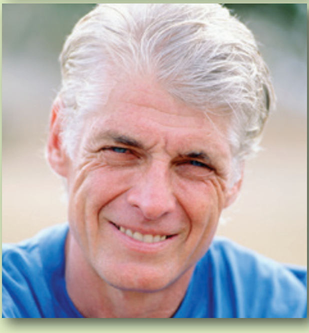
## A CONSUMER GUIDE TO

# ANNUITIES



Maryland
INSURANCE ADMINISTRATION

# A CONSUMER GUIDE TO ANNUITIES

Maryland
INSURANCE ADMINISTRATION

# TABLE OF CONTENTS

# WHO WE ARE

The Maryland Insurance Administration (MIA) is the state agency that regulates the business of insurance in Maryland. If you have a question about insurance or experience a problem, the MIA may be able to help.

# HOW WE HELP CONSUMERS

We provide assistance to consumers, businesses, health care providers (including doctors and hospitals), and producers (agents or brokers) in all areas of insurance, including life, health, disability, annuities, long term care, automobile, homeowners, and property.

The MIA can:

- provide you with educational materials about the different types of insurance coverages, and guides to help you compare rates among insurers writing automobile, homeowners, health coverage for small employers, and Medicare supplement policies;
- suggest actions or procedures you may take to help resolve your insurance problem;
- forward a copy of your complaint to the insurance company, if appropriate;
- obtain written or verbal information or explanations on your behalf from the insurance company or its representatives;
- investigate a company's action(s) to determine compliance with state laws, regulations and policy contracts; and
- take corrective action against a company if it violated a state law, regulation or policy that the MIA enforces. A violation may have occurred if an insurance carrier, insurance producer (agent), or another entity who is engaged in the business of insurance:
    - did not pay or authorize the payment for covered, medically necessary services;

- has improperly denied or delayed payment of all or some portion of your claim;
- improperly terminated your insurance policy;
- improperly raised your insurance premiums;
- made false statements to you in connection with the sale of insurance or the processing of insurance claims;
- did not make required disclosures; or
- overcharged you for services, including premium finance charges.

# RESOURCES FOR CONSUMERS

The MIA produces consumer guides, rate comparisons and frequently asked questions related to various types of insurance. The following is a partial list of available publications:

- *Consumer Guide to Homeowners Insurance*
- *Consumer Guide to Automobile Insurance*
- *An Insurance Preparedness Guide for Natural Disasters*
- *A Consumer Guide to Life Insurance.*

You can get a copy of any of these publications and others by:

- downloading it from our website, *www.insurance.maryland.gov*, on the Consumer Publications page;
- submitting a request by phone or in writing to the MIA;
- visiting our booth at community events around the state; or
- finding these printed materials at various state and local agencies.

# WHAT IS AN ANNUITY?

An annuity is a contract between you and an insurance company under which you make either a lump sum payment or a series of payments, and in exchange, the insurance company agrees to make payment to you in the future. The amount of this payment is determined according to the terms of the contract and the market environment. It typically varies depending upon the amount of the original payment, the length of the investment, and any withdrawals, among other factors. Although annuities are not life insurance, most include death benefits. Annuities are frequently used as an investment tool; however, they may not be the best investment option for you.

This publication provides a general explanation of annuities and other information to help you decide whether purchasing an annuity makes good financial sense for you. Annuity contracts can vary greatly, and many are quite complex. If you're considering purchasing an annuity, it's a good idea to consult an accountant or financial adviser.

## FIVE BASIC QUESTIONS FOR UNDERSTANDING ANNUITIES

An annuity can have a number of features, requirements, and options. The details can be difficult to understand, even for an experienced investor. You can gain a better understanding of an annuity by knowing the answers to these five questions:

- How does the annuity earn interest?
- How do you pay premiums into the annuity fund?
- When does the annuity start paying you?
- How does the annuity pay you?
- What administrative fees and charges does the annuity have?

These answers can help provide an overall sense of the annuity's main characteristics.

## TYPES OF ANNUITIES

There are two basic types of annuities – fixed and variable.

In a **fixed annuity,** the insurance company guarantees that you will earn a minimum rate of interest during the time your account is growing. The interest rate may fluctuate. Fixed annuities tend to be more conservative. The guaranteed rate may be higher or lower than the interest rate you would earn in a bank savings account.

An equity index or fixed index annuity is a variation of the fixed annuity. Your premiums can be divided between a fixed account and based on the performance of a particular stock index, such as the Standard & Poor's 500 Stock Price Index, the Dow Jones Industrial Average or other major indexes.

**Variable annuities** offer the chance to earn greater returns than the typical fixed annuity, but also have greater risk and require more active involvement by the annuity holder. These annuities are highly dependent on the performance of the stock market and generally make no guarantees about earnings. If the annuity fund performs poorly, you could lose some or all of your original investment.

For example, if you own a variable annuity, in one year, you could choose to put 40 percent of your accumulated value into the annuity's bond fund, 40 percent into its stock mutual fund, and 20 percent into its money market account. Meanwhile, another purchaser of the same annuity could allocate his or her accumulated value in a completely different way. This means that investors who purchase the same variable annuity will have different rates of return, depending upon the performance of their different allocations. Most variable annuities will allow you to change your allocation for free a certain number of times per year, after which, charges may apply.

Some variable annuities offer a "fixed interest account" within their investment options. The account essentially functions like a fixed annuity within the variable annuity, guaranteeing a minimum rate of return on dollars allocated there. A fixed interest account can be a valuable feature in times of economic downturn.

Unlike fixed annuities, most variable annuities are classified as securities by the Securities and Exchange Commission, because performance is heavily dependent on the stock market. An agent selling variable annuities must maintain a securities license in addition to the Maryland insurance license.

# UNDERSTANDING SURRENDER CHARGES

Most annuities will charge you a substantial penalty for a withdrawal from your accumulated value during the surrender period. This penalty, called a surrender charge, is typically highest in the early years of the annuity, and may be reduced or eliminated over time. Surrender charges commonly range from 5 to 15 percent of the amount withdrawn. High surrender charges easily can erase any earnings you may have gained through an annuity and could cause you to lose money. These penalties are the primary reason an annuity generally is preferred as a long-term investment, and therefore, may be unsuitable for individuals who may have more immediate needs to access their funds. You should discuss the tax consequences of early withdrawal with a tax advisor.

# HOW DO YOU PAY PREMIUMS INTO THE ANNUITY FUND?

**Single premium annuities** are contracts where you pay the entire premium up front in one lump sum. An advantage of a single premium annuity is that the full amount of your premium begins earning interest from day one.

**Flexible premium annuities** allow you to pay however much you want, when you want, within certain limits. Most flexible premiums will require certain minimum premium payments, at least in the early years. In some cases, companies also may place a cap on the maximum amount you can contribute.

# WHEN DOES THE ANNUITY START PAYING YOU?

**Immediate annuities** begin the payout phase within a very short period of time, from 1 to 13 months, for example. For this reason, immediate annuities are typically paid for in a single premium, since the entire premium amount must accumulate before the payout phase begins. The purpose of an immediate annuity typically is to convert a large sum of cash into a steady stream of income for an extended period of time.

**Deferred annuities** begin the payout phase some time after purchase. The time when the payout begins is dependent on the contract. The majority of annuities sold today are deferred annuities. Instead of receiving a payout, you also have the option of rolling the amount over into another annuity or to extend your existing annuity.

An advantage of a deferred annuity is that it allows your investment dollars to grow tax-deferred for an extended period. This means you don't pay taxes on the annuity's earnings as they accumulate, only when you make a withdrawal or receive a payout. A tax-deferred investment will generally grow at a higher rate than a comparable type of investment in which earnings are taxed annually.

# HOW DOES THE ANNUITY PAY YOU?

The annuity payout can be structured in a number of ways. Summaries of some of the most common payout structures are provided below. Not all annuities offer these options, and some may offer others. Be sure to read the actual annuity contract, in addition to any brochures the agent may give you, to learn about the features of the annuity and how the payout is structured.

- **Life only.** The company makes payments for as long as the recipient lives. Payment amount is largely determined by life expectancy – the longer the recipient can be expected to live, the smaller the payment amount will be.

There is no guarantee that the total amount invested will be returned. On the other hand, the recipient is guaranteed the income for the remainder of his or her lifetime. If the recipient lives a long time, more than the amount paid into the annuity could be received.

- **Fixed period.** The recipient receives a payment for a specific number of years. Payments after the recipient's death may be made to a designated beneficiary.
- **Life with period certain.** Payments are made during the lifetime of the recipient with a guaranteed minimum payment. That means if the recipient dies without receiving the minimum payment, a balance is paid to the named beneficiary.
- **Joint and survivor life.** The company pays the annuitant or survivor for as long as either is alive.

# SMART SHOPPING FOR ANNUITIES

If you decide that an annuity might be a good investment option for you, use these tips to help you shop:

- **Shop around.** Compare the guaranteed interest rate, and fees and surrender charges of multiple annuity contracts. Also, compare an annuity's projected return with other types of investments. Even with an annuity's tax advantages, other investments may provide an equal or better return while providing less restrictive access to your money.
- **Make sure the time frame for payout is right for your needs.** Remember that annuities are not short-term investments. They frequently take at least several years to become profitable.
- **Know how much risk you are willing to take on.** It's important to decide the level of risk you're willing to accept before you purchase an annuity. Weigh that against the risk posed by the type of annuity you're considering. Fixed annuities guarantee a minimum rate of return. Variable annuities have the potential to earn significantly more, but you also could lose money.
- **Verify that the agent and company are licensed.** Agents and companies must have a Maryland insurance license to legally sell annuities in the state. In addition, agents who sell variable annuities must have a federal securities license. Although it won't avoid every potential problem, verifying the agent

or company's license is a good first step toward ensuring that an annuity is legitimate and meets minimum state requirements. You can quickly verify licensing status by calling the MIA at 410-468-2000 or 800-492-6116.

- **Consider the company's financial condition.** Annuities are a long-term investment. A company that's in solid financial shape is more likely to be around when it's time for you to collect on your investment. You can learn a company's financial rating from an independent rating organization such as:

A.M. Best
800-424-2378
*www.ambest.com*

Moody's Investors Service
212-553-0377
*www.moodys.com*

Fitch Ratings
800-893-4824
*www.fitchratings.com*

S&P Global Ratings
877-772-5436
*www.spglobal.com/ratings*

Demotech, Inc.
800-354-7207
*www.demotech.com*

- **Take your time to consider.** It's probably not a good idea to purchase an investment as complex as an annuity on a first visit with an agent. Take all the time you need to make a decision. If you feel you are being pressured to make a decision quickly, you may want to go elsewhere. It's a good idea to ask a trusted family member or friend to accompany you when you meet with the agent.
- **Maryland has a legally mandated free-look period.** All annuities sold in Maryland come with a 10-day free-look period. During this period, you can cancel the contract for any reason. If you have a fixed annuity and cancel within the free-look period, you may be entitled to a full refund. If you have a variable annuity, you may not receive a refund for any loss in the investment. Use this time to reread the contract and make sure it meets your financial needs. If the annuity doesn't offer a free-look period, be careful. If you have already purchased an annuity, and it does not have a free-look period, you may file a complaint with the MIA.
- **Be wary of annuities sold door-to-door or over the telephone.** While most annuities sold door-to-door or over the telephone are legitimate, these sales techniques can lend themselves to fraud operations. If you do buy an annuity in this manner, obtain the company's physical address and make sure you have a way to contact the agent or company.
- **Consider consulting an accountant, financial adviser, or a trusted family member or friend.** If you purchase an annuity that you don't fully

understand, you could be in store for surprises down the road. A finance professional may help you understand the annuity and evaluate it in comparison to other investment products. Also, you may want to discuss the annuity with a trusted family member or friend who can assist you with making financial decisions.

# QUESTIONS TO ASK BEFORE YOU BUY

*Ask yourself:*

- How much retirement income will I need in addition to Social Security, pension, savings, and any other income or investment sources?
- Will I need income for myself only or for someone else as well?
- How much can I afford to pay in premiums?
- How will the annuity contract fit in with my total financial planning?
- How long can I leave money in the annuity?
- When will I need income payments?

*Ask the agent or company:*

- Is this a single premium or flexible premium contract?
- Are any administrative charges deducted from my premium or contract value?
- How is the interest rate determined?
- Is there a guaranteed minimum interest rate?
- How long is the company's credited (current) interest rate guaranteed?
- How often does the company change the credited rate?
- What is the company's history regarding renewal of the credited rate?
- Are there surrender charges or other penalties if I want to end the contract early?
- Can I get a partial withdrawal without paying fees or losing interest?
- Are charges waived for larger withdrawals if I am confined to a nursing home or diagnosed with a terminal illness?

- Is there a death benefit and how does it work?
- What are the options for benefit payments?

# TRADING YOUR ANNUITY FOR A NEW ONE

If you are considering replacing one annuity for another, it is a good idea to carefully compare your old product with the new one. Are the death benefits the same? Is there a surrender charge to get out of the old annuity? Are the annual fees and new surrender charges higher for the new product? Will there be a new surrender charge period for the new product?

Also, keep in mind that your insurance producer (agent or broker) will earn a new commission if you switch annuities. Advising a client to change annuities for the sole purpose of earning a commission, without regard to the client's best financial interest, is a practice called "churning" and is against the law in Maryland. If you believe you are a target of churning, you may file a complaint with the MIA. To file a complaint online, go to: *https://enterprise.insurance.maryland.gov/consumer/ConsumerPortalWelcomePage.aspx*

It is also a good idea to consult with your financial advisor to make certain you fully understand any tax consequences before you replace your annuity.

# FILING A COMPLAINT

Consumers may file complaints with the Maryland Insurance Administration. The MIA can only investigate complaints concerning policies issued in Maryland or to a Maryland resident. You may find complaint forms on the MIA's website, *www.insurance.maryland.gov.* Once completed, these should be mailed to the MIA along with copies of any relevant correspondence you received about your annuity. For further assistance, call the MIA at 800-492-6116.

**People with disabilities may request this document in an alternative format. Requests should be submitted in writing to the Chief, Communications and Public Engagement at the address listed below.**

Maryland
INSURANCE ADMINISTRATION

200 St. Paul Place, Suite 2700
Baltimore, MD 21202
410-468-2000
800-492-6116
800-735-2258 TTY

*www.insurance.maryland.gov*

*www.facebook.com/MdInsuranceAdmin*
*www.twitter.com/MD_Insurance*
*www.instagram.com/marylandinsuranceadmin*

MIA-AN-1 (2/21)