A Consumer's Guide to Annuities

Message from the Commissioner

The North Carolina Department of Insurance has a responsibility to inform and educate insurance consumers. This guide is made available to help residents of North Carolina better understand annuities.

For purposes of this guide, an annuity is an insurance contract that requires an insurance company to make specified payments to you at regular intervals for a specified period of time. There are many different types of annuity contracts and a variety of annuity options available to help solve various financial problems and needs. For example, deferred annuities are ideally suited to help individuals accumulate money for future income needs, and a life annuity is a payout option that guarantees specified payments will continue for as long as you live. I believe you will find this guide to be informative and helpful.

Your Department of Insurance is available to help guide you through these complicated matters. I want every North Carolinian to know that help is available by calling our toll-free number 1-800-546-5664.

Table of Contents

This guide is intended to help you better understand annuities. If you currently have an annuity, the terms of your contract will determine what benefits you are entitled to. Please refer to the provisions of your policy if you have any questions about your particular annuity contract.

An annuity is an insurance contract designed to provide an individual with income for an established period of time, often beginning at retirement age. Payments are generally made on a monthly basis and may continue for as long as you live or for a stated period of time. Payments may begin immediately or may be deferred until some future date. Most annuities are long term contracts and generally should not be considered or purchased for short-term purposes.

Annuities may be appealing and useful in a variety of situations. The following are some examples:

- Companies funding their employees' pension plans,
- Individuals who are not covered under traditional pension plans or who desire to supplement their future incomes,
- Individuals who have sold a business,
- Individuals who have sold a home,
- A widow, widower or divorcee who needs to convert a lump sum cash settlement into income, but wants safety and security in terms of future payments and guarantees,
- Grandparents who wants to provide for their grandchildren, or
- Someone who desires to set aside or accumulate funds for future needs.

Types of Annuities

Immediate or Deferred

Immediate annuities begin providing periodic benefit payments immediately after they are purchased. They are particularly attractive to people who retire and wish to convert savings and/or investment accounts into income payments.

Deferred annuities provide you with a period of time to fund the contract after the purchase date. Premiums paid and the interest earned during the accumulation period are credited by the insurer to the policy's accumulation fund and a minimum guaranteed interest rate is customarily provided by the insurer during this period. Under a deferred annuity, the annuitant simply defers "annuitization" of the contract and receipt of annuity benefit payments to some future date.

Single Premium or Installment Premium

Annuity contracts may be either single premium or installment premium. Single premium contracts require you to fully fund the annuity contract in one single premium payment. Installment premium contracts allow an annuity to be funded by means of premium payments over a period of time. Most often, installment premium annuities are also flexible premium contracts that allow you to pay as much as you desire whenever you choose, within specified limits.

Fixed Dollar or Variable

A fixed annuity provides fixed-dollar income payments backed by the guarantees in the contract. For example, the company may guarantee that the interest rate on the funds accumulating in the policy will be at least three percent. Guarantees are based on conservative assumptions, so that the company will be able to fulfill its promises and obligations regardless of economic conditions. In many instances, actual interest crediting rates may be greater than minimum guarantees; however, if you are shown any illustrations of how an annuity might grow in the future, you should keep in mind that the non-guaranteed values may turn out to be lower or higher than those shown.

Variable annuities are funded with securities, stocks and unsecured bonds, which tend to fluctuate with economic conditions. The value of a variable annuity depends upon the value of the underlying securities used to fund the annuity contract. You, the owner, or annuitant, bear the investment risk as the value of the annuity increases or decreases based upon investment performance of the security, often referred to as the separate account. For this reason you should be certain that the annuity purchased is suitable for your needs and investment tolerance. The sales associate/representative you work with will help you with this by asking a series of questions to help determine if a variable annuity is suitable for you. An annuity is classified as a variable annuity if its value during either the accumulation period, or the payout period, is based on the value of a security. Some variable annuities provide a choice of either a variable payout or a fixed payout. The North Carolina Department of Insurance and the U.S. Securities and Exchange Commission regulate companies authorized to sell variable annuities in North Carolina. Licensed life insurance agents, banks and brokerage houses that sell variable annuities must also hold a securities license.

Equity – Indexed Annuities (see appendix for additional information)
The accumulation value of the annuity is based upon the increase or decrease of a specified index (such as a stock index). The calculations used to det1n th (e v)7.1(a)-0.8(lu)7.1t1nay diffef oroou. Thoy

Costs Associated with Buying an Annuity

How much you pay for an annuity depends on how much monthly income you desire, your age when you buy the annuity contract and the time when you want to start receiving benefits. It also depends on how you wish to make your payments (e.g.: in a single sum or in a series of payments). For a single-premium deferred annuity, the smallest amount of purchase payment a company will accept may be $2,500 or more. For a flexible premium retirement annuity, the company may accept payments of less than $100, although more may be required during the first year. You should compare annuity contracts offered by different companies since sales charges, surrender charges, interest rates and benefit payments can vary.

Sales Charges

Most companies offer plans with no sales charge. They are called "no-load" plans. However, you should be aware there are many types and amounts of charges that can be associated with the sale of annuity contracts. Companies may refer to these charges by different names. Some annuities are "front loaded," which means that most of the costs are charged to the policyholder up front at the beginning of the contract. Others are "back loaded," which means that most of the costs are charged at a later date or at the end of the contract. Still others spread their charges evenly throughout the life of the annuity.

Surrender Charges

Most annuities allow you to surrender your contract if the contract has not been annuitized (i.e. benefit payments have not yet started). Upon surrender, the contract terminates and you may be required to pay a surrender charge. Early surrender charges typically apply and are imposed during the first five to 15 years from the date the policy is issued. Some companies waive the surrender charge if the interest rate being credited to the contract falls below a specified level. Immediate annuity contracts cannot be surrendered, and there is no surrender value after the contract is annuitized.

The cash surrender value is the contract value less early surrender charges. Depending on the terms of the annuity contract and the policy's performance, the cash surrender amount may be less than premiums paid. In addition, there may be tax penalties imposed in connection with cash surrendered policies. Be sure you understand the tax implications and consequences prior to surrendering an annuity contract.

Things to Consider Before Purchasing an Annuity

As described earlier, annuity products may be used to accumulate and convert funds to guaranteed income that may be needed now or later, such as solving retirement needs. Consequently, annuities are generally considered to be long term contracts. To avoid being penalized, policyholders must be willing to make a long-term commitment when purchasing an annuity. Other more appropriate investments exist for those seeking short-term opportunities. You might wish to consult a trusted financial advisor who has no vested interest in your investment choice prior to applying for an annuity.

Talk with several reputable agents who have expertise with annuities and shop around before investing your money. Consider all of the consequences and replacement costs if you are considering replacement of an existing annuity contract. Be sure you consider both the advantages and disadvantages. Remember to carefully compare your existing policy with any new proposed policy and consider such factors as the guaranteed interest rate, the surrender charges and the administrative and maintenance fees. A high interest rate during the first year is not always the better choice. This is especially true if the interest rates drop to a low minimum rate the following years with high surrender charges and additional fees. Ask your agent for the company's history on crediting its interest rates and check to see how credited interest rates vary between new issues and renewal years.

Ask for required disclosure materials. Many companies will offer you computer generated sales illustrations that provide a customized projection for the contract under consideration. Be sure that you receive all of the pages of the illustration, and carefully read and study them. Also, be sure you understand guaranteed values and non-guaranteed projections and estimates.

Please note that values and income figures may be shown on both a "guaranteed" and an "illustrated non-guaranteed" basis. Illustrations of guaranteed values show the minimum values and benefits that will be paid under the contract. Illustrations of "non-guaranteed" values show the values and benefits which could possibly be paid if the assumed interest rates and/or investment goals are achieved and met for the period shown.

Be aware that some companies may advertise high interest crediting rates and bonuses on their annuity products. However, depending upon the terms of the annuity contract, the advertised interest and/or bonus may not be available to the annuitant if the contract is surrendered for cash. In other words, some contracts may credit and accumulate interest and/or bonuses to the policy's annuitization value (not the cash value) and the annuitant may be required to receive policy benefits over a long period of time in order to receive the advertised high interest and/or bonuses. This is another reason it is very important for applicants to carefully read and understand the terms of the annuity contract prior to purchasing the policy.

Shopping For Annuities

Since most insurance companies and many agents advertise, telephone directories, newspaper, radio, television and the Internet may also provide information to assist you in purchasing insurance in your area.

Most agents are reputable professionals who are well trained in their area of expertise. Agents must be licensed to sell life insurance in North Carolina. Choose one with whom you feel comfortable and who will answer your questions. To verify if an agent is licensed, contact the North Carolina Department of Insurance, Agent Services Division at (919) 733-7487. If you are considering the purchase of a variable annuity, the agent should also be licensed by the Securities and Exchange Commission (series 6 and series 63 license) to sell variable products, which are considered to be securities, and you should receive a prospectus describing the investment alternatives available to you.

As with any major purchase, it is recommended that you shop around to make sure you get the most for your money. Companies must be licensed to conduct business in North Carolina. To verify that a company is properly licensed, you may contact the North Carolina Department of Insurance, Consumer Services Division at (919) 733-2032 or toll free 800-546-5664.

Seek Unbiased Information

Information is available to consumers from a number of sources. These sources include consumer publications, public libraries, consumer groups and your North Carolina Department of Insurance.

Financial strength and ability to meet financial obligations to policyholders is very important. Independent organizations such as A.M. Best, Standard & Poor's, Moody's Investors Service and others publish financial ratings. You should consider checking with at least two organizations to evaluate a company's strength. The ratings for insurers can be found in most public libraries, by asking your agent or on the Internet. (**NOTE:** These agencies rate companies according to their present financial ability to pay claims, not by quality of products offered or by past or future ability to pay claims.)

The North Carolina Department of Insurance does not rate or recommend insurance companies, but will provide the date a company was licensed in North Carolina and its complaint ratio.

Insurance Tips

Before You Buy

- Shop around. Compare contracts offered by several companies.
- Verify that the agent and company you choose to do business with are both licensed in North Carolina.
- Be certain that you understand the effect of all charges and penalties that you may incur under the contract.
- Check whether the annuity contract allows you to change the amount of your premium payments. Find out what happens if you stop paying premiums altogether.
- DO NOT PAY CASH. When you purchase an annuity, make your check or money order payable to the insurance company, NOT THE AGENT. Be sure to get a receipt.
- Make sure you fully understand any policy you are considering and that you are comfortable with the company, agent and product.
- Ask questions. Your annuity contract may represent a considerable investment and may significantly impact your family's future.
- Compare contract summaries and policy benefits for similar contracts from several companies. Choose the one that best fits your needs at the most favorable premium rate.
- If you are buying an annuity contract for an Individual Retirement Account or another tax deferred retirement program, make sure that you are eligible. Also make sure that you understand any restrictions connected with the program.
- Determine the difference between guaranteed values and non-guaranteed projections.
- Ask your accountant about any potential tax consequences.
- If you are shown a presentation illustrating tax savings, find out what assumptions are used. Be sure the assumptions apply in your case.

After The Purchase

- ***READ THE CONTRACT* -** When you receive your new annuity contract, read it carefully. Ask the agent and company for an explanation of anything you do not understand.
- Keep in mind that you have a minimum 10-day "free look" period, 20-days if the purchase involved the replacement of an existing annuity or life insurance policy, in case you change your mind. If you cancel during the free look period, the company must return your premium without penalty.
- Periodically review your contract to make sure it continues to meet your needs.
- Your annuity contract should be kept in a safe place with your other important documents, such as a safe deposit box or fire proof safe. The name of the company and policy number should be kept in a safe place (at a separate location from your original policy) in case the policy is misplaced or lost.
- Make sure the insurance company always has your current address.

Frequently Asked Questions

What does "free look" mean?
"Free look" is the period of time, usually 10 days, following policy delivery in which the applicant can return the contract for a full refund of premium.

I purchased an annuity contract in another state. Do North Carolina insurance laws apply?
No. The laws and regulations of the state of issue apply. North Carolina law applies only to policies and contracts applied for and issued in North Carolina.

What happens if I die before my deferred annuity payments begin?
Generally, a death benefit equal to the contract value is payable to your beneficiary if you die before you annuitize your policy (i.e., you begin receiving benefits). Other contracts may provide that the death benefit will be the total premiums paid if that amount is greater than the contract value.

What should I know about interest rates?
Please remember that interest rates tend to fluctuate depending upon economic conditions. Although interest crediting rates may start out unusually high (especially during the first year), some companies will quickly lower them after the guaranteed period expires.

Can I borrow from my annuity contract?
Many annuities also provide that you may borrow a portion of your contract value, under certain conditions, without terminating the contract. Fees and loan interest may be charged by the company and deducted from the amount of the loan. You may also be able to use the annuity as collateral for a bank loan.

The North Carolina Life And Health Insurance Guaranty Association

To protect North Carolina life and health insurance policyholders against insurer insolvency, the North Carolina General Assembly created the North Carolina Life and Health Guaranty Association. The Guaranty Association provides up to $300,000 of benefits per person (for guaranteed policy benefits) on covered policies, in the unlikely event of insurer insolvency. The association is funded by insurers licensed to do business in North Carolina.

Appendix

Appendix prepared by the National Association of Insurance Commissioners.

Equity Indexed Annuities

What are equity indexed annuities?
An equity-indexed annuity is a fixed annuity, either immediate or deferred, that earns interest or provides benefits that are linked to an external equity reference or an equity index. The value of the index might be tied to a stock or other equity index. One of the most commonly used indices is Standard & Poor's 500 Composite Stock Price Index (the S&P 500), which is an equity index. The value of any index varies from day to day and is not predictable.

When you buy an equity-indexed annuity you own an insurance contract. You are not buying shares of any stock or index. While immediate equity-indexed annuities may be available, this appendix will focus on deferred equity-indexed annuities.

How are they different from other fixed annuities?
An equity-indexed annuity is different from other fixed annuities because of the way it credits interest to your annuity's value. 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 you get and when you get it depends on the features of your particular annuity.

Your 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 your annuity also will not drop below a guaranteed minimum. For example, many single premium annuity contracts guarantee the minimum value will never be less than 90 percent of the premium paid, plus at least 3 percent 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.

What are some of the contract features?

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.

Indexing Method – The indexing method means the approach used to measure the amount of change, if any, in the index. Some of the most common indexing methods, which are explained more fully later on, include annual reset (ratcheting), high-water mark and point-to-point.

Term – The index term is the period over which index-linked interest is calculated. In most product designs, interest is credited to your annuity at the end of a term. Terms are generally from one to 10 years, with six or seven years being most common. Some annuities offer single terms while others offer multiple, consecutive terms. If your annuity has multiple terms, there will usually be a window at the end of each term, typically 30 days, during which you may withdraw your money without penalty. For installment premium annuities, the payment of each premium may begin a new term for that premium.

Participation Rate – The participation rate decides how much of the increase in the index will be used to calculate index-linked interest. For example, if the calculated change in the index is 9 percent and the participation rate is 70 percent, the index-linked interest rate for your annuity will be 6.3 percent (9 percent x 70 percent = 6.3 percent). A company may set a different participation rate for newly issued annuities as often as each day. Therefore, the initial participation rate in your annuity will depend on when it is issued by the company. The company usually guarantees the participation rate for a specific period (from one year to the entire term). 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.

Cap Rate or Cap – 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. In the example given above, if the contract has a 6 percent cap rate, 6 percent, and not 6.3 percent, would be credited. Not all annuities have a cap rate.

Floor on Equity Index-Linked Interest – The floor is the minimum index-linked interest rate you will earn. The most common floor is zero percent. A zero percent floor assures that even if the index decreases in value, the index-linked interest that you earn will be zero and not negative. As in the case of a cap, not all annuities have a stated floor on index-linked interest rates. But in all cases, your fixed annuity will have a minimum guaranteed value.

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.

Interest Compounding – Some annuities pay simple interest during an index term. That means index-linked interest is added to your original premium amount but does not compound during the term. Others pay compound interest during a term, which means that index-linked interest that has already been credited also earns interest in the future. In either case, however, the interest earned in one term is usually compounded in the next.

Margin/Spread/Administrative Fee – 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. For example, if the calculated change in the index is 10 percent, your annuity might specify that 2.25 percent will be subtracted from the rate to determine the interest rate credited. In this example, the rate would be 7.75 percent (10 percent - 2.25 percent = 7.75 percent). In this example, the company subtracts the percentage only if the change in the index produces a positive interest rate.

Vesting – Some annuities credit none of the index-linked interest or only part of it, if you take out all your money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100 percent at the end of the term.

How do the Common Indexing Methods Differ?

Annual Reset – Index-linked interest, if any, is determined each year by comparing the index value at the end of the contract year with the index value at the start of the contract year. Interest is added to your annuity each year during the term.

High-Water Mark – The index-linked interest, if any, is decided by looking at the index value at various points during the term, usually the annual anniversaries of the date you bought the annuity. The interest is based on the difference between the highest index value and the index value at the start of the term. Interest is added to your annuity at the end of the term.

Point-to-Point – The index-linked interest, if any, 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. Interest is added to your annuity at the end of the term.

What are Some of the Features and Trade-Offs of Different Indexing Methods?
Generally, annuities offer *preset* combinations of features. You may have to make trade-offs to get features you want in an annuity. This means the annuity you choose may also have features you don't want.

What is the Impact of Some Other Product Features?

Cap on Interest Earned – While a cap limits the amount of interest you might earn each year, annuities with this feature may have other product features you want, such as annual interest crediting or the ability to take partial withdrawals. Also, annuities that have a cap may have a higher participation rate.

Averaging – Averaging at the beginning of a term protects you from buying your annuity at a high point, which would reduce the amount of interest you might earn. Averaging at the end of the term protects you 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 you earn when the index rises either near the start or at the end of the term.

Participation Rate – The participation rate may vary greatly from one annuity to another and from time to time within a particular annuity. Therefore, it is important for you to know how your annuity's participation rate works with the indexing method. A high participation rate may be offset by other features, such as simple interest, averaging or a point-to-point indexing method. On the other hand, an insurance company may offset a lower participation rate by also offering a feature such as an annual reset indexing method.

Interest Compounding – It is important for you to know whether your annuity pays compound or simple interest during a term. While you may earn less from an annuity that pays simple interest, it may have other features you want, such as a higher participation rate.

Is there always a charge to take my money out early?
Your annuity may have a limited "free withdrawal" provision. This lets you make one or more withdrawals without charge each year. The size of the free withdrawal is limited to a set percentage of your annuity's guaranteed or accumulated value. If you make a larger withdrawal, you may pay withdrawal charges. You may also lose index-linked interest on amounts you withdraw.

Most annuities waive withdrawal charges on withdrawals made within a set number of days at the end of each term. Some annuities waive withdrawal charges if you are confined to a nursing home or diagnosed with a terminal illness. You may, however, lose index-linked interest on withdrawals.

Are dividends included in the index?
Depending on the index used, stock dividends may or may not be included in the index's value. For example, the S&P 500 is a stock price index and only considers the prices of stocks. It does not recognize any dividends paid on those stocks.

What are some other equity-indexed annuity contract benefits?

Annuity Income payments – One of the most important benefits of deferred annuities is the right to use the value built up during the accumulation period to provide income payments during the payout period. While income payments are usually made monthly, you can often choose more or less frequent payments. The size of income payments is based on both the accumulated value in your annuity and the annuity's "benefit rate" that is in effect when income payments begin.

The insurance company uses the benefits rate to compute the amount of income payment it will pay you for each $1,000 of accumulated value in your annuity. The benefit rate usually depends on your age and sex, and the form of annuity payment you have chosen. You can usually choose from many forms of annuity payments. You might choose payments that continue as long as you live, or as long as either you or your spouse live, or payments that continue for a set number of years.

How do I know if an equity-indexed annuity is right for me?
The questions listed below may help you decide which type of annuity, if any, meets your retirement planning and financial needs. You should consider what your goals are for the money you may put into the annuity. You need to think about how much risk you're willing to take with the money. Ask yourself:

- How long can I leave my money in the annuity?
- What do I expect to use the money for in the future?
- Am I interested in a variable annuity with the potential for higher earnings that are not guaranteed and willing to risk losing the principal?
- Is a guaranteed interest rate more important to me, with little or no risk of losing the principal?
- Or, am I somewhere in between these two extremes and willing to take some risks?

Questions you should ask your agent or the company.

- What is the guaranteed minimum interest rate?
- What charges, if any, are deducted from my premium or my contract value?
- How long is the term?
- What is the participation rate and how long is the participation rate guaranteed?
- Is there a minimum participation rate?
- Does my contract have a cap?
- Is averaging used? How does it work?
- Is interest compounded during a term?

- Is there a margin, spread or administrative fee? Is that in addition to or instead of a participation rate?
- Which indexing method is used in my contract?
- Can I get a partial withdrawal without paying charges or losing interest? Does my contract have vesting?
- Does my annuity waive withdrawal charges if I am confined to a nursing home or diagnosed with a terminal illness?
- What annuity income payment options do I have?
- What is the death benefit?

Glossary of Life Insurance Terms

***Accumulation Period* –** The time during which you pay money into an annuity contract and build up a fund to provide a deferred annuity.
***Annuitant* –** The person entitled to receive annuity payments or who now receives them.
Annuitize – A method of receiving annuity benefits through a series of income payments for life or some other defined period
***Individual Retirement Account (IRA)* –** An account set up by an individual that in some cases allows contributions to be deducted from income and permits earnings on contributions to accumulate tax-deferred until retirement, regardless of whether the contributions are deductible. Under the 1986 tax law, only those who do not participate in a pension plan at work or who do participate and meet certain income guidelines can make tax-deductible contributions to an IRA. All others can make contributions to an IRA on a non-deductible basis.
***Load* –** Any sales fees or charges you pay in purchasing an annuity contract.
***Payout Period* –** The period during which you receive the income from your annuity contract.
***Principal* –** The amount you pay into your annuity contract as distinguished from the interest that is credited to it.
***Surrender* –** Voluntary cancellation of a policy for its cash value.
***Surrender Charges* –** Contractual charges imposed by an insurance company in the event of early policy cancellation.

How to Reach Us

You can reach the North Carolina Department of Insurance, Consumer Services Division at:

800-546-5664 Toll free inside North Carolina
919-733-2032 Outside of North Carolina
919-715-0319 TDD (Telephone Device for Deaf Caller)
919-733-0085 Fax

You can find additional information including our complaint form on the North Carolina Department of Insurance Web site at **www.ncdoi.com**.

The address for the North Carolina Department of Insurance, Consumer Services Division is:

Consumer Services Division
North Carolina Department of Insurance
1201 Mail Service Center
Raleigh, NC 27699-1201

NCDOI 599 (May 03)