Annuity Solutions

# What is an Annuity?

## Reference Guide

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# What is an Annuity?

An annuity is a contract issued by an insurance company. It is usually longer term and, when purchased should have a purpose. Annuities are most often bought for future retirement income. Only an annuity can pay an income that can be guaranteed to last as long as you live. What makes annuities different from CDs and some other investments is the tax treatment given them by the I.R.S.

There are different kinds of annuities.

**Immediate Annuities or SPIAs (single premium immediate annuities)**
Income payments start no later than one year after you pay the premium. Most often, income payments start the very next month after purchasing the annuity. See page 5 "Single Premium Immediate Annuities" for more details.

**Deferred Annuities**
Income payments usually start many years after purchasing the annuity, if ever. The funds earn interest and grow during the "deferral period".

Deferred Annuities have two periods:

- Accumulation: Funding of the annuity through a lump sum (single premium) or several payments (flexible premium) plus the interest earnings. The earnings grow tax-deferred as long as you leave them in the annuity.
- Distribution: Withdrawing your funds. You may take an income for life or a specified period of time, or take a lump sum (cash it in).

**Fixed Deferred Annuity**
During the accumulation period of a fixed deferred annuity, your money earns interest at rates set by the insurance company. It's predictable. The company guarantees that it will pay no less than a minimum rate of interest.

**Equity Indexed Deferred Annuity (EIA)**
During the accumulation period of a fixed EIA, your money earns interest-based rates that are linked to an external equity reference or an equity index. The company guarantees that it will pay no less than a minimum rate of interest.

**Qualified Money**
Money that has never been taxed—A qualified annuity is funded with pre-tax dollars, as is an IRA, 401(k) or similar retirement plan. You'll pay income taxes on both the contributions and earnings when you begin taking payments.

**Non-Qualified Money**
Money that you've already paid taxes on (money in a checking account, savings account, life insurance policy, etc). You will only pay taxes on the interest earned in a non-qualified annuity when you begin taking payments.

## Fixed Annuities

How is the interest rate determined for a fixed annuity? During the accumulation period, the money earns interest at rates that change from time to time. The interest rate that is credited is declared by the company, usually on an annual basis.

## Current Interest Rate

**Current Rate**
The rate the company decides to credit to your contract at a particular time. The company will guarantee it will not change for some time period.

**Initial Rate**
An interest rate the insurance company may credit for a set period of time after you first buy the annuity. The initial rate in some contracts may be higher than it will be later. This is often called a bonus rate.

**Renewal Rate**
The rate credited by the company after the end of the set time period. The contract tells how the company will set the renewal rate.

**Multi-Year Rate**
Some fixed, deferred annuities credit the same rate throughout the entire length of the policy. The initial rate and the renewal rates are guaranteed to be the same rate for the length of the surrender period. After that time period, the annuity, if kept in force, will be credited with a current annual renewal rate as set by the insurance company.

**Multiple Interest Rates**
Some annuity contracts apply different interest rates to each premium you pay or to premiums you pay during different time periods. *The minimum guaranteed interest rate is the lowest rate your annuity will ever earn. This rate is stated in the contract.*

## Surrender or Withdrawal Charges

If you need access to your money, you may be able to take all or part of the value from your annuity at any time during the accumulation period. You may pay a surrender charge or withdrawal charge if you take out more than the penalty free amount or if you surrender the entire policy. The Surrender Charge (withdrawal charge) is usually a percentage of the value of the contract as stated in your policy. Often, surrender charge percentage amounts reduce over the years that you keep the policy until they actually dwindle down to nothing. The Surrender Period is the amount of time, in years, that those surrender charges apply. A company may waive the surrender charges in certain situations.

Some annuities have stated terms. When the term is up, the contract may automatically renew. You're usually given a short period of time, often 30 days, called a window, to decide if you want to renew the policy at current rates for another term or surrender the policy without penalty.

In some annuities, there is no charge if you surrender your contract when the company's current interest rate falls below a certain level. This is often called a bail-out option.

In a multiple-premium annuity, the surrender charge may apply to each premium paid for a certain period of time. This may be called a rolling surrender or withdrawal charge.

Some annuity contracts have a market value adjustment (MVA) feature. If interest rates are different when you surrender your annuity from when you bought it, a market value adjustment may make the cash surrender value higher or lower. Since you and the insurance company share this risk, an annuity with an MVA feature may credit a higher rate than an annuity without that feature.

## Free Withdrawal

Your annuity may have a limited free withdrawal feature. This lets you make one or more withdrawals without a charge. The size of the free withdrawal is often limited to a set percentage, most commonly 10% of your contract value. If you make a larger withdrawal, you may pay the withdrawal charges. Some contracts don't specify surrender charges in a percentage style and you may lose any interest over the minimum guaranteed rate on the amount withdrawn.

Some annuities waive the withdrawal charges in certain situations such as when a policy holder dies, is confined to a nursing home, loses a job or is diagnosed with a terminal illness. The 10% IRS penalty will still apply to those taking free withdrawals under the age of 59 ½ (discussed on page 7).

## Annuitization—Annuity Income Payments

One of the most important benefits of deferred annuities is your ability to use the value built up during the accumulation period to give you a lump sum payment or to make income payments during the payout period. Income payments are usually made monthly, but you may choose to receive them quarterly, semi-annually or annually. The size of the income payments is based on the accumulated value in your annuity and the annuity's benefit rate in effect when income payments start. The benefit rate usually depends on your age and sex and the annuity payment option you choose. For example, you might choose payments that continue as long as you live, as long as your spouse lives or for a set number of years.

**Payment Options are as follows:**

- **Period Certain Only:** Period certain means a number of years you chose. Payments will continue for the duration of the number of years you chose, and then cease. If you should die before the end of the stated number of years, your beneficiary would continue to receive the payments for the remainder of those years.
- **Life Only:** Payments will continue for the rest of your life. You cannot outlive your income. Upon your death, payments stop.
- **Life and Period Certain:** Life and period certain means payments will continue for the rest of your life, but for no less than the stated number of years. If you should die before the end of the stated number of years, your beneficiary would continue to receive the payments for the remainder of those years.

- **Life Only with Installment Refund (cash back option):** Payments will continue for the rest of your life. If you should die before you have been repaid your initial investment, the balance of your initial investment will be paid in like installments to your beneficiary.
- **Joint and Survivor:** Payments are guaranteed during the lifetime of two people. After the death of one, payments continue for the lifetime of the surviving person. You can chose to have either full payments, or a percentage you chose, to continue for the lifetime of the survivor. You can also specify a period certain, and if both individuals were to die within the period certain, payments would continue to the named beneficiary for the remainder of the period certain.

## Death Benefit

In the event you die before you begin taking any income payments, the company will pay a death benefit to your beneficiary. The amount will either be the full accumulated value or the cash surrender value as stated in your contract.

## Free Look Provision

Many states have laws that give you a set number of days to look at the annuity policy after you buy it. If you decide during that time that you don't want the annuity, you can return the contract and get all of your money back. This is often referred to as a free look or right to return period. The free look period should be prominently stated in your contract.

## Single Premium Immediate Annuities

A Single Premium Immediate Annuity is a contract between you and an insurance company. By paying in a lump sum of money, you are guaranteed to receive a series of payments over a period of time. The amount of the payment is determined by both the current interest rate at the time your contract is issued and by choices you make from a wide variety of payment options. Once your contract is issued, your payments are fully guaranteed for the period of time you have chosen. Like annuitization options on deferred annuities, payment options are as follows:

- **Period Certain Only:** Period certain means a number of years you chose. Payments will continue for the duration of the number of years you chose, and then cease. If you should die before the end of the stated number of years, your beneficiary would continue to receive the payments for the remainder of those years.
- **Life Only:** Payments will continue for the rest of your life. You cannot outlive your income. Upon your death, payments stop.
- **Life and Period Certain:** Life and period certain means payments will continue for the rest of your life, but for no less than the stated number of years. If you should die before the end of the stated number of years, your beneficiary would continue to receive the payments for the remainder of those years.
- **Life Only with Installment Refund (cash back option)**: Payments will continue for the rest of your life. If you should die before you have been repaid

your initial investment, the balance of your initial investment will be paid in like installments to your beneficiary.

- **Joint and Survivor:** Payments are guaranteed during the lifetime of two people. After the death of one, payments continue for the lifetime of the surviving person. You can chose to have either full payments, or a percentage you chose, to continue for the lifetime of the survivor. You can also specify a period certain, and if both individuals were to die within the period certain, payments would continue to the named beneficiary for the remainder of the period certain.

### Tax-Favored Income?

If you use after-tax funds to purchase a single premium immediate annuity, the income payments you receive are only partially taxable. The non-taxable portion of each payment is a level percentage that represents the return of principal over the life of the contract. Depending on your age and the payment option you chose, this percentage will vary. If you are using tax-qualified funds (IRA, TSA, 401k money, for example) to purchase your Single Premium Immediate Annuity, the payments you receive are generally fully taxable as you receive them because they represent funds that have not been taxed before.

### No Investment Risk

Once your contract is issued, you can count on your payments not to change in amount or frequency. You will enjoy the financial security of a guaranteed income with no investment risk. Economic conditions or investment returns may change, but your payment is guaranteed to remain the same.

A Single Premium Immediate Annuity offers a variety of options so you may tailor your income schedule to suit your needs. You can choose to receive payments monthly, quarterly, semiannually or annually.

## Split Annuities

A Split Annuity is not an annuity policy but a combination of two annuity products. A single premium immediate annuity and a single premium deferred annuity. It is structured in such a way as to produce immediate income for a guaranteed period of time and to restore your original principal at the end of that time period.

### Tax Treatment of Annuities

Under current federal law, annuities receive special tax treatment. Income tax on annuities is deferred, which means you aren’t taxed on the interest your money earns while it stays in the annuity. You’ll be earning interest on the money you’re not paying in taxes, which means you can accumulate more money over a shorter period of time, which, ultimately, will provide you with a greater income. Another advantage of tax deferral is that the tax bracket you’re in when you receive annuity income payments may be lower than the one you were in during the accumulation period. Most states’ tax laws on annuities follow the federal law.

**Non-Qualified Annuities**
Part of the payments you receive from an annuity will be considered as a return of the premium you've paid into the annuity. You won't have to pay taxes on that part. The other part of those payments is considered interest you've earned. You must pay taxes on the part that is considered interest when you withdraw the money. You may also have to pay a 10% tax penalty if you withdraw the accumulation before age 59 ½.

**Qualified Annuities**
100% of the payments are taxable because the money has never been taxed before. You may also have to pay a 10% tax penalty if you withdraw the accumulation before age 59 ½.

**Types of Tax-Qualified Annuities:**

- **IRA:** A retirement planning tool available for most working individuals who do not have a retirement plan at work. It is a personal savings plan that offers you tax advantages to set aside money for retirement. Two advantages are that you may be able to deduct your contributions to your IRA in whole or part, depending on your circumstances and, generally, amounts in your IRA, including earnings and gains, are not taxed until you withdraw them.
- **Roth IRA:** The Roth IRA is a personal savings plan that offers you tax advantages to set aside money for retirement. Contributions to the Roth IRA are not tax deductible, but interest earned and capital gains are tax free. In addition, withdrawals are not taxed, provided you met the Roth IRA guidelines.

There are several types of qualified plans available for group situations, as well.

## Comparison

| | Qualified | Non-Qualified |
|---|---|---|
| **Contributions** | Limited | No Limits |
| **Tax Deductible** | Yes, except Roth | No |
| **Tax Deferred** | Yes | Yes |
| **IRS Age Penalties** | Yes (59 ½) | Yes (59 ½) |
| **IRS Penalty Exceptions** | Yes | Yes |
| **Taxed When Withdrawn** | Entire Amount, except Roth | Only on Gain |
| **Required Distribution** | At age 70 ½, except Roth | No |
| **Penalty Free Withdrawals** | Yes | Yes |
| **Surrender Penalties** | Yes | Yes |

## What is the Penalty Tax and When does it apply?

An IRS penalty tax, currently 10%, may be payable on any withdrawal of interest or qualified premium made prior to age 59 ½, including the allowable “penalty free” withdrawal amount.

**Avoidance of the Pre-59 ½ Distribution Penalty**

If you make a withdrawal prior to age 59 ½ from your traditional IRA, you must pay an additional tax of 10%. This tax is 10% of the part of the distribution that you have to include in gross income. It is in addition to any regular income tax on the amount you have to include in gross income.

However, if you stringently adhere to one of three withdrawal methods that the IRS approves of, you many make withdrawals prior to age 59 ½ and avoid the Premature Distribution Penalty Tax.

**An Annuity Payout Option**

You can receive distributions from your traditional IRA that are part of a series of substantially equal payments over your life (or your life expectancy), or over the lives (or joint life expectancies) of you and your beneficiary, without having to pay the 10% additional tax, even if you receive such distributions before you are age 59 ½.

You must use an IRS-approved distribution method and you must take at least one distribution annually for this exception to apply. One IRA-approved method is known as the "life expectancy method". Unlike for minimum distribution purposes, this method, when used for this purpose, results in the exact amount required, not the minimum amount.

The payments under this exception must continue for at least 5 years, or until you reach age 59 ½, whichever is the longer period. This 5-year rule does not apply if a change from an approved distribution method is made because of the death or disability of the IRA owner. The payment must be calculated on the life or life expectancy of the recipient of the IRA and payments be made no less frequently than annually.

If the payments under this exception are changed before the end of the above required periods for any reason other than the death or disability of the IRA owner, he or she will be subject to the 10% additional tax. For example, if you received a lump-sum distribution of the balance in your traditional IRA before the end of the required period for your annuity distributions and you did not receive it because you were disabled, you would be subject to the 10% additional tax. The tax would apply to the lump-sum distribution and all previous distributions made under the exception rule.

There are two other IRS-approved distribution methods that you can use. They are generally referred to as the "amortization method" and the "annuity factor method." These two methods are complex and require the assistance of a tax professional. For more information about these methods see IRS Notice 89-25 in Internal Revenue Cumulative Bulletin 1989-1.

**Other Exceptions are:**

- Death
- Disability

- Higher education
- First-time home purchase
- Paying medical insurance premiums after losing your job

**Required Minimum Distribution**

On the flip side of the government not wanting you to withdraw your money at too young an age, it also has rules to prevent you from not withdrawing the money soon enough. (This is done so that the government can tax it.) You usually need to begin taking money from your IRA no later than April 1 of the calendar year following the date you turn age 70 ½.

The rules established by the government regarding these Required Minimum Distributions, their timing, the amounts, the recalculations and the effect various beneficiary designations have on them are a complex part of the Internal Revenue Code. There is a penalty assessed if the RMD requirements are not fulfilled.

## Why Buy an Annuity?

**Savings Advantages**

Many people today are using tax-deferred annuities as the foundation of their overall financial plan instead of certificates of deposit or savings accounts. Although CDs and Annuities are very similar, there are significant differences between the two. The most important difference is that annuities allow for the deferral of the taxes due on the interest earned until the interest is withdrawn. Like CDs, annuities have a surrender charge; however, most annuities allow liberal free withdrawal provisions.

**Tax Advantage**

The tax advantage is deferred taxes while the money grows and possibly lower tax on withdrawals if the tax bracket you are in when you start receiving income is lower than the tax bracket you were in while you were accumulating money.

**The Tax-Deferred Advantage**

To illustrate the increased earnings capacity of tax-deferred interest, compare it to fully taxable earnings. $25,000 at 6% interest will earn $1,500 of interest in a year. A 28% tax bracket means that approximately $420 of those earnings will be lost in taxes, leaving only $1,080 to compound the next year. If these same earnings were tax-deferred, the full $1,500 would be available to earn even more interest. The longer you can postpone taxes, the greater the gain.

**Money Doesn't "Mature"**

An annuity policy does not "mature" like a bond or a CD. Both your principal and interest will automatically continue to earn interest until withdrawn or you reach age 100. You can let your money continue to grow, make withdrawals or begin receiving an annuity income at any time.

**Avoid Probate**

If a premature death should occur, the accumulating funds within your annuity may be transferred to your named beneficiaries, avoiding the expense, delay, frustration and publicity of the probate process. Like most assets, the annuity is part of your taxable estate. Your heirs can chose to receive a lump sum payment, or a guaranteed monthly income.

### Safety

Your tax-deferred annuity is safe. A qualified legal reserve life insurance company is required to meet its contractual obligations to you. These reserves must, at all times, be equal to the withdrawal value of your annuity policy. In addition to reserves, state law also requires certain levels of capital and surplus to further increase policyholder protection. Legal reserve refers to the strict financial requirements that must be met by an insurance company to protect the money paid in by all policyholders. These reserves must be, at all times, equal to the withdrawal value (principal plus interest less early withdrawal fees, if any) of every annuity policy. State insurance laws also require that a life insurance company must maintain certain minimum levels of capital and surplus, which provide additional policyholder protection.

### Tax Deferred Account

- Amount Deposited into a Tax Deferred Account: $100,000
- Current Interest Rate: 6.00%

### Taxable Account

- Amounted Deposited into a Taxable Account: $100,000
- Current Interest Rate: 6.00%
- Tax Bracket: 27.5%

## Difference in account values over a ten year period

| Tax Deferred Account | | | Taxable Account | | | |
|---|---|---|---|---|---|---|
| Balance | Interest | Value | Balance | Interest | Value | Difference |
| $100,000 | $6,000 | $106,000 | $100,000 | $4,359 | $104,350 | $1,650 |
| $106,000 | $6,360 | $112,360 | $104,350 | $4,539 | $108,889 | $3,471 |
| $112,360 | $6,742 | $119,192 | $108,889 | $4,737 | $113,626 | $5,476 |
| $119,102 | $7,146 | $126,248 | $113,626 | $4,943 | $118,569 | $7,679 |
| $126,248 | $7,575 | $133,823 | $118.569 | $5,158 | $123,726 | $10,096 |
| $133,823 | $8,029 | $141,852 | $123,726 | $5,382 | $129,108 | $12,743 |
| $141,852 | $8,511 | $150,363 | $129,108 | $5,616 | $134,725 | $15,638 |
| $150,363 | $9,022 | $159,385 | $134,725 | $5,861 | $140,585 | $18,800 |
| $159,385 | $9,563 | $168,948 | $140,585 | $6,115 | $146,701 | $22,247 |
| $168,948 | $10,137 | $179,085 | $146,701 | $6,381 | $153,082 | $23,003 |

# Equity-Indexed Annuities

### What are Equity-Indexed Annuities? (EIAs)

An equity-indexed annuity is a fixed annuity, either immediate or deferred, that earns interest or provides benefits that are linked to an external equity reference or an equity index. The value of the index might be tied to a stock or other equity index. One of the most commonly used indices is Standard & Poor's 500 Composite Stock Price Index (the S&P 500)[1], which is an equity index. The value of any index varies from day to day and is not predictable.

When you buy an equity-indexed annuity you own an insurance contract. You are not buying shares of any stock or index.

While immediate equity-indexed annuities may be available, this guide will focus on deferred equity-indexed annuities.

*[1]S&P is a registered trademark of the McGraw-Hill Companies, Inc., used with permission.*

### How are EIAs different from other fixed annuities?

An EIA is different from other fixed annuities because of the way it credits interest to your annuity's value. Some fixed annuities only credit interest calculated at a rate set in the contract. Other fixed annuities also credit interest at rates set from time to time by the insurance company. EIAs credit interest using a formula based on changes in the index to which the annuity is linked. The formula decides how the additional interest, if any, is calculated and credited. How much additional interest you get and when you get it depends on the features of your particular annuity.

Your EIA, like other fixed annuities, also promises to pay a minimum interest rate. The rate that will be applied will not be less than the minimum guaranteed rate, even if the index-linked interest rate is lower. The value of your annuity also will not drop below a guaranteed minimum. For example, many single premium contracts guarantee the minimum value will never be less than 90 percent of the premium paid, plus at least 1.5% in annual interest (less any partial withdrawals).

### What are some of the Equity-Indexed Contract Features?

Two features that have the greatest effect on the amount of additional interest that may be credited to an equity-indexed annuity are the indexing method and the participation rate. It is important to understand the features and how they work together. The following describes some other equity-indexed annuity features that affect the index-linked formula.

### Indexing Method

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

### Term

The index term is the period over which index-linked interest is calculated; the interest is credited to your annuity at the end of a term. Terms are generally from 1 to 10 years, some shorter or longer, 10 being average. Some annuities offer single terms, while others offer multiple, consecutive terms.

If your annuity has multiple terms, there will usually be a window at the end of each term, typically 30 days, during which you may withdraw your money without penalty. For installment premium annuities, the payment of each premium may begin a new term for that premium, although it is not common.

### Participation Rate

The participation rate decides how much of the increase in the index will be used to calculate index-linked interest. For example, if the calculated change in the index is 9% and the participation rate is 70%, the index-linked interest rate for your annuity will be 6.3% (9% x 70% = 6.3%). A company may set a different participation rate for newly-issued annuities as often as each day.

Therefore, the initial participation rate in your annuity will depend on when it is issued by the company. The company usually guarantees the participation rate for a specific period (from one year to the entire term). When that period is over, the company sets a new participation rate for the next period. Some annuities guarantee that the participation rate will never be set lower than a specified minimum or higher than a specified maximum.

### Cap Rate or Cap

Some annuities may put an upper limit, or cap, on the index-linked interest rate. This is the maximum rate of interest the annuity will earn. In the example given above, if the contract has a 6% cap rate, 6%, and not 6.3%, would be credited. Not all annuities have a cap rate.

### Floor on Equity Index-Linked Interest

The floor is the minimum index-linked interest rate you will earn. The most common floor is 0%. A 0% floor assures that even if the index decreases in value, the index-linked interest that you earn will be zero and not negative. As in the case of a cap, not all annuities have a stated floor on index-linked interest rates. But in all cases, your fixed annuity will have a minimum guaranteed value.

### Averaging

In some annuities, the average of an index's value is used rather than the actual value of the index on a specified date. The index averaging may occur at the beginning, the end, or throughout the entire term of the annuity.

### Interest Compounding

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

### Margin/Spread/Asset Fee

In some annuities, the index-linked interest rate is computed by subtracting a specific percentage from any calculated change in the index. This percentage, sometimes referred to as the margin, spread or asset fee, might be instead of, or in addition to, a participation rate. For example, if the calculated change in the index is 10%, our 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.

### Vesting

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

## How do the common indexing methods differ?

### Annual Reset

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

### High-Water Mark

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

### Low-Water Mark

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

### Point-to-Point

The index-linked interest, if any, is based on the difference between the index value at the end of the term and the index value at the start of the term. Interest is added to your annuity at the end of the term.

## What are some of the features and trade-offs of different indexing methods?

Generally, equity-indexed annuities offer preset combinations of features. You may have to make trade-offs to get features you want in an annuity. This means the annuity you choose may also have features you don't want.

| | Features | Trade-Offs |
|---|---|---|
| **Annual Reset** | Since the interest earned is "locked in" annually and the index value is "reset" at the end of each year, future decreases in the index will not affect the interest you have already earned. Therefore, your annuity using the annual reset method may credit more interest than annuities using other methods when the index fluctuates up and down often during the term. This design is more likely than others to give you access to index-linked interest before the term ends. | Your annuity's participation rate may change each year and generally will be lower than that of other indexing methods. Also, an annual reset design may use a cap or averaging to limit the total amount of interest you might earn each year. |
| **High-Water Mark** | Since interest is calculated using the highest value of the index on a contract anniversary during the term, this design may credit higher interest than some other designs if the index reaches a high point early or in the middle of the term, then drops off at the end of the term. | Interest is not credited until the end of the term. In some annuities, if you surrender your annuity before the end of the term, you may not get index-linked interest for that term. In other annuities, you may receive index-linked interest, based on the highest anniversary value to date and the annuity's vesting schedule. Also, contracts with this design may have a lower participation rate than annuities using other designs or may use a cap to limit the total amount of interest you might earn. |

| | Features | Trade-Offs |
|---|---|---|
| **Low-Water Mark** | Since interest is calculated using the lowest value of the index prior to the end of the term, this design may credit higher interest than some other designs if the index reaches a low point early or in the middle of the term and then rises at the end of the term. | Interest is not credited until the end of the term. In some annuities, if you surrender your annuity before the end of the term, you may not get index-linked interest for that term. In other annuities, you may receive index-linked interest, based on the highest anniversary value to date and the annuity's vesting schedule. Also, contracts with this design may have a lower participation rate than annuities using other designs or may use a cap to limit the total amount of interest you might earn. |
| **Point-to-Point** | Since interest cannot be calculated before the end of the term, use of this design may permit a higher participation rate than annuities using other designs. | Since interest is not credited until the end of the term, typically 10 years, you may not be able to get the index-linked interest until the end of the term. |

## What is the impact of some of the other Equity-Indexed Annuity product features?

**Cap in Interest Earned**

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

**Averaging**

Averaging at the beginning of a term protects you from buying your annuity at a high point, which would reduce the amount of interest you might earn. Averaging at the end of the term protects you against severe declines in the index and losing index-linked interest as a result. On the other hand, averaging may reduce the amount of index-linked interest you earn when the index rises either near the start or at the end of the term.

**Participation Rate**

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

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

## What will it cost me to take my money out before the end of the term?

In addition to the information discussed in this guide about surrender and withdrawal charges and free withdrawals, there are additional considerations for EIAs. Some annuities credit none of the index-linked interest or only part of it if you take out money before the end of the term. The percentage that is vested, or credited, generally increases as the term comes closer to its end and is always 100% at the end of the term.

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