CA 4-Hour Annuity Training

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CA 4-Hour Annuity Training

I. Identify and Discuss Suitability

Suitability of Certain Annuity Transactions

One of the purposes of insurance regulation is to establish standards and procedures regarding recommendations made to a consumer that result in a transaction involving annuity products. The goal is to ensure that the insurance needs and financial objectives of the consumer as of the time of the transaction are appropriately addressed.

Suitability information means that it is reasonably appropriate to determine the suitability of a recommendation, including the following;

- Age
- Annual income
- Financial situation and needs, including the financial resources used for the funding of the annuity
- Financial experience
- Financial objectives
- Intended use of the annuity
- Financial time horizon
- Existing assets, including investment and life insurance holdings
- Liquidity needs
- Liquid net worth
- Risk tolerance
- Tax status

Applicability, Exemptions

The regulations apply to any recommendation to purchase or exchange an annuity that is made to a consumer by an agent or insurer; and results in the recommended purchase or exchange. Unless otherwise specifically included, the regulations do not apply to recommendations involving:

- direct response solicitations if there is no recommendation based on information collected from the consumer under the regulations
- contracts used to fund employee pension benefit plans or employee covered by ERISA
- a Section 401 or 408 plan
- a Section 457 government or church plan
- a nonqualified deferred compensation arrangement
- settlements of or assumptions of liabilities for personal injury/dispute or claim resolution
- prepaid funeral benefits contracts

The establishment of suitability standards for carriers and producers helps them to determine whether the purchase or replacement of a long-term care insurance product is appropriate for the financial needs of the applicant. The main purpose of suitability standards is to make clear that life and health insurers cannot classify individuals without a rational basis for each decision.

In recommending that individual consumers, including consumers over the age of 65, purchase or exchange an annuity, the insurance producer (or insurer where no producer is involved), must have reasonable grounds for believing that the recommendation is suitable for the individual consumer on the basis of the facts disclosed by the individual consumer as to his or her investments and other insurance products and as to his or her financial situation, needs, and objective.

Importance of Determining Client Suitability

During its 2003 fall national meeting, the National Association of Insurance Commissioners (NAIC) adopted the Senior Protection in Annuity Transactions Model Act, a model regulation designed to help protect senior consumers when they purchase or exchange annuity products. In 2010 the NAIC went back to the well, so to speak, and adopted a Suitability in Annuity Transactions Model Regulation that extends protection to all consumers. The intent of the earlier measure is to ensure that the insurance needs and financial objectives of senior consumers (age 65 or older) are appropriately addressed. The model legislation is intended to provide senior consumers peace of mind that they are well protected when making financial decisions, according to an NAIC press release. The regulation lists standards and procedures for insurers and insurance producers relating to the purchase or exchange of annuity products involving senior consumers;

- In recommending to a senior consumer the purchase of an annuity or exchange of an annuity that results in another insurance transaction, the insurance producer, or the insurer where no producer is involved, must have reasonable grounds for believing that the recommendation is suitable for the senior consumer on the basis of the facts disclosed by the senior consumer as to his or her investments and other insurance products and as to his or her financial situation and needs.
- Prior to the purchase or exchange of an annuity based on a recommendation, there must be reasonable efforts to obtain information about the senior consumer’s financial status, tax status, investment objectives, and other information that could be reasonably considered by the insurance producer or insurer in making recommendations to the senior consumer.
- Neither an insurance producer, or an insurer where no producer is involved, will have any obligation to a senior consumer related to any annuity transaction if a consumer refuses to provide relevant information requested by the insurer or insurance producer, decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer, or fails to provide complete or accurate information. An insurer or insurance producer’s

recommendation will be considered reasonable under the circumstances actually known to the insurer or producer at the time of the recommendation.

- An insurer must assure that a system to supervise recommendations is in place that is reasonably designed to achieve compliance with the regulation. An insurer may meet its obligations by conducting periodic reviews or by contracting with a third party, such as an independent agency, to maintain the supervisory system and to provide certification to the insurer that the supervision is occurring.
- Compliance with the National Association of Securities Dealers Conduct Rules regarding suitability will satisfy the requirements for variable annuities. However, this does not limit the insurance commissioner's ability to enforce the provisions of the new regulation.

Additionally, the model regulation does exempt insurers and insurance producers from recommendations involving direct-response solicitations (where no recommendations are made based on information provided by the consumer pursuant to the regulation), as well as various funded contracts covered under federal law.

Need for Information Prior to Making Recommendations

It is the duty of agents to reminded potential purchasers that annuities are not suitable for all investors, particularly those who may need cash for short term needs. Producers must recognize the need for information. This is true for fixed as well as variable annuities, whose hybridization of both securities and insurance features may be more difficult to understand.

The Florida Office of Insurance Regulation announced in September 2012 a multi-state settlement agreement between Allianz Life Insurance Company, and 44 jurisdictions involving the sale of fixed annuity products from 2001 to 2008. The lead states in the examination included Florida, Iowa, Minnesota, and Missouri. The settlement agreement included corrective action to be taken by the company, a remediation plan, and a $10 million penalty to be paid to the participating states – Florida expects to receive in excess of $1 million of this payment.

Some consumers who purchased annuities during these years complained to Allianz regarding the suitability of the annuities for their circumstances or representations made by Allianz or its agents during the sale of an annuity. Under the remediation plan, Allianz will implement a review process addressing new and previously filed complaints by customers who purchased an eligible fixed annuity product between 2001 and 2008.[1]

The Consumer's Financial Status

Questions should be asked by seniors (or on their behalf) before purchasing an annuity. Among the questions:
Might I need this money in the short term?

[1] Florida Office of Insurance Regulation Statement: http://www.floir.com/pressreleases/viewmediarelease.aspx?id=1959

Do I have enough money now to purchase this product?
What am I paying for each feature?
Are the extra fees worth it for me?
Will I have to take out a home loan to keep up with payments?

Insurance agents using annuities with a client age 65 or older must have reasonable grounds for believing that the annuity is appropriate for the consumer. This is after the representative obtains the necessary client financial information when determining annuity suitability. The rules also say that producers do not have obligations to the client if the senior refuses to provide pertinent information or decides to enter into an insurance transaction that was not recommended by the producer.

Insurers must design compliance standards to ensure that senior clients are getting appropriate advice and that producers are following the rules. Companies are charged with the responsibility to make sure that their agents or producers are getting the right information to serve the consumer well. Insurers have a responsibility to set up guidelines and education and to monitor their insurance producers. It is the responsibility of the agent to verify that all compliance issues, all financial suitability forms promulgated by the insurer for a particular policy or class of policies are presented to the prospective annuity purchaser.

Regulatory turf issues are not ruled out. A spokesperson for the American Council of Life Insurers said that with variable annuities included in the NAIC proposal, there is a potential conflict of the supervisory duties of broker-dealers under the NASD rules. The Senior Protection Annuity Model Act provisions say the supervisory role rests with the insurance company. The NASD requires that broker-dealers supervise its reps that sell insurance with already-created compliance rules. It is not clear how the two sets of rules would mesh. Nonetheless, the licensee must the California Insurance Code and pronouncements of the Department of Insurance.

Consumer Tax Status

A primary concern for consumers is determining how much income tax will be owed on payments from the annuity contract. The tax treatment of a distribution depends on if it is received before or after the annuity starting date, and on the amount of the investment. Cash withdrawals from deferred or retirement annuities before age 59½ are generally subject to a 10% penalty tax on the portion included in gross income. Payments received on or after the annuity starting date are treated differently.

The General Rule- This is a calculation method prescribed by the IRS. Under the General Rule, an individual determines the tax-free part of each annuity payment based on the ratio of the cost of the contract to the total expected return. Expected return is the total amount the taxpayer and other eligible annuitants can expect to receive under the contract. To figure it, a person must use life expectancy (actuarial) tables prescribed by the IRS. The General Rule must be used if a person receives pension or annuity payments from:

1) A nonqualified plan (such as a private annuity, a purchased commercial annuity, or a nonqualified employee plan), or
2) A qualified plan if the person is age 75 or older on the annuity starting date and his or her annuity payments are guaranteed for at least 5 years.

Consumer Investment Objectives

It is generally considered that the first step in establishing financial goals is to analyze the current financial condition. This can be easily accomplished by examining assets and establishing a budget. Budgeting should also include cash reserves for emergencies and insurance coverage. Once the current financial condition has been evaluated, the second step is to establish broad investment objectives. There are essentially three primary investment goals:

- Preservation of principal.
- Generation of stable after-tax income.
- Appreciation of principal.

Investment Objectives- Like so many aspects of life, terms of art can sometimes hinder effective communication. In one allegorical case, the broker testified that he asked his client what his investment objectives were and the client replied, "To Make Money!" This cavalier response sent a message that the client was willing to take big risks in order to get big gains. The broker noted "speculation" as the client’s investment objective, yet the client testified that what he <u>meant</u> was that he wanted his money to grow, but <u>not</u> at the expense of his principal.
"Investment objective" is what is known as a term of art in the securities industry. It does not mean that an investor knows what specific investments he or she wants to make. Nor does it require some abstract or philosophical response. Standard choices when considering investment objectives are:
Preservation of Principal- The investor does not want to lose any of the money being invested. Such people are generally more comfortable with conservative, stable investments and are not willing to take any risk of principal (the only risk one might be willing to assume is the amount and certainty of the income or appreciation).
Stable Income- The investor wants to generate income from the money being invested and is willing to take some small risk in order to receive increased income.
Appreciation of Principal- The investor has more of a long-term investment horizon. He or she may be saving for a future goal and is willing to take some risk (approximately 10% of portfolio is a common rule of thumb) in order to increase the growth potential. Or it could be that diversification to achieve a combination of both income and some capital appreciation is desired. Such individuals are comfortable with moderate risk.

Other investment categories include-
Aggressive Growth – Investing in order to maximize returns.
Speculation - The investor is willing to lose all or a substantial portion of the money.

The Objectivity Dilemma

Customer disputes can center on the issue of the nature of the client's investment objectives. Setting investment objectives can be difficult for several reasons. First, the great majority of investors don't have a clear understanding of what they want to do. And for those who do, they do not clearly express it. Second, insurers, brokerage firms, or regulators require a few pre-printed boxes of investment objectives be shown on the new account form. These categories may prove to be too limiting or too susceptible to interpretation (subjective in nature). Look at the issue from another perspective; the agent checks <u>all</u> of the boxes for the client's investment objectives, reasoning that the client said he or she wanted to do a little of everything. This defeats the purpose of the information– There is no yardstick or guide to ensure that suitable investments are being made. Arguably, everything is suitable and the agent has carte blanche to recommend anything and everything under the sun to the client.

Documentation cannot be stressed enough. The insurance professional must make sure that a written record shows that investment objectives reflect the overall guidelines for how the client wants his or her investments handled.

Other Information

Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain information concerning such other information used or considered to be reasonable by the insurance producer, or the insurer where no producer is involved, in making recommendations to the senior consumer.

Agents should assist in determining suitability for annuity sales with information gleaned from questions directed to the potential purchaser. This should be in printed form, signed or acknowledged by the senior, so that both parties know an effort was made to get everything down in writing. Information needed includes;

- Age
- Tax bracket
- Upcoming financial needs (does the senior anticipate withdrawing one third or more of his or her total cash and investments for a major purchase, college tuition, or other major need?)
- The need for income, whether adequate funds for emergency financial needs are available.
- Expected future earnings from employment
- What percentage of monthly income is used to pay installment debts (credit cards, auto loans, etc.)
- What percentage of total income is derived from current investments?
- The ability and willingness to take risk
- The individual's investment knowledge and prior investing experience

Clear and concise information is essential to clearly spelling out investment objectives.

A. Licensing Requirements for Life-only Agents

Here are the requirements for selling annuities. The requirements apply to agents as indicated.

1. Training

Licensed insurance agents who want to sell annuities must satisfactorily complete eight hours of training before selling annuities (the eight-hour annuity training course). In subsequent insurance license renewal periods, life agents who sell annuities must complete four hours of annuity training. The hours will count toward the licensee's continuing education requirement. The required training must be approved by the commissioner and consist of topics related to annuities, and California law, regulations, and requirements related to annuities, prohibited sales practices, the recognition of indicators that a prospective insured may lack the short-term memory or judgment to knowingly purchase an insurance product, and fraudulent and unfair trade practices. Topics primarily intended to promote the sale or marketing of annuities do not count.

Training requirements do not apply to nonresident agents representing direct response insurers. The term 'direct response insurer' means;

- The insurer does not initiate telephone contact with insureds or prospective insureds.
- Agents of the insurer speak with insureds and prospective insureds only by telephone, and at the request of the insureds or prospective insureds.
- Agents of the insurer are assigned to speak with insureds or prospective insureds on a random basis, when contacted.
- Agents of the insurer are salaried and do not receive commissions for sales or referrals.

(Section 1749.8 of the California Insurance Code (CIC))

B. Checklist as Required by Section 10509.914(e) of the CIC

At the time of sale of an annuity the agent must do all of the following:

- Make a record of any recommendation subject suitability requirements of Section 10509.914(a) of the CIC
- If applicable, obtain a customer-signed statement documenting the customer's refusal to provide suitability information.
- Get a signed statement from the consumer acknowledging that an annuity transaction is not recommended if the customer decides to buy an annuity contrary to the agent's recommendation.

(Section 10509.914(e) of the CIC)

C. Insurer Responsibilities as Required by Section 10509.914(f)(D) & (E) of the CIC

Insurers should establish a supervision system reasonably designed to achieve the insurer's and producers' compliance with mandates on insurance suitability. The supervision system should include:

- Procedures to inform producers of the pertinent requirements listed here.
- Standards for insurance producer product training and compliance.
- Product-specific training and materials.
- Procedures for review of each recommendation prior to issuance of an annuity.
- Methods to detect recommendations that are not suitable.
- System audit features.

Third-party vendors can be used to administer/monitor the compliance system if the contractor is monitored and management certifies the contract function.

Consumers must not be dissuaded from or talked out of any of the following:

- Truthfully responding to an insurer's request for confirmation of suitability information
- Filing a complaint
- Cooperating with the investigation of a complaint

All the mandates and proscriptions outlined in the section above apply to Financial Industry Regulatory Authority (FINRA) broker-dealer sales of variable and fixed annuities (Section 10509.914 of the CIC).

Insurers must maintain procedures for review of each recommendation before annuity issuance. The procedures must be designed to ensure that there is a reasonable basis to determine recommendations are suitable. Review procedures can use a screening system (electronic, physical, or otherwise) to identify selected transactions for additional review. The review system may be designed to require additional review of transactions identified by selection norms. The insurer is to maintain reasonable procedures to detect recommendations that are not suitable, including (but not limited to);

- confirmation of consumer suitability information
- systematic customer surveys
- interviews, confirmation letters
- programs of internal monitoring

This does not preclude the insurer from applying sampling procedures or by confirming suitability information after issuance or delivery of the annuity. (Sec. 10509.914 (f)(D) & (E) of the CIC)

II. Identifying and Discussing Contract Provisions

The provisions described here are all common but each one is not available in every contract. **Purchasers must read the contract!** The terms and conditions should be understood by the buyer before completion of the sale. The descriptions here are examples only. Features included in a contract will be defined in the contract. Thus the “owner,” “annuitant,” and “beneficiary” will all be spelled out in the contract definitions.

Contract loans- A loan provision may be included in an annuity contract. In general, this feature allows one to borrow up to a specified amount of the annuity’s accumulated value. Since it is a loan, interest will accumulate and it most likely will be to the owner’s advantage to repay it. Like the withdrawal privilege, a loan provision can give some liquid features to an annuity.

Return of principal guarantee - Surrender of the contract should be avoided whenever possible, but individual circumstances may leave a person with no other choice. If an annuity must be surrendered, this feature gives assurance that the company will pay no less than the total dollars that have been paid in premiums (minus any prior partial withdrawals). It applies even if the amount is greater than the cash surrender value defined by the contract.

Minimum Initial Premium- Each annuity contract will designate a minimum premium that the policyowner must pay to purchase an annuity. Normally these amounts are in the $5,000–$10,000 range for single-premium policies and $25–$50 per month for flexible-premium policies. Insurance companies may designate a different minimum amount, depending on the type of funds the client places inside the annuity. For example, a policy might show a minimum premium of $1,000 for a qualified single-premium annuity but still keep the nonqualified annuity minimum premium at $5,000. Lower premium amounts are common for qualified contracts so that the annuity can accept small annual IRA contributions.

Issue Age Each annuity contract will have a provision for the minimum and maximum age of the owner or the annuitant who can purchase the contract. Generally, the insurance company is more interested in the age of the annuitant for purposes of mortality. But the issue age of the owner is also important because of legal issues related to minors who purchase the contract. Normally, an insurance company does not want a minor to own one of its policies because of the minor’s legal right, upon reaching the age of 18, to rescind a purchase made while he or she was a minor. Usually, annuity contracts allow annuitants between the ages of 18 and 85. Some companies may stop issuing annuities at age 70 or 75; other companies will issue annuities up to age 90. In addition, the insurance company may limit the issue age based on the type of funds in the annuity. Qualified annuity contracts typically carry a maximum issue age of 70, while nonqualified annuities will be issued to age 85 or 90. The reason for the qualified funds’ limitation is based on the minimum distribution requirements for qualified annuity contracts. The tax code stipulates that qualified plans distribute a certain percentage of the account after the owner reaches age 70 1/2.

Options Involving the Spouse- The spouse as the beneficiary of an annuity contract may choose not to accept the death benefit and instead may choose to continue the annuity contract with the insurance company. The surviving spouse can roll over tax free all or part of a distribution from a qualified retirement plan received from a deceased employee. The rollover rules apply if the surviving spouse were the employee. You can roll over the distribution can be rolled over into a qualified retirement plan or a traditional or Roth IRA. The insurance company will change the owner from the deceased person's name to that of the spouse.

Settlement Options- A settlement option is any one of the various methods for the payment of the proceeds or values of an insurance policy (annuities included) that may be selected. Deferred annuity contracts also include provisions for taking the money out of the contract at some future date determined by the contract owner. So, this distribution could commence upon annuitization of the principal amount or at some other agreed-upon date in the future. These optional modes of settlement include; taking a lump-sum withdrawal, leaving the proceeds in the contract at interest, choosing fixed-period or fixed-amount payments, or selecting the various life contingent or joint-life-contingent options. Little attention is given to these contractual provisions in periods of high interest rates. During times of low interest rates and with increasing longevity, the guaranteed lifetime annuitization factors and interest rate guarantees can represent real value. The minimum payout rates for settlement options are listed in the annuity policy. In a normal economy, these rates are much lower than what the annuity company can afford to pay. Therefore, it is important for the owner to look at the guaranteed settlement option rates in the policy and compare those rates to the current offerings from the insurance company to be sure to obtain the best rates available. Surrender of the contract should be avoided whenever possible, but circumstances may leave the policyholder with no choice. If someone must surrender his or her annuity, this feature gives assurance that the company will pay no less than the total dollars that have been paid in premiums — minus any prior partial withdrawals already taken. It applies even if the amount is greater than the cash surrender value defined by the contract.

Death Benefits- If the entire annuity value is not consumed during retirement, when the annuitant dies, the annuity will still be in force. Annuities contracts have provide for a beneficiary or some other party to legally receive the values at the annuitant's death. The death benefit can be classified in one of two ways depending on how the death benefit is payable in the policy: Policies are either annuitant driven or owner driven.

A. Issue Ages

The insurance contract has the basic elements of any other contract. Those elements are summarized (not in correct order) by the acronym COALL. It stands for Consideration, Offer, Acceptance, Legal capacity to contract, and Legality of subject matter. Notice is given to the fact that <u>in writing</u> is not an element that must be present to have an enforceable contract. This is important, insurance professionals should be careful about verbal modifications of contracts. Generally speaking, a person has the legal capacity to contract when he or she reaches the age of majority, 18 years. In common law, persons under 18 can contract, but the contract is voidable at his or her discretion.

At the upper-end of the age spectrum contracts allow annuitants up to age 85. Some companies may stop issuing annuities at age 70 or 75; other companies will issue annuities up to age 90. In addition, the insurance company may limit the issue age based on the type of funds in the annuity. Qualified annuity contracts typically carry a maximum issue age of 70, while nonqualified annuities will be issued to age 85 or 90. The reason for the qualified funds' limitation is based on the minimum distribution requirements for qualified annuity contracts. The tax code stipulates that qualified plans distribute a certain percentage of the account after the owner reaches age 70 1/2.

With respect to insurance and annuity contracts, the common law provisions have been modified by statute. An insurance or annuity contract may be issued to or indicate the named insured as a person under the age of 18 for the benefit of the minor or for the benefit of the parents, spouse, child, or siblings of the minor. Likewise, a contract can be issued to a minor, subject to written consent of a parent or guardian, upon the life of any person in whom the minor has an insurable interest for the minor's benefit or such minor's parents, spouse, or siblings. Subject to approval of a parent or guardian, a minor may give a valid discharge for any benefit accruing or for any money payable. Contractual matters involving minors under the age of 16, as determined by the nearest birthday (meaning 15½), need the written consent of a parent or guardian. These minimum age limitations are subject to the terms of the California Probate Code, which gives mechanisms for a guardian or conservator to act in *loco parentis,* in the place of the parents. That is, in the best interest of the ward or conservatee. (Section 10112 of the CIC)

B. Maximum Ages for Benefits to Begin

Non-Qualified Annuities- Annuities are based on life expectancy. Being non-qualified, the tax code specifies no maximum age limitation for contributions or withdrawals. It is at the issuer's discretion as to age at which payments must begin. Once annuitization occurs, payments must be spread evenly over the life expectancy of the annuitant.

Qualified Plans- To make sure that most of the retirement benefits are paid to the plan participant during his or her lifetime, rather than to subsequent beneficiaries after an individual's death, the payments that are received from qualified retirement plans must begin no later than the plan participant's ***required beginning date*** (defined later). The payments each year cannot be less than the ***minimum required distribution***.

If the actual distributions to an individual in any year are less than the minimum required distribution for that year, he or she is subject to an additional tax. The tax equals 50% of the part of the required minimum distribution that was not distributed. A qualified retirement plan includes a qualified employee annuity plan and a tax-sheltered annuity plan (403(b) plan) (for benefits accruing after 1986).

Required beginning date. Unless the rule for 5% owners and IRAs applies, the plan participant must begin to receive distributions from the qualified retirement plan by April 1 of the year that follows the ***later*** of:

- The calendar year in which the subject individual reaches age 70½, or
- The calendar year in which the person retires.

***5% owners**.* If a person is a 5% owner of the employer maintaining the qualified retirement plan, the plan participant must begin to receive distributions from the plan by April 1 of the year that follows the calendar year in which he or she reaches age 70½. This rule does not apply if the retirement plan is a government or church plan.

A person is a 5% owner if, for the plan year ending in the calendar year in which he or she reaches age 70½, the person in question owns (or is considered to own under section 318 of the Internal Revenue Code) more than 5% of the outstanding stock (or more than 5% of the total voting power of all stock) of the employer, or more than 5% of the capital or profits interest in the employer.

Age 70½. A person reaches age 70½ on the date that is 6 calendar months after the date of their 70th birthday. For example, if your 70th birthday was on June 30, 2012, you reached age 70½ on December 30, 2012. If your 70th birthday was on July 1, 2012, you reached age 70½ on January 1, 2013.

Required distributions. By the required beginning date, as explained above, the plan participant must either:

1) Receive his or her entire interest in the plan (for a tax-sheltered annuity, the entire benefit accruing after 1986), or

2) Begin receiving periodic distributions in annual amounts calculated to distribute the entire interest (for a tax-sheltered annuity, the individual’s entire benefit accruing after 1986) over a person’s life or life expectancy or over the joint lives or joint life expectancies of the plan participant and his or her designated beneficiary (or over a shorter period).

C. Premium Payments

Incorporated life insurers that issue policies on the reserve basis can collect premiums in advance. Insurers are limited by statute as to the amount of advance premium that can be collected. However, the Insurance Code does not limit the ability of insurers to accept payment under an agreement that provides for an accumulation of such funds for the purpose of purchasing annuities at future dates. (Section 10540 of the CIC)

D. Surrender Charges

Annuity contracts carry a surrender charge. A typical contract could have a surrender charge in effect over the first 10 years, but decreasing in amount each year. The contract will explain how the surrender charge applies. An annuity is a long-term investment. The surrender charge discourages the annuity owner from using the funds as a piggy bank. It also allows the insurer to cover the expense of selling and issuing the contract. The charge is usually a percentage of either the fund’s accumulated value or the total premiums paid. Surrender charges are generally waived under certain circumstances, such as death or disability of the annuitant.

Insurance products sold to individuals 60 years of age or over in California shall provide an examination period of 30 days after receipt for the purpose of review of the contract. Return during this “free look” period voids the policy, with premiums fully refundable. If premiums or fees are not refunded in a timely manner (no later than 30 days) interest shall be due on the outstanding balance at the statutorily prescribed rate. Policies and certificates are to note this right of return on the cover page in at least 10-POINT UPPERCASE TYPE. (Section 786 of the CIC)

Section 10127.10 of the California Insurance Code goes on to say that any policy delivered after July 1, 2004 must have the cancellation/refund notice printed or attached to it. Delivering or mailing it to the insurer or agent from whom it was purchased can cancel the policy. The insured may return the policy by mail or otherwise during the 30 day period.

Annuity contracts for senior citizens that contain a surrender charge period need to disclose the surrender period and all associated penalties in 12-point bold print on the cover sheet of the policy or disclose the location of the surrender information in bold 12-point print on the cover page of the policy, or printed on a sticker that is affixed to the cover page or to the policy jacket. The notice required by this section may appear on a cover sheet that also contains the disclosure required by subdivision (d) of the California Insurance Code Section 10127.10. (Section 10127.13 of the CIC)
The word “values” as used in other sections of this book includes surrender value. (Section 10127.11 of the CIC)

Whenever an insurer provides an annual statement to a senior citizen policyowner of an individual life insurance policy or an individual annuity contract issued after January 1, 1995, the insurer shall also provide the current accumulation value and the current cash surrender value. (Section 10127.12 of the CIC)

1. Market Value Adjustment

Market value adjustments are features added to some deferred annuities to discourage surrenders prior to their contractual maturity date. If, during the contract period and before the maturity date, money in excess of any free-corridor amount is withdrawn, it is subject to a market value adjustment. The market value adjustment is an increase or decrease in the annuity’s value, depending on the level of the general economy’s interest rates relative to the interest rates of the contract from which the withdrawal is taken. Annuities with market value adjustment features often offer a slightly higher interest rate than a comparable fixed annuity without such features. The market value adjustment works in the annuity contract in a manner similar to the way individual bond prices fluctuate. For example, if a contract owner has an annuity with a contractual interest rate of 8 percent with 5 years left prior to its maturity date, and similar contracts are being issued with 4 percent interest rates, the contract owner can expect some gain upon early surrender. This is because the surrender will relieve the insurance company from its 8 percent obligation in a market where interest rates have decreased to 4 percent. On the other hand, if the opposite occurred and the old contractual obligation was for 4 percent in a current interest rate market of 8 percent, the contract owner can expect a negative MVA and therefore will receive a smaller

2. Impact of Surrender Charges on Principal

Surrender charges are a reduction of principal. They do not reduce the interest earned portion of an annuity. However, subsequent earnings will be reduced because of the reduction of principal. The idea behind surrender charges is to make it less tempting for annuity owners to draw funds out of the contract. This allows the insurer to keep the contract owner's money longer and that way recover costs associated with the contract.

3. Surrender Charge Waivers- Triggering Events

With a waiver, access can be provided to an annuity before retirement. Some annuities contain a waiver that triggers payments not subject to the usual surrender fees. This is a "waiver of surrender charge benefit." Section 10271.1 of the California Insurance Code states that the insurer waives the surrender charge usually levied for a withdrawal of funds from the account value of an annuity contract if the owner, insured, or annuitant, as applicable, meets one of the following:

- Is receiving, as prescribed by a licensed health care practitioner or certain social services professionals, care in or is confined to a nursing home or similar facility. The care cannot be defined more restrictively than as in the Medicare program, or is confined in a residential care facility or residential care facility for the elderly, as defined in the Health and Safety Code. Out-of-state providers of services must be comparable in license and staffing requirements to California providers.
- Develops any medical condition where life expectancy is projected to be less than or equal to a limited period of time that shall not be restricted to a period of less than 12 months or greater than 24 months.
- Unemployment, either voluntary or involuntary, is another condition for which a waiver of surrender charges could be added.
- Becomes totally disabled in that during the first 24 months of total disability, the owner, insured, or annuitant, as applicable, is unable to perform his or her job due to sickness or bodily injury. After the first 24 months of total disability, he or she is unable work at any other job the individual could reasonably be expected to perform satisfactorily in light of his or her age, education, training, experience, station in life, or physical and mental capacity. The total disability may include presumptive total disability, such as the loss of sight, hearing, speech and/or the loss of use of two or more appendages.
- Has any medical condition that would, in the absence of treatment, result in death within a limited period of time, as defined by the supplemental benefit, but is not restricted to a period of less than six months.
- Has a chronic illness. That is, meets the requirements for long-term care; the inability to perform two or more activities of daily living as set forth in subdivisions (a) and (g) of Section 10232.8, meaning the insured needs human assistance, or needs continual substantial supervision. Or, the insured has an impairment of cognitive

ability, meaning a deterioration or loss of intellectual capacity due to mental illness or disease, including Alzheimer's disease or related illnesses that require continual supervision to protect oneself or others.

Surrender charges are commonly deducted from withdrawals. There may also be a limited free withdrawal privilege. In most cases, there is no extra charge for certain crisis waivers because they are built into the contract when purchased. Variable annuity contracts may offer crisis waivers for an additional expense. Certain tax consequences could apply to such withdrawals. The insurance professional should advise clients to check with a tax advisor before withdrawing funds from an annuity.

4. Required Notice and Printing Requirements

When penalties are associated with surrender of the contract the notification requirement can be met through a notice in 12-point bold print on the cover page making the mandated disclosures or by indicating the location of this information in the policy. Every individual life insurance policy and every individual annuity contract, other than variable contracts and modified guaranteed contracts, subject to this section, that is delivered California are required to have a notice either printed on the cover page or policy jacket in **12-point bold print** with one inch of space on all sides or printed on a sticker that is affixed to the cover page or policy jacket (initial verbiage of the notice is shown below. (Section 10127.10 of the CIC);

"IMPORTANT

YOU HAVE PURCHASED A LIFE INSURANCE POLICY OR ANNUITY CONTRACT. CAREFULLY REVIEW IT FOR LIMITATIONS.

THIS POLICY MAY BE RETURNED WITHIN 30 DAYS FROM THE DATE YOU RECEIVED IT FOR A FULL REFUND BY RETURNING IT TO THE INSURANCE COMPANY OR AGENT WHO SOLD YOU THIS POLICY. AFTER 30 DAYS, CANCELLATION MAY RESULT IN A SUBSTANTIAL PENALTY, KNOWN AS A SURRENDER CHARGE."

E. Policy Administration Charges and Fees

Every insurer that sells annuities charges fees which are connected to the contract. These fees cover the company’s costs of administering the annuity. Annuities may charge a nominal annual contract maintenance fee such as one percent of the cash value not to exceed $20–$50. These fees are usually deducted from the annuity cash values, and they will often expire when the contract accrues a certain amount of cash value, such as $5,000 or $10,000. Variable annuities have investment management fees and fund exchange fees- a limited number of exchanges are allowed each year at no charge. Insurers also charge some form of surrender charge for liquidation of the policy.

F. Withdrawal Privilege Options

In the event the policyowner needs to access funds prior to maturity, the owner has the option of requesting a withdrawal, also called a partial surrender. Withdrawal provisions in deferred annuity contracts allow the policyowner limited withdrawal of funds prior to maturity of the contract. The surrender or withdrawal, if made during the surrender charge period, is normally subject to a surrender charge. If the withdrawal is requested after the policy is beyond its surrender charge period, the policyowner should be able to access the withdrawal without any charges imposed by the insurance company. Withdrawals are not expected to be repaid to the annuity contract. With flexible-premium policies, the withdrawal can later be paid into the annuity policy as new premiums. Annuity policies do not generally have loan provisions available to the policyowner due to tax consequences.

III. Identify and Discuss Income Distributions

How income distributions are taxed depends on whether they are *periodic payments* (amounts received as an annuity) that are paid at regular intervals over several years or *nonperiodic payments* (amounts not received as an annuity). This material is presented as introductory material only. Tax statutes can change every year. **IRS publications or a tax professional should be consulted before completing tax returns**

Periodic and nonperiodic payments

Distributions from pension or annuity plans may include amounts treated as a recovery of cost (investment in the contract). If any part of a distribution is treated as a recovery of cost, that part is tax free. The first step in figuring how much of a distribution is taxable is to determine the cost of the pension or annuity. Cost is generally net investment in the contract as of the annuity starting date (or the date of the distribution, if earlier). This amount is the sum of total premiums, contributions, or other amounts paid. This includes amounts an employer contributed that were taxable to the worker when paid.

It does not include amounts withheld from pay on a tax-deferred basis (money that was taken out of gross pay before taxes were deducted). It also does not include amounts contributed for health and accident benefits (including any additional premiums paid for double indemnity or disability benefits). From this total cost subtract the following amounts.
Any refunded premiums, rebates, dividends, or un-repaid loans that were not included in income and received by the later of the annuity starting date or the date on which the first payment was received.
Any other tax-free amounts received under the contract or plan by the later of the above dates.

Periodic

The periodic payments received from a pension or annuity are amounts paid at regular intervals (such as weekly, monthly, or yearly) for a period of time greater than one year (such as for 15 years or for life). These payments are also known as amounts received as an annuity.

Nonperiodic

Nonperiodic distributions receive under a pension or annuity plan are also known as amounts not received as an annuity. They include all payments other than periodic payments and corrective distributions. The following items are treated as non-periodic distributions;

- cash withdrawals
- distributions of current earnings (dividends) on investment.
- certain loans (loans treated as distributions)
- the value of annuity contracts transferred without full and adequate consideration.

How to determine the taxable amount of a nonperiodic distribution depends on whether it is made before the annuity starting date, or on or after the annuity starting date. If it is made before the annuity starting date, its tax treatment also depends on whether it is made under a qualified or nonqualified plan;
If it is made under a nonqualified plan, its tax treatment depends on whether it fully discharges the contract, is received under certain life insurance or endowment contracts, or is allocable to an investment made before August 14, 1982.

Distribution On or After Annuity Starting Date

If a nonperiodic payment is received from an annuity contract on or after the annuity starting date, this generally must include all of the payment in gross income. For example, a cost-of-living increase in a pension after the annuity starting date is an amount not received as an annuity and, as such, is fully taxable.

If a nonperiodic distribution is received before the annuity starting date from a qualified retirement plan, generally only part of it can be allocated to the cost of the contract. The part allocated to the cost is excluded from gross income. The remainder is included in gross income.

If a nonperiodic distribution is received before the annuity starting date from a plan other than a qualified retirement plan (nonqualified plan), it is allocated first to earnings (the taxable part) and then to the cost of the contract (the tax-free part). This allocation rule applies, for example, to a commercial annuity contract bought directly from the issuer. Gross income includes the smaller of:

- the nonperiodic distribution
- the amount by which the cash value of the contract (figured without considering any surrender charge) immediately before receipt of the distribution exceeds the investment in the contract at that time

If money is borrowed from a retirement plan, the loan must be treated as a nonperiodic distribution from the plan unless it qualifies for the exception to the loan-as-distribution rule;
At least part of certain loans under a qualified employee plan, qualified employee annuity, tax-sheltered annuity (403(b) plan), or government plan is not treated as a distribution from the plan. This exception to the loan-as-distribution rule applies only to a loan that either:

- Is used to acquire the contract owner's main home, or
- must be repaid within 5 years

If a loan qualifies for this exception, it must be treated as a nonperiodic distribution only to the extent that the loan, when added to the outstanding balances of all other loans from all plans exceeds the lesser of:

- $50,000, or
- half the present value (but not less than $10,000) of the nonforfeitable accrued benefit under the plan, determined without regard to any accumulated deductible employee contributions.

To qualify for the exception to the loan-as-distribution rule, the loan must re-quire substantially level payments at least quarterly over the life of the loan. Income distribution involves other technical elements which need not concern us further.

A. Introduction to Application of a Split Annuity

A split annuity involves simultaneously purchasing at least two annuities with a single premium payment. The term “split annuity” involves the splitting of a lump sum of money between two or more annuities. A split annuity is a retirement planning approach aimed at providing current income, preserving principal value or capital. An individual simultaneously buys an immediate annuity for a term certain and a deferred annuity for a single premium. The premium is divided between the immediate and deferred annuities so that, at current interest rates, the deferred annuity’s accumulation value at the end of the immediate annuity’s term certain will approximately equal the total original premium.

For retirement planning purposes, the split annuity can provide a larger monthly income than a CD, and if properly structured eliminates investment risk. The split annuity combines two types of annuities, an immediate and deferred annuity. The immediate annuity will pay a guaranteed monthly income while the deferred annuity allows the money to be left to grow without being inhibited by income taxes. The money that is growing inside the deferred annuity replaces the money that is being paid to the annuitant from the immediate annuity. This enables the retiree to maintain a level investment account, similar to a CD or an investment in a bond.

B. Introduction to Various Settlement Options

Settlement options are the various methods by which an annuity can be liquidated. It is the payment option. Generally, the annuity owner makes the settlement option selection. It can be made when the contract is purchased or delayed until the time benefit payments begin.

1. Life Annuity

The life annuity is a general payout category in which the payout is guaranteed for life. Sometimes known as a straight life annuity, the life annuity pays a benefit for as long as the annuitant lives, and then it ends. Whether the annuitant lives past 100 years of age or dies one month after the annuity period starts, the annuity payments will continue only until he or she dies. In other words, there is no guarantee as to the minimum amount of benefits under a life annuity.

There is a risk to the annuitant that he or she might not live long enough once the annuity period begins to collect the full value of the annuity. If an annuitant dies shortly after benefits begin, the insurer keeps the balance of the unpaid benefits. This settlement option will pay the highest amount of monthly income to the annuitant because it's based only on life expectancy with no further payments after the death of the annuitant.

2. Joint Survivor

Joint life annuities protect the annuitant and a coannuitant (such as a spouse) against outliving their resources. With a joint life and survivorship (or last survivor) annuity, there are more than one (usually two) annuitants, and both receive payments until one of them dies. A stated monthly amount is paid to the annuitant and upon the annuitant's death, the same or a lesser amount is paid for the lifetime of the survivor. The joint-survivor option is usually chosen as one of three alternatives: joint and 100% survivor, joint and two-thirds survivor, or joint and 50% survivor. The reasoning is that the survivor of the two annuitants may see a reduction in living expenses and not need as much income to live as before the first annuitant's death. To counter that reasoning, depending upon the remaining annuitant's other income, remaining lifespan, and inflation rate, the remaining annuitant may not see a reduction in expenses at all.

3. Period Certain

The easiest settlement concept is the fixed period annuity. The fixed period settlement option allows the annuitant to receive the accumulated value in the annuity over a set number of years. So, the annuitant could elect to receive the accumulated value over a five or ten year period. The formula to use to determine the periodic value of the payments is the same as the loan payment formula;

Calculating the Payment Amount per Period

The formula for calculating the payment amount is shown below.

$$A = P\,\frac{r(1+r)^n}{(1+r)^n - 1}$$

where

A = payment Amount per period
P = initial Principal (loan amount)
r = interest rate per period
n = total number of payments or periods

If not already having done so, the insurance professional should become familiar with present/future value concepts. The present/future value concept and time value of money calculations can be practiced on the Internet or on a reasonably-priced hand-held business function calculator.

4. Cash Refunds

A cash refund annuity refunds the unpaid nominal amount of the premium in the event that the annuitant dies before the full amount of the initial premium has been distributed. The differences in purchase rates are a function of time and interest rates. If the annuitant dies before receiving total income at least equal to the premiums paid, the beneficiary receives the difference in a lump sum.

C. Advantages and Disadvantages of Annuitization Options

Many variables are involved in determining the proper annuitization option for individual purchasers of annuity products, including their Social Security income, other annuity income sources, out-of-plan retirement savings, other assets (real estate, etc.) and participants' overall health. The complexities involved in evaluating each individual's situation mean that any default requirement would need to be considered carefully. Two things are certain; the individual will have to decide a future course of action based on today's knowledge, and hindsight will always be 20-20. In any situation where annuitization is by choice (as opposed to being the only option for all, as in many defined benefit plans), adverse selection will increase costs as the healthier people select annuities at a higher rate. That is, those who think they will live longer will opt for straight annuitization. That cost will be subsidized by those who believe they will not survive as long; this puts a premium on survivor-oriented options.

IV. Identify and Discuss Variable Annuities

As the name implies, with a variable annuity the annuity holder receives varying rates of return on the funds placed in the annuity. The return is dependent on the risk taken by the annuity holder and the economic performance of the various components of the annuity portfolio.

Both the individual and group annuity markets have changed over time, from markets primarily for fixed annuities to markets with growing use of variable annuities. Fixed annuities provide a guaranteed nominal payout during their liquidation phase. They distribute a given principal across many periods, but they do not provide a constant real (i.e., adjusted for inflation) payout stream if the price level changes. When inflation is low, the real value of the annual distribution will not vary much over the liquidation period. But even modest inflation rates of 3-5 percent per year, if they persist throughout the liquidation period, can lead to substantial erosion in the real value of annuity payouts. At an inflation rate of 3 percent per year, for example, the real value of annuity payouts in the first year of any liquidation period is more than twice that of the same nominal payout 24 years later. At an inflation rate of 6 percent per year, the real value of payouts is halved in only 12 years.

Variable annuities, by design, address the risk of purchasing power erosion that is associated with fixed nominal annuities. Unlike fixed annuities that promise a constant nominal payout, variable annuities provide an opportunity to select a payout that bears a fixed relation to the value of an asset portfolio. If these assets tend to rise in value with the nominal price level, then the payout on the variable annuity will adjust to mitigate, at least in part, the effects of inflation. Because variable annuities are defined in part by the securities that beck them, they are more complex contracts than fixed annuities. In spite of their complexity, however, they have become one of the most rapidly growing annuity products in recent years.

Variable Annuities- How They Work

Variable annuities are structured to have both an investment component and an insurance element. During the accumulation phase, premium payments are used to purchase “investment units,” the price depending on the value of the variable annuity’s underlying asset portfolio. For example, if this portfolio consists of common stocks and if share prices are high when a premium payment is made, then this payment will buy relatively few units, and vice versa. During the accumulation phase, variable annuities resemble mutual funds in many respects, although there are differences, and the assets in many variable annuity products are explicitly managed by mutual fund providers. The dividends, interest, and capital gains on the assets that underlie the investment units are reinvested to purchase additional investment units. When the accumulation phase of the variable annuity ends, the accumulated value of the investment units is transformed into “annuity units.” This transformation occurs as though the accumulation units were cashed out and used to purchase a hypothetical fixed annuity. The annuitant does not receive a stream of fixed annuity payments, but this hypothetical annuity plays an important role in computing actual payouts. The payout amount for the hypothetical annuity is used to credit the annuitant with a number of annuity units. Many variable annuities also allow annuitants the option of choosing a fixed annuity stream, or some combination of a fixed stream and a variable stream of payouts.

The actual variable annuity payout in each period depends on the number of annuity units that the annuitant is credited with, and, over some range of asset returns, on the value of the assets in the variable annuity's underlying portfolio. If the value of this portfolio rises by more than the increase implicit in the assumed interest rate, after the annuitant has converted to annuity units, for example because of rising nominal prices, then the payout will rise during the payout phase. If the value of the underlying assets falls, however, the value of the payout will also decline. The variable annuity's possibility of fluctuating payments is both an attraction (it provides potential protection against rising consumer prices) and, for some potential buyers, a disadvantage (the nominal payout stream is not certain).

Several product innovations have expanded the menu of investment options available for variable annuities. First, the range of portfolio investments that can be held through variable annuity policies has increased. Although the first variable annuities focused exclusively on diversified common stock portfolios, policies now offer variable annuities tied to more specialized portfolios of equities as well as to bonds or other securities. Variable annuities typically allow policyholders to move their assets among various policy sub-accounts, usually with different investment objectives, without fees or penalties. Second, virtually all variable annuities now offer lump-sum withdrawal options after the policy has reached a specified maturity date, as well as the possibility of withdrawing the principal in a set of periodic lump-sum payments. These features make it possible to use variable annuities as an asset accumulation vehicle without necessarily purchasing an annuity-like payout stream when the accumulation phase is over. This is because variable annuity contracts contain a purchase-rate guarantee.

Variable Annuity Development

Variable annuities were introduced in the United States by the Teachers Insurance and Annuities Association-College Retirement Equity Fund (TIAA-CREF) in 1952. The first variable annuities were qualified annuities that were used to fund pension arrangements. Variable annuities grew slowly during the next three decades-in part, because of the need to obtain regulatory approval for these products from many state insurance departments. Because variable annuities are usually backed by assets, such as corporate stocks, that do not guarantee a fixed minimal payout, the reserves that back these policies are maintained in separate accounts from the other policy reserves of life insurance companies. No major insurance company other than TIAA-CREF had issued a variable annuity policy as of 1960, primarily because state laws prohibited insurers from supplying a new class of products backed by common stock assets that were segregated from the insurer’s other assets.

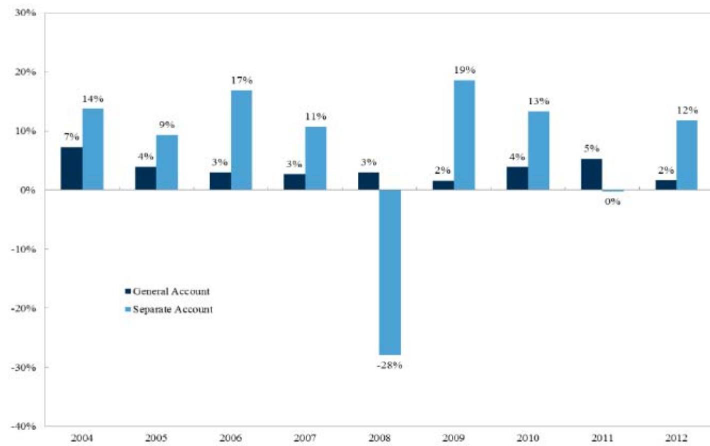
Net Written Premium

Approximately 75 percent of Life-Health sector revenue is derived from premiums charged for insurance and financial products and services; the remaining 25 percent is largely comprised of earnings on investments and administrative fees charged for asset management services. Net written premium is a principal measure of size and growth of the insurance industry. In 2012, Life-Health sector aggregate premiums totaled $645 billion, of which life insurance (individual and group life policies) generated 20 percent, annuity products generated 53 percent, and the balance originated from accident and health insurance (*e.g.,* disability or long-term care needs). As the accompanying illustrations show, premium growth was disrupted by the financial crisis, but Life-Health sector aggregate premiums reached record levels in 2012.

Table IV A shows that Life-Health sector general investment account assets grew from $3.0 trillion to $3.4 trillion from 2008 to 2012. Growth slowed significantly from 2005 through 2009, but has increased again since 2010, in part due to underlying premium growth.

Separate accounts are held apart from the general investment account of an insurer and are created by sales of products for which the contract holder retains the investment risks (variable annuities). Although the investment risks on separate account assets are borne by the respective policyholders, the related insurance and annuity products often include 'riders' such as minimum guaranty benefits or other financial guarantees, which expose the general accounts of insurers to varying degrees of market risk.

Figure IV A Life Insurer General and Separate Accounts Assets Annual Growth



Separate account assets grew at rates that ranged from 9 to 23 percent from 2003-2007. The robust growth was driven by both the strong performance of equity markets during that period (approximately 80 percent of separate account assets are in stocks) and the popularity of guaranteed minimum benefit provisions that were offered by many insurers. Life-Health insurers offer variable annuity contracts as a way to compete with the investment product offerings of other financial institutions, such as securities firms and investment managers. The appeal of prospective variable annuity policyholders is the ability to build vale by investing premiums, while minimizing potential losses through insurer-provided minimum return guarantees.

Table IV A **Life-Health Sector General and Separate Account Assets**

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
General Account Assets	$3,178,979,434	$3,230,475,723	$3,356,501,480	$3,534,370,609	$3,592,523,599
General Account Assets Annual Growth	2.99%	1.62%	3.90%	5.30%	1.65%
Separate Account Assets	$1,369,012,979	$1623,768,736	$1,840,187,240	$1835,604,761	$2,053,201,169
Separate Account Asset Annual Growth	-27.93%	18.61%	13.33%	-0.25%	11.85%
Total Assets	**$4,547,965,512**	**$4,854,244,459**	**$5,196,688,720**	**$5,369,975,370**	**$5,645,724,768**
Total Assets Annual Growth	**-8.79%**	**6.73%**	**7.05%**	**3.33%**	**5.14%**

An insurer can use derivatives to hedge against market risks related to the guaranteed minimum benefit provisions of variable annuities, but the reserves and expenses associated with these hedges are included in the general account of the insurer. Therefore, increases and decreases in such reserves and expenses have a direct impact on the surplus of the insurer.

During the financial crisis, sharp declines in equity markets and other asset classes led to losses in separate account balances and decreased popularity of variable annuity products. Minimum guarantees helped minimize losses for many policyholders, but exposed life insurers to 'un-hedged' market risks.

Table IV B: **Life-Health Sector Invested Asset Compositions**
($000s)

	2008 Y	2009 Y	2010 Y	2011 Y	2012 Y
Bonds	$2,149,276,710	$2,291,134,801	$2,426,488,366	$2,536,285,669	$2,547,282,250
Preferred Stocks	64,004,406	11,685,702	9,116,406	8,082,049	7,783,814
Common Stocks	49,199,457	62,220,108	68,737,147	70,349,507	69,677,752
Mortgage Loans	328,010,174	315,953,480	307,376,528	323,083,104	335,600,334
Real Estate	20,042,478	19,468,931	19,690,208	20,592,003	21,384,013
Contract Loans	119,249,454	120,008,543	123,488,426	125,976,946	127,480,245
Derivatives	NA	NA	21,575,963	44,356,616	41,576,588
Cash & Short Term Investments	146,206,650	121,990,395	95,063,036	96,535,159	106,605,395
Other Investments	142,329,672	129,390,522	124,659,046	135,274,141	149,242,016
Total Cash & Investments	**$3,018,319,002**	**$3,071,852,481**	**$3,196,195,125**	**$3,360,535,194**	**$3,406,632,407**

Life-Health sector invested asset allocations have been relatively stable, with approximately 75 percent in bonds, 10 percent in mortgage loans, and the balance in stocks, short-term assets, and other assets. Life-Health insurer portfolio compositions must comply with state laws regarding insurer investments, which include diversification requirements and disclosure requirements.[2]

[2] *Annual Report of the Insurance Industry*, 2013, Federal Insurance Office, U.S. Treasury

A. License Requirements

Variable annuities are structured to have both an investment component and an insurance element. During the accumulation phase, premium payments are used to purchase “investment units,” the price depending on the value of the variable annuity’s underlying asset portfolio.

1. Prospectus

An important source of information about a variable annuity's investment options is the prospectus. Interested individuals should request the prospectuses for the product's mutual fund investment options. After reading them carefully, one will be better able to allocate purchase payments among the investment options offered. Consideration should be given to a variety of factors with respect to each fund option, including the fund's investment objectives and policies, management fees and other expenses that the fund charges, the risks and volatility of the fund, and whether the fund contributes to the diversification of the overall investment portfolio.

Buyers of variable annuity products must be provided with a prospectus. By investing in a product whose market value can fluctuate, the assumption of risk by the holder of the annuity is a key element of the variable annuity. A variable annuity contract or variable life insurance policy is subject to the prospectus delivery requirements of the Securities Act of 1933 (15 U.S.C. Section 77a et seq.). The SEC has opined that online securities offerings are governed by the same rules as traditional offerings and that anything that has traditionally been accomplished using paper media should also be possible using electronic media. For example, when an issuer or underwriter uses the Internet to deliver a prospectus, it must;

- Provide **timely and adequate notice** of the delivery of information,
- Ensure that the online communication system is **easily accessible** to potential subscribers, and
- Create some **evidence of delivery** of the prospectus.

2. Financial Industry Regulatory Authority (FINRA)

The Financial Industry Regulatory Authority (FINRA) is a Self Regulatory Organization, the largest independent regulator for all securities firms doing business in the United States. FINRA's mission is to protect investors by making sure the United States securities industry operates fairly and honestly. FINRA oversees brokerage firms and registered securities representatives. FINRA offers regulatory oversight over all securities firms that do business with the public, plus those offering professional training, testing, and licensing of registered persons, arbitration and mediation, and market regulation for certain exchanges. FINRA was formed by a consolidation of the member regulation, enforcement and arbitration operations of the New York Stock Exchange, NYSE Regulation, Inc., and NASD in 2007

A variable annuity is considered to be a security under federal law and is subject to regulation by the Department of Insurance and the Securities and Exchange

Commission. Anyone selling a variable annuity product must have the required securities licenses. The sale of variable annuities is overseen by FINRA.

Complex Product

In 2012, FINRA issued guidance on heightened supervision of complex products. Such products are not defined, but their principal characteristics are stated as containing multiple features which affect the return under various scenarios. This particularly applies if it is unreasonable to expect an average retail investor to detect the existence of the product features, or understand how they may interact to impact the returns.

The **FINRA Regulatory Notice 12-03** provides guidance to firms about the supervision of complex products, which may include a security or investment strategy with novel, complicated or intricate derivative-like features, such as structured notes, inverse or leveraged exchange-traded funds, hedge funds and securitized products, such as asset-backed securities. These features may make it difficult for a retail investor to understand the essential characteristics of the product and its risks. The notice identifies characteristics that may render a product “complex” for purposes of determining whether the product should be subject to heightened supervisory and compliance procedures and provides examples of heightened procedures that may be appropriate. The complexity of a product often necessitates more scrutiny and supervision by a firm.

Complex Risk

The fact that a product is “complex” indicates that it presents an additional risk to retail investors because its complexity adds a further dimension to the investment decision process beyond the fundamentals of market forces. This may be the case even though the complexity of some products may arise from features that seek to reduce the probability of investment losses in particular situations. Regulators have expressed concern about complex products because the intricacy of these products can impair the ability of registered representatives or their customers to understand how the product will perform in a variety of time periods and market environments, and can lead to inappropriate recommendations and sales.

Although Regulatory Notice 12-03 provides guidance about the characteristics of complex products, it does not define a “complex product” or provide an exhaustive list of features that might render a product “complex.” Moreover, some relatively simple products may also present significant risks to investors that warrant heightened scrutiny or supervision. Each firm is responsible for determining which products require enhanced compliance and supervisory procedures.

Any product with multiple features that affect its investment returns differently under various scenarios is potentially complex. This is particularly true if it would be unreasonable to expect an average retail investor to discern the existence of these features and to understand the basic manner in which these features interact to produce an investment return.

B. Typically Common Contract Provisions

The written contract forms the backbone of the insurance transaction. When reviewing a contract, certain language or clauses may seem abstruse to both agent and layperson. The purpose of this section is to help explain the purpose and effect of some of the terms found in contracts.

1. General vs. Separate Accounts

Variable annuities allow money to be invested in insurance company "separate accounts" (which are sometimes referred to as "subaccounts" and in any case are functionally similar to mutual funds) in a tax-deferred manner. In addition, many variable annuity contracts offer a guaranteed minimum rate of return (either for a future withdrawal and/or in the case of the owner's death), even if the underlying separate account investments perform poorly. The separate account provides the variable investment options and along with the general account provides the foundation of a variable annuity. The investment fund options (often dozens of mutual funds) are referred to as subaccounts. In contrast to the general account, the separate account is not guaranteed by the insurance company. The returns of the subaccounts are variable rather than fixed, so the contract holder rather than the insurance company assumes market risk. The separate account is “separate” from the general assets of the insurance company, so there is no credit risk in the event that the insurer becomes insolvent.

2. Variable Options

It is important that the purchaser understands the several options available and makes an informed decision about which features he or she wants. Variable options tend to seek growth; their return will vary with market conditions. Compare this with fixed options which lean toward maximizing current income or preserving capital. All guarantees are backed by the claims-paying ability of the company.

Variable investment options are associated with specific funds, each of which is managed by a portfolio manager who invests the money of annuity owners according to guidelines that specify the type of stocks or bonds to be purchased and the investment approach. The guidelines may be broadly or narrowly defined according to the prospectus of each subaccount. Variable annuity owners need to be sure their choice of options is in line with their personal goals, their tolerance for risk, and the number of years until their retirement. Variable annuities feature a wide range of investment options during the accumulation phase. Like mutual funds, there are aggressive, bond, large cap, small cap, technology- the list goes on. The investor will be able to find something that works for their particular risk appetite and portfolio. Variable annuity contract holder settlement options are much like those offered under other annuity contracts. Settlement options are the methods by which the annuity owner can select to receive payments of benefits under the annuity contract.

The insurer reports separately, as assets and liabilities, investments held in the separate accounts and liabilities of separate accounts if:

- Such separate accounts are legally recognized;
- Assets supporting the contract liabilities are legally insulated from the Company's
- general account liabilities;
- Investments are directed by the contract holder; and
- All investment performance, net of contract fees and assessments, is passed through to the contract holder.

3. Equity-Based

Equity-based guarantees refer to applying equity indexes as an option in the valuation of the accounts. In this context, equity means stock market investments as opposed to bond market investments (investing in debt). Some form of guarantee as to the minimum value is made by the insurer regarding the value of the portfolio held by the annuitant in the variable accounts. The theory is this gives upside investment potential (gains) while limiting downside risk (losses).

Such products are relatively new. The insurance industry has had limited experience in setting and implementing reserves for products containing equity-based guarantees. Furthermore, limited data on policyholder behavior makes it difficult for actuaries to develop methodologies to price and evaluate these products.

4. Risk-Based

This feature refers to interest rate risk. An interest rate guarantee based on bond or interest rate indexing is designed to guarantee the minimum value of the variable accounts in the variable annuity. That is, the minimum interest rate the insurer will guarantee for the principle amount in the contract. Inflation, which is uncertain when the annuity is purchased, can reduce the real value of the annuity payout. The absence of markets for purchasing power-adjusted annuities has been pointed out as one of the important rationales for government-provided retirement income programs[3]. The establishment of inflation-indexed Treasury securities may facilitate the introduction of purchasing-power-adjusted annuities by some insurance companies.

This comes down to a solvency issue for the insurer. A risk an insurer takes with respect to annuity contracts is the risk that actual expenses exceed those assumed in pricing. If the policyholder is given too high a guaranteed minimum interest rate, insurer liquidity issues arise. If the insurer offers too low a minimum interest rate, it will not attract any business. The reserve requirements are involved when addressing such issues. Such calculations are beyond the scope of this book but the interested reader can search the Internet for more information on any of the terms mentioned.

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[3] "A Framework for Social Security Analysis," Peter Diamond *Journal of Public Economics*, vol. 8, no. 3 (1977), pp. 275-298.

C. Charges and Fees

The charges and fees under a variable annuity are different from those found in fixed annuities. This comes from the fact that variable annuities are subject to a greater degree of regulation because variable annuities are considered to be securities. The prospective purchaser of a variable annuity must be given a prospectus. Also, agents who sell these products must maintain a Securities and Exchange Commission license to sell securities, in addition to the state-issued license. Fees commonly charged to holders of variable annuities include;

- companies can charge a fee for each variable investment account to cover the extra management expenses associated with the particular account
- a mortality expense, generally 1%, is deducted proportionately from each of the variable accounts as well

There can be a fee for switching between accounts or funds offered by the variable annuity. Annuity holders can transfer funds from the guaranteed account to (or between) variable accounts. A certain minimum number of such transfers might be gratis, after which fees apply. The issuer can also regulate timing or frequency of jumps between accounts.

D. Dollar Cost Averaging

This is a system of buying securities on a regular basis with a fixed dollar amount at regular intervals. Dollar cost averaging helps eliminate the worry of catching the market at the right time. With dollar cost averaging, money is invested gradually, at regular intervals, into professionally managed portfolios. This allows the policyholder to take advantage of market highs and lows, buying more shares when the price is low and fewer shares when the price is high. A key benefit is that over time, the average per-unit cost will normally be lower than either the high or the average price.

Here is a simple example to illustrate how dollar cost averaging works. A person consistently invests $100 each month for three months. The investment chosen initially costs $10 per share. In the first month, this means 10 shares are bought. Then the next month, the market drops. This is not necessarily bad news. Even though the shares purchased last month for $10 are now only worth $8, one needs to remember that consistent $100 investments per month are being made. Because the price has dropped, the monthly $100 now buys 12.5 shares instead of 10.

Annualized Interest Rates and Fixed Account Bonuses- Bonus interest rates are extra amounts of interest granted to new purchasers of fixed-interest deferred annuities that are paid in addition to the normal stated current interest rate. These amounts are usually based on the total dollars contained in the contract during its first year. Bonus plan annuities are designed to attract money from existing annuity contracts, which still may be subject to a surrender charge, by paying extra interest in the first year. This extra interest (the bonus) is designed to offset some of the loss caused by the termination of the old policy. Potential purchasers must understand that these bonuses have an indirect cost behind them. Thus, the agent must be sure to tell prospects of any circumstance in which the bonus will not be paid, such as early termination or surrender. Interest rate bonuses often encourage replacement of annuities. The policyowner is lured by the high interest rate and a bonus above the normal current interest rate; the annuity owner may feel that the bonus will help to offset any surrender penalties he or she may incur. Bonus annuities will bear much higher surrender charges than a nonbonus product, putting the policyowner at a still greater disadvantage.

E. Death Benefit Guarantees

For variable annuities that provide cash surrender benefits, the death benefit is to be at least equal to the cash surrender benefit. The cash surrender benefits are not to be less than the present value of that portion of the maturity value of the paid-up annuity benefit which would be provided under the contract at maturity arising from considerations paid prior to the time of cash surrender, reduced by prior withdrawals or partial surrenders of the contract. The present value is calculated on the basis of an interest rate not more than 1 percent higher than the interest rate specified in the contract for accumulating the net considerations to determine the maturity value, decreased by indebtedness including interest, and increased by any existing additional amounts credited by the company to the contract. Cash surrender benefit cannot be less than the minimum nonforfeiture amount. (Section 10168.4 of the CIC)

F. Living Benefit Guarantees

Variable annuity contracts offer "living benefit" guarantees. For an additional cost, the contract holder may be able to purchase guarantees regardless of the account value. Living benefits give principal protection throughout the entire term of a variable annuity contract. Besides being offered in new contracts, some companies allow them to be added to existing contracts. Guaranteed living benefits are usually offered as riders to variable annuity contracts for an optional charge, as noted below. Charges typically are asset based (or, expressed as a percentage of account value, e.g., 15 basis points is the same as 0.15%).

If the underlying investments perform well, there will be an excess amount in the policy at the end of the withdrawal period. If they perform poorly and the account value is depleted before the end of the withdrawal period, the investor can still continue to make withdrawals until the full amount of the original investment is recovered. If the investor decides to terminate the contract before the end of the withdrawal period, he or she will receive the cash surrender value of the contract. A step-up feature has been introduced that periodically (e.g., annually or every five years) locks in higher guaranteed withdrawals if investments do well. The living benefits come in several forms;

- **Guaranteed Minimum Income Benefit-** A guaranteed minimum income benefit (GMIB) rider is designed to provide the investor with a base amount of lifetime income when they retire regardless of how the investments have performed. It guarantees that if the owner decides to annuitize the contract (for life, life plus a certain period, or the lives of two people), payments are based on the amount invested, credited with an interest rate--typically 4-5%. An investor must annuitize to receive this benefit and there is typically a seven-ten year holding period (in a few instances, a seven-year holding period) before it can be exercised. Age limits may also apply.

- **Guaranteed Minimum Accumulation Benefit-** A guaranteed minimum accumulation benefit (GMAB) rider guarantees that an owner's contract value will be at least equal to a certain minimum percentage (usually 100%) of the amount invested after a specified number of years (typically 7-10 years), regardless of actual investment performance. Many GMABs require some form of asset allocation.
- **Guaranteed Minimum Withdrawal Benefit-** A guaranteed minimum withdrawal benefit (GMWB) rider guarantees that a certain percentage (usually 5-7%) of the amount invested can be withdrawn annually until the entire amount is completely recovered, regardless of market performance. (Reducing withdrawals in one year does not allow for increased withdrawals in subsequent years. However, if a contract owner defers withdrawals and the account value grows, the amount of subsequent withdrawals allowed may be larger.)
- **Guaranteed Lifetime Withdrawal Benefit-** Another type of GMWB rider that guarantees withdrawals for life was introduced in 2004. The guaranteed lifetime withdrawal benefit (GLWB) guarantees that a certain percentage (typically 2-8%, often based on age) of the amount invested can be withdrawn each year for as long as the contract holder lives. This percentage may vary depending on the person's age when withdrawals begin. New benefits, such as spousal continuation (which guarantees withdrawals for two lives), have recently been introduced.
- **Standalone Lifetime Benefit-** An innovative new annuity product, a standalone lifetime benefit (SALB), was introduced in 2008. The SALB provides protection that is similar to that provided by the GLWB, while adding flexibility with the various types of assets that can be protected.
- **Long-Term Care Protection-** Some annuity contracts have features designed to address aging Americans' concerns about long-term care (LTC). Many contracts permit owners to withdraw money from their contracts for long-term care needs without incurring surrender charges. Surrender charges may be waived if, for example, a contract owner has been confined to a nursing home for a minimum period or has suffered a critical illness. Additional benefits may be offered such as eldercare resources, referral and consultation services, and discounted long-term care services from a specified group of providers.

With the enactment of the Pension Protection Act of 2006, new hybrid products which combine annuities with LTC are being introduced. Beginning in 2010, tax-free distribution status was given to both annuity assets and LTC rider benefits used for a qualified LTC purpose. Under prior law, withdrawals taken from the annuity to pay the LTC premiums were taxable and subject to a 10% penalty prior to age 59½.

V. Identify and Discuss Fixed Annuities

Insurance companies develop and sell annuity contracts. The contract between the insurer and the client describes what happens during the accumulation and distribution phases of the contract. It sets forth the rights and obligations of the contracting parties. Generally speaking, the client agrees to be a purchaser and to place money into an annuity contract in order to have the rights offered under the contract. The insurance company agrees to the obligations because it has the capacity to meet those obligations and is in the business of doing so as a for-profit enterprise. Although insurance companies are regulated by the individual states and contract forms have to be acceptable to each state, in the interest of efficiency, there is a great deal of standardization in all annuity contracts.

A. Typically Common Contract Provisions

A contract will contain provisions that protect the interests of parties to the agreement while trying to achieve some goal or objective. As a standard form or adhesion contract, the provisions are reviewed or drafted by the legal department of the insurer. It is important that everyone understands the contract language.

1. Death Benefits

All deferred annuity contracts provide for a death benefit prior to the annuity starting date. Death payments after the annuity starting date would be a form of settlement option. Tax code changes in 1985 provide that a death benefit is payable if any owner of the annuity dies before the maturity date. Some annuities provide that a death benefit is payable only if the owner dies, so long as the contract provides for a new annuitant to take the place of the deceased annuitant.

a. Lump Sum vs. Annuitization

The amount of the death benefit payable under a deferred fixed annuity will normally be the accumulated value of the contract, possibly reduced by any applicable surrender charge. Variable annuities also provide a death benefit, based on total premiums paid or the annuity's account value. Federal tax law calls for the distribution within five years of a contract's entire cash value if the 'holder' (owner) dies before the maturity date. The entire death benefit must be distributed within five years of the date of the owner's death. Any portion of the participant's interest that is payable to a beneficiary designated by the participant must be distributed either under the five-year rule or under the following exception to the five-year rule (the life expectancy rule)

b. Provisions

There is an exception to the five-year rule, if the death benefit is paid as an annuity over the life, or a period not longer than the life expectancy, of the beneficiary and the payments start within one year of the owner's date of death. If an annuity contract has joint owners, the distributions at death rules are applied upon the first death. Under a special exception to the distribution at death rules, if the beneficiary is the surviving spouse of the owner, the annuity contract may be continued with the surviving spouse as the owner. If the owner of the annuity is a non-natural owner, then the annuitant's death triggers the distribution at death rules. In addition, the distribution at death rules is also triggered by a change in the annuitant on an annuity contract owned by a non-natural person.

2. Charges and Fees

Annuity contracts will designate a minimum premium that the policyowner must pay to purchase an annuity. Normally these amounts are in the $5,000–$10,000 range for single-premium policies and $25–$50 per month for flexible-premium policies. Insurance companies may designate a different minimum amount, depending on the type of funds the client places in the annuity. For example, a policy might show a minimum premium of $1,000 for a qualified single-premium annuity but still keep the nonqualified annuity minimum premium at $5,000. Lower premium amounts are common for qualified contracts so that the annuity can accept small annual IRA contributions. Deferred annuities may charge a nominal annual contract maintenance fee such as one percent of the cash value not to exceed $20–$50. These fees are usually deducted from the annuity cash values, and they will often expire when the contract accrues a certain amount of cash value such as $5,000 or $10,000. Recent competition among annuity products, however, has made this contract provision less common in newly issued annuity contracts.

3. Interest Rates Strategies

The amount of interest the annuity product earns is of primary importance to the owner of the policy. In addition, because the initial interest rate is guaranteed for some period of time in the terms of the contract, the length of the guarantee period is critical. A potential annuity purchaser needs to know how the insurance carrier has typically treated its policyholders in terms of renewal interest rates. These are the interest rates declared once the initial guaranteed interest rate period has expired.
Two questions a person should ask when considering the purchase of an annuity are;

- What is the current interest rate being paid?
- For what length of time is that interest rate guaranteed? Will it be one year, two years, five years, or longer?

a. Annual

Annual interest rates are the interest rates guaranteed for one year. The length of time the annuity will pay the initial interest rate is important. Purchasers need to know how long they can count on the insurance company paying the higher initial interest rate. Often, the interest rate guarantee period is tied to the length of the annuity's surrender charge period. Fixed-interest deferred annuity contracts will also provide a minimum interest rate, and the insurance company guarantees that it will never credit an interest rate less than this percentage to the annuity. This rate has typically been 3 %. Interest rates in the economy fell towards 1% in the first half-decade of the 21st Century. Although a boon for contract holders, the 3% guaranteed rates caused insurers to see more money go out the window than was coming in the front door. The result has been a movement to tie minimum interest rates to economy-wide rates, not set them in stone. **Bonus Interest Rates- T**hese are extra amounts of interest granted to new purchasers that are paid in addition to the normal stated current interest rate. Based on the total dollars contained in the contract during its first year, these rates are designed to attract money from existing annuity contracts. The agent and the potential purchaser should be well informed regarding any bonus interest rates. Bonus rates are enticements. Bigger enticements usually mean bigger constraints down the road when that bonus will be applied or earned. Forfeiture or withdrawal prior to the end of the surrender charge period could void the bonus

b. Multi-year

Multi-year guarantee annuities do not provide the liquidity of annual guarantee annuities and surrender charges are usually imposed if the annuity is surrendered prior to the end of the present guarantee period. Most annuities allow that for a specified period of time, usually 30 days, the multi-year guarantee contract can be surrendered without being penalized by surrender charges. If the annuity owner has not surrendered the annuity, it is then renewed for a multi-year period which is the same as the original period, although the annuity owner may select a different renewal period. Surrender charges for a multi-year guarantee annuity usually do not apply if withdrawals are of an amount that is less than the credited interest or if the annuity owner elects to receive periodic income payments (annuitizes). Of course, if the death of the owner of the annuity occurs then death benefits are paid with no surrender charge.

4. Interest Rate Crediting Methods

Companies use several methods to establish the current interest rate to be credited to their accumulation accounts.

a. Portfolio Rates

The portfolio average method credits all policyholders with a composite rate of interest that reflects the company's earnings on its entire portfolio of investments during the year in question. During periods of rising interest rates, the interest credited to the "new" contributions received during the year will be heavily influenced by the interest earned on investments attributable to "old" contributions; those received and invested 5, 10, 15 or more years earlier. The interest credited will therefore be stabilized. Thus, when interest rates are rising, contributions made in the year 199X earn 4%, funds placed in the accounts (old or new) in year 199Y earn 4.5%, and all funds in year 199Z earn 5%. When interest rates are falling, contributions made in the year 200X earn 4%, funds placed in the accounts (old or new) in year 200Y earn 3.5%, and all funds in year 200Z earn 3%.

b. New Money Rates
With new money rates (sometimes referred to as the ‘banding’), the contributions made by all policyholders in any given period are banded together and credited with a rate of interest consistent with the actual yield that such funds obtained during that period. If a company's average return on all money is 4% in a given period, the contributions made by all participants during the current period may be credited with 5% if the company was able to make new investments that, on average, returned in excess of 5% interest. Additionally, the interest rate credited on those contributions should continue to earn 5% until the monies are reinvested. After reinvestment, the interest on these contributions will change and the rate credited to contributions banded in the following period could be higher or lower.
With increasing interest rates and reinvestment of assets every year, an investment in year 199x might earns 5% (the new money rate for that year) and then earn 5.25% in the second year and 5.5% in the third year. An investment in year 2 earns 10% (the new money rate for that year) and then earns 10.25% in the second year and 10.5% in the third year. Finally, an investment in year 3 earns 11%.

c. First Year Bonus ‘Teaser’ Rates
This is additional interest granted to new purchasers of annuities that is paid on top of the normal stated current interest rate. These amounts are usually based on the total dollars contained in the contract during its first year. These annuities are often used to attract money from existing annuity contracts, which still may be subject to a surrender charge, by paying extra interest in the first year. This extra interest (the bonus) is designed to offset some of the loss caused by the termination of the old policy. A Bonus rates is an incentive to get people to purchase an annuity. Big bonus incentives mean bigger constraints on when that bonus will be applied or earned. Any forfeiture and possibly even a withdrawal prior to the end of the surrender charge period could void the bonus. Interest rate bonuses often encourage replacement of annuities. The policyowner is lured by the high interest rate and a bonus above the normal current interest rate; the annuity owner may feel that the bonus will help to offset any surrender penalties. Bonus annuities can bear much higher surrender charges than those annuities found without the feature.

d. Annualized Interest Rate Calculations on Bonuses – Fixed Accounts
Bonus interest rates are extra amounts of interest granted to new purchasers of fixed-interest deferred annuities that are paid in addition to the normal stated current interest rate. These amounts are usually based on the total dollars contained in the contract during its first year. Bonus plan annuities are designed to attract money from existing annuity contracts, which still may be subject to a surrender charge, by paying extra interest in the first year. This extra interest (the bonus) is designed to offset some of the loss caused by the termination of the old policy. Potential purchasers must understand that these bonuses have an indirect cost behind them. Thus, the agent must be sure to tell prospects of any circumstance in which the bonus will not be paid, such as early termination or surrender. Interest rate bonuses often encourage replacement of annuities. The policyowner is lured by the high interest rate and a bonus above the normal current interest rate; the annuity owner may feel that the bonus will help to offset

any surrender penalties he or she may incur. Bonus annuities will bear much higher surrender charges than a nonbonus product, putting the policyowner at a still greater disadvantage.

5. Minimum guaranteed Interest Rates

The Standard Nonforfeiture Law (SNFL) for annuities was developed by the NAIC in the late 1970's. The model law mandates a 3% minimum guaranteed interest rate for fixed annuities. This minimum caused solvency concerns to emerge among insurers offering annuity products as interest rates drifted lower through the first half-decade of the beginning of the 21st Century. Many of the investments of life insurers do not provide yields sufficient to support a 3% guaranteed yield. California AB 284 (2003) is legislation that addresses the issue. The bill provides a uniform method of calculating minimum nonforfeiture amounts. It modifies the interest rate applicable to accumulations under annuity contracts, the amounts by which those accumulations may be decreased, and the minimum amount of considerations used to determine the minimum nonforfeiture amount. The new provisions apply to contracts issued on and after January 1, 2006, but insurers apply them, on a contract-form-by-contract-form basis, to any contract issued on or after January 1, 2004. The bill also allows the Insurance Commissioner to adopt regulations to implement the provisions.

The mechanics of rate determination can be outlined as follows:
The minimum nonforfeiture amount at any time at or prior to the commencement of any annuity payments shall be equal to an accumulation up to that time, at the **rates of interest indicated below**, of the net considerations paid prior to that time, decreased by any prior withdrawals or partial surrenders, an annual contract charge (currently $50), and state premium tax paid by the company for the contract, and any loans or indebtedness outstanding. The net considerations for a given contract year used to define the minimum nonforfeiture amount is 87.5 percent of premium during that contract year.
Interest rates- The interest rate used in determining minimum nonforfeiture amounts is the lesser of 3% or the following:

- The five-year Constant Maturity Treasury Rate reported by the Federal Reserve as of a date, or averaged over a period, rounded to the nearest one-twentieth of 1 percent, no longer than 15 months prior to the contract issue date or redetermination date, reduced by 125 basis points, where the resulting rate is not less than 1 percent.
- The interest rate applies for an initial period and may be redetermined for additional periods. The redetermination date, basis, and period are to be stated in the contract.

If a contract provides substantive participation in an equity-indexed benefit, it may increase the reduction described above by up to an additional 100 basis points to reflect the value of the equity index benefit. The present value at the contract issue date and at each redetermination date thereafter, of the additional reduction may not exceed the market value of the benefit. (Section 10168.25 of the CIC)

a. Low Interest Rate Environment Impact

The end of the first decade of the 21st Century saw a period of low interest rates. If an annuity is purchased in such a time, the currently low-interest-rate environment will depress the payout received. When market interest rates are low, insurers (like everyone else) can only pay the prevailing low rate to ‘rent’ an annuity contract owner’s capital. In the future interest rates may rise. Personal circumstances often require potential annuity purchasers to decide now (whenever that ‘now’ may be) about how to use retirement funds.

VI. Identify and Discuss Indexed Annuities

These are a special class of annuities that yield returns on contributions based on a specified equity-based index. Indexed annuities are complex financial instruments whose return varies more than a fixed annuity, but not as much as a variable annuity. Indexed annuities have more risk (but more potential return) than a fixed annuity but less risk (and less potential return) than a variable annuity. Indexed annuities offer a minimum guaranteed interest rate combined with an interest rate linked to a market index. Because of the guaranteed interest rate, indexed annuities have less market risk than variable annuities. They also have the potential to earn returns better than traditional fixed annuities when the stock market is rising.

In economics and finance, an index is a statistical measure of changes in a representative group of individual data points. These data may be derived from any number of sources, including company performance, prices, productivity, and employment. Economic indices (index, plural) track economic health from different perspectives. An index or stock index is a method of measuring the value of a section of the stock market. It is computed from the prices of selected stocks (typically a weighted average). It is a tool used by investors and financial managers to describe the market, and to compare the return on specific investments. An index is a mathematical construct, so it may not be invested in directly. Similar to indexed annuities discussed in this section, there are mutual funds and exchange-traded funds which attempt to 'track' an index.

An index is a means of reflecting price or quantity compared with a standard or base value. The base usually equals 100 and the index number is usually expressed as 100 times the ratio to the base value. For example, if a commodity costs twice as much in 1970 as it did in 1960, its index number would be 200 relative to 1960. Index numbers are used especially to compare business activity, the cost of living, and, in the case at hand, a metric against which economic performance can be measured. An index facilitates the reduction of unwieldy business data into easily understood terms. There is a substantial body of economic analysis concerning the construction of index numbers, desirable properties of index numbers and the relationship between index numbers and economic theory.

Investment Advice

Index measurements aside, fairly and simply, a policy must do what the agent says it will do. Agents are trained by their insurance companies, but not to high levels of detail. They know enough to talk up the policy, but may not be well-versed in the mechanics of a specific policy. Not knowing particulars about a product is not a sin, but fabricating song-and-dance responses to a prospective purchaser's questions is certainly not right.

Agent statements that are seen as 'investment advice' are a case in point. Variable annuities and equity indexed annuities fall outside of the state definition of a "security." In many states, the state regulators do not view this as an impediment to enforcing investor protection safeguards under state securities laws under certain circumstances. Specifically, a growing number of state securities regulators are taking the position that when a financial professional such as a registered insurance agent confers with a client about that client's overall financial picture, including the value of the securities in their portfolio, the state's investment adviser laws apply. The regulators argue that when an insurance agent recommends that any of the client's securities be sold in order to generate funds that are subsequently used to purchase an insurance product, the insurance agent's conduct comes within the definition of an "investment adviser," since the agent provided advice regarding securities and was ultimately compensated from the annuity sale. Therefore, the state regulators reason that investment adviser registration and the fiduciary standards of conduct for an investment adviser – including investor suitability standards – apply to the transaction.

So if an agent is not licensed to sell investments, he or she should think twice about advising a client to cash out a security in order to buy an indexed annuity or other insurance product. Examples of regulatory actions reinforce the point:
The Massachusetts Securities Division issued a consent order to Investors Capital Corporation for allegedly allowing its representatives to use unregistered investment advisor services to sell indexed annuities.
In 2005, The Tennessee Securities Division took action against financial professionals who recommended liquidating securities positions and using the proceeds to purchase indexed annuities or other products.
The same year, the Texas State Securities Board warned the public to be wary of unlicensed individuals selling securities. Other states have reportedly sanctioned agents for providing investment advice without a license.

Industry observers suggest that state securities regulators aren't going after insurance products per se, but rather are concerned about the market conduct of insurance professionals who hold themselves out as investment advisors while selling annuities.

> *"If the [insurance-only] agents are advising people to sell mutual funds or get out of 401(k)s, they are acting as investment advisers. And in my state, being an unregistered investment adviser is a felony."* - Joseph Borg, Alabama Securities Commissioner and Past President of the North American Securities Administrators Association.

This quote is just one of many warning shots that regulators launched at insurance-only agents who sold equity indexed annuities. The insurance-only agent should make sure he or she is not acting as an unregistered investment adviser with discussing how to fund an equity-indexed annuity. The Investment Advisers Act of 1940, Section 202(a)(11) defines an investment adviser as, "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities..."
This definition can be broken down into three elements:

1) advice concerning securities;
2) in the business of providing investment advice; and
3) for compensation

If an insurance-only agent meets all three of the elements, they could be deemed an unregistered investment adviser and subject to disciplinary actions by the Securities and Exchanges Commission or a State's securities department. When looking at the first element, advice concerning securities, the SEC and the courts have broadly interpreted this language. The advice can be about securities in general, such as the stock market or about specific securities. In fact, telling a client when to purchase a stock, when to sell a stock, when to switch to a different investment, how a security is valued, and whether investing in securities at all, has all been considered advice under the definition of investment adviser.

The advice must concern securities, which is broadly defined in Section 202(a)(18) the Advisers Act, and the definition of securities includes notes, bonds, stock (common and preferred), options and much more. These investments are commonly found in a client's investment portfolio. This means the insurance-only agent needs to be concerned that they are giving investment advice, as defined above, when telling a client to sell a mutual fund, stock, bond or other security to purchase an equity indexed annuity. Unless the insurance-only agent is telling a client to exchange, move or sell a fixed insurance product, they could be considered giving investment advice as defined by the Advisers Act. All insurance professionals should carefully consider and review the advice they give to clients when discussing their investments.

Minimum Return

When indexed annuities were first sold in the mid-1990s, the guaranteed minimum return was typically 90 percent of the premium paid at a 3 percent annual interest rate. As the product developed (in part because of changes to state insurance laws), the guaranteed minimum return became at least 87.5 percent of the premium paid at 1 to 3 percent interest. However, if an indexed annuity is surrendered early, there may be a significant surrender charge and a 10 percent tax penalty that will reduce or eliminate any return. If the policyholder is certain he or she will not need to liquidate the annuity,[4]

[4] FINRA- "Equity-Indexed Annuities- A Complex Choice" www.finra.org

Market index

A market index tracks the performance of a specific group of stocks representing a particular segment of the market, or in some cases an entire market. For example, the S&P 500 Composite Stock Price Index is an index of 500 stocks intended to be representative of a broad segment of the market. There are indexes for almost every conceivable sector of the stock market. Most indexed annuities are based on the S&P 500, but other indexes also are used. Some allow investors to select one or more indexes. The index-linked gain depends on the particular combination of indexing features that an indexed annuity uses. The most common indexing features are covered in the next section.

Two things that affect the amount of additional interest that may be credited 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. Other features of equity index annuity contracts vary from product to product.

Premium Payments- The majority of products on the market are single premium deferred annuities; with the purchaser making one premium payment that is accumulated for a specific period prior to payout. Some insurers offer flexible premium deferred annuities, permitting multiple premium payments in amounts determined by the purchaser, and immediate annuities, providing for immediate commencement of the payout

A. Primary Interest Crediting Strategies

The index-based return depends on the particular combination of indexing features specified in the contract. The return of equity index annuities is typically based on the S&P 500 Index, but other domestic and international indices are also used. Some products permit the contract owner to select one or more indices from a specified group of indices. Index growth generally is computed without regard to dividends. There are several methods for determining the change in the relevant index over the period of the contract;

- The "point-to-point" method compares the level of the index at two discrete points in time, such as the beginning and ending dates of the contract term.
- The "high water mark" or "look-back" method compares the highest index level reached on specified dates throughout the term of the contract (e.g., contract anniversaries) to the index level at the beginning of the contract term.
- The "annual reset," "cliquet," or "lock-in" method compares the index level at the end of each contract year to the index level at the beginning of that year, with the gain for each year "locked in" even if the index declines in the following year.

The most common indexing features are further described below. Averaging techniques may be used with these formulas to dampen the volatility of index changes. For example, in the point-to-point method, the ending index value could be computed by averaging index values on each of the final 90 days of the contract term.

1. Monthly Averaging

This method uses the monthly closing market levels to determine the index level at the end of the contract term. The interest rate provides a return equal to the monthly average S&P of the previous year, times a participation rate which is then adjusted, as dictated under the contract, to be not less than zero- or other floor- nor higher than the CAP or maximum rate (say 14%). Suppose in year 1, the S&P goes up 20%- the client would get not 14% but about half that due to averaging. In the second year, the S&P did a -10%, but the client would just show no return at all due to the zero floor. In year 3, the S&P went up 20%- the client would get about 7%.

2. Point to Point

The point-to-point design credits interest based on the difference between the index value at the beginning and end of a period of at least one year. The change in the index is a "price change only" measure and does not reflect dividends. For example, the S&P 500 Index is at 900 and at the end of the crediting period the index result is 1,100. A gain of 22 percent is realized. The point-to-point design can be annual with an annual reset, or over a longer period of time, also known as a term point-to-point, that normally ranges from 7 to 12 years without a reset. The point-to-point term method works best in upward-trending markets over time, whereas the point-to-point with annual reset tends to work best in uncertain and volatile markets.

a. Annual

The annual point-to-point method calculates the interest return every contract year. It eventually combines these returns to arrive at the total return for the contract term. This method resets the starting point for the calculation each year on the contract anniversary and allows the owner to take advantage of economic upswing after a period of market loss or correction.

b. Long-Term Point to Point

The long-term point-to-point method compares the level of the index at two discrete points in time, such as the beginning and ending dates of the contract term in the point-to-point method, the ending index value could be computed by averaging index values on each of the final 90 days of the contract term. An example is 7 year, point-to-point, based on the S&P 500, using 6 month index averaging, with 80% participation, and a guaranty of 100% accumulating at 3%. Point-to-point methods credit interest as a portion of the percentage growth in the underlying index from the beginning of the term to the end of the term. Long term averaging may be used at the end of a multi-year point-to-point benefit determination, that is, when the index benefit is determined solely upon the change in the index from the beginning of the index term period to the end of the index term period, which could be up to ten years. Such averaging might be over a period of 2 to 24 months and commonly might use the average of monthly indices, Index-based interest is credited to the contract value either when it is calculated or at the end of the term. Interest in point-to-point contracts invariably is credited at the end of the term because its amount is unknown until then.

3. High Water Mark

This method of calculating the value of the index uses a fixed starting point to begin the computation. It does not reset the starting point of the index calculation periodically as other indexing methods might do. The annuity holder with this type indexing will only see positive interest appreciation when index levels are above the index point at the beginning. High water methods credit interest as a portion of the percentage growth in the underlying index from the beginning of the term to the highest value the index has achieved at specified measurement points up to the end of the term. Typically, these measurement points are the anniversaries in the contract, but they could occur with greater frequency. Each of these measurement points could use some averaging technique.

4. Annual Resets

This type of annuity calculation is also known as the 'ratchet' method. The annual reset design credit index-based interest to the current contract value on an annual basis. Most ratchets operate annually; however, less frequent application is possible.

5. Combination Methods

The following variations of the design are used for the reset/ratchet method. The discussion above pointed out other combinations.

Method of accumulation- A compound ratchet applies the index-based interest rate to the current contract value at the time of the crediting. A simple ratchet applies the index-based interest rate to the premium minus cumulative withdrawals at the time of the crediting.

Length of guaranty of index change recognition-.The current participation rate, spread charge, or cap can be guaranteed for the entire term, only for the current interest crediting period, or for some intermediate period. If the guaranty is only for the current interest crediting period, a lesser guaranty commonly is provided for the balance of the term and subsequent terms.

Annual averaging of index values within each year- This is used for ratchet designs to reduce the volatility in the interest credited to the contract. Another result is that a nominally higher portion of the calculated index increase rate is reflected in the interest rate. Methods used are daily averaging, monthly averaging, and quarterly averaging. These methods reflect on average half to slightly more than half of the annual index increase percentage; however, the portion will vary considerably from year to year depending upon the profile of the index volatility during the year. Ratchet Payment guaranties provide an increase over the most recent annuity payment if equity index based interest exceeds the assumed interest rate. This is analogous to a ratchet benefit in a deferred equity indexed annuity.

B. Spreads

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%, the annuity might specify that 2.25% will be subtracted from the rate to determine the interest rate credited. In this example, the rate would be 7.75% (10% - 2.25% = 7.75%). In this example, the company subtracts the percentage only if the change in the index produces a positive interest rate.

C. Cap Rates

The cap rate operates to limit the amount of growth in the applicable market index that will be credited to the equity-indexed annuity. The cap is an upper limit on the amount of growth that can be passed on the annuity holder. The cap rate is expressed as a percentage. For example, an equity-indexed annuity with a participation rate (discussed in the next segment) of 100% might provide that a maximum of 12% of the gain in the index will be passed on to the value of the contract.

D. Participation Rates

In an equity-indexed annuity this is the amount or percentage of the increase in the market index that will be paid on the principal. The participation rate is a multiplier applied to the percentage increase in the index in order to determine the index-based interest rate. Participation rates are dependent upon interest rates and call option costs and, consequently, are determined separately at the beginning of each period during which they are guaranteed. The highest participation rates are for point-to-point products and lowest for ratchet products. In some contracts, the participation rate, frequently between 75% and 110%, is multiplied by index growth to determine the applicable share of index appreciation to be credited. The participation rate is typically set at the time the annuity is purchased and may be reset either annually or at the start of the next contract term. Other contracts specify a percentage, called the "margin" or "spread," that is subtracted from index growth to determine the applicable share of index appreciation to be credited.

E. Minimum Guaranteed Interest Rate

Equity-indexed annuity contracts provide a minimum guaranteed interest rate for a set period of time. Even with a guaranteed rate, equity-indexed annuities do not guarantee that investors won’t lose money. They do guarantee a minimum rate of return (typically 3% or less) but the guaranteed rate is less than the risk-free rate of return offered on US Treasury securities with the same maturity as the annuity. Also, the guaranteed rate of return is applied to a percentage of the amount invested and sometimes without compounding. On some contracts, no interest is credited unless the annuity is held to maturity. Holding constant the guaranteed rate of return, the higher the risk-free interest rate, the less valuable equity-indexed annuities are to investors.

At any point in time, the value of the contract is the higher of the minimum guaranteed interest rate (a fixed value) or the index-credited value (which can fluctuate). At the end of the contract's term, the value of the minimum guaranteed interest rate will be at least equal to the total premiums paid. If the index-credited value of the contract is greater than the minimum guaranteed interest rate value, the minimum guaranteed interest rate value is irrelevant.

The traditional insurance and annuity pricing method calculates the net premium of a product as the expected present value of its benefits with respect to a mortality law. In order to protect the insurance company against the mortality risk, the premium is determined as the net premium plus a loading that is based on premium principles (the mathematically derived premium calculation). However, the traditional actuarial pricing is difficult to extend directly to the valuation of equity-linked products since these products are embedded with various types of financial guarantees.

The minimum guaranteed interest rate, compounded over the life of the indexed annuity, provides the floor below which the value of the contract cannot go. The index-credited value of the contract is the value derived from the relevant index; the more the index increases in value, the more the contract's index-credited value increases. So, if the stock market goes up, the contract's value will be higher than the minimum guaranteed interest rate, rendering the minimum guaranteed interest rate moot. However, if the market does not go up, the minimum guaranteed interest rate will determine the contract's value. Each year the insurance company applies the minimum guaranteed interest rate to the contract as well as the rate derived from the index. In effect the contract maintains two values over its life:

- the minimum guaranteed interest rate value
- the index-credited value

The minimum guaranteed interest rate is applied to only a portion of the premiums. For example, the company might apply the minimum guaranteed interest rate to 87.5% of premiums. Thus, if the company says its minimum guaranteed interest rate is 3%, and then the effective rate is lower than 3%, provided the rate is applied to less than 100% of premiums.

F. Impact of Premature Surrender Charges

A "surrender charge" is a type of sales charge that must be paid if policyowner sells or withdraws money from an annuity during the "surrender period"-a set period of time that typically lasts six to eight years after purchase of the annuity. Surrender charges will reduce the value of-and the return on investment.

As with other annuity contracts, surrender charges apply if the indexed annuity contract is given up before a specified period of years. The idea is to make it less tempting for annuity owners to draw funds out of the contract and as well as to allow the insurer to recover costs associated with the contract. Surrender charges are commonly deducted from withdrawals, but these charges often are eliminated for a 30 to 45 day window at the end of each index term. There may also be a limited free withdrawal privilege.

Option theory predicts that an annuity contract (true for many types of assets) will be surrendered if and only if the surrender value exceeds the fair value of the contract. That can depend on the value of embedded options and guarantees. It could also be that policyholders might surrender their contract due to liquidity constraints. The policyholder typically has the right to surrender the policy in return for the current value of the underlying fund, possibly subject to a predefined surrender penalty. In rising markets, the value of the underlying fund will increase and thus the economic value of the guarantee will fall. The value of the guarantee less the value of the future fees for these guarantees may become negative. At this stage, the policyholder has a strong incentive to exercise the surrender option. In reality, annuity providers usually do not assume this behavior for all policyholders because the economic value of the guarantee might not be fully evident to the policyholders and there probably are a number of factors independent of the value of the guarantee that will drive policyholder actions (e.g. some policyholders will surrender because they need liquidity, even if their guarantees are valuable).

1. Two-tier Annuities- Define Concepts

A two-tiered annuity is a type of fixed annuity in which the interest rate credited to the annuity depends on the distribution option. The insurer uses a lower interest rate if the owner chooses to convert the contract as a lump sum at some point. Contracts that annuitize and go into the payment stage are credited with a higher rate of interest. This is done to encourage the election of a periodic payout of the annuity. The basic concept is that a client agrees to hold (defer) his or her contract for a stipulated amount of time. When the policyholder is ready to access funds, he or she must be willing to take them as a series of payments for a minimum of say, 5 to 10 years. With the principal tied up for that length of time, the insurer can afford to pay up to a 10 percent bonus.

It may seem to the purchaser, however, that the surrender charge lasts forever on this product. If the deferral period runs 10 or 15 years, at some point after purchase people realize they do not have a financial time horizon quite as long-term as they first imagined. Often the first-year interest rates are quite high relative to the market, as are subsequent guarantees. Commissions are also typically high relative to other products. The insurer can offer high rates and high commissions because those rates are predicated on the assumption that the policyholder will stay with the product through annuitization. The annuitization requirements may allow for a 'term certain,' but usually requires a life contingency option. If the policyholder did not annuitize, the surrender charge can combine with a lower interest credit retroactive to the inception of the policy. So, the policyholder receives one tier of interest by staying with the contract through annuitization and a lower tier if they do not.

So it is that a two-tier annuity differs from other annuities in that the annuitant cannot take a lump sum without giving up a considerable amount of return. To get the full value out of the annuity, the payout must be an income stream over the minimum number of years agreed upon in the contract with the insurance company. Because two-tier annuities are more restrictive in respect to liquidity than traditional annuities, insurers can invest premiums more freely, in less liquid investments or in investments with longer time projections for higher returns. All things equal, a two-tier annuity should yield higher returns than an identical annuity that does not require payouts as an income stream. The policyholder loses access to funds for the length of the income phase. The individual is locked in from the time of purchase of the contract through the deferral period.

G. Charges and Fees

A selling point of indexed annuities is they do not have a schedule of fees like that of variable annuities. A contract maintenance charge is ordinarily deducted each year from the value of an annuity. Other administrative charges can be deducted at an annual rate stated in the contract. This can amount to over 1% of the contract’s value annually. Other charges can apply for the death benefit or any other options chosen at the time the contract is executed.

It could be argued that caps, participation rates, and spreads serve as proxies for fees. Indexed annuities use a spread, margin or asset fee in addition to, or instead of, a participation rate. This percentage will be subtracted from any gain in the index linked to the annuity. For example, if the index gained 10 percent and the spread/margin/asset fee is 3.5 percent, then the gain in the annuity would be only 6.5 percent.

Equity-indexed annuities were designed primarily to be used for retirement purposes, and thus had significant surrender charges and long surrender periods. Suitability issues arose over accusations producers sold the product to consumers known to have shorter term investment needs. A 'Complexity Complex' (a seemingly-inherent feature of several annuity products), including its crediting rate calculations, indexing methods, and distribution stipulations, makes it hard for investors to understand and compare it against other products. This makes the product prone to intentional and incidental producer misrepresentation and inadequate disclosure.

The SEC felt it was within their prevue to pursue classifying indexed annuities as securities (as variable annuities are) in 2008, making them subject to SEC oversight. Their attempt to regulate indexed-annuities was eventually overturned by the federal courts; the SEC had failed to determine if states were adequately protecting policyholders. As such, equity-indexed annuities were left to be regulated by the states. The NAIC responded to suitability concerns over equity-indexed annuities by adopting the Senior Protection in Annuity Transactions Model Regulation in 2003. Model provisions were designed to address the inappropriate sales of annuities to persons over the age of 65 (ultimately extended to all consumers). The NAIC adopted more stringent suitability standards for annuities with the 2010 Suitability in Annuity

Transactions Model Regulation. As part of the Dodd-Frank Act, the regulation of certain qualifying insurance policies and annuity contracts (namely indexed annuities) would be granted an exemption from being treated as a security under federal securities laws or by any future SEC action. Following the adoption of the NAIC Suitability in Annuity Transactions Model, states are eligible to regulate indexed annuities issued on or after June 16, 2013.

VII. Available Riders

A rider is a written agreement attached to an insurance policy or annuity contract that limits or expands the policy's terms or coverage. Riders may increase the premium paid to the insurance company. Strictly speaking, a rider is documentation attached to an existing policy that augments or deletes from policy provisions. It is generally used to extend coverage for some specific reason. Endorsements are themselves often standardized. Basically, endorsements or riders are the documents used to shape the standardized policy to fit individual needs.

GLWB Rider

The guaranteed lifetime withdrawal benefit (GLWB) rider allows policyholders to get lifetime income payments while continuing to have access to the annuity's remaining cash value. A GLWB option typically subjects the annuity owner to specific age restrictions or income limitations, depending on the particular optional benefit offered with a given annuity. With most plans, the annuity premium is invested in subaccounts or earns interest. The policyholder can elect to receive annual withdrawals from the annuity that last for the rest of his or her life (minimum guaranteed withdrawal). The amount of the withdrawal is determined by applying a percentage (withdrawal percentage) to the premium or the cash value, whichever is greater at the time of the election. Withdrawals are subtracted from the cash value. The amount of the withdrawal will not decrease, even if the cash value decreases or is exhausted. The contract owner also continues to control the investment of the remaining cash value within the product.

There are caveats. Guaranteeing an income that lasts for life requires a significant sacrifice of expected bequest values to the heirs. The income guarantee has other potential costs: There may be an over-valuation of the guarantee compared to the impact of inflation on the income stream over time and the level (albeit guaranteed) payments will experience a diminution of value when compared to rolling historical periods of market returns.

After record high sales in 2011 and 2012, first quarter of 2013 indexed annuity sales dropped four percent to $7.8 billion, its lowest level in two years. However, election rates of guaranteed lifetime withdrawal benefit (GLWB) riders on indexed annuities remain strong. In the first quarter, 72 percent of consumers elected a GLWB rider, when available. LIMRA estimates that 88 percent of indexed annuities products in the market offer GLWB riders.[5]

A. Life Insurance Rider

A life insurance rider would be just that. An increased, separate, amount would be paid for life insurance protection in some amount. Such insurance could feature an accelerated benefit option that allows for the early payment of some portion of the policy's face amount should the insured suffer from a terminal illness or injury. Any direct coupling of whole life insurance and an annuity contract would seem to fly in the face of the Supreme Court's decision in *Helvering v. Le Gierse*[6], where just such a coupling was decided to be a hedging or investment transaction, not insurance.

Tax-qualified term life- Tem life as a part of an annuity contract is considered incidental life insurance. If all of a person's 403(b) accounts invest only in mutual funds, then he or she has no incidental life insurance. If someone has an annuity contract, a portion of the cost of that contract may be for incidental life insurance. If so, the cost of the insurance is taxable to the individual in the year contributed and is considered part of the basis when distributed. The employer will include the cost of a person's insurance as taxable wages in box 1 of Form W-2. Not all annuity contracts include life insurance. If it does, the plan participant will need to figure the cost of life insurance each year the policy is in effect.

Figuring the cost of incidental life insurance. If it is determined that part of the cost of an annuity contract is for an incidental life insurance premium, he or she will need to determine the amount of the premium and subtract it from the includible compensation. To determine the amount of the life insurance premiums the individual will need to know the following information.

- The value of the life insurance contract, which is the amount payable upon the named insured's death.
- The cash value of the life insurance contract at the end of the tax year.
- The taxpayer's age on his or her birthday nearest the beginning of the policy year.
- The current life insurance protection under an ordinary retirement income life insurance policy, which is the amount payable upon death minus the cash value of the contract at the end of the year

B. Long-Term Care Benefits Rider

Annuities can have riders that meet a future need. An annuity with a long-term care rider that will pay for nursing home costs is an example of a rider that addresses a future concern. A long-term care rider fills the bill among consumers because it provides for two needs; provides the prospect of a stable retirement income while protecting against the financial risk associated with chronic long-term health problems. Many LTC

[5] http://www.limra.com/Posts/PR/News_Releases/LIMRA__Annuity_Sales_Decline_in_First_Quarter_of_2013.aspx
[6] (1941) 312 U.S. 53

riders are similarly constructed, providing coverage for catastrophic illnesses that require home health care, like an in-home nurse or aide, or long-term hospitalization, or a nursing home stay.

1. Terms of Riders

These riders are designed to provide benefits without cutting into the monthly payments received from an annuity. Thus, a long-term care rider on an annuity can provide great coverage in the event of an accident or unplanned illness. Any benefit added to a contract will have a cost; which can be a drawback. There can be minimum deposits required, sometimes ranging from $30,000 to $50,000 for the initial product purchase. Many annuities with long-term care riders require that the annuity be held for a certain term, such as 7-10 years. It is important that careful attention is given to how the contract defines "catastrophic" or "chronic" illness.

2. Difference Between Crisis Waivers & Long-Term Care Riders

Strictly speaking, a waiver is an intentional and voluntary surrender of some known right, which generally may either result from an express agreement or can be inferred from circumstances. It is the relinquishment of a known right that may result from the affirmative acts of the insured, the insurer or the insurer's authorized agents. Waiver also results from the insurer's non-action, with knowledge of the applicable facts.

This section refers to annuity contracts that contain a provision that waives surrender charges if certain conditions are met. These provisions allow for withdrawal of some or all of the annuity's accumulated value if a specific crisis condition exists such as the need for long-term care. Crisis provisions can vary from contract to contract, and may require the contract be in force for a minimum numbers of years or for the owner to have reached a specified age. Also, crisis waivers may require an additional premium.

Concerning endorsements or riders, these are written modifications of an insurance policy that change the original, often standardized, contract of insurance. Endorsements may broaden or narrow the original policy language. Strictly speaking, a rider is documentation attached to an existing policy that augments or deletes from policy provisions. It is generally used to extend coverage for some specific reason. Endorsements are themselves often standardized. Basically, endorsements or riders are the documents used to shape the standardized policy to fit individual needs. At least one form must be added to the insuring agreement and the terms and conditions in order to structure a complete contract. In this instance, the addition is the long-term care coverage.

Pension Protection Act of 2006

This act included key provisions addressing the taxation of combination annuity plans featuring long-term care insurance. The rules apply only to nonqualified annuities (purchased with after-tax dollars) coupled with tax-qualified long-term care riders. The

Act clarified that, effective Jan. 1, 2010; long-term care insurance benefits paid out of these plans (even if a portion of those serves to reduce account values in the underlying annuity) are paid as tax-free long-term care insurance benefits. This is a watershed event. Prior to that date there was no mechanism that allowed for gains in a contract to be paid out on a tax-free basis. In addition, the law also allows for 1035 exchanges into combination plans. This is noteworthy in light of the many trillions of dollars deposited in existing annuities.

Benefit payout structures under such plans are typically defined as accelerated benefits. The policy's qualifying event for benefits, that is, the definition of chronic illness must match the definition established in HIPAA. The long-term care benefit payments are made from the annuity account value while waiving surrender charges. This is usually combined with some form of tail benefit payable after account values are depleted. The benefit is paid monthly and is usually expressed as a percent of the annuity account value at the time of initial claim. For example, 1/24 of the lifetime LTC benefit limit may be payable for 24 or more months from the account value, with a 12, 24, or 48 month extension of benefit "tail" as selected by the client. This creates the opportunity to convert what would have been partially taxable account values from the annuity into tax-free payouts that range from 150% to 300% of the account value as LTCI benefits.

C. Skilled Nursing Facility Rider

A rider that adds skilled nursing facility benefits to the contract. The term "skilled nursing facility" refers to the level of skilled medical care required. Medicare.gov defines the term as; “A nursing facility with the staff and equipment to give skilled nursing care and, in most cases, skilled rehabilitative services and other related health services.”
The California Health and Safety Code defines the term like this;
"Skilled nursing facility" means a health facility that provides skilled nursing care and supportive care to patients whose primary need is for availability of skilled nursing care on an extended basis (California Health and Safety Code Sec. 1250).

D. Hospice Rider

This type of policy rider would offer hospice care, which is delivered in a person's home, or in a hospice setting. It is designed to meet the physical, emotional, and spiritual needs of those who are nearing death. Hospice care includes pain management, and focuses on working with the dying person's immediate family, the clergy, and the person's medical care providers. Here is an example of how a hospice rider might be styled;

> After the first Contract Year You may take one additional Penalty-free Withdrawal of up to 100% of Your Contract Value if the Annuitant is confined in a Qualified Care Facility and said confinement is an initial confinement occurring after the end of the first Contract Year. The confinement must be for at least 90 consecutive days, 30 consecutive days for Hospice, and We must receive written confirmation of said confinement from the Qualified Care Facility and a written

recommendation/referral for such confinement from the Annuitant's Qualified Physician.

This Rider is a one-time use Benefit. This Rider is exhausted once You take Your one additional Penalty-free Withdrawal.

All other Limitations under the Base Contract apply.[7]

E. Loan Provisions

It is difficult for most people to forecast their financial needs accurately for more a couple years in the future. This potential need for liquidity is a reason insurers allow loans to be taken out against a policy. As another means to provide some liquidity and avoid the effects of early surrender, many indexed annuities provide for "free withdrawals" up to a contractually-stated maximum number of withdrawals. These contracts also typically contain loan provisions that allow owners additional penalty-free access to accumulation values. Annuity products impose surrender charges that can start out at about 6% or 7% initially, then decrease each year until it reaches zero. Some have much higher fees and/or longer terms.[8] Moreover, surrender during this period might also trigger forfeiture of premium bonuses and interest credits. This could be seen as further argument for the loan feature. As pointed out elsewhere in the text, if a person borrows money from his or her annuity, the loan must be treated as a nonperiodic distribution from the plan unless it qualifies for certain exceptions (home purchase, specific repayment conditions). This treatment also applies to any loan under a contract purchased under a retirement plan, and to the value of any part of the interest in the plan or contract that an individual pledges or assigns (or agrees to pledge or assign). It applies to loans from both qualified and nonqualified plans, including commercial annuity contracts purchased directly from the issuer.

VIII. Penalties

Here is a listing of penalties for insurance licensees in California who decide to violate or circumvent proper sales practices. See Attachment III for further discussion.

A. Violation of Provisions in Section 780 or 781 of the CIC

An insurance company, its officers or agents must not misrepresent the terms of a policy issued or promised to be issued by the insurer, the benefits or privileges agreed to in the policy, or the future dividends payable under the policy. Insurers or their representatives must not make any statement that is known, or should have been known, to be a misrepresentation of the following:

- The terms of a policy issued by the insurer or sought to be negotiated by the person making or permitting the misrepresentation
- The benefits or privileges promised
- The future dividends payable

[7] Arkansas Ins Dept. product filing http://www.insurance.arkansas.gov/LH/FilingElectronic/20108/AMEQ-126531820.pdf.
[8] California Teachers Assoc. CTA.org *What happens when you surrender an Annuity?*

Agents must not use falsehood or misrepresentation to persuade a policyholder to lapse, forfeit or surrender his or her insurance. Conversely, insurers and their agents may not use any representation or comparison of insurers or policies to an insured which is misleading, for the purpose of inducing or tending to induce the individual to lapse, forfeit, change or surrender his or her insurance, whether on a temporary or permanent plan (Section 780 and 781 of the CIC).

Any person violating the provisions of Sections 780 or 781 (as laid out in the paragraphs above) can be punished with up to one year in jail and/or a fine up to $25,000. Where a victim's loss is over $10,000 the fine can be up to three times the amount of loss suffered by the victim and/or one year in jail. The victim's restitution gets satisfied before any fine is collected. (Section 782 of the CIC).

B. Administrative Penalty, Amounts, Rescission of Contracts

Any person or entity engaged in transactions of insurance, other than an insurer, who knowingly violates the rules regarding sales practices for agents is liable for an administrative penalty-

For the first violation, the penalty is no less than $1,000. A second or subsequent time an agent commits a knowing violation of this article, he or she is liable for an administrative penalty of no less than $5,000 and no more than $50,000 for each violation.

If an action is brought by the commissioner against a licensee pursuant to the previous paragraph and it is determined that the licensee may reasonably be expected to cause significant harm to seniors, the commissioner may suspend his or her license pending the outcome of a hearing made available to the licensee.

Insurers who violate the articles relating to sales practices are liable for an administrative penalty of $10,000 for the first violation. Insurers who violate this article with a frequency as to indicate a general business practice or commits a knowing violation of this article, is liable for an administrative penalty of no less than $30,000 and no more than$300,000 for each violation.

The commissioner may require rescission of any contract found to have been marketed, offered, or issued in violation of Insurance Code articles pertaining to good sales practices. (Section 789.3 of the CIC)

C. Allegations of Misconduct Against a Person 65 Years or Over

A proceeding that involves allegations of misconduct committed against a person age 65 or over (pursuant to Section 1668, 1668.5, 1738, 1739, or 12921.8) is to be held within 90 days after receipt by the department of the notice of defense (information concerning a fact/situation actually communicated to a person by an authorized party), unless the department or the administrative law judge grants a continuance of the hearing. A continuance of the hearing may, but need not, be granted for one or more of the following reasons;

- death or incapacitation of a party, a representative or attorney of same, a witness, or of the parent, child, or member of the household of any of these persons, when it is not feasible to substitute another representative, attorney, or witness because of the proximity of the hearing date
- lack of proper notice of hearing
- material change in the status of the case where a change in the parties or pleadings requires postponement, or an executed settlement or stipulated findings of fact obviate the need for hearing; partial amendment of the pleadings is not good cause
- a continuance request signed by all parties, or their authorized representatives, that is communicated to the administrative law judge no later than 25 business days before the hearing
- required substitution of the representative or attorney of a party
- unavailability of a party, representative, attorney of a party, or witness to an essential fact, due to a conflicting and required appearance in a judicial matter if, when the hearing date was set, the person was not aware of the conflicting dates
- unavailability of a party, a representative or attorney of a party, or a material witness due to an unavoidable emergency
- failure by a party to comply with a timely discovery request if the continuance request is made by the party who requested the discovery.

(Section 1738.5 of the CIC).

D. Administrative Penalties

Anyone other than an insurer, who is engaged in the business of insurance and who violates the provisions of Chapter 4 Article 8 of the California Insurance Code (requirements for replacement of life insurance and annuity policies) is liable for an administrative penalty of no less than one thousand dollars ($1,000) for the first violation. A second or subsequent violation of the particular provisions of the Insurance Code earns an administrative penalty of no less than five thousand dollars ($5,000) and no more than fifty thousand dollars ($50,000) for each violation. Insurers who violate the provisions are liable for an administrative penalty of ten thousand dollars ($10,000) for the first violation. Insurers violating the provisions of the Insurance Code with a frequency as to indicate a general business practice is liable for an administrative penalty of no less than thirty thousand dollars ($30,000) and no more than three hundred thousand dollars ($300,000) for each violation. After a hearing conducted in a fashion in compliance with Chapter 4.5 (commencing with Section 11400) and Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code, the commissioner may suspend or revoke the license of any person or entity that violates this article. (Section 10509.9 of the CIC).

Attachment III Penalties Defined

(Section 782, 786, 789.3, 1738.5, 10509.910 et seq. of the CIC)

California Insurance Code	Violation	Penalty
Section 782 Establishes penalties for violation of section 780 and section 781	**Section 780** - Prohibited Misrepresentation **Section 781** - Twisting (see page 3 for actual language)	Punishable by fine not to exceed $25,000, or if victim loss exceeds $10,000, the fine not to exceed 3 times the loss suffered by the victim, by imprisonment not to exceed 1 year or by both a fine and imprisonment Restitution to victim pursuant to Section 1202.4 of the Penal Code shall be satisfied before any fine imposed by this section is collected
Section 786 Provides for an examination period of 30 days after the receipt of the policy or certificate for purposes of review of the contract	no violations or penalties cited in this section (see page 3 for actual language)	
Section 789.3 Administrative penalties; amounts; rescission of contracts	**Section 789.3:** (a) and (b) by broker, agent, or other person engaged in the transactions of insurance other than an insurer (see page 4 for actual language) (d) and (e) by insurer	789.3(a) minimum $1,000 for the first violation 789.3(b) minimum $5,000 and no more than $50,000 each subsequent violation 789.3(c) Commissioner may suspend or revoke license 789.3(d) $10,000 for the first violation 789.3(e) minimum $30,000 and no more than $300,000 each violation thereafter 789.3(f) Commissioner may require rescission of contract

Section 1668.1 Acts that constitute cause to suspend re revoke any permanent license issued pursuant to this chapter	no violations or penalties cited in this section (see page 5 for actual language)	
Section 1738.5 A proceeding held pursuant to section 1668, 1668.5, 1738, 1739, or 12921.8	no violations or penalties cited in this section (see page 5 for actual language)	
Section 10509.9 Administrative penalties:	**Section 10509.9:** (a) and (b) by any agent or other person or entity engaged in the business of insurance other than an insurer (see page 6 for actual language) (c) and (d) by insurer (see page 6 for actual language) (e) by person or entity after a hearing (see page 6 for actual language)	10509.9 (a) $1,000 for the first violation 10509.9 (b) minimum $5,000 and no more than $50,000 each subsequent violation 10509.9 (c) $10,000 for the first violation 10509.9 (d) minimum $30,000 and no more than $300,000 each violation thereafter 10509.9 (e) the Commissioner may suspend or revoke the license
Section 10509.916 **Insurer responsibilities**	violations and penalties to be determined (see page 7 for actual language)	

Current Law

This list includes the statutes stated in SB 618 and the penalty statute from AB 689 (Chapter 295, Statutes of 2011) Insurance: annuity transactions, Section 10509.914 of the California Insurance Code, which will take effect on January 1, 2012.

Section 780: An insurer or officer or agent thereof, or an insurance broker or solicitor shall not cause or permit to be issued, circulated or used, any statement that is known, or should have been known, to be a misrepresentation of the following:

(a) The terms of a policy issued by the insurer or sought to be negotiated by the person making or permitting the misrepresentation.
(b) The benefits or privileges promised thereunder.
(c) The future dividends payable thereunder.

Section 781: (a) A person shall not make any statement that is known, or should have been known, to be a misrepresentation (1) to any other person for the purpose of inducing, or tending to induce, such other person either to take out a policy of insurance, or to refuse to accept a policy issued upon an application therefore and instead take out any policy in another insurer, or (2) to a policyholder in any insurer for the purpose of inducing or tending to induce him or her to lapse, forfeit or surrender his or her insurance therein.
(b)A person shall not make any representation or comparison of insurers or policies to an insured which is misleading, for the purpose of inducing or tending to induce him or her to lapse, forfeit, change or surrender his or her insurance, whether on a temporary or permanent plan.

Section 782: Any person who violates the provisions of Section 780 or 781 is punishable by a fine not exceeding twenty-five thousand dollars ($25,000), or in a case in which the loss of the victim exceeds ten thousand dollars ($10,000), by a fine not exceeding three times the amount of the loss suffered by the victim, by imprisonment in a county jail for a period not to exceed one year, or by both a fine and imprisonment. Restitution to the victim ordered pursuant to Section 1202.4 of the Penal Code shall be satisfied before any fine imposed by this section is collected.

Section 786: All disability insurance and life insurance policies and certificates offered for sale to individuals age 65 or older in California shall provide an examination period of 30 days after the receipt of the policy or certificate for purposes of review of the contract, at which time the applicant may return the contract. The return shall void the policy or certificate from the beginning, and the parties shall be in the same position as if no contract had been issued. All premiums paid and any policy or membership fee shall be fully refunded to the applicant by the insurer or entity in a timely manner.

a) For the purposes of this section a timely manner shall be no later than 30 days after the insurer or entity issuing the policy or certificate receives the returned policy or certificate.

b) If the insurer or entity issuing the policy or certificate fails to refund all of the premiums paid, in a timely manner, then the applicant shall receive interest on the paid premium at the legal rate of interest on judgments as provided in Section 685.010 of the Code of Civil Procedure. The interest shall be paid from the date the insurer or entity received the returned policy or certificate.

(c) Each policy or certificate shall have a notice prominently printed in no less than 10-point uppercase type, on the cover page of the policy or certificate and the outline of coverage, stating that the applicant has the right to return the policy or certificate within 30 days after its receipt via regular mail, and to have the full premium refunded.

(d) In the event of any conflict between this section and Section 10127.10 with respect to life insurance, the provisions of Section 10127.10 shall prevail.

Section 789.3: (a) Any broker, agent, or other person or other entity engaged in the transactions of insurance, other than an insurer, who violates this article is liable for an administrative penalty of no less than one thousand dollars ($1,000) for the first violation.

(b) Any broker, agent, other person, or other entity engaged in the business of insurance, other than an insurer, who engages in practices prohibited by this article a second or subsequent time or who commits a knowing violation of this article, is liable for an administrative penalty of no less than five thousand dollars ($5,000) and no more than fifty thousand dollars ($50,000) for each violation.

(c) If the commissioner brings an action against a licensee pursuant to subdivision (a) or (b) and determines that the licensee may reasonably be expected to cause significant harm to seniors, the commissioner may suspend his or her license pending the outcome of the hearing described in subdivision (c) of Section 789.

(d) Any insurer who violates this article is liable for an administrative penalty of ten thousand dollars ($10,000) for the first violation.

(e) Any insurer who violates this article with a frequency as to indicate a general business practice or commits a knowing violation of this article, is liable for an administrative penalty of no less than thirty thousand dollars ($30,000) and no more than three hundred thousand dollars ($300,000) for each violation.

(f) The commissioner may require rescission of any contract found to have been marketed, offered, or issued in violation of this article.

Section 1668.1: (a) The licensee has induced a client, whether directly or indirectly, to cosign or make a loan, make an investment, make a gift, including a testamentary gift, or provide any future benefit through a right of survivorship to the licensee, or to any of the persons listed in subdivision (e).

(b) The licensee has induced a client, whether directly or indirectly, to make the licensee or any of the persons listed in subdivision (e) a beneficiary under the terms of any intervivos or testamentary trust or the owner or beneficiary of a life insurance policy or an annuity policy.

(c) The licensee has induced a client, whether directly or indirectly, to make the licensee, or a person who is registered as a domestic partner of the licensee, or is related to the licensee by birth, marriage, or adoption, a trustee under the terms of any intervivos or testamentary trust. However, if the licensee is also licensed as an attorney in any state, the licensee may be made a trustee under the terms of any intervivos or testamentary trust, provided that the licensee is not a seller of insurance to the trustor of the trust.

(d) The licensee, who has a power of attorney for a client has sold to the client or has used the power of attorney to purchase an insurance product on behalf of the client for which the licensee has received a commission.

(e) Subdivisions (a) and (b) shall also apply if the licensee induces the client to provide the benefits in those subdivisions to the following people:

(1) A person who is related to the licensee by birth, marriage, or adoption.
(2) A person who is a friend or business acquaintance of the licensee.
(3) A person who is registered as a domestic partner of the licensee.

(f) This section shall not apply to situations in which the client is:

(1) A person related to the licensee by birth, marriage, or adoption.
(2) A person who is registered as a domestic partner of the licensee.

Section 1738.5: A proceeding held pursuant to Section 1668, 1668.5, 1738, 1739, or 12921.8 that involves allegations of misconduct perpetrated against a person age 65 or over shall be held within 90 days after receipt by the department of the notice of defense, unless a continuance of the hearing is granted by the department or the administrative law judge. When the matter has been set for hearing, only the administrative law judge may grant a continuance of the hearing. The administrative law judge may, but need not, grant a continuance of the hearing, only upon finding the existence of one or more of the following:

(a) The death or incapacitating illness of a party, a representative or attorney of a party, a witness to an essential fact, or of the parent, child, or member of the household of any of these persons, when it is not feasible to substitute another representative, attorney, or witness because of the proximity of the hearing date.

(b) Lack of notice of hearing as provided in Section 11509 of the Government Code.

(c) A material change in the status of the case where a change in the parties or pleadings requires postponement, or an executed settlement or stipulated findings of fact obviate the need for hearing. A partial amendment of the pleadings shall not be good cause for continuance to the extent that the un-amended portion of the pleadings is ready to be heard.

(d) A stipulation for continuance signed by all parties, or their authorized representatives, that is communicated with the request for continuance to the administrative law judge no later than 25 business days before the hearing.

(e) The substitution of the representative or attorney of a party upon showing that the substitution is required.

(f) The unavailability of a party, representative, or attorney of a party, or witness to an essential fact, due to a conflicting and required appearance in a judicial matter if, when the hearing date was set, the person did not know and could neither anticipate nor at any time avoid the conflict, and the conflict, with the request for continuance, is immediately communicated to the administrative law judge.

(g) The unavailability of a party, a representative or attorney of a party, or a material witness due to an unavoidable emergency.

(h) Failure by a party to comply with a timely discovery request if the continuance request is made by the party who requested the discovery.

Section 10509.9: (a) Any agent or other person or entity engaged in the business of **insurance**, other than an insurer, who violates this article is liable for an administrative penalty of no less than one thousand dollars ($1,000) for the first violation.

(b) Any agent or other person or entity engaged in the business of insurance, other than an insurer, who engages in practices prohibited by this chapter a second or subsequent time or who commits a knowing violation of this article, is liable for an administrative penalty of no less than five thousand dollars ($5,000) and no more than fifty thousand dollars ($50,000) for each violation.

(c) Any insurer who violates this article is liable for an administrative penalty of ten thousand dollars ($10,000) for the first violation.

(d) Any insurer who violates this article with a frequency as to indicate a general business practice or commits a knowing violation of this article, is liable for an administrative penalty of no less than thirty thousand dollars ($30,000) and no more than three hundred thousand dollars ($300,000) for each violation.

(e) After a hearing conducted in accordance with Chapter 4.5 (commencing with Section 11400) and Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code, the commissioner may suspend or revoke the license of any person or entity that violates this article.

(f) Nothing in this section shall be deemed to affect any other authority provided by law to the commissioner.

Section 10509.916: (a) An insurer is responsible for compliance with this article. If a violation occurs, either because of the action or inaction of the insurer or its insurance producer, the commissioner may, in addition to any other available penalties, remedies, or administrative actions, order any or all of the following:

(1) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this article.

(2) A managing general agent or an insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this article.

(3) Penalties and sanctions pursuant to Section 10509.9. For purposes of Section 10509.9, this article shall be deemed to be part of Article 8 (commencing with Section 10509), and the commissioner may in a single enforcement action seek penalties for a first and a second or subsequent violation.