the initial subject area. Because of this perception that the salesperson has their best interests in mind, seniors may conclude that they need not totally understand what the pros and cons of an annuity are for their specific situation nor the impact of surrender penalties on their net worth, or far-off annuitization dates on their liquidity, or the sale of an annuity or other investment to buy the annuity offered on the taxes they will owe.

The customer should be verbally cautioned to get independent legal or financial advice, especially before he or she sells or liquidates any holdings to purchase an annuity. This admonition is in addition to the written warning mandated by the Insurance Code. This laborious process of education and disclosure should lead to fewer unsuitable annuity sales and more satisfied customers. But insurers can still do more to catch errors and protect themselves and their customers.

The NASD, like the Insurance Commissioner, recommends that insurers develop systems for reviewing applications, rather than only written practices and policies for producers to follow. Running the application through a computer system loaded with a "suitability rules engine" that will automatically "red flag" problematic applications is an effective first screen. Certainly the insurer should review these "kicked-out" applications and investigate further if there appears to be missing or unusual information in the application. In these cases, close review of the customer questionnaire and disclosures made will be necessary. But computers alone cannot provide detection of all unsuitable sales. Yes, these are guidelines for suitability but it also falls in the category of legal and ethical – particularly ethical. A best practice system for review of annuity sales must include more than review of the computer-flagged applications. Of course, a multi-state insurer should ensure that all the producers selling its insurance products in California are licensed in the state.

789.8 (b) of the California Insurance Code states that if a life agent offers to sell to an elder any life insurance or annuity product, the life agent shall advise an elder or elder's agent in writing that the sale or liquidation of any stock, bond, IRA, certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of this product may have tax consequences, early withdrawal penalties, or other costs or penalties as a result of the sale or liquidation, and that the elder or elder's agent may wish to consult independent legal or financial advice before selling or liquidating any assets and prior to the purchase of any life or annuity products being solicited, offered for sale, or sold.

Legal Authority

Unfair marketing and sales tactics in certain circumstances may be criminal elder abuse under Welfare and Institutions Code section 115610.30(a)(2). The Insurance Code prohibits: (1) churning and twisting—misleading claims or material omissions leading to the replacement of insurance products (Ins. Code sections 781 and 10509.8); and (2) lead-generating gambits or advertisements that are misleading (Ins. Code section 787). Moreover, under Insurance Code section 785, dealings with seniors require a heightened duty of honesty, integrity and fair dealing. The Commissioner, along with other state and local officials, is determined to stop these fraudulent practices by pursuing all appropriate administrative, civil and criminal enforcement remedies necessary to the task. These sections may apply to insurers as well as agents, and certainly insurers may be parties in any enforcement action if an agent participates in any activities set forth in Insurance Code sections 790.03. Insurers should clearly define the high standard of fair dealing expected of agents when working with seniors. Insurers should review and approve solicitation materials and techniques. Insurers may be subject to suspension of a certificate of authority under Insurance Code section 704 or fine under section 704.7 if an insurer permits its life agents to engage in deceptive marketing schemes.

AB 2107 (Scott, Chapter 442), Elder Abuse:

- imposes the duty of honesty, good faith, and fair dealing on insurers, brokers, agents, and others engaged in the business of Medicare supplemental insurance and long-term care insurance with respect to prospective policyholders. This bill would only permit life agents, on or after July 1, 2001, to sell or offer for sale to an elder or his or her agent any financial product on the basis of the product's treatment under Medi-Cal after providing the elder or his or her agent with a specified disclosure, in writing, explaining the resource and income requirements of the Medi-Cal program, including, but not limited to, certain exempt resources, certain protections against spousal impoverishment, and certain circumstances under which an interest in a home may be transferred without affecting Medi-Cal eligibility. The bill would exclude from the application of these disclosure provisions credit life insurance, as defined.
- requires the State Bar to make a report, by December 31 of each year, to the Legislature on the provision of financial services by lawyers to elders, as specified. The report would include the number of complaints filed and investigations initiated, the type of charges made, and the number and nature of disciplinary actions taken by the State Bar.
- revises the definition of existing law that defines financial abuse for the purpose of reporting and investigating elder and dependent adult abuse.

Section VI
Keeping The Annuity Sale Suitable For The Consumer

The annuity business long has been criticized by regulators and consumer advocates for misrepresenting its products and preying on senior citizens. Now a number of states, including California, are implementing laws that would increase the oversight and scrutiny of some annuity sales. Special emphasis is being paid to provisions that limit the amount of time annuity sellers can impose penalties -- so-called surrender charges -- for canceling an annuity contract early. Other proposed laws impose additional requirements on companies to make sure they are selling annuities only to "suitable" investors.

There is growing pressure at the federal and state level to curb abusive sales practices in the trillion-dollar annuity industry.

Challenges For Consumers and Annuity Sales Personnel

The explosive growth of sales in fixed annuity products has brought new attention to the sales and marketing of these products. With millions of Americans looking for financial products that meet their need for income and security during retirement, it is critical for the industry to have in place stringent standards for suitability of sales so that consumers can make appropriate buying decisions. Some of the challenges for the fixed annuity marketplace include the following items.

Appropriate Disclosures

Making sure the customer receives the proper disclosures at the point of sale is essential. Many companies have developed standard disclosure forms to help their sales staff provide this important information. Some groups have been exploring a universal disclosure form that could help standardize the information consumers receive.

Suitable Sales

Annuities can be complex products requiring adequate education and explanation so that consumers know they are getting an appropriate product to meet their individual needs. A careful needs-based analysis of a consumer's long-term financial goals and needs should be conducted to assure that a sale is suitable.

Supervision and Monitoring

Another important element of suitable sales is the proper supervision and monitoring of the sales force. Companies should have in place a set of rigorous standards for their sales force – standards that are measured and enforced. An important element of a company's compliance program should be adequate, up-to-date training for the field force and those in other distribution channels.

Various Distribution Channels

Fixed annuities are distributed through a variety of sales channels that can create a challenge for the insurance company and the consumer. It's important for companies to have in place policies and procedures to help assure that sales are being conducted properly no matter who is making those sales.

Industry Regulations

Senior Protection in Annuity Transactions Model Regulation ("Suitability Model") was adopted by the NAIC in 2003. This new model was another tool that regulators could use to protect consumers from inappropriate sales practices in addition to the NAIC's Annuity Disclosure Model Regulation. The Suitability Model imposes certain duties and responsibilities on insurers and insurance producers regarding the suitability of a sale or exchange of an annuity to a consumer. Specifically, in recommending to a consumer the purchase of an annuity or the exchange of an annuity, the insurance producer, or the insurer if no producer is involved, must have reasonable grounds for believing that the recommendation is suitable for the consumer.

To ascertain the product's suitability, prior to the execution of a purchase or exchange of the recommended annuity, the insurance producer, or insurer if no producer is involved, must make all reasonable efforts to obtain information concerning: (1) the consumer's financial status; (2) the consumer's tax status; (3) the consumer's investment objectives; and (4) any other information used or considered to be reasonable in making the recommendation to the consumer.

Ensuring Compliance
To ensure compliance with these requirements, an insurer must establish and maintain a system of supervision that includes maintaining written procedures and conducting periodic reviews of its records that must be reasonably designed to assist in detecting and preventing violations of the model.

Consumer Considerations
Purchasing life and annuity products is often a complicated and confusing process for consumers of all ages, not just for seniors. There are many factors a consumer should consider before purchasing any insurance or financial product including a company's financial strength and commitment to ethical business practices. High standards in the marketplace are essential for consumers and to promote healthy competition. In 2006, IMSA also put into place enhanced suitability standards for all annuity sales that incorporate the essential elements of the NAIC model for suitability. Again, these standards apply nationally to IMSA companies no matter where they are domiciled or sell their products and protect consumers purchasing products from IMSA-qualified companies.

All consumers should verify that they are dealing with a licensed agent when purchasing an annuity by following three simple steps: Before buying an annuity, they should stop, call their state insurance department, and confirm that the producer is properly licensed.

When it comes to annuities, inappropriate sales practices can occur in many ways and come from a variety of sources. Anyone can be a victim, but senior citizens remain a prime target. Below are a few ways which anyone can use to protect himself or herself:

- Always review the contract before deciding to buy an annuity -- Terms and conditions of each annuity contract will vary.
- Understanding the long-term nature of the purchase -- An annuity should be kept long enough so the charges do not take too much of the money invested.
- Compare information for similar contracts from several companies -- Comparing products may help one to make a better decision.
- An explanation of anything not understood.
- Quality of service -- Important factor in making a decision.
- Current license of company and agent --In order to sell insurance in your state, companies and agents must be licensed with the state insurance department.
- Company's credit rating -- Legitimate insurers have their "creditworthiness" rated by independent agencies such as Standard & Poor's, A.M. Best Co. or Moody's Investors Services. An "A+++" or "AAA" rating is a sign of a company's strong financial stability.
- The proof is in the paperwork -- Keeping detailed records after research is complete will assist in making the purchase of any particular policy

Evaluating The Suitability of An Annuity
To find out if an annuity is right, the consumer needs to think about what his or her financial goals are for the future and analyze the amount of money to invest in an annuity on an ongoing basis. Annuities should not be purchased to reach short-term financial goals. The following questions could be asked in order to find out if it is of benefit to the consumer:

- How much retirement income will I need in addition to what I will get from Social Security and my pension plan?
- Will I need supplementary income for others in addition to myself?
- How long do I plan on leaving money in the annuity?
- When do I plan on needing income payments?
- Will the annuity allow me to gain access to the money when I need it?
- Do I want a fixed annuity with a guaranteed interest rate and little or no risk of losing the principal?

- Do I want a variable annuity with the potential for higher earnings that aren't guaranteed and the possibility that I may risk losing principal?
- Or, am I somewhere in between and willing to take some risks with an equity-indexed annuity?

Some state officials, organizations and consumers have voiced concern that not all annuity sales are suitable, given a client's financial circumstances. One response to this concern is the NAIC's development of the Senior Protection in Annuity Transactions Model Regulation. The stated purpose of this regulation is to "ensure that the insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed." To achieve this purpose the regulation places a duty on the broker to demonstrate that he or she has "reasonable grounds for believing that the recommendation is suitable" for a particular client, based on facts disclosed by the client "as to his or her investments and other insurance products and as to his or her financial situation and needs."

Generally speaking, something is suitable if it is appropriate to a purpose or an occasion. In the world of annuity sales, it can probably be identified by affirmatively answering the question:
Does this annuity make sense for this individual, given his unique financial background and investment objectives? Most adopted regulations identify types of information that the broker should obtain prior to the sale or exchange of an annuity. The list includes information concerning the client's

- financial status,
- tax status,
- investment objectives, and
- any other information "used or considered to be reasonable by the insurance producer" in making a recommendation.

There are protections for the broker — for example, if a client provides you with incorrect or incomplete information. Keep in mind, however, if a client does not want to discuss the appropriateness of an annuity, it's likely advisable to tread carefully**.** As a client should be wary of a broker who is making a sales pitch before understanding his goals and needs, so should a broker be wary of a client who is not forthcoming about goals and needs.
The flip side to your understanding the client's background is the client's understanding of the particular annuity being proposed — its product features, expenses, charges, etc.

Tracking Annuity Sale Abuses
There is no doubt that abuses do exist and that state and federal officials entrusted with the responsibility of protecting consumers must remain vigilant in their oversight of annuity sales. To this end, the NAIC continues to track trends and provide insurance regulators and consumers with the tools they need to identify and stop unfair practices. In addition, Insurance Commissioners and the NAIC have issued a Consumer Alert to warn senior citizens about abusive sales practices and to urge them to be sure that they fully understand the product they are purchasing before signing the contract.

Annuities will play a vital role in the financial plans of tomorrow's retirees and will continue to grow as a way of providing Americans' retirement security. It is critical that these products be matched with the needs of the consumer.

----- End of course -----