A Consumer Guide For Annuity Products in New York

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This guide provides information designed to help you understand annuity products sold in New York and some of the factors you should consider when purchasing an annuity.

What is an annuity?

An annuity can be defined as a contract between the owner and an insurer in which the insurer agrees to make periodic income payments, beginning either immediately (within 12 months) or at some future date (stated in the contract or selected by the owner). The payments are made for a specified period of time or the remainder of one or more lives. The lives on which payments depend are called *annuitants*. The owner is often the annuitant and the person to whom periodic payments are made.

Two Kinds of Annuities

There are two basic kinds of annuity contracts. An annuity is either an immediate annuity or a deferred annuity.

- **Immediate Annuity**. An immediate annuity is an annuity contract in which payments start within 12 months of the date of purchase. The immediate annuity is purchased with a single premium. The periodic payments are generally substantially equal and made monthly, quarterly, semi-annually or annually.
- **Deferred Annuity.** A deferred annuity is an annuity contract in which periodic income payments are not scheduled to commence for at least 12 months. Periodic payments are deferred until a maturity date stated in the contract or, if earlier, a date selected by the owner of the contract.

IMMEDIATE ANNUITY CONTRACTS

The most common annuity income payment options available under immediate annuity contracts include the following:

- **Straight Life Annuity**. Under this option, the insurer makes periodic payments for the annuitant's lifetime. An option based upon the annuitant's survival is called a life contingent option. The owner/annuitant cannot outlive the income payments.

- **Life Contingent with Period Certain**. Under this option, the periodic payments are made during the greater of the annuitant's lifetime or a specified period, such as 10 or 20 years. If the annuitant dies before the end of the specified period, a beneficiary receives the periodic payments for the remainder of the certain period.

- **Life Contingent with Refund Feature**. Under this option, the periodic payments are made during the annuitant's lifetime. If the annuitant dies before the sum of the periodic payments made date equals the premium paid, the excess is paid to the beneficiary either in cash or installments.

- **Joint & Survivor Annuity**. Under this option, there are two annuitants (called joint annuitants) and the periodic payments continue until the death of both annuitants. The income payment amount may continue at 100% when only one annuitant is alive or be reduced (50%, 66.67%,

75%) during the life of the surviving annuitant. Usually, joint annuitants are husband and wife.

- **Period Certain Annuity**. Under this option, the periodic payments are made for a specified period of time (e.g., 5, 10 or 20 years). The payments are payable to a beneficiary if the annuitant dies prior to the end of the specified period. Income payments will cease at the end of the period.

IMPORTANT IMMEDIATE ANNUITY FEATURES YOU SHOULD KNOW

- Income payments are usually payable in fixed dollar amounts, such as $100 per month, and do not provide protection against inflation.
  - Some immediate annuities provide inflation protection with periodic increases based upon a fixed rate (3%) or an index such as the Consumer Price Index ("CPI").
  - An annuity with a CPI adjustment will start with lower payments or require a higher initial premium, but it will provide at least partial protection from the risk of inflation.
  - In variable annuities, income payments fluctuate with the investment experience. Income payments remain constant if the investment performance (after all charges) equals the assumed investment return (AIR) stated in the contract. If the investment performance exceeds the AIR, payments will increase. If the investment performance is less than the AIR, payments will decrease.

- Immediate annuities generally do not permit partial withdrawals or provide for cash surrender benefits.

- However, some contracts provide access to cash through a commutation provision. This provision allows you to withdraw funds in exchange for a reduction or elimination of future periodic payments.

- Immediate annuities include a free look period of 10 to 30 days in which you can request the refund of your premium.

- Immediate annuities provide longevity protection if you select a life contingent income option.

- Persons with shorter-than-average life expectancy may qualify for higher annuity payments than standard rates would provide. Such persons should seek insurers that use substandard underwriting and consider the annuitant's health status in determining annuity income payments.

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FACTORS TO CONSIDER WHEN PURCHASING AN IMMEDIATE ANNUITY

There are many factors to consider when purchasing an immediate annuity contract.

- Do you have sufficient financial resources to meet your income needs without purchasing an annuity? In other words, can you manage and take systematic withdrawals from such resources, without fear of outliving your resources?

- If you are concerned with the risk of outliving your financial resources, then you should consider purchasing an immediate annuity at least in an amount sufficient to cover your basic living expenses.

The income payments under the life contingent immediate annuity income option you select are based upon your age, gender, mortality table used by the insurer and premium paid to the insurer. For some options, your health and marital status may be considered.

- A straight life annuity will provide a higher monthly income payment for a given premium than life contingent annuity with a period certain or refund feature. In other words, the cost of a specified income payment (e.g., $100 per month) will be higher for a life contingent annuity with a period certain or refund feature than for a straight life annuity.

- However, since payments cease upon the annuitant's death with a straight life annuity, the

owner / annuitant assumes the risk that only a small percentage of the premium paid will be received in periodic payments if the annuitant dies shortly after the purchase (or earlier than his or her life expectancy).

- You should compare the costs of the various income options in determining the income option that best suits your needs.

If an immediate annuity is purchased, the income option selected should be appropriate under the circumstances.

- For example, a person with a dependent spouse may want to consider a joint and survivor annuity.

- A person concerned with receiving a minimum return on his or her annuity premium may want to consider a life contingent option with a period certain or a refund feature.

- A variable immediate annuity is often chosen to keep pace with inflation during your retirement years. However, such option exposes the annuitant to additional investment risk because income payments can decline in a falling market.

DEFERRED ANNUITY CONTRACTS

As noted above, under deferred annuity contracts, the periodic income payments are deferred for a period of at least 12 months.

The periodic income payment amount is determined when the contract is purchased or a premium is paid in the case of a ***paid-up deferred annuity*** or at commencement of such payments (upon annuitization) based upon the amount of funds accumulated under the contract in the case of an ***accumulation annuity***.

The amount of the income payment depends on the premium paid for the paid-up deferred annuity and on the accumulation account for an accumulation annuity and on the annuity income option chosen.

Paid-up Deferred Annuity

A paid-up deferred annuity is an annuity contract in which each premium payment purchases a fixed dollar income benefit that commences on a specified date, such as a person's retirement date. The contracts do not maintain an account value.

- In the past, employers used this contract to fund employee retirement benefits. Each premium payment purchased a stream of income. At an employee's retirement, the income streams were added together. The employer could maximize the employee's retirement benefit if the contract did not provide for a death benefit or cash surrender benefit.

- Today, insurers are marketing a similar product, often referred to as ***longevity insurance***. The contracts are generally purchased at retirement (age 65) and income payments are not scheduled to commence for a specified time period, such as 20 years (at age 85). The contracts generally do not provide cash surrender benefits and may not provide a death benefit.
    - The premium cost for this product is much less than for an immediate annuity.
    - This contract allows a person to retain control over most of his or her other assets during retirement, while securing longevity protection.

Accumulation Annuity

An *accumulation annuity* is a deferred annuity contract in which premiums paid less expenses are accumulated in an account (during the contract's accumulation phase) and the accumulation amount is applied to purchase an annuity income option at a selected retirement age (during the payout phase). The most significant features of accumulation annuities include the following:

- *Account value.* Unlike a paid-up deferred annuity, an accumulation annuity maintains an account value which is used in determining all contract benefits. New York law establishes minimum standards for the computation of such account value by prescribing maximum charges and minimum interest.

- *Cash surrender benefit*. Most accumulation annuities are required to provide access to contract funds through partial or full withdrawals, also called surrenders, at any time prior to or at retirement. Surrender charges, subject to statutory maximums discussed below, may be applied to such withdrawals.
  - When purchasing an accumulation annuity, you should consider whether you will need funds deposited in the contract prior to the expiration of the surrender charge period.
  - Most contracts permit withdrawals below a specified level (e.g., 10% of the account value) on an annual basis without surrender charge.
  - Cash surrenders may be subject to a six-month deferral.
- *Death benefit.* Accumulation annuities generally provide for a cash payment in the event of death prior to annuitization. In New York, death benefits are not treated as surrenders and, as such, are not subject to surrender charges.
- *Annuitization benefit*. Accumulation annuities allow contract holders to apply their accumulation amount to purchase income options at the more favorable of the contract's guaranteed rates or the insurer's current single premium immediate annuity rates at the time of purchase. The contract may have a stated annuitization date (maturity date), but will usually allow annuitization at any time after the first year.

- The annuity income options listed for immediate annuities above are generally available under deferred annuity contracts.

- With an accumulation annuity, the contract owner is said to *annuitize* his or her accumulation account. In other words, the owner converts the accumulation account into an income stream.

- You should compare the income payments available under the contract to comparable payment options under single premium immediate annuities available in the market offered by other insurers.

- You can make periodic withdrawals from the account value in lieu of annuitizing. Many contracts permit withdrawals of up to 10% of the account value per year without applying surrender charges.

- One advantage of taking periodic or systematic withdrawals instead of annuitizing, is that you still have access to your account value. You can make a partial withdrawal if you need additional funds. In addition, your account value continues to be maintained and credited with current interest or investment earnings.

- Of course, by taking periodic or systematic withdrawals you run the risk of depleting your account value and outliving the contract's accumulated funds.

Four Types of Accumulation Annuities

There are four basic types of accumulation annuities offered by life insurers in New York. The four types differ in how investment income is credited under the contracts. The first three listed below are considered fixed deferred annuities (or non-variable deferred annuities) because the account values do not vary directly with the investment experience of the supporting assets during the accumulation period.

- Excess Interest Annuity
- Modified Guaranteed Annuity
- Equity Indexed Annuity
- Variable Annuity

Excess Interest Annuity

The excess interest annuity is the most common type of accumulation annuity. The contract guarantees a minimum interest rate for the life of the contract, but permits the insurer to declare discretionary excess interest. Such discretionary excess interest is generally determined and guaranteed annually in advance and is based upon present and anticipated earnings on current investments of the insurer. The periodic changes in excess interest permit insurers to offer rates that adjust in response to prevailing market rates.

- The minimum interest rate (from 1% to 3%) is based upon the five-year constant maturity treasury index. In most contracts, the minimum interest rate is set at issue, but some contracts permit the minimum rate to be adjusted periodically.

- Excess interest contracts provide flexibility with respect to premium payments (single or flexible).
- For excess interest annuities, the surrender charge is capped at 10% and generally reduces to 0% after a number of years (e.g., 7 to 10 years).

Modified Guaranteed Annuity ("MGA")

A modified guaranteed annuity ("MGA") is an accumulation annuity that guarantees principal and a high rate of interest on amounts deposited for a specified time period up to ten years with an unqualified right to withdraw an unadjusted cash surrender benefit upon the expiration of the specified time period. Generally, the contract holder can select from a number of guarantee periods offered by the insurer (e.g., 3, 5, 7, 10 years). Withdrawals made prior to the expiration of the specified period may be subject to a market value adjustment and a withdrawal charge.

- Unlike the excess interest rate which can change each year, the interest rate in a MGA is guaranteed for the specified guarantee period (up to 10 years). No excess interest is expected to be credited.
- A market value adjustment adjusts a contract's account value on surrender or withdrawal to reflect changes in interest rates since the receipt of contract funds and the remaining duration of the interest rate guarantee. The adjustment can be positive or negative.
- For MGAs, the withdrawal charge (surrender charge) is limited to 7% and must reduce by 1% each year.

- Like a certificate of deposit, at the expiration of the guarantee, the accumulation amount can be renewed at the company's new MGA rate.

- MGAs may, but usually do not, provide for a market value adjustment on the disability or retirement of the owner.

- The death benefit in an MGA cannot be reduced by a market value adjustment. However, a positive market value adjustment can increase the death benefit.

Equity Indexed Annuity ("EIA")

An equity indexed annuity is an accumulation annuity that credits excess interest in accordance with an external market index, such as the Standard & Poor's 500 Composite Stock Price Index. EIAs provide their owners with the potential for larger interest credits based on growth in the equities market and provide a guaranteed minimum floor to avoid the downside risk that accompanies direct investment in equities.

Unlike excess interest annuities, the amount of excess interest to be credited is not known until the end of the year and there are usually no partial credits during the year. However, the method for determining the excess interest under an EIA is determined in advance.

For an EIA, it is important that you know the indexing features used to determine such excess interest. You should know whether:

- the index interest crediting method compares index values on an annual or more frequent basis;
- includes a monthly or annual interest rate cap on the amount that can be credited;
- participates fully or partially (e.g., 70%) in the index return,
- deducts a spread or margin (e.g., 2%) from the index gain, and
- permits the insurer to alter such method in future years.

You should also know that the minimum floor for an EIA differs from the minimum floor for an excess interest annuity. In an EIA, the floor is based upon an account value that may credit a lower minimum interest rate and may not credit excess interest annually. In addition, the withdrawal charge for equity indexed annuities starts at 10% and declines by 1% each year.

Variable Annuity

A variable annuity contract can be defined as a contract in which amounts paid to the insurer are allocated to one or more separate accounts and in which the account value or annuity benefits payable under the contract vary with the investment performance of the assets allocated to the separate account.

Separate accounts typically are organized into separate portfolios called *sub-accounts*, each with its own investment objective (e.g., money market sub-account, bond or income-related sub-account or stock type sub-account). The allocation of the

amounts paid into the contract is generally elected by the owner and may be changed by the owner, subject to any contractual transfer restrictions.

The following are important features of and considerations in purchasing variable annuities:

- The contract holder bears the investment risk associated with assets held in a separate account (or sub-account). Consumers should understand the risks inherent in the investment options selected.

- Withdrawals from a variable annuity may be subject to a surrender charge. You should be aware of the size of the charge and the length of the surrender charge period.

- You should request a copy of the prospectus.

Variable annuities can provide benefits that exceed the contract’s account value. Most variable annuities include a death benefit equal to the greater of the account value, the premium paid or the highest anniversary account value. Many variable annuity contracts now offer guaranteed living benefits that provide a guaranteed minimum account, income or withdrawal benefit.

For variable annuities with such guaranteed benefits, consumers should be aware of the charges for such benefit guarantees as well as any limitation or restriction on investments options and transfer rights.

Other Features and Factors to Consider

Bonus Annuities. Many accumulation annuities (both fixed and variable deferred annuities) provide for the crediting of a bonus rate (typically, 1%, 2%, 3%) on amounts deposited under the contracts for the first year. For fixed deferred annuities, the bonus rate is added to the interest rate declared for the first contract year.

Consumers should know how long the bonus rate will be credited, the interest rate to be credited after such bonus rate period and any additional charges attributable to such bonus, such as any higher surrender or mortality and expense charges, a longer surrender charge period or a bonus recapture charge on death.

Consumers should be wary of replacing an existing contract solely to receive a bonus on another product.

Suitability. Annuity products have become increasingly complex. It is imperative that you as a consumer understand the products that are available or that are recommended as well as the tax ramifications of these products.

You should only purchase annuity products that suit your needs and goals and that are appropriate for your financial and family circumstances.

Agents and brokers licensed by the New York State Department of Financial Services are required to be competent and trustworthy. However, you should assess whether any recommendation made regarding a purchase or replacement of an insurance or annuity product serves your interests and is suitable. Also,

you should make sure that the agent or broker is licensed in good standing with the Department.

Replacement. Before replacing an existing insurance or annuity product, you should compare the two policies, be aware of the consequences of replacement (new surrender charge and contestability period) and be sure that the new product suits your current needs.

Agents are required to provide you with prescribed comparison forms to help you decide whether the replacement is in your best interest.

Tax Aspects. Annuity contracts provide certain tax advantages. Income taxes on interest and investment earnings in deferred annuities are deferred. However, you should know that, in general, a partial withdrawal or surrender from an annuity before the owner reaches age 59 ½ is subject to a 10% tax penalty. Special care should be taken in roll-over situations to avoid a taxable event.

You should make sure that the contract you select is appropriate for your circumstances. For example, if you purchase a tax qualified annuity, minimum distributions from the contract are required when you reach age 70 ½. You should know the impact of minimum distribution withdrawals on the guarantees and benefits under the contract. Guaranteed living benefits in variable annuities often restrict withdrawals or limit or reduce benefits because of withdrawal activity.

You should consult a competent tax advisor for assistance.

Guaranty Fund. Generally, immediate and deferred annuity contracts issued to a New York resident by a licensed life insurance company that provide fixed benefit guarantees are covered by the Life Insurance Company Guaranty Corporation of New York for up to $500,000.

Such fixed benefit guarantees include the guaranteed minimum death benefit and guaranteed living benefits in variable annuity contracts.

Separate account investment options that limit guarantees to the contract holder's interests in assets allocated to the separate account are not covered by the guaranty fund. Generally, claims under a variable annuity contract would be satisfied out of such separate account assets.

Buy New York. Annuity products approved for sale in New York generally provide greater consumer protections than products sold elsewhere. The minimum account values are higher, charges are lower and annuitization and death benefits are more favorable.

You should make sure that you are buying a New York approved annuity product. Be wary of an agent who suggests that you sign an application outside New York to purchase a non-New York product.

Where to File a Complaint.

Financial Fraud & Consumer Protection Division
NYS Department of Financial Services

25 Beaver Street
New York, NY 10004-2319
(212) 480-6400

One Commerce Plaza
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