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Annuities

This chapter includes a discussion about annuities. It is important for you to understand what annuities are and how they differ from life insurance. By the end of this chapter, you will be able to describe the different roles of the owner, annuitant, and beneficiary, discuss different classification of annuities such as immediate vs. deferred and fixed vs. variable, and identify proper uses of different types of annuities.

TERMS TO KNOW

Deferred — withheld or postponed until a specified time or event in the future
IRS — Internal Revenue Service: a U.S. Government agency responsible for collecting of taxes, and enforcement of the Internal Revenue Code
Life contingency — dependent upon whether or not the insured is alive
Liquidation of an estate — converting a person's net worth into a cash flow
Natural person — a human being
Qualified plan — a retirement plan that meets the IRS guidelines for receiving favorable tax treatment
Suitability — a requirement to determine if an insurance product or an investment is appropriate for a particular customer

A. Annuity Principles And Concepts

Educational Objectives:

II.C.1. Be able to identify definitions of an *annuity, accumulation period and distribution phase.*

II.C.2. Be able to identify the parties to an annuity*: annuitant, owner, beneficiary.*

An **annuity** is a contract that provides income for a specified period of years, or for life. An annuity protects individuals against outliving their money. Annuities are not life insurance, but rather a vehicle for the accumulation of money and the **liquidation of an estate**. Annuities are marketed by life insurance companies. Licensed life insurance agents are authorized to sell some types of annuities.

Annuities do not pay a face amount upon the death of the annuitant. In fact, they do just the opposite. In most cases, the payments stop upon the death of the annuitant. Annuities use *mortality tables*, but these tables reflect a longer life expectancy than the mortality tables used for life insurance. *Mortality tables* indicate the number of individuals within a specified group (e.g., males, females, smokers, nonsmokers) starting at a certain age, who are expected to be alive at a succeeding age.

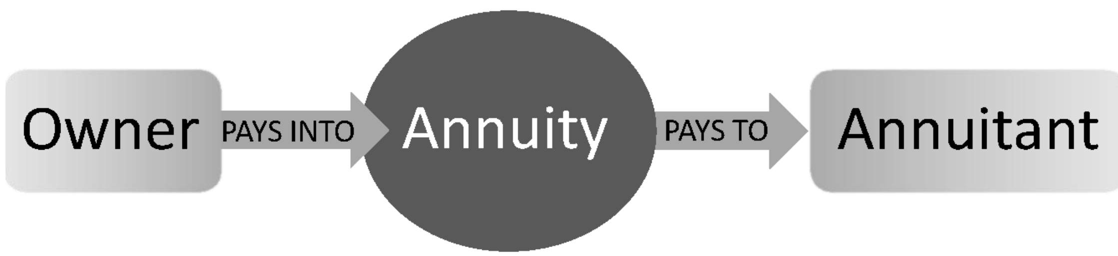
1. The Parties

Owner – The purchaser of the annuity contract, but not necessarily the one who receives the benefits. **The owner of the annuity has all of the rights,** such as naming the beneficiary and surrendering the annuity. The owner of an annuity may be a corporation, trust, or other legal entity.

Annuitant – The person who receives benefits or payments from the annuity, whose life expectancy is taken into consideration, and for whom the annuity is written. The annuitant and the contract owner do not need to be the same person, but most often are. A corporation, trust or other legal entity may own an annuity, but the **annuitant must be a natural person**.

Know This! Because annuities are based on the life expectancy of an annuitant, the annuitant must be a natural person, regardless of who owns the policy.

Beneficiary – The person who receives annuity assets (either the amount paid into the annuity or the cash value, whichever is greater) if the annuitant dies during the accumulation period, or to whom the balance of annuity benefits is paid out.

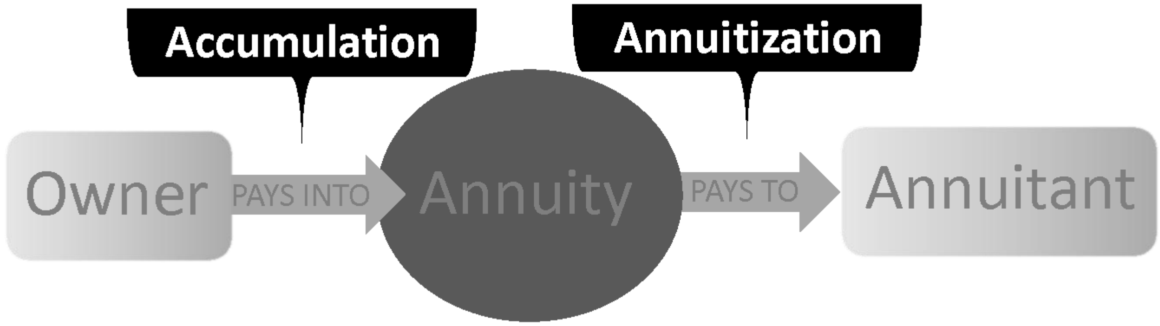


2. Accumulation Period vs. Annuity Period

The **accumulation period**, also known as the **pay-in period**, is the period of time over which the owner makes payments (premiums) into an annuity. Furthermore, it is the period of time during which the payments earn interest on a tax-deferred basis.

The **annuity period**, also known as the **annuitization period**, **liquidation period**, or **pay-out period,** is the time during which the sum that has been accumulated during the accumulation period is converted into a stream of income payments to the annuitant. The annuity period may last for the lifetime of the annuitant or for a specified period, which could be longer or shorter. The *annuitization date* is the time when the annuity benefit payouts begin (trigger for benefits).

Know This! During the accumulation period, funds are paid INTO the annuity. During the annuity period, funds are paid OUT to the annuitant.



The annuity income amount is based upon the following:

- The amount of premium paid or cash value accumulated;
- The frequency of the payment;
- The interest rate; and
- The annuitant's age and gender.

An annuitant whose life expectancy is longer will have smaller income installments. *For example,* all other factors being equal, a 65-year-old male will have higher annuity income payments than a 45-year-old male (because he is younger), or than a 65-year-old female (because women statistically have a longer life expectancy).

Know This! Shorter life expectancy = higher benefit; longer life expectancy = lower benefit.

If an annuitant dies during the accumulation period, the insurer is obligated to return to the beneficiary either **the cash value** or **the total premiums paid**, whichever is greater. If a beneficiary is not named, the death benefit will be paid to the annuitant's estate.

B. Types Of Annuities

Educational Objectives:

II.C.4. Be able to differentiate between the different types of annuities: *fixed (general account), variable (separate account), and equity indexed.*

II.C.5. Be able to identify the different annuity distribution choices and funding mechanisms: *immediate and deferred (single premium and flexible premium).*

II.C.6. Be able to identify the following:

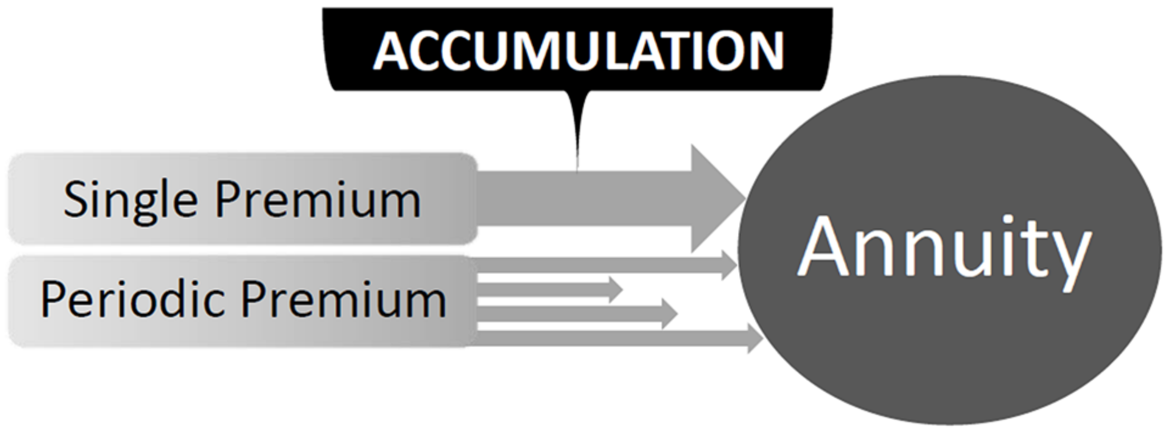
a. Qualified vs. nonqualified annuities
b. Group vs. individual annuities
c. Market value adjusted annuities
d. Tax-sheltered annuities (Internal Revenue Services 403(b) plan)

Annuities can be classified according to how premiums are paid into the annuity, how premiums are invested, and when and how benefits are paid out.

Know This! Classification of annuities:

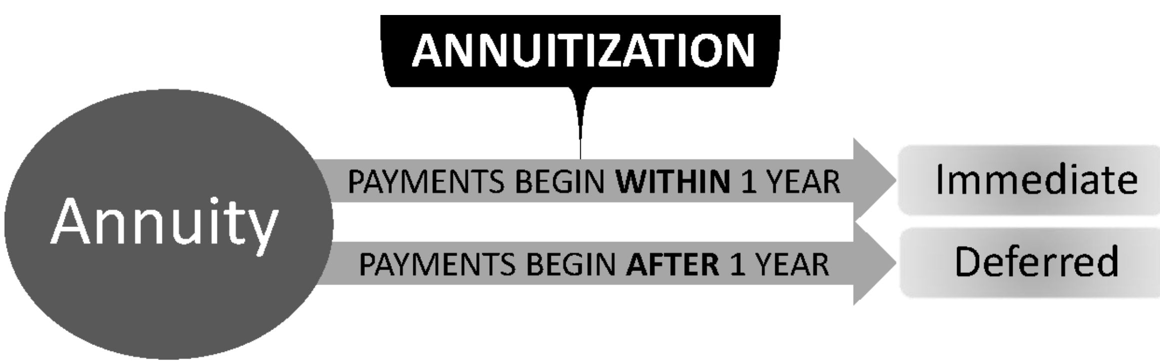
- Premium payment method: single premium vs. periodic
- When income payments begin: immediate vs. deferred
- How premiums are invested: fixed vs. variable
- Disposing of proceeds: pure life, annuity certain, or life refund annuity

1. Premium Payment Options



The first way to classify annuities can be based on how they can be funded (paid for). There are 2 options: a **single premium** (one-time lump-sum payment) or through **periodic payments** in which the premiums are paid in installments over a period of time. Periodic payment annuities can be either **level premium**, in which the annuitant/owner pays a fixed installment, or **flexible premium**, in which the amount and frequency of each installment varies.

2. Immediate vs. Deferred Annuities



Annuities can also be classified according to when the income payments from the annuity begin. An **immediate annuity** is one that is purchased with a single, lump-sum payment and provides income payments that start **within one year** from the date of purchase. Typically, an immediate annuity will make the first payment as early as 1 month from the purchase date. Most commonly, this type of annuity is known as a Single Premium Immediate Annuity (SPIA).

A **deferred annuity** is an annuity in which the income payments begin sometime **after one year** from the date of purchase. Deferred annuities can be funded with either a single lump sum (Single Premium Deferred Annuities — SPDAs) or through periodic payments (Flexible Premium Deferred Annuities — FPDAs).

Periodic payments can vary from year to year. The longer the annuity is deferred, the more flexibility for payment of premiums it allows.

Know This! An immediate annuity is purchased with a *single premium*.

Know This! Income payments from a deferred annuity begin sometime *after 1 year* from the date of purchase.

Nonforfeiture

The nonforfeiture law stipulates that a deferred annuity must have a guaranteed surrender value that is available if the owner decides to surrender the annuity prior to annuitization (e.g., 100% of the premium paid, less any prior withdrawals and related surrender charges). However, a 10% penalty will be applied for early withdrawals (prior to age 59 ½).

Surrender Charges

The purpose of the surrender charge is to help compensate the company for loss of the investment value due to an early surrender of a deferred annuity.

A surrender charge is levied against the cash value, and is generally a percentage that reduces over time. A common surrender charge might be 7% the first year, 6% the second year, and 5%, 4%, 3%, 2%, 1%, and 0% respectively thereafter. Therefore, if the annuity is surrendered in the 8th year or after there would be no further surrender charge. **At surrender, the owner gets the premium, plus interest (the value of the annuity), minus the surrender charge.**

Example:

Assume that the annuity owner paid $700 in premium, which accumulated a total of $35 of interest, and a surrender charge is $70. If the annuity is surrendered prematurely, what will the annuity value be at surrender? The answer is $665.

($700 Premium + $35 Interest) - $70 Surrender Charge = $665 Value of the Annuity

3. Annuity Investment Options

Annuities may be classified as fixed or variable based on how the premium payments are invested.

Fixed Annuities

A **fixed annuity** provides the following features:

- Guaranteed minimum rate of interest to be credited to the purchase payment(s);
- Income (annuity) payments that do not vary from one payment to the next; and
- The insurance company guarantees the specified dollar amount for each payment and the length of the period of payments as determined by the settlement option chosen by the annuitant.

With fixed annuities, the annuitant knows the exact amount of each payment received from the annuity during the annuity period. This is called **level benefit**

payment amount. A disadvantage to fixed annuities is that the purchasing power that they afford may be eroded over time due to inflation.

General Account Assets

Fixed annuity premiums are deposited into the life insurance company's **general account.** The general account is comprised mostly of conservative investments like bonds. These investments are secure enough to allow the insurance company to guarantee a specified rate of interest, as well as assure the future income payments that the annuity will provide.

Know This! In fixed annuities, the premiums are deposited in the company's *general account*.

Interest Rate Guarantees (Minimum vs. Current)

In fixed annuities, the **insurer bears the investment risk**. Future interest rates actually paid by an insurer are based upon the performance of the insurance company's general account. However, the rate may not drop below a policy's **guaranteed minimum** (typically 3%). Should interest rates drop below this guaranteed rate, the insurer is obligated to pay the guaranteed rate amount.

During the accumulation phase, the insurer will invest the principal, or accumulation, and give the annuitant a guaranteed interest rate based on a minimum rate as specified in the annuity, or the **current interest rate**, whichever is higher. The minimum rate is the lowest rate that the principal can contractually earn.

Equity Indexed Annuities

Indexed (or equity indexed) annuities are fixed annuities that invest on a relatively aggressive basis to aim for higher returns. Like a fixed annuity, the indexed annuity has a *guaranteed minimum* interest rate (typically, 3 or 4%), which provides a guarantee for a certain rate of growth. At the end of the contract term, the annuity will be credited with the greater of the **guaranteed minimum** value or the **current (indexed)** value. The *current interest* rate that is actually credited is often tied to a familiar index like the Standard and Poor's 500.

Generally, the insurance companies reserve the initial returns for themselves but pay the excess to the annuitant. *For example*, the company may keep the first 4% earned for itself, but any accumulation in excess of 4% is credited to the annuitant's account. So if the interest earned is 12%, the company keeps 4% and credits the client’s account with 8%.

Equity indexed annuities are less risky than a variable annuity or mutual fund but are expected to earn a higher interest rate than a fixed annuity.

Variable Annuities

A **variable annuity** serves as a hedge against inflation, and is variable from the standpoint that the annuitant may receive different rates of return on the funds that are paid into the annuity. Listed below are the 3 main characteristics of variable annuities:

- **Underlying Investment** — the payments that the annuitant makes into the variable annuity are invested in the insurer's separate account, not their general account. The separate account is not part of the insurance company's own investment portfolio, and is not subject to the restrictions that are applicable to the insurer's own general account.
- **Interest Rate** — the issuing insurance company does not guarantee a minimum interest rate.
- **License Requirements** — a variable annuity is considered a **security** and is regulated by the Securities Exchange Commission (SEC) in addition to state insurance regulations. An agent selling variable annuities must hold a securities license in addition to a life insurance license. Agents or companies that sell variable annuities must also be properly registered with FINRA.

Variable premiums purchase **accumulation units** in the fund, which is similar to buying shares in a Mutual Fund. Accumulation units represent ownership interest in the separate account. Upon annuitization, the accumulation units are converted to **annuity units**. The income is then paid to the annuitant based on the value of the annuity units. The number of annuity units received remains level, but the unit values will fluctuate until actually paid out to the annuitant.

FEATURES	FIXED ANNUITY	VARIABLE ANNUITY
Interest Rate	Guaranteed by insurer	No guarantee
Underlying Investment	General account (safe, conservative)	Separate account (equities, no guarantee)
License Needed	Life insurance	Life insurance PLUS securities
Expenses	Guaranteed	Guaranteed
Income Payment	Guaranteed	No guarantee

Market Value Adjusted Annuities

A **market value** or **market value adjusted** annuity (MVA), also known as a **modified guaranteed** annuity (MGA), is a single-premium deferred annuity that allows the owner to lock in a guaranteed interest rate over a specified maturity period, anywhere between 3 to 10 years. In a MVA, penalties for a premature surrender depend upon current interest rates at the time of surrender.

For example, assume that a client purchased a 10-year 6% fixed annuity tied to the Bond Fund Index Interest Rate (Moody's). If the client withdraws his/her money in 5 years and the current interest rate at that point is 6%, there is no adjustment. If the current interest rate at the time of surrender is 8%, a penalty will be assessed. If the interest rate at surrender is 4%, the insurance company may pay a bonus. The market value adjustment is usually a percentage of the difference between the contracted rate of interest in the annuity and the current rate at surrender. The insurance company requires the annuitant to share in the market risk of changing interest rates, if the annuity is surrendered early.

Educational Objective:

II.C.7. Be able to identify and differentiate between different types of annuity payment options: *life, life with period certain, period certain, life with refund, joint life and joint and survivor annuities.*

Annuity payment options specify how annuity funds are to be paid out. They are very similar to the settlement options used in life insurance that determine how the policy proceeds are distributed to the beneficiaries.

Life Contingency Options - Pure Life vs. Life with Guaranteed Minimum

The life annuity will pay a specific amount for the remainder of the annuitant's life. With **pure life**, also known as **life-only** or **straight life**, this payment ceases at the annuitant's death (no matter how soon in the annuitization period that occurs). This option **provides the highest monthly benefits** for an individual annuitant. Under this option, while the annuity payments are guaranteed for the lifetime of the annuitant, there is no guarantee that all the proceeds will be fully paid out.

Under the **life with guaranteed minimum** settlement option, if the annuitant dies before the principal amount has been paid out, the remainder of the principal amount will be refunded to the beneficiary. This option is also called **refund life**. It guarantees that the entire principal amount will be paid out.

Know This! Pure life annuity provides the highest monthly benefit, but there is no guarantee that the entire principal will be paid out.

There are two types of refund life annuities:

- **Cash refund** — when the annuitant dies, the beneficiary receives a lump-sum refund of the principal minus benefit payments already made to the annuitant. Cash refund option does not guarantee to pay any interest.
- **Installment refund** — when the annuitant dies, the beneficiary will continue to receive guaranteed installments until the entire principal amount has been paid out.

Note, however, that any unpaid annuity benefits following the death of an annuitant are taxable when paid to the beneficiary.

Life with period (term) certain is another life contingency payout option. Under this option, the annuity payments are guaranteed for the *lifetime of the annuitant*, and for a *specified period of time* for the beneficiary. *For example,* a life income with a 20-year period certain option would provide the annuitant with an income while the annuitant is living (for the entire life). If, however, the annuitant dies shortly after payments begin, the payments will be continued to a beneficiary for the remainder of the 20-year period.

Single Life vs. Multiple Life

Single life annuities cover **one life**, and annuity payments are made with reference to one life only. Contributions can be made with a single premium or on a periodic premium basis with subsequent values accumulating until the contract is annuitized.

Multiple life annuities cover **2 or more lives**. The most common multiple life annuities are joint life, and joint and survivor.

Joint Life

Joint life is a payout arrangement where two or more annuitants receive payments until the first death among the annuitants, and then payments stop.

Joint and Survivor

The **joint and survivor** arrangement is a modification of the life income option in that it guarantees an income for two recipients that neither can outlive. Although it is possible for the surviving recipient(s) to receive payments in the same amount as the first recipient to die, most contracts provide that the surviving recipients will receive a reduced payment after the first recipient dies. Most commonly, this option is written as "joint and ½ survivor" or "joint and 2/3 survivor," in which the surviving beneficiary receives ½ or 2/3 of what was received when both beneficiaries were alive. This option is commonly selected by a couple in retirement. As with the life income option, there is no guarantee that all the proceeds will be paid out if both beneficiaries die shortly after the installments begin.

Annuities Certain (Types)

In contrast with life contingency benefit payment options, annuities certain are **short-term annuities** that limit the amounts paid to a certain fixed period or until a certain fixed amount is liquidated.

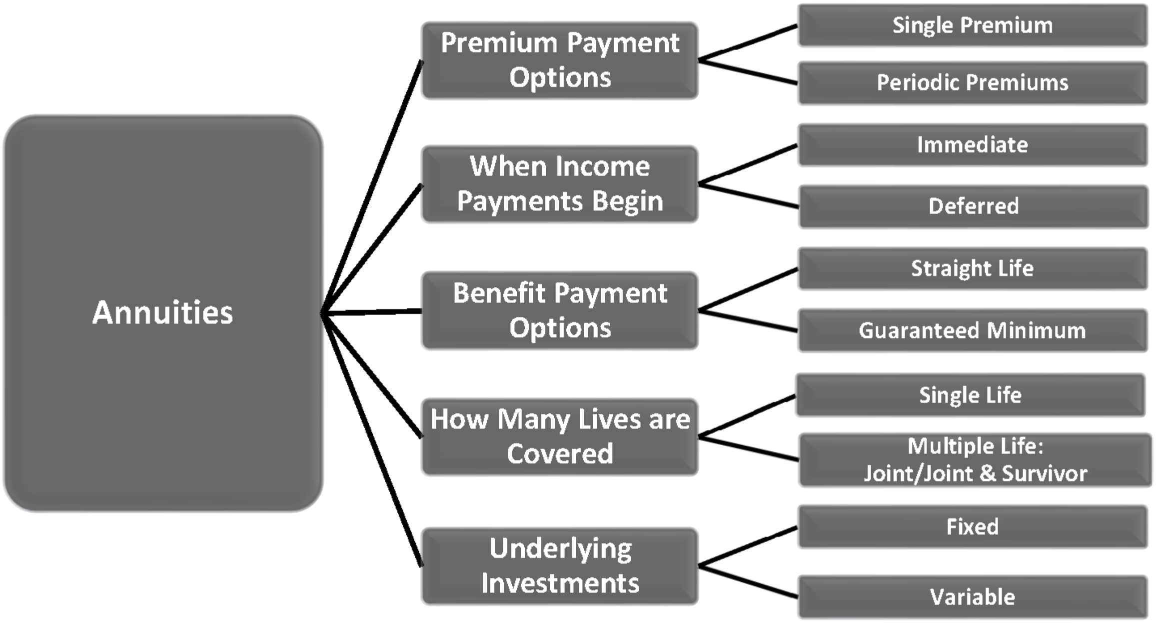
Fixed Period

With **fixed-period installments**, the annuitant selects the time period for the benefits, and the insurer determines how much each payment will be, based on the value of the account and future earnings projections. This option pays for a specified amount of time only, whether or not the annuitant is living.

Know This! The fixed-period option pays for a specific time only, whether or not the annuitant is living.

Fixed Amount

With **fixed-amount installments**, the annuitant selects how much each payment will be, and the insurer determines how long the benefits will be paid by analyzing the value of the account and future earnings. This option pays a specific amount until funds are exhausted, whether or not the annuitant is living.



C. Uses Of Annuities

1. Personal Uses

Educational Objective:

II.C.3. Be able to identify the business and personal uses for annuity products.

Lump-sum Settlements

Annuities may serve as an ideal financial vehicle for someone who comes into a large lump sum of money, such as inheritance, lottery, award of damages from a lawsuit, proceeds from a sale of a business, or a lump-sum distribution from a qualified pension plan. In this case, a person may purchase a **single premium immediate annuity**, which will convert the lump sum into a series of periodic payments, providing a stream of income for the annuitant.

Retirement Income

Since annuities are a popular means to provide retirement income, they are often used to fund **qualified retirement plans**, which means they meet the IRS guidelines to receive favorable tax treatment.

Qualified vs. Nonqualified

A **qualified** retirement plan is one that conforms to the requirements of federal tax laws and for which the Internal Revenue Service (IRS) recognizes contributions to the plan as tax-deductible expenses to the employer. When a plan is qualified, it receives favorable tax treatment. Employer contributions are tax-deductible expenses at the time they are made, and the employee is not taxed on the employer's contribution until the benefits are actually received. Also, the increase during the accumulation period is not subject to taxation until benefits are actually received. Another requirement for qualified plans is that they cannot discriminate in coverage, contributions or benefits in favor of highly compensated employees, shareholders, or company officers.

A **nonqualified** retirement plan is one in which the contributions are not exempt from taxation. However, increase of the funds during the accumulation period are not taxed until they are actually received.

Guaranteed Minimum Withdrawal Benefit

Retirement annuities may offer a **Guaranteed Minimum Withdrawal Benefit** (GMWB) option to the annuitant. With this option, the annuitant can withdraw a maximum percentage of his or her investment annually until the initial investment has been recovered. This option protects the annuitant against investment losses.

Qualified retirement annuities can be **individual** (such as individual retirement accounts — IRAs), and **group** (such as tax-sheltered annuity — TSA, or profit-sharing pension plans).

Individual Retirement Annuity

Anyone with *earned income* can have an **IRA (Individual Retirement Annuity** or Account). An individual can contribute 100% of earned income up to a specified amount. A married couple could contribute a specified amount that is double the individual amount, even if only one person had earned income, but each must maintain a separate account not exceeding the individual limit. The excess contribution penalty for traditional IRAs is 6%, until withdrawn.

Earned income means salary, wages, and commissions, but would not include income from investments, unemployment benefits, or income from trust funds.

Usually, an individual's **contributions to a traditional IRA are tax deductible** for the year of the contribution. Any eligible person not participating in a qualified retirement plan can take a full deduction from taxable income up to the maximum limit. If you are a participant in another qualified retirement plan, there are income limitation tests to determine how much, if any, of one's IRA contribution is tax deductible. Individuals who are not covered by an employer-sponsored plan may deduct the full amount of their IRA contributions regardless of their income level.

Regardless of the deductible status of the IRA contribution, IRA assets grow tax deferred.

Tax-sheltered Annuity - 403(b)

A 403(b) plan or a tax-sheltered annuity (TSA) is a qualified plan available to employees of certain **nonprofit organizations** under **Section 501(c)(3)** of the Internal Revenue Code, and to employees of public-school systems.

Contributions can be made by the employer or by the employee through salary reduction and are excluded from the employee’s current income. As with any other qualified plan, 403(b) limits employee contributions to a maximum amount that changes annually, adjusted for inflation. The same catch-up provisions also apply.

Know This! 403(b) plans are for nonprofits and public-school systems.

Education Funds

In addition to providing income for retirement and estate liquidation, annuities can be used to accumulate funds for college education. An annuity can provide savings on a tax-deferred basis for the education expenses of the annuitant.

Long-Term Care Needs

Under the Pension Protection Act of 2006, annuitants are allowed to transfer money from an annuity to pay for long-term care insurance premiums, tax free. In the past, distributions from nonqualified annuities were taxed; however, now, distributions can be used to pay for long-term care premiums and, in many cases, eliminate the taxes on the annuity gains. As a result, many insurers now offer a hybrid annuity with a long-term care feature. These policies provide for income, long-term care, or both.

2. Business Uses

While annuities may be used in business as investment vehicles, they are more commonly used by businesses as the vehicle to fund employee retirement plans that are established by the employer or jointly with other employers or a union. The plan may be set up for the employees of a particular business, or it may be a multiemployer plan, serving the workers from a number of related or unrelated firms. These plans, upon the retirement of the employee, will supplement Social Security retirement benefits. The employer benefits from the existence of the plan by higher employee retention.

3. Suitability

Educational Objective:

II.C.9. Be able to identify the following:

a. The required suitability information to be obtained prior to making recommendations to a consumer
b. Exceptions to suitability as stated in CIC 10509.912
c. The need for consumer's awareness of liquidity limitations or surrender charges
d. The standards for determining whether agent's recommended transactions meet consumer's insurance needs and financial objectives

The principal use of an annuity is to provide income for **retirement**; however, an annuity may be used for any accumulation of cash or simply to liquidate an estate. Because of the various uses of annuities, agents should always assess how well a recommended product will meet the applicant's needs and resources — the **suitability** of a product.

Know This! The main use of annuities is to provide retirement income.

It is a producer's responsibility to make sure that annuity transactions address consumers' needs and financial objectives. To ensure suitability, producers must make a reasonable effort to obtain relevant information from the consumer and evaluate the following factors:

- Age;
- Annual income;
- Financial situation and needs (including financial resources used to fund an annuity);
- Financial experience;
- Financial objectives;
- Intended use of an annuity;
- Financial time horizon;
- Existing assets (including investment and life insurance holdings);
- Liquidity needs;
- Liquid net worth;
- Risk tolerance;
- Tax status;
- Potential reverse mortgage; and
- Intention to apply for means-tested government benefits (e.g., Medi-Cal, veteran's aid and attendance benefit).

Insurers are required to establish standards and procedures, as well as a system to supervise recommendations to consumers that result in transactions involving annuity products. In the case of an exchange or replacement of an annuity, the exchange or replacement must be suitable, and the consumer must be informed of various features of the annuity, such as the potential surrender period and surrender charges, tax penalties, mortality and expense fees, potential charges for riders, and market risks.

Suitability requirements **do not apply** to the following transactions:

- Direct response solicitations where there are no recommendations based on information collected from the consumer;
- Employee pension or welfare benefit plans covered by the Employee Retirement Income Security Act (ERISA);
- A plan described by Section 401(a), 401(k) — profit-sharing plans, 403(b) — tax-sheltered annuities, 408(k), or 408(p) of the Internal Revenue Code (IRC);
- Government or church plans;
- Employer-sponsored nonqualified deferred compensation plans;
- Settlements of or assumptions of liabilities associated with personal injury litigation or any dispute or claim resolution process; and
- Prepaid funeral contracts.

D. Senior Consumers

Educational Objective:

II.C.10. Be able to identify the rules regarding the sale to seniors age 65 and older (CIC 785-789.10):

a. Know what types of disclosures are required if the applicant requests an immediate investment of funds in a variable annuity (CIC 10127.10)

As required by the California Insurance Code, all insurers, agents and brokers who solicit insurance to insureds age 65 or older, owe those insureds a **duty of honesty, good faith and fair dealing.**

Any **advertisement** designed to produce leads based on a response from a potential insured that is directed towards persons 65 years of age or older must prominently disclose that an agent may contact the applicant.

Insurers or agents may not **use real or fictitious na**mes that are deceptive or misleading with regard to the status, character, or representative capacity of the insurer or agent, or to the true purpose of the advertisement. The use of misleading terminology or advertising materials is also prohibited.

If a life agent offers to sell to a senior consumer any annuity product, the agent must advise the senior in writing that the sale or liquidation of any stock, bond, individual retirement account, 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 senior or his/her agent may wish to consult independent legal or financial advice before the transaction.

Individuals who violate these regulations are subject to the following **administrative penalties**:

- $1,000 for the first violation; and
- $5,000 - $50,000 for second or subsequent violations.

If the Commissioner determines that the licensee's actions may cause significant harm to seniors, the Commissioner may suspend the producer's license. Insurers who violate these rules are liable for an administrative penalty of $10,000 for the first violation, and $30,000 - $300,000 for each subsequent violation.

1. Disclosures

Every individual annuity that is delivered or issued to a senior citizen in this state must have printed on the front or on the cover page a notice stating that, after receipt of the policy by the owner, the policy may be returned for cancellation to the insurer or agent from who it was purchased. The period of time for the return must be clearly stated in the notice and must be at least **30 days**.

During the 30-day period, the premium for a variable annuity may be invested only in fixed-income investments and money-market funds unless the owner specifically directs that the premium is invested in the mutual funds within the annuity.

If the annuitant waives the right to the fixed-income requirement by directing that the funds be immediately invested, and then cancels the annuity anyway, the annuitant is entitled to the account value on the date the annuity is returned to the insurer. This is not the full value that the free look originally guaranteed. The account value must be refunded by the insurer within 30 days from the date that the insurer is notified that the owner has cancelled the policy.

E. Chapter Recap

This chapter explained key concepts related to annuities, from the parties to the contract to different annuity classifications. Let’s recap the main concepts you need to know:

ANNUITIES	
Phases	• *Accumulation period* - payments in, to insurer • *Annuitization period* - payments out, to insured
Parties	• *Annuitant* - insured; policy issued on annuitant's life; must be a person • *Beneficiary* - will receive any amount contributed to annuity (plus any gain) if annuitant dies during accumulation period • *Owner* - has all rights to policy (usually annuitant); can be corporation or trust
Types of Annuities	• *Fixed Annuities* - guaranteed, fixed payment amount; premiums in general account • *Variable Annuities - p*ayment not guaranteed; premiums are in separate account, and invested in stocks and bonds • *Indexed Annuities* - interest rate tied to an index; earn higher rate than fixed annuities, not as risky as variable annuities or mutual funds
Premium Payments	• *Single* - ONE lump-sum payment. The principal is created immediately (used for both immediate and deferred annuities). • *Periodic (level or flexible)* - multiple payments; annuity principal fund is created over time (used for deferred annuity only)
Income Payments	• *Immediate* - purchased with a single premium. Income payments start within one year of the date of purchase. • *Deferred* - purchased with either lump sum or periodic-payments premium. Benefits start sometime after one year from the date of purchase (often used to accumulate funds for retirement).
Settlement Options	• *Lump-sum* - at annuitization, and all interest accumulated is taxable. Additional 10% penalty can be imposed prior to annuitant's reaching 59 1/2. • *Life Only* - insured cannot outlive income. Any monies not paid out are retained by company at insured's death. Pays highest monthly amount. • *Refund Life Annuity* - guaranteed lifetime income. If the annuitant dies, the balance is "refunded" to the beneficiary. The installment refund option pays the beneficiary until the purchase amount is paid out. The cash refund option refunds the balance of the original annuity purchase amount minus payments made to the annuitant. • *Joint Life* - 2 or more annuitants receive payments until first death, then payments cease. • *Joint and Survivor* - income for 2 or more that cannot be outlived. Often used with period certain. When one annuitant dies, the other receives either 1/2 or 2/3 of the original payment amount. • *Life with Period Certain* - specific monthly payment for life and a specific period of time (e.g., Life plus 10-year certain). If the annuitant dies before the payment period is up, the payment goes to beneficiary.

	• *Annuities Certain* - payments guaranteed for a fixed period or until a certain fixed amount is paid out. NO LIFE option. • Any unpaid annuity benefits following the death of an annuitant are taxable when paid to the beneficiary.
Interest Rate	• *Guaranteed* - company must pay this minimum percentage (usually, 3%). • *Current* - exceeds guaranteed rate. Paid to the annuitant when the company's own investment is better than expected.