AN OVERVIEW OF ANNUITIES AND RELEVANT REGULATIONS

WHAT IS AN ANNUITY?

- An annuity is a written contract between the purchaser and a life insurance company in which the company promises to make periodic payments to the purchaser, starting immediately or in the future.
- If the payments are delayed to the future, you have a **deferred annuity**. If the payments start immediately, you have an **immediate annuity**.
- The most common use for income payments from an annuity contract is to fund retirement.

An Annuity Is NOT

- An annuity is different from life insurance [life insurance insures against the risk of dying early; an annuity insures against the risk of living too long]
- An annuity is not a savings account or savings certificate and should not be bought for short-term purposes
- An annuity may **<u>not</u>** be appropriate for older or retired individuals because of the long holding periods and surrender charges

HOW TO THINK OF ANNUITIES

- Not a liquid asset: at most, you can withdraw 10% of your premium penalty-free during the first few years of the contract.
- Low rate of return: fixed annuities offer guaranteed interest but at a low rate; they may not keep up with inflation.
- Safety of principal: your fixed annuity will not lose money as a result of market declines. Caveat: you will lose money if you withdraw principal early. This is called a "surrender" to which penalties apply.

Annuities Through The Ages

- A.D. 225---A Roman judge produced the first known mortality table for “annua” which were lifetime stipends made once per year in exchange for a lump sum payment.

Annuities Financed Wars

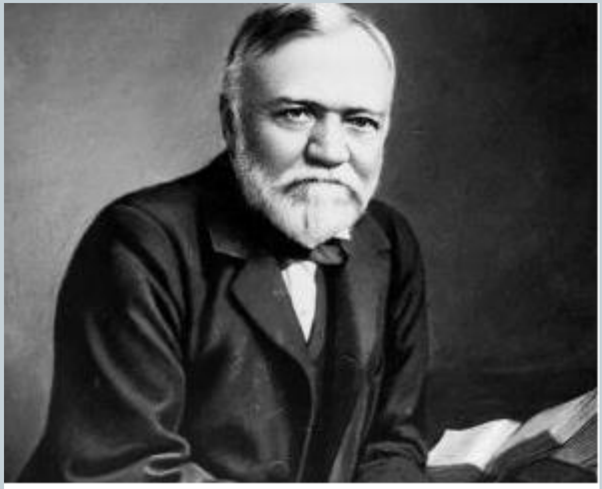
- 1600s—England, locked in war with France, issued the first government-backed annuity called the State of Tontine of 1693.

18^{th} Century

- 1776-The National Pension Program for Soldiers was passed prior to signing the Declaration of Independence. It provided annuity payments to soldiers and their families.

20^{th} Century

- 1905-Andrew Carnegie established the Teacher's Pension Fund. This eventually became the Teacher's Insurance and Annuity Association (TIAA) in 1918 to provide annuities to teachers. It lives on as the TIAA-CREF Financial Services.



The Great Depression

- 1930s: During the Great Depression, investors looked to annuities and life insurance as safe havens from financial ruin.

Social Security is essentially an annuity

- 1940: Ida May Fuller became the first Social Security Recipient. Single, with no children, she lived to age 100. She received $23,000 in lifetime payments.

Variable and Indexed Annuities Introduced

- 1952: TIAA-CREF offered the first variable deferred annuity which enable educators to invest part of their retirement in equities as a hedge against inflation.
- 1960: Variable Life Ins. Co. (VALIC) marketed a nonqualified variable annuity that boosted the popularity of annuities.
- 1994: Keyport Life Ins. Co. introduced indexed annuities.

Annuities are Big Business

- LIMRA reported 229 billion in sales of individual annuities in 2014.
- In a USA Today article, New York Life reported that an investor who purchased an annuity in the 1980s for $100,000, has collected $800,000 from the insurer.

TYPES OF ANNUITIES

- **Fixed Annuity**: Guaranteed rate of return and pay out.

- **Equity-Indexed Annuity** (EIA): a fixed annuity tied to the performance of an index (S&P, Dow Jones, Nasdaq). EIAs have the potential to earn returns better than traditional fixed annuities when the market is rising. On the other hand, in a down market, you may earn nothing while the fixed annuities keep chugging along at 2% or 3%.

Types of Annuities

- **Variable Annuity**: variable annuities are securities. Your premiums are invested in the market and you, rather than the insurer, carry the risk.

- **Immediate Annuity (aka SPIA)**: the payouts begin within the first year of the annuity; there is no deferral period. These annuities may allow for a higher level of spending than would be sustainable from a typical portfolio of other investments. i.e. a 65 year old male could purchase an inflation-indexed annuity paying 5.35% annually *for the rest of his life*. Downside: if the purchaser dies the next day, the money is gone. The insurer keeps the premium.

ANNUITY FEATURES: Choose an Index

An equity-indexed annuity will offer one or more indices to choose from:

S&P 500

Dow Jones

Nasdaq

S&P MidCap

Russell 2000

EuroSTOXX 50

Choose a Crediting Strategy

The annual point to point strategy compares the change in the index at the beginning and ending dates of the contract term.

1	**Contract begins January 3**
	Beginning Index Value: **7950**
2	**Second, the ending value of this equation is the value of the chosen index one contract year later on January 3.**
	Ending Index Value: **8909**
3	**Next the beginning value is subtracted from the ending value.** Ending Index Value – Beginning Index Value
	8909 – 7950 = difference of **959**
4	The difference is then divided by the beginning value giving us the percentage of index change using the **Annual Point-to-Point Crediting Method/Index Account Option**.
	$\frac{959}{7950}$ = 0.1206 = **12.06%* Gain**
	* Note: Please keep in mind that after the percentage change has been determined Participation Rate and/or Cap Rate may be applied.
5	**Finally, the gain may be subject to a cap and/or participation rate. Ask your sales representative for current cap rates and participation rates if applicable.**

Annual Point to Point May Feel Like a Lottery

Whether you experience a gain or loss depends on how the market performs on your specific policy anniversary:

Mary buys an annuity on 8/5/2014 using the S&P 500 index: on anniversary of 8/5/2015, S&P gained 161 points, or +8.3%

John buys an annuity on 8/24/2014: on anniversary of 8/24/2015, S&P lost 95 points, or -4.8%

Monthly point to point strategy

This method calculates the monthly percentage change in the index. Each month the cap applies to the calculation. There is no cap on negative changes. The monthly changes are added together to determine the annual interest amount to be credited.

Because there is no cap on the downside, all of the gains can be lost due to one bad month.

Example of Monthly Point to Point

Date	Price	Dollar Change	Percentage Change	Monthly Capped Change
9/16/10	1,124.66	N/A	N/A	N/A
10/16/10	1,176.19	51.53	4.6%	1.8%
11/16/10	1,178.34	2.15	0.2%	0.2%
12/16/10	1,242.87	64.53	5.5%	1.8%
1/16/11	1,293.24	50.37	4.1%	1.8%
2/16/11	1,336.32	43.08	3.3%	1.8%
3/16/11	1,256.88	-79.44	-5.9%	-5.9%
4/16/11	1,319.68	62.80	5.0%	1.8%
5/16/11	1,329.47	9.79	0.7%	0.7%
6/16/11	1,267.64	-61.83	-4.7%	-4.7%
7/16/11	1,316.14	48.50	3.8%	1.8%
8/16/11	1,192.76	-123.38	-9.4%	-9.4%
9/16/11	1,216.01	23.25	1.9%	1.8%
Total Monthly Capped Changes				**-6.4%**
Interest Credited				***0.0%***

Other crediting strategies

- High water mark (look back): looks at the index value at various points during the contract, usually the annual anniversary. It uses the highest of these values and compares it to value at the start of the term. Declines are ignored. This method not used since 2004.
- Annual Reset: Compares the change in the index from the beginning to the end of the year. Declines are ignored. Your account value resets either at the same value or a higher value, but never at a lower value.

Limitations on Interest Crediting

- Participation rate: A participation rate determines how much of the gain in the index will be credited to the annuity. For example, the insurer may set the participation rate at 80%, which means the annuity would only be credited with 80% of the gain experienced by the index.
- Cap rate: The cap rate is stated as a percentage and is the maximum rate of interest the annuity will earn.
- Spread or Margin: Sometimes used in place of participation rate. If the index gained 10% and the spread is 3.5%, the gain in the annuity will be 6.5%.

How participation and cap rates impact returns

Recall the annual point to point strategy we discussed that recognized a 12% gain for the year. Assume the annuity had an 80% participation rate and 4% cap:

12% gain X 80% participation rate = 9.6%

However, the annuity has a cap of 4%; therefore the insured does not receive either 12% or 9.6%--he receives 4%.

- NOTE: cap and participation rates may change annually. You may see your cap rate fall each year.

SURRENDER CHARGES/PENALTIES

Bonus Gold INDEX-1-07*

SURRENDER CHARGES

Surrender Charges are deducted from your Contract Value in the event of:

1. Full Surrender or
2. Withdrawals in the first year or
3. Withdrawals in excess of the Penalty-free Withdrawal amount during the surrender charge period shown below:

Issue Ages 0-80

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17+
%	20	19.5	19	18.5	18	17.5	17	16	15	14	12	10	8	6	4	2	0

Surrender Charges may vary by state.

- Withdrawals made prior to age 59 ½ may be subject to a 10% federal tax penalty.

RIDERS

- Terminal Illness Rider: This rider is available with both fixed and variable annuities. Waives surrender charges otherwise applicable for a portion or all of your annuity's accumulation value if you suffer from a terminal illness with a medical life expectancy of one year or less.
- Nursing home rider: Allows you to access your account value without penalty. For example, if you are confined to a qualified facility, you might be able to take your money out over 5 years to cover nursing home costs.

INCOME RIDERS

An income rider is an optional benefit that can be attached to an annuity for an additional fee. It will provide a lifetime income stream that you can turn on in the future.

Some income riders grow at a contractually guaranteed rate that will compound during the deferral years (rollup rate), increasing the future lifetime income stream.

Taking income depletes the value. When the insured dies, the beneficiaries get what’s left of the accumulation value, which may be zero.

You CAN lose money in an annuity!!

- Many insurance companies only guarantee that you will receive 87.5% of the premiums you paid, plus 1% to 3% interest. Therefore, you could lose money on your investment if you surrender your annuity early. Also, most annuities include harsh surrender penalties for early withdrawals.

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Surrender Charges may vary by state.

Annuitization

You can chose to annuitize your annuity at the maturity date or earlier. This converts your principal into a guaranteed income stream for the duration of your life. This is the part of the annuity that protects against outliving your annuity assets.

Contracts have a variety of annuitization options:

- Life Option: Typically provides the highest payout because the monthly payment is calculated only on the life of the annuitant. After death, no more payments are made.

Annuitization Options

- Joint-Life Option: Allows you to continue the retirement income to your spouse upon your death. The monthly payment is lower than that of the life option because the calculation is based on the life expectancy of both spouses.
- Period Certain: The value is paid over a period of time of your choosing, such as 10, 15, or 20 years. If you elect a 20-year period certain and die within 15 years, the contract is guaranteed to pay your beneficiary for the remaining five years.

Annuitization Options

- Life With Guaranteed Term: Gives you an income stream for life—like the life option—but you can select a guaranteed period, such as 10 years, under which your annuity is obligated to pay your beneficiaries if you die before the guaranteed period is over.

Some contracts allow systematic withdrawals during the payout phase. You have complete control over the timing and amount of distributions but no protection against outliving your assets.

Know these terms

- Accumulation Value: generally means the premium plus interest (less any withdrawals you made).

- Cash Value: The amount you receive upon surrender, which is the Accumulation Value less the surrender charges.

- Minimum Guaranteed Value: the minimum value your contract will provide as the cash surrender value. Generally, 87.5% of the premium.

Are you glad you asked about annuities?

THE NEED FOR SUITABILITY GUIDELINES

- About 20 years ago, state insurance regulators identified some alarming trends with regard to annuity sales.
- Companies and agents were misleading consumers into purchasing products that were not suitable for their needs and were failing to disclose important information to consumers.
- Seniors were particularly targeted because they had cash reserves and were vulnerable to the sales pitch.

THE NEED FOR SUITABILITY GUIDELINES

- One insurer reported that 74% of annuities issued were to seniors age 65 and above; 35% of the sales involved replacement.

- Another insurer reported that 76% of new annuity sales were to seniors age 65 and above, and 37% were issued to seniors age 76 and above.

Serious Violations

- In an enforcement action, OCI alleged an agent violated the law by making unsuitable sales to 40 elderly consumers. He was ordered to pay $281,000 in forfeitures and his license was revoked. Among other things:
- He forged signatures, falsified birth dates, used false and misleading advertisements, and failed to disclose surrender periods and charges.

SERIOUS VIOLATIONS

In another enforcement action, OCI alleged the agent falsely told a consumer she had sold the consumer three annuity contracts which were locked in the agent's safe. The agent provided the consumer with false contract documents. In fact, the agent had stolen nearly $600,000 in premium funds.

The agent's license was revoked, and she was ordered to pay full restitution to the consumer and $632,000 in penalties.

CAUTION: CHURNING

- Churning or twisting occurs when an agent misrepresents the facts to replace an existing annuity with a new annuity with the same or a different company. The agent uses misleading information or sales tactics to persuade the customer to surrender the current policy and use the cash value to fund a new contract.
- In 2015, four insurers paid $3.5 million in restitution to Wisconsin consumers due to churning of annuities.

WISCONSIN SUITABILITY LAW

- Wis. Stat. 628.347: In recommending to a consumer the purchase of an annuity … an insurance intermediary … shall have reasonable grounds to believe that the recommendation is suitable for the consumer on the basis of facts disclosed by the consumer as to his or her investments, other insurance products, and financial situation and needs, including the consumer’s suitability information.

SUITABILITY INFORMATION

- Age
- Annual income;
- Financial information and needs, including how the annuity will be funded;
- Financial experience and objectives
- Intended use of the annuity
- Financial time horizon
- Existing Assets
- Liquidity needs
- Liquid net worth
- Risk tolerance and tax status

INSURER’S DUTIES

An insurer may not issue an annuity recommended by an agent unless it is reasonable to believe the annuity is suitable based on the consumer’s suitability information.

An insurer must establish a supervisory system to ensure compliance with the suitability law, including maintaining procedures for review of each recommendation to detect unsuitable recommendations. The insurer and agent shall retain the customer’s suitability information for 6 years.

RED FLAGS

- Age 75 or over, or resides in nursing home
- Annual income is $20,000 or less; or is less than 120% of annual expenses;
- Premium for annuity is more than 25% of applicant's household net worth (excluding primary residence) or more than 75% of household liquid assets (assets that can be quickly converted to cash with no uncertainty as to value and no penalty)

RED FLAGS

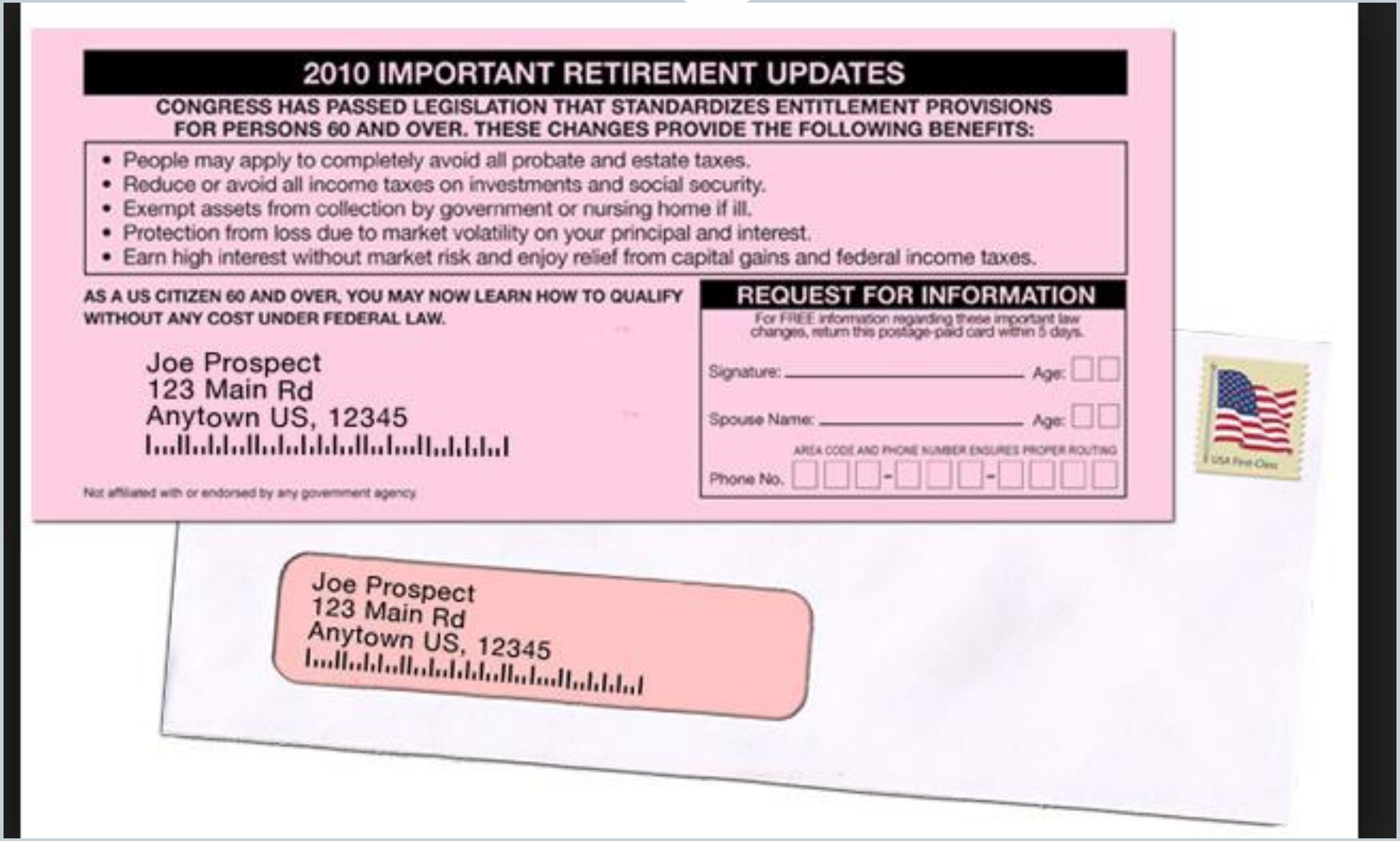
- Liquid assets are less than $50,000
- Significant increase in expenses or decrease in income is anticipated during surrender period
- Premium financed by a loan or mortgage
- Applicant has had another annuity exchange in the past 36 months

CONSEQUENCES

- OCI may order an insurer or agent to take corrective action for any consumer harmed as the result of an insurance code violation, including forfeiture, penalties, restitution, and suspension or revocation of license.
- One insurer paid $925,000 as a forfeiture based on its failure to supervise annuity sales;
- One insurer paid $1.5 million as a forfeiture based on its failure to supervise annuity sales.

Most insurance agents are polite and knowledgeable

But some agents will show up uninvited!



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CLOSE ✕

FRAUDULENT SALES PITCHES

- "This annuity will protect your assets from Medicaid spend down requirements"
- "You will be able to withdraw your money"
- "You are guaranteed not to lose principal"
- Exaggerating the rate of return
- Failing to explain conditions for receiving the bonus
- Failing to compare the features of annuities in a replacement
- Failing to explain how interest is credited
- Failing to identify surrender charges

PROTECT YOURSELF

- Do not allow an insurance agent to be a signatory on your bank accounts.
- Do not write checks to an insurance agent or the agency—the check should be made payable to the insurer.
- Read before you sign anything. Ask questions. Call the insurer if you don't understand the agent.
- Review the suitability form—is the information accurate?
- If necessary, ask the agent to leave your house-don't buy an annuity to be polite—Just say no!

Protect Yourself

- Take notes during meetings with the agent and save them.
- Ask questions in writing and request a written response (i.e. e-mail)
- Learn how to read your annual statement. It will tell you:
  - What index you are in
  - How much interest was credited to your account
  - The renewal interest rate for the fixed account
  - The new cap rate for the indices
  - Your accumulation value, cash value, minimum guaranteed value.

To summarize: When May a Sale Be Unsuitable?

- Failure to obtain sufficient information to determine needs
- Failure to take into consideration the consumer's needs
- Consumer will incur substantial tax penalties or early surrender fees from a replaced product
- Consumer will be subject to a new lengthy surrender charge period
- Agent recommends putting most of consumer's liquid assets into an annuity
- Agent recommends replacing an annuity with one that is basically the same, or with one the consumer does not have the same expected benefits or protections as the first
- Agent fails to fully explain the contract provisions, or the consumer does not fully understand the provisions of the policy
- Many other reasons based on personal circumstances of consumer

DON'T BE SHY-ASK QUESTIONS

- What is the guaranteed minimum interest rate?
- What charges, if any, are deducted from my premium?
- What charges, if any, are deducted from my contract value?
- How long is the term?
- What is the participation rate?
- For how long is the participation rate guaranteed?
- Is there a minimum participation rate?
- Does my contract have a cap?
- 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?
- What are the surrender charges or penalties if I want to end my contract early and take out all of my money?
- 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?

For more information:

- Office of the Commissioner of Insurance: http://oci.wi.gov/
- The Financial Industry Regulatory Authority:

  www.finra.org
- The Securities and Exchange Commission

www.sec.gov/investor/alerts/secindexedannuities.pdf