

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 section will provide you with information on various annuity products and what you should know before buying an annuity.

Things to Consider When Buying an Annuity

Many insurance companies offer annuity products, and the annuity offerings between insurance companies can be quite different. The financial strength among insurance companies can be quite different, too. So an important 'first cut' in evaluating an annuity is the financial strength of the issuing company. Companies such as Standard & Poor's and AM Best provide independent ratings on the financial strength of insurance companies. These ratings are available through the insurance company or through a financial services provider.

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 securities and are regulated by 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.

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.

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.

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 do mutual funds, for example. Annuities also carry surrender charges that can last for several years.

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. Use the checklist to help you decide.

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 following details:

- Confirm the financial rating of 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 on 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 financial services 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, 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.