Consumer Counselor

Insurance Information for Michigan Consumers

Know What You Are Getting When You Buy an Annuity

An annuity is a financial product sold by an insurance company. It involves a contract between you and the insurance company that outlines the terms and conditions of the annuity. Annuities are generally used to accumulate tax-deferred savings under which you make a lump-sum payment, or series of payments, to the insurance company. In return, the insurer agrees to make periodic payments to you beginning immediately or at a future date. This publication will provide you with information on various annuity products and what you should know before buying an annuity.

Types of Annuities
Annuities are typically purchased through a financial services provider who is licensed and registered to sell annuities and other insurance-related products. They are considered experts on the annuity products they recommend and sell to their customers. The following are types of annuity products:

- Fixed-Rate Annuity
  The insurance company agrees to pay the contract holder no less than a specified rate of return for a pre-determined period.

- Indexed Annuity
  The insurance company credits the contract holder with a return that is based on changes in an index, such as the S&P 500 Index. Indexed annuity contracts also provide that the contract value will be no less than a specified minimum, regardless of the performance of the underlying index.

- Variable Annuity
  A variable annuity offers sub-accounts or mutual funds through which the contract holder can invest in the stock and bond markets. The rate of return, and the value of the annuity, are "variable" and dependent upon the performance of the underlying investments selected. Variable annuities are regulated by DIFS and the Securities and Exchange Commission (SEC).

Costs and Payments
Annuities are generally used to accumulate tax-deferred savings under which you make a lump sum payment, or series of payments, to the insurance company. This is often referred to as the "accumulation phase." In return, the insurer agrees to make periodic payments to you beginning immediately or at a future date. This process is referred to as "annuitization:" the process of converting your annuity into a series of periodic income payments.

You should not annuitize your annuity without careful consideration. Once you decide to annuitize, you cannot reverse your decision. There is no flexibility to increase or decrease the payments or extend or shorten the length of time payments are made. You cannot make any lump-sum withdrawals either.

There are different options for how long payments will continue:

1. Annuity Certain - An option in which you receive payments for a certain period, for example, 10, 15 or 20 years. If you die prior to the ending of the period, your beneficiary(ies) will receive payments until the payment term ends.

2. Life Annuity - Under the Life Annuity, you have four pay-out options:
   - Straight Life – pays until you die;
   - Life Annuity with Period Certain - pays until you die or for a specified time period, whichever is longer;

- Life Annuity with Refund - pays until you die. Your beneficiary(ies) are guaranteed to get a portion of the money the annuitant paid into the annuity returned as a lump sum (as long as the amount paid out to the annuitant didn't exceed the paid-in amount);
- Life Annuity with Joint and Survivorship – pays until the annuitant dies and the spouse continues to receive payments until their death.

Attributes and Benefits

The general attributes (features) and benefits of annuities include: guarantee of principal, tax deferral, death benefits and income benefits. These benefits are referred to as "riders" that bring additional costs to the contract. As a result, annuities typically carry higher overall expenses than mutual funds, for example. Annuities also carry surrender charges that can last for several years.

Many insurance companies offer attractive riders and bonuses, but it can be confusing how the bonuses are credited and what happens to the value of the annuity if the insured passes away or terminates the policy. It is important that you understand how these riders and bonuses work. This begins with understanding that annuities featuring certain riders have two different values: a contract value and an income value.

- Contract Value
  The contract value is the money you initially invest. If you terminate the annuity contract, the contract value is the amount the insurance company would give back to you, minus any surrender charges or withdrawals you have taken over the life of the annuity.
- Income Value
  The income value is the number the insurance company will use to calculate how much money you'll receive when you decide to use the rider (most often associated with a "Guaranteed Lifetime Income Benefit Rider"). Essentially, the income value is a multiplier used to calculate the monthly annuity payment. You do not receive the income value if you surrender the annuity and your beneficiaries do not receive the income value upon your death. Bonuses associated with the rider only apply to the income value.

Is an Annuity Right for You?

Only when you are fully informed about the annuity's features and benefits, the costs of the benefits or "riders," all other fees and expenses, the liquidity provisions, and the surrender charges, are you prepared to answer the question of whether an annuity is right – or not right – for you.

It is important to read your annuity contract and understand its terms. Do not be afraid to ask questions if there is something you do not understand. Michigan requires an insurance company to allow for a 10-day "free look" period after its initial delivery wherein you may terminate the annuity and receive a full refund.

A checklist to help you decide if an annuity may be right for you follows on the next page. If you have additional questions about annuities, contact the Department of Insurance and Financial Services (DIFS) at the address or telephone number listed below.

About DIFS

The mission of the Michigan Department of Insurance and Financial Services (DIFS) is to work to provide a business climate that promotes economic growth while ensuring that the insurance and financial services industries are safe, sound and entitled to public confidence. DIFS provides consumer protection, outreach and education services to Michigan citizens. It strives to create and maintain active relationships with both consumers and licensees in the insurance and financial services industries to ensure adequate protections while fostering growth, strength and sustainability.

For more information please contact the Department of Insurance and Financial Services at 877-999-6442 or visit www.michigan.gov/difs.

Annuity Checklist

First, contact DIFS, the insurance regulator for the state of Michigan, and confirm the following:

- ✓ The insurance company is registered and licensed with DIFS.
- ✓ The insurance product being recommended is registered with DIFS.
- ✓ The soliciting agent/advisor is registered with DIFS and has the proper licenses to sell insurance products in Michigan.

Second, ask your financial services provider to provide you with the following details:

- Confirm the financial rating of the issuing insurance company.
- Know the annuity's features, benefits and caveats.
- Fixed annuity: Know the "floor" or guaranteed minimum interest rate.
- Fixed annuity: Know how and when the new rate is declared and the terms.
- Variable annuity: Evaluate the diversity of the sub-account options and performance.
- Indexed annuity: Know the "participation rate" or "cap rate."
- Know the total annual management fees by percentage and all other expenses and "rider" costs.
- Know the tax treatment for accumulated growth and withdrawals.
- Know the length of the contract (in years).
- Know the year-by-year surrender charges.
- Know the terms for penalty-free withdrawals.

Completing the annuity checklist requires gathering a lot of information and knowing the meanings of a lot of terms. Make it the responsibility of the provider recommending the annuity to provide you with the information and explanations necessary for completing this checklist. You only need to get the information - not do the work. Remember, one of the purposes of a checklist is to ensure that information you gather, or that is provided to you, is complete and to an explicit level of detail so that you can make informed decisions.

One last thing to do is to ask the financial services provider recommending the annuity the following question: "In recognition of all the other types of investments and combinations of investments available to me, why is this annuity a suitable choice for me?" Get the answer in writing.

To find out if an insurance company, agency, or agent is licensed, or if you have other insurance questions, please contact DIFS toll-free at 877-999-6442 or visit the website at www.michigan.gov/difs.