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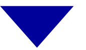

A Word On Annuity Suitability Training

This course meets Department of Insurance Guidelines for Annuity Training. Specifically, this course is one of four sanctioned by the State to meet the 4-Hour "refresher" training required every two years by the end of your license renewal. This course addresses annuity suitability, however, there is additional Suitability Training you must fulfill that is supplied by your carrier (insurance company) to meet the State's Annuity Suitability Training spelled out in AB 689.

There is much confusion about recent legislation (AB 689) and "training" required on or before January 1, 2012. A 12/6/11 letter from the DOI attempts to clarify:

Do I need to take a new 8-hour or 4-hour annuity course?

NO. ***Existing 8-Hour and/or 4-Hour annuity training courses (INCLUDING THIS COURSE) taken through Affordable Educators, are STILL valid courses to meet annuity training*** rules for agents selling these products. If you have taken an 8-hour or 4-hour annuity refresher course to meet your current renewal period, ***you do not need to take it again*** to meet annuity suitability rules.

So what is the annuity suitability training required?

According to the State and AB 689, *insurance producers that sell annuity products must complete the **insurer's product-specific training***. Any insurance producer who has not completed the insurer's annuity product-specific training is precluded from selling those annuity products until the product-specific training is completed.

The annuity product-specific training is a separate requirement from the eight and four-hour annuity training (THIS COURSE). And, per the legislation above, *this training MUST come from your insurer.*

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SECTION I
Annuity Suitability

Let's Discuss Annuity Suitability

Annuities can play a role in a client's ***overall*** financial plan. A client views annuities in terms of a desire for ***income, safety of principal and tax advantages***. From the agent's perspective, however, more needs to be done to uncover the ***client's true needs***, reflected in growth vs. income requirements, risk tolerance, liquidity specifications, now and in the future, and whether tax deferral benefits are worthwhile to pursue. Agents can be vital players in solving these client needs. It follows, that the greater agent due care exercised, the more suitable AND valuable his service.

There are variety of techniques that are accepted and used to determine customer needs or suitability. Some are more traditional than others. Most are seen as solutions to ***identify*** a certain customer segment. They give logical, rational explanations about where the customer fits in but do not explain how the customer ***feels and cares***. Policy applications are an example of information an agent might use to identify who he is about to insure.

Who should invest in annuities?

One rule of thumb follows that a client looking for a long-term investment with a tax bracket greater than 15 percent might consider annuities. Other likely candidates include moderate or high tax bracket individuals looking for a conservative way to shelter current income or growth over a long period of time, i.e., retirement monies.

Fixed rate annuities might be an alternative for CDS, GNMAs (Ginnie Maes), T-Bills or other similar obligations. Variable annuities are better geared to individuals who seek tax deferral, yet willing to ride with the ups and downs that accompany stock and mutual fund investments.

Once an annuity can be established as an appropriate investment opportunity, agents must carefully weigh the following choices and discuss same with each client:

Immediate Annuity vs. Deferred Annuity

Clients may have ***current*** income needs or the desire to ***defer*** income for greater growth. Perhaps a combination is appropriate. Tax planning and liquidity are key considerations for the agent.

Single Premium vs. Flexible Premium

Client's generally have a ***lump sum*** to invest or need to ***accumulate*** by paying into a savings plan. Short and long-term liquidity is an important consideration.

Fixed Rate vs. Variable Rate

Client's may have needs to ***lock-in*** their yields or go for ***growth***. One group is typically a CD type investor as opposed to those who are willing and able to incur greater risk. Agents needs to carefully explain the potential loss of principal possible in variable plans. Agents should review potential interruptions in return of principal and yield that can develop with either fixed or variable contracts.

Yield vs. Guarantees

It is logical that the stronger the guarantee the lower the yield. Agents must explain that a higher first year yield may include bonuses or special incentives to invest that later disappear. This type of contract should be compared to other contracts that may offer a slightly lower yield that is ***locked in*** for a specific period, i.e., determining overall ***predictable*** yield over time is important due diligence. In the same vein, a disclosure would be appropriate as to the method used by the insurer to ***adjust*** yield. A contract with a guaranteed yield spread may be more appropriate for some clients than a yield that is adjusted by the insurer's board of directors. Equally important is whether yield is ***banded,*** i.e., are yields adjusted separately for certain blocks of investors or are investors who entered five years ago given the same yield as new investors.

Yield vs. Liquidity

Clients demanding easy access to their money should be prepared to settle for lower overall yields. Agents need to go farther to determine special needs such as the potential for large sums of money to pay for a potential illness or nursing home. Certain contracts allow penalty free withdrawals for special circumstances. Due care dictates that agents carefully and clearly explain all surrender charges associated with the contract and when they occur.

Maturity options

Annuity contracts may mature at specific ages. This can affect BOTH a client's long-term investment planning as well as tax planning. A client wishing to plan for long term deferral to age 95, for example, might be disappointed to learn that the contract must ***annuitize*** at age 85. Further, agents MUST disclose the potential tax affect of a maturing annuity. Pre-1981 Annuities deliver ***principal first***, then tax interest or appreciation. Post 1981 annuities tax interest or appreciation first then deliver principal. Also to be considered is ***annuitization*** of the contract where a systematic withdrawal and payoff of the contract over time delivers some principal and taxes interest and appreciation with each payment.

Withdrawals & IRS Penalties

Where the client is withdrawing all or part of an annuity contract PRIOR to age 59.5, he should be apprised of the ten percent IRS penalty for early withdrawals. At present, this can only be avoided where the annuitant dies or becomes substantially disabled or, where annuitization is chosen within one year of investing in the annuity contract.

Guaranteed Death Benefits

Where agents assist in estate planning, due care would involve a disclosure concerning death benefits. Most fixed rate contracts guarantee the return of principal and any appreciation (interest left to grow). However, agents should uncover and review factors concerning potential surrender penalties or how they may be avoided, as well as the basis of the guarantee. Is the death benefit guarantee, for example, the greater of ALL contributions of principal OR simply the value of the contract on the date of the annuitant's death?

Settlement Options & Taxes

Clients should be made to understand that, at best, annuities represent tax deferral, not tax free income. Unless the beneficiary of the annuity is a surviving spouse, taxes on the accumulated growth will be due -- there is NO step-up in basis. The tax liability is the difference between the amount invested subtracted from the value of the annuity contract, multiplied by the beneficiary's tax bracket. Options to mitigate this include five year or lifetime annuitization of the contract.

Other settlement options that should be discussed with the client include possible options such as life annuity, joint and last survivor, lifetime with period certain, etc.

State Guaranty Fund Coverage

Rules governing state guaranty coverage should be disclosed to the client. If the State does NOT permit advanced disclosure concerning guaranty fund protection, the agent should privately exercise diligence in planning annuity purchases. The primary concern? Is the full amount of the annuity covered against insurer failure. Perhaps due care is served by ***diversifying*** among several insurers and/or between fixed AND variable contracts to take full advantage of guaranty protection.

Titling Options

If the agent is advertising tax and estate planning advice he should disclose the consequences of titling contracts. Where no tax or estate counseling is provided, the agent should still exercise due care by disclosing the fact that titling consequences may result and offer to refer a competent attorney or tax expert before any purchasing decisions. As a general rule, the death of an owner or annuitant triggers a death benefit which carries tax liability. Unless the survivor beneficiary is the spouse, the beneficiary must take a lump sum and pay the tax or annuitize over a minimum five-year period. An important area for agents to investigate is whether the annuity contract enforces or waives surrender charges where a death of the annuitant or owner has occurred. In some contracts, the surrender charge can be deferred where an owner dies and a contingent owner is allowed.

Essential Annuity Due Care Questions

- ✓ Is the client interested in growth or income?
- ✓ Is the client interested in current income or retirement income? How soon does he need to start receiving income?
- ✓ How much risk is the client ready to accept today and in the future? Could he stand the loss of his entire investment? How would an interruption in income affect him?
- ✓ What are the client's liquidity needs in the short-, intermediate- and long-term?

- ✓ What is the client's federal/state tax bracket? Does tax deferral through annuities make sense?
- ✓ Is the client under age 60, and is it likely that he will need to withdraw major portions of the annuity in the future? Will the ten percent penalty offset the benefits of tax deferral?
- ✓ Does the client demand full and complete protection of principal? Or, can the client afford to take risk in hopes of greater appreciation using variable contracts?
- ✓ Is the preservation of principal more important to the client than the effects inflation may have against a fixed yield?
- ✓ What are the survivor spouse/family needs in the event the client dies? How can these needs be accomplished?

Suitability & The Law

At this point, you may be asking . . . what's the bid deal? People need annuities, I sell them! Why does everything have to concern the law? Well, in general, an agent may not have a ***legal duty*** to secure ***complete*** insurance protection or place an annuity to fill every conceivable need an insured might have, but there is definite legal obligation to explain ***policy / product options*** that are ***widely available at a reasonable cost*** (Southwest Auto Painting v Binsfield - 1995). Likewise, an agent has a legal duty to use ***reasonable skill*** in asking certain questions during the application process to determine types of coverage / product needed (Smith v Dodgeville Mutual Insurance – 1997). Further, failing to determine the nature and extent of the product / coverage requested as in Butcher v Truck Insurance Exchange - 2000, may subject you to a lawsuit.

NOTE: Confused about how the life insurance or casualty court cases above impact the selling of annuities? Don't be. The courts view the sale of insurance the same whether it involved home insurance or annuities. For example, an annuity agent who failed to disclose options available under an annuity contract might be sued using the auto painting case above as a precedent.

For a majority of suitability lawsuits, the basis of liability is relationship and purpose. Legally a ***personal relationship is created*** when a prospective insured consults an insurance agent, provides that agent with specific information about his unique circumstances and relies on the agent to obtain appropriate coverage tailored to these circumstances. Courts have recognized that the relationship between a prospective insured and an insurance agent (like the relationship of attorney and client) is that of principal and agent, for the purpose of negotiating a policy suitable to the client's needs (Nu-Air Manufacturing Co. V. Frank B. Hall & Co. - 1987). Further, an insurance agent owes the prospective insured a duty of unwavering loyalty similar to that owed by an attorney to a client. It is the special ***fiduciary nature*** of the relationship between a prospective insured and an insurer that lends the relationship a ***personal character*** similar in scope to the lawyer-client relationship. For this reason, alleged acts of negligence on the part of an insurance agent who has been consulted for the ***express purpose*** of meeting a client's unique needs create a ***personal tort***.

In Forgione v. State Farm Insurance - 1995, it was determined that the insureds made ***express representations*** to the agent about the importance of arranging a set of policies that would prevent a gap in coverage. The insureds ***relied*** on these agents to obtain the appropriate coverage, and the agents failed to use reasonable care, skill and diligence to procure ***suitable policies***. The allegations in the complaint make clear that the insureds ***expected*** the agents to

respond to the couple's unique, personal insurance needs. A $600,000 claim proved that a ***gap in coverage existed*** and therefore it was not a suitable policy.

In another case (Anderson v. Knox - 1961) agent Leland Anderson had specialized in the sale of what is referred to as bank financed insurance or insurance under the bank loan plan. The plan was that premiums would be provided by borrowing the amounts thereof from a bank and securing the bank by assignment of old and new policies. What is significant about the Knox case is the testimony by the client:

'I had my faith in him because he was recommended by a leading business man in the Territory. I figured he knew what he was talking about. He had all the facts in my case. I figured he was giving me something that was designed for me.'

The court determined that Knox ***did rely*** upon Anderson's statements and that it would be unreasonable to argue that Knox should have found out for himself, because of some principle of caveat emptor, that the program was not at all what it was represented to be.

California Annuity Law Trends & Licensing Requirements

The trend in law surrounding the sale of annuities in California has resulted in a growing duty by insurance agents to find responsible and suitable products for their clients in a full disclosure environment. Consider the following legislative measures, past and recent:

SECTION 10509.914 (2012) In recommending annuities to individual consumers, including consumers over the age of 65, for purchase or exchange, ***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 objectives and reasonable belief of the following:

- The consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and surrender charge, potential tax penalty if the consumer sells, exchanges, surrenders, or annuitizes the annuity, mortality and expense fees, investment advisory fees, potential charges for and features of riders, limitations on interest returns, insurance and investment components, and market risk.

- The consumer would receive a tangible net benefit from the transaction.

- The particular annuity as a whole, the underlying subaccounts to which funds are allocated at the time of purchase or exchange of the annuity, and riders and similar product enhancements, if any, are suitable, and in the case of an exchange or replacement, the transaction as a whole is suitable, for the particular consumer based on his or her suitability information.

- In the case of an exchange or replacement of an annuity, the exchange or replacement is suitable, including taking into consideration all of the following: Whether the consumer will incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, such as death, living, or other contractual benefits, or be subject to increased fees, investment advisory fees, or charges for riders and similar product enhancements; whether the consumer would benefit from product enhancements and

improvements; whether the consumer has had another annuity exchange or replacement and, in particular, an exchange or replacement within the preceding 60 months.

- Prior to the execution of a purchase, exchange, or replacement of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain the consumer's suitability information.

- Except as permitted under subdivision (d), an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information. The preceding sentence and subdivision (d) notwithstanding, neither a producer nor an insurer shall in any event recommend to a person 65 years of age or older the sale of an annuity to replace an existing annuity that requires the insured to pay a surrender charge for the annuity that is being replaced, where purchase of the annuity does not confer a substantial financial benefit over the life of the policy to the consumer, so that a reasonable person would believe the purchase is unnecessary.

SB 1065 (1993) Requires special disclosures to senior citizens concerning accumulation and surrender values as well as provisions to cancel.

AB 1667 (1994) Defines the role of the California Insurance Guarantee Association and establishes certain product exemptions.

SB 1505 (1994) Makes more changes to cancellation procedures and notice requirements applicable to annuity sales.

SB 203 (1997) Revises previous law concerning annuity benefits in the event of default or surrender and allows the Commissioner to modify mortality tables.

SB 1718 (1998) Changes the unconditional right to refund from 20 to 30 days.

AB 2107 (2000) Reinforces the agent's duty of honesty and fair dealing and establishes special handling where Medi-Cal eligibility is concerned.

SB 423 (2000) Authorizes variable contract living benefits

AB 2984 (2002) Regulates annuity and life sales by depository institutions.

AB 284 (2003) Tightens paid-up and surrender benefits and provides for a uniform method of calculating nonforfeiture amounts.

SB 618 (2003) Establishes new penalties and control over the unfair acts licensees, especially for clients age 65 and older.

SB 620 (2003) Redefines annuity suitability and sales practices to seniors including the prohibition of sale in certain circumstances. Also establishes the requirement for the special annuity training present in this course. If a life agent offers to sell to an elder (age 65 or older) any life insurance or annuity product, the life agent shall advise an elder or elder's agent ***in writing that the sale or liquidation*** of any stock, bond, IRA, certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of this product ***may have tax consequences***, early withdrawal penalties, or other costs or penalties as a result of the sale or liquidation, and that the elder or elder's agent may wish to consult independent legal or financial advice before

selling or liquidating any assets and ***prior to the purchase of any life or annuity products*** being solicited, offered for sale, or sold.

SB 483 (2008) Designed to bring California into compliance with provisions of the Deficit Reduction Act of 2006 which lengthened the "look-back" period for asset transfers to establish Medicaid's eligibility for nursing home coverage from 3 to 5 years, requiring annuities to be disclosed and states to be named a beneficiary for the cost of Medicaid assistance with certain specific exceptions.

Section 1749.8 (2012) of the California Insurance Code (CIC) requires that every insurance producer who sells annuities shall satisfactorily complete eight hours of training prior to soliciting consumers to sell annuities. This section further requires insurance producers to complete four hours of training every two years prior to their license renewal.

AB 1416 (2011) included an amendment to Section 1749.8 to state that the four hours of annuity training is to be completed prior to each license renewal.

Section 10509.915(a) CIC (2012) An insurance producer shall not solicit the sale of an annuity product unless the insurance producer has adequate ***knowledge of the pro***duct to recommend the annuity and the insurance producer is in compliance with the insurer's standards for product training. ***Insurance producers may rely on insurer-provided product-specific training*** standards and materials to comply with the product-specific training requirement.

Section 10509.915(b)(2012) In addition to the above, an insurance producer shall complete a one-time eight credit-hour annuity training course by an proved education provider, prior to commencing the transaction of annuities. Further, every producer who engages in this state in the sale of annuity products shall satisfactorily complete a four-hour refresher annuity course prior to license renewal every two years.

AB 689 (2011) Effective January 1, 2012. AB 689 adopts several of the provisions of the National Association of Insurance Commissioners (NAIC) Suitability in Annuity Transactions model regulations adopted by California. Similar to AB 1416, the changes in AB 689 do not change the existing annuity training requirements.

Annuity Licensing & Training

A California Life-Only license shall entitle the licensee to transact insurance coverage on human lives, ***including benefits of endowment and annuities***, and may include benefits in the event of death or dismemberment by accident and benefits for disability income.

Before a Life-Only agent can sell annuities in California, he or she must meet special training requirements per ***Section 1749.8*** of the California Insurance Code.

(a) Every life agent who sells annuities shall satisfactorily complete eight hours of training prior to soliciting individual consumers in order to sell annuities.

(b) Every life agent who sells annuities shall satisfactorily complete four hours of training prior to each license renewal. For resident licensees, this requirement shall count toward the licensee' s continuing education requirement, but may still result in completing more than the minimum number of continuing education hours set forth in this section.

(c) The training required by this section shall be approved by the commissioner and shall 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. Subject matter determined by the commissioner to be primarily intended to promote the sale or marketing of annuities shall not qualify for credit towards the training requirement. Any course or seminar that is disapproved under the provisions of this section shall be presumed invalid for credit towards the training requirement of this section unless it is approved in writing by the commissioner.

Newer annuity products (combo plans) combine an annuity product PLUS a rider that may provide benefits for long term care or life insurance or both. Ordinarily, one would think that an agent needs to also possess an Accident and Health license to sell any long term care products, however, the state allows Life-Only agents to sell these combo type plans without the A&H license.

NOTE: Agents selling annuity products with long term care riders are advised that they need to take the special California 8-Hour Long Term Care Training before discussing LTC needs or benefits with any clients. Also, AB 689 requires agents take "annuity suitability training", specific to the products they sell, direct from their carriers (insurance companies).

Required Checklist

10509.914(e) An insurance producer or, where no insurance producer is involved, the responsible insurer representative, shall at the time of sale do all of the following:

*(1) Make a record **of any recommendation** subject to subdivision (a) of this section.* (These types of notes should be entered into the client's file or database and be accessible for reference or review by the State).

*(2) Obtain a customer signed statement **documenting a customer's refusal to provide suitability information**, if any.* (This can be as simple as a handwritten sheet of paper, signed by the client stating that the client refuses to provide requested information. To limit suitability exposure this letter should disclose to the client that failure to provide the required information may limit the protections offered under the law. Check with your compliance department before making or using any such form.)

*3) Obtain a customer signed statement acknowledging that an **annuity transaction is not recommended** if a customer decides to enter into an annuity transaction that is not based on the insurance producer's or insurer's recommendation.*

An agent may be absolved of the suitability requirements if the client refuses to give the agent the required information, the client provides false or incomplete information, or the client chooses to purchase annuities against the recommendation of the agent.

Insurer Responsibilities

Under 10509.914 of the California Insurance Code, responsibilities also apply to insurers as follows:

An insurer shall establish a supervision system that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this article, including, but not limited to, all of the following:

(A) The insurer shall maintain reasonable procedures to inform its insurance producers of the requirements of this article and shall incorporate the requirements of this article into relevant insurance producer training manuals.

(B) The insurer shall establish standards for insurance producer product training and shall maintain reasonable procedures to require its insurance producers to comply with the requirements of Section 10509.915.

(C) The insurer shall provide product-specific training and training materials which explain all material features of its annuity products to its insurance producers.

(D) The insurer shall maintain procedures for review of each recommendation prior to issuance of an annuity that are designed to ensure that there is a reasonable basis to determine that a recommendation is suitable. The review procedures may apply a screening system for the purpose of identifying selected transactions for additional review and may be accomplished electronically or through other means, including, but not limited to, physical review. An electronic or other system may be designed to require additional review only of those transactions identified for additional review by the selection criteria.

(E) The insurer shall maintain reasonable procedures to detect recommendations that are not suitable. This may include, but is not limited to, confirmation of consumer suitability information, systematic customer surveys, interviews, confirmation letters, and programs of internal monitoring. Nothing in this subparagraph prevents an insurer from complying with this subparagraph by applying sampling procedures or by confirming suitability information after issuance or delivery of the annuity.

SECTION II
Contract Provisions

Choices among annuity contracts are numerous and can be quite complex. It is your ethical and legal responsibility to know the difference between various contracts you are selling as well as options that are widely available. Following is a discussion of provisions common to many annuity offerings:

Issue Age *(CIC 10112)*

Annuities can be purchased by just about anyone. Some companies place maximum age limits on owners and/or annuitants -- usually between ages 75 and 90. Younger buyers, under 18, may even possess all legal rights associated with owning contracts as long as they have the written consent of a parent or guardian. Of course, in the case of a minor, any liability resulting from the ownership of the annuity accrues to the parent or guardian.

Maximum Age For Benefit

Most companies generally require that annuitants be under the age of 75 when the contract is initially signed. Others allow a range up to age 90. Benefits are trigged when something happens to an annuitant or owner. However, some contracts ***require*** distribution or an orderly liquidation once the annuitant reaches a certain age, typically 80 or 85.

Premium Payments *(CIC 10540)*

Premiums for annuities are usually paid in one of three ways:

1) In the first method, the customer pays a single, lump sum premium when the contract is signed. For example, an individual may purchase an annuity with a single payment of $10,000, $50,000, or any other minimum amount that the insurance company will accept. Lump sum premiums can be paid for either immediate annuities or deferred annuities.

2) The second method is available only for deferred annuities. In this option, the customer pays premiums on a regular schedule (annual, semiannual, quarterly or monthly) until the date on which benefit payments begin. Some individuals choose this option because it is similar to making regular deposits in a savings account -- a comfortable, familiar habit.

3) The third option, is the flexible premium annuity. This feature permits flexibility in the timing and amount of premium payments. The flexible premium annuity often is attractive to individuals who want a program in which they can vary the amounts they save each year. People who earn commissions or other types of irregular income and families with growing children are two examples of customers who may be interested in a product with this type of flexibility. For example, contract terms of a typical flexible premium annuity may require an initial minimum deposit of $2,500. If the contract remains in effect, the funds that already have been paid in will continue to accrue interest, even if the annuity owner does not wish to pay into the annuity on a regular schedule. Most variable annuities are flexible premium contracts.

Note: An incorporated life insurer issuing life insurance policies on the reserve basis may collect premiums in advance. Such insurers may also accept moneys for the payment of future premiums related to any policies issued by it. No such insurer may accept such moneys in an amount to exceed (1) the sum of future unpaid premiums on any such policy or (2) the sum of 10 such future unpaid annual premiums on any such policy if such sum is less than the sum of future unpaid premiums on any such policy. This section shall not limit the right of such insurers to accept funds under an agreement which provides for an accumulation of such funds for the purpose of purchasing annuities at future dates.

Surrender Charges (CIC 10127.10, 10127.12, 10127.13)

Most annuities levy a surrender charge (from 0 to 8%) for any withdrawals that exceed the free withdrawal (discussed below) privilege (typically 10%). The surrender charge usually fades away in time (0 to10 years). If your client withdraws money from a variable annuity within a certain period after a purchase payment, he will also incur a surrender charge. It is important to advise clients that this charge could effect the value of his account and reduce overall earning potential.

Example: Mark's annuity contract specifies a 6-5-4-3-2-1-0 surrender penalty structure. This means that the company's withdrawal or surrender penalty lasts for six years. The first year penalty is 6%, then 5% in the second year; 4% in year 3 and so on. After six years, there is no penalty to withdraw or surrender. Also, Mark may have the option to take free withdraws along the way as long as the amount taken out does not exceed the 10% free withdrawal limit.

Example: Ellen purchased a variable annuity contract with a $10,000 purchase payment. The contract has a schedule of surrender charges, beginning with a 7% charge in the first year, and declining by 1% each year. In addition, she is allowed to withdraw 10% of your contract value each year free of surrender charges. In the first year, she decides to withdraw $5,000, or one-half of your contract value of $10,000 (assuming that your contract value has not increased or decreased because of investment performance). In this case, she could withdraw $1,000 (10% of contract value) free of surrender charges, but she would pay a surrender charge of 7%, or $280, on the other $4,000 withdrawn. Ellen's overall earnings are reduced by $280 -- a reduction that might not occur in other investment mediums.

Market Value Adjustment

In periods of rapidly dropping or rising interest rates, insurers have developed a new tool to adjust yields -- the market rate adjustment (MVA). Simply put, the MVA will increase or decrease the surrender penalty, depending on market rates at surrender compared to the contract period guarantee rate. In other words, the MVA is a separate and additional adjustment made at the time of an early surrender that can be either negative or positive for your client. It all depends if interest rates have increased or decreased at the time your client wants to withdraw his money. The MVA does not typically apply to the free withdrawal portion or surrenders taken after the death of an annuitant.

Impact of Surrender Charges on Principal

Market rate adjustments can be very complex. Some are expressed as a factor or percentage rate adjustment tied to a certain block of securities owned by the insurer. If your client decides to withdraw funds from his annuity at a time when market rates have risen, the insure will lose

principal) (money) when selling his securities and need to charge your client a higher penalty. If rates have dropped, there will be less MVA penalty.

Example: The value of Frank's annuity is $50,000. In the current year, his surrender charge is 6% or $3,000. However, since Frank purchased his annuity ***market interest rates have risen*** and his insurer indicates a MAV adjustment of $1,500 is necessary to offset the loss they will incur when they sell certain securities to return Frank's money. So, Frank's current surrender value is calculated as follows: $50,000, less $3,000 surrender charge, ***less*** $1,500 MVA adjustment for a net surrender value of $45,500.

Example: Sally needs to withdraw her $50,000 annuity with a current surrender charge of 6% or 3,000. Since Sally purchased this annuity, ***interest rates have dropped*** so her insurer has indicated that her MVA will actually soften her total surrender charges. Sally's current surrender value is calculated as follows: $50,000, less $3,000 surrender charge, ***plus*** $1,800 MVA adjustment for a net surrender value of $48,800.

Surrender Charges & Required Notices

There are a few exceptions to the collection of surrender charges where senior citizens (over age 65) are concerned:

- Surrender charges cannot be levied if a client ***cancels*** his annuity contract ***within the 30-day*** free look period.
- Whenever an insurer provides an ***annual statement*** to a senior citizen for his individual annuity contract issued after January 1, 1995, the insurer shall also provide the current accumulation value and the current cash surrender value, i.e., the surrender charges are disclosed.
- All annuity contracts for senior citizens that contain a surrender charge period shall either 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.

Policy Administrative Charges and Fees

Not all the money a contract owner pays into an annuity are invested, since some are used for sales commissions and fees. These charges differ among companies and among contracts. Some companies (mostly fixed annuity plans) have no charges other than the surrender fees discussed in the last section. In the event the insured dies, for instance, they guarantee to pay the beneficiary ***at least*** the amount paid in to the contract, regardless of the current cash value of the contract.

Variable contracts are quite different. Each typically has its own schedule of fees and other charges, and the investor should carefully assess these before making a purchase. These can include annual contract charges, management fees and mortality charges.

Withdrawal Options

Most annuities allow withdrawals of up to 10 and percent per year after an initial waiting period of one year, without cost, fee or penalty. The ***free withdrawal*** is typically based on a

percentage of principal, not the current value. However, some companies calculate the penalty free withdrawal on the greater of the current value or principal contributed.

Example: Mary invests $50,000 in an annuity and later adds another 25,000. In a few short years, her account grows to $100,000. Mary suddenly needs funds to pay for nursing home costs she has occurred. The maximum she can withdraw from most companies is $7,500 or 10% of her principal invested. More liberal companies might allow her to take out $10,000 or 10% of her current account value.

Some companies also let you take out ***all*** of your account growth (accumulated interest) at any time without a fee or penalty. Others levy penalties only during a prescribed period of time . . . the first five or seven years.

Example: Bill has owns a $250,000 annuity. His account is now worth $350,000. His insurer allows free annual withdrawals up to 10 percent based on the value of his ***original contribution*** or $25,000 per year and/or up to his annual earnings without penalty. If Bill needs it, he can take a $100,000 free withdrawal.

A few companies also permit cumulative withdrawals. So, if your client hasn't needed to withdraw any funds, the amount he has not taken out accumulates to his credit.

Example: Susan's $100,000 annuity permits cumulative 10% annual free withdrawals -- $10,000 per year. It's been three years since Susan has owned her contract and she has not withdrawn a single dollar. A health care emergency requires additional cash. Her insurer allows her to take $30,000 from her account without penalty.

Note: Free withdrawals are a nice feature but it is not something that should completely ***drive*** your decision to recommend a particular annuity. Why? Because, a majority of people who own annuities never use their free withdrawal option and the restrictions on withdrawals typically fade away in a matter of years.

Annuitization Options

The annuity is an investment vehicle often used for retirement. These days, however, people are concerned more than ever about outliving their retirement nest egg. Many insurers respond to this with an array of annuitization options that can provide a stream of income for a specified period of years or for life!

When a client chooses to annuitize, the insurance company will turns their principle into a monthly, quarterly, semiannual, or annual income. Once a decision is made there is typically no turning back, although some new plans allow a client to stop receiving payments and take the remainder in a lump sum.

There are several ways to receive annuity income payments:

A ***straight life annuity*** provides income until the annuitant dies.

An ***annuity certain annuity*** provides income for a fixed period of time, such as 10 or 20 years.

A ***variable life annuity*** provides variable income during the annuitant's lifetime.

A ***variable life with period certain annuity*** provides variable income during the annuitant's lifetime. If the annuitant dies before the designated certain period, the insurer will pay the contingent payee you have selected.

A ***life income with refund annuity*** provides income throughout the life of the annuitant. If the annuitant dies before receiving payments at least equal to the purchase price of the annuity, the insurer will pay a refund to the contingent payee you have selected.

A ***life annuity with period certain annuity*** provides income until the annuitant dies. If the annuitant dies before the designated certain period, the insurer will pay the balance to contingent payee you have selected.

A ***joint and survivor annuity*** provides income to two or more individuals until all of the individuals die. Some contracts might reduce the amount paid to the surviving spouse after the death of the first spouse.

Other annuity income options include a lump sum payout or systematic distributions.
Which type of annuity is right for me?

Who would annuitize? Someone who wants out of his annuity without incurring a surrender charge. A widow or widower with no kids may care more about living comfortable doing their retirement years than skimming off their retirement and possibly outliving their money. Another strategy is to buy enough life insurance to cover the loss of the income from your death then elect the highest annuity payout without the fear of leaving a spouse broke.

In analyzing the decision to annuitize it is important to consider the following:

- In a fixed rate contract, the interest rate assigned to the payout will be frozen. There will be no adjustment for inflation or growth.

- The annuitization period will dramatically effect the payout amount. A $100,000 contract annuitized over five years will produce a much higher payment than one over 10 years. It also follows that a lifetime payout will be even less.

SECTION III
Income Distributions

The annuity is an investment vehicle often used for retirement. These days, however, people are concerned more than ever about outliving their retirement nest egg. Many insurers respond to this with an array of income distributions or annuitization options that can provide a stream of income for a specified period of years or for life!

When a client chooses to annuitize, the insurance company will turns their principle into a monthly, quarterly, semiannual, or annual income. Once a decision is made there is typically no turning back, although some new plans allow a client to stop receiving payments and take the remainder in a lump sum.

Split Annuity In Retirement Planning

A split annuity is the term given to an effective strategy that utilizes two or more different annuity products - one designed to generate monthly income and the other to restore the original starting principal over a set period of time.

The split annuity is considered by some an efficient and investment vehicle, typically using what is known as a single premium deferred annuity and a single premium immediate annuity. Within the split annuity, the immediate annuity repays your client a set sum of money each and every month over a specified period of time. The other annuity is left in place to grow on a fixed interest basis, with the goal being that by the time your client's monthly payments are depleted, the deferred annuity will be fully restored to its original starting principal. Your client can then restart the process with prevailing interest rates or reevaluate your retirement and investment strategy as needed.

The limits placed on the use of a split annuity are typically related to the issuing ages of the annuity policies, usually 0-85 for non-qualified funds (you have paid taxes on them) and 0-70 for qualified money (your client has not yet paid taxes on them). The immediate income period can range anywhere from 3 to 20 years, depending on principal, insurance carrier, current rates and the objective of the split annuity.

The split annuity can also be used as an asset management tool to ensure fixed or regular payments are met automatically over a set period of time. For a fixed mortgage payment as an example, the income portion of the split annuity can be credited to an account that is automatically debited for the monthly amount. The deferred annuity is simultaneously rebuilding the principal in the background, set to restore your client's original amount over a set number of years.

Settlement Options

There are several ways to receive annuity income payments:

A ***straight life annuity*** provides income until the annuitant dies. 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.

Needless to say, there's 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.

An ***annuity certain annuity*** provides income for a fixed period of time, such as 10 or 20 years. Most often, the period is 10 years because this is the approximate average life expectancy of a male who retires at age 65). Obviously, the annuitant could outlive the minimum number of years specified in the contract, in which case the income payments continue until his or her decease.

Under a life annuity with period certain, income installments must be paid for the number of years guaranteed in the contract. Therefore, if the annuitant dies after payments have started but before the guaranteed number of years (the "certain installments") has elapsed, the annuitant's beneficiary will receive income payments until the remainder of the guaranteed period expires.

Example: If Mr. Smith, the annuitant, retires at age 65 and selects the life with 10 years certain option and dies at age 70, his survivor will continue to receive the monthly annuity payments for the balance of the period certain, in this case five more years.

A ***variable life annuity*** provides variable income during the annuitant's lifetime.

A ***variable life with period certain annuity*** provides variable income during the annuitant's lifetime. If the annuitant dies before the designated certain period, the insurer will pay the contingent payee you have selected.

A ***life income with refund annuity*** provides income throughout the life of the annuitant. If the annuitant dies before receiving payments at least equal to the purchase price of the annuity, the insurer will pay a refund to the contingent payee you have selected.

The length of time for which income payments will be made to the annuitant under a refund life annuity contract is the same as that for a straight life annuity. Thus, with this option the annuitant will receive payments for as long as he or she lives.

The main difference between the two is that the refund annuity guarantees an amount at least equal to the purchase price of the contract will be paid out. If the annuitant lives for an extended amount of time after annuity income payments begin, he or she could receive more in benefits than the contract cost. But, if the annuitant dies before an amount equal to the annuity's

purchase price has been paid, the annuitant's beneficiary will receive the difference in cash or installment payments.

A ***life annuity with period certain annuity*** provides income until the annuitant dies. If the annuitant dies before the designated certain period, the insurer will pay the balance to contingent payee you have selected. Your client receives a guaranteed payout for life that includes a period certain phase. If he dies during the period certain phase of the account, his beneficiary will continue to receive the payment for the remainder of the period. For example, life with a 10 year period certain is a common arrangement. If your client dies five years after he begins collecting, the payments continue to his survivor for five more years.

A ***joint and survivor annuity*** provides income to two or more individuals until all of the individuals die. Some contracts might reduce the amount paid to the surviving spouse after the death of the first spouse.

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. For example, if the annuitant was receiving $1,000 monthly under a joint and 50% survivor option, the survivor would receive $500 (50% of $1,000) monthly upon the death of the annuitant.

The joint-survivor annuity is significantly different and must be distinguished from the joint life annuity, which covers two or more annuitants and provides monthly income to each until one of them dies. Following the death of one annuitant, *all* income benefits cease. The joint life annuity can be viewed as a special case of the straight life annuity, with payments ending at the first death among the joint life annuitants

Other annuity income options include a lump sum payout or systematic distributions.

Surrender Charge Waivers and Triggers

Which type of annuity settlement is right for your client? The answer may be different for each client. Some may want out of their annuity without incurring a surrender charge. A widow or widower with no kids may care more about living comfortable during their retirement years than skimming off their retirement and possibly outliving their money. Another consideration is the fact that the payout from an annuity is at a fixed rate of interest with no inflation protection. And, the annuitization period will dramatically effect the payout amount. A $100,000 contract annuitized over five years, for example, will produce a much higher payment than one over 10 years. It also follows that a lifetime payout will be even less. One strategy is to buy enough life insurance to cover the loss of the income from your death then elect the highest annuity payout without the fear of leaving a spouse broke.

In addition to these considerations, it is important to assess the many waivers and riders available in new annuity plans. Individually or in combination, they can serve as effective estate planning tools since they distributes remaining contract values to your client's beneficiaries without going through probate. Listed below are a few to review:

Nursing Home Waiver - If your client becomes seriously disabled or needs to go to a nursing home, their annuity contract may hopefully contain a waiver that triggers payments or withdrawals that are ***not subject*** to the usual surrender fees. Serious health changes, such as a chronic long term are illness, may also trigger annuity payments. Not all annuity permit crisis

waivers. In general, they seem to be more common and generous in fixed annuities, rather than variable contracts. And, situations that trigger the waiver and allow your client to make early annuity withdrawals vary from company to company. For instance, one insurer might require a 90-day nursing home confinement before your benefits are activated, while another might call for 60 days.

Terminal Illness Rider - After the first contract year, if your client is diagnosed by a physician as having a terminal illness (prognosis of survival is 12 months or less), he may have the option with the Terminal Illness Rider to withdraw say up to 25 percent of the annuity's Account Value without incurring an early withdrawal charge. There may be no additional charge for this rider, but the withdrawal provision may be used only once over the duration of the contract.

Unemployment Waiver - Unemployment waivers are very rare. One that we know of, allows your client to withdraw from its contract if he is unemployed for more than 30 days.

Disability Waiver - The risk of disability is greater than the risk of death at all ages between 20 and 65. That said, it makes sense to protect your clients financially if the become disabled, and that includes annuity considerations. Unfortunately, relatively few insurers offer a disability waiver. Where these waivers exist few will purposefully leave the definition of "disability" fluid. Some may state that if the owner/annuitant is unable to work, and thus can't earn a living, and a doctor attests to this, they will allow full access to the annuity without imposing surrender charges. This is a more liberal interpretation. More than likely, definition of disability will be considerably more stringent.

Charges and Fees - In most cases, there's no extra charge for waivers because they're built into the contract when purchased. There are, however, certain tax consequences that could apply to such withdrawals. It is always best to advise your client check with a tax advisor before taking money out of their contract.

Death Benefit - In the unfortunate event of the death of the contract owner, the beneficiary will receive a death benefit from the annuity. In the event of the contract owner's death before income payments have begun, the beneficiary will be paid a certain value of that annuity. In some cases, if the spouse is the surviving joint owner or sole beneficiary, then he or she may succeed to the ownership of the annuity with all the rights and privileges of the original owner, as allowed by IRS regulations.

Access to Funds - Annuities are designed to accumulate money for retirement and provide their best possible benefit if left intact, without taking any withdrawals. However, it's nice to know that your client may have access to the funds in his annuity if he needs them. Some products offer a number of options to withdraw the money in your annuity, including 10 percent Penalty-Free Withdrawals and First-Year Credited Interest Withdrawals. Remember that for certain withdrawals, they may be subject to charges.

SECTION IV
Variable Annuities

To understand the structure of the variable annuity, we must compare it to the fixed annuity. Like the fixed annuity, the variable annuity is a contract between an individual and a life insurance company. With both types, the owner contributes premiums that, along with their earnings, are accumulated within the policy contract. At an agreed-upon time, the insurance company begins making payments to the annuitant. Payments are made over the individual's lifetime or for some other stipulated period.

In general, insurance companies invest funds for their fixed products in long-term bonds and other non-speculative issues. In contrast, the premium payments made on a variable annuity are not combined with the insurance company's general investments; instead, they are placed in stocks, government securities and other types of fluctuating investments. These investments have more growth potential than those that underlie other investments, but they are also subject to a greater degree of risk. The investments make up a portfolio that is managed in much the same way as a typical mutual fund. For many years, marketers of annuity products, along with savings institutions, emphasized the advantages of conservative and secure investments.

Then, rising inflation rates began to affect the average person's standard of living. Beginning in the 1960s, people became aware that they had to plan for more retirement dollars just to keep pace with anticipated increases in living costs. Savers sought financial instruments that could more readily keep up with inflation. Individuals of even average means were turning to the stock market for an increasing portion of their investments. Like savings institutions, insurance companies looked for ways to improve their traditional products. In an attempt to combine traditional annuity guarantees with the growth potential of a securities investment, they developed the variable annuity. The prospectus will warn potential investors against all of these issues.

Additional License Requirements

Prospectus

Variable annuities are sold by prospectus ***only***. Some fixed annuities, where interest rates are tied to market indexes, also require a prospectus. Most, however, are guided by the terms in the policy which can be reviewed through a specimen or sample policy. The prospectus will show how accumulated funds are invested and the resulting payout and warn potential investors on issues such as inflation, loss of investment, loss of liquidity, etc. For example, during the 1930s, when U.S. economy was experiencing only moderate inflation rates, many people purchased annuities for retirement, in the belief that they ensured a comfortable, guaranteed income for life. A successful insurance company advertisement of the late 1930s enthusiastically proclaimed, "Retire for life on $300 a month!" Such a claim would require many disclosures if sold by prospectus.

Financial Industry Regulatory Authority (FINRA)

One should be aware that the marketing of variable annuities by some sellers deserves scrutiny, especially when seniors are the targeted investors. The ***Financial Industry Regulatory Authority (FINRA)*** helps play a role here as an independent regulator to help identify high-risk

firms, brokers and products. When rules are broken, they bring discipline to bear by barring FINRA membership or issuing fines. FINRA also offers tools and help to investors assess security-oriented investments such as variable annuities.

Common Contract Provisions

General vs Separate Accounts

Variable annuities come in many different flavors. One difference lies in who has control over investing the money deposited into the annuity. With ***general accounts***, the insurance company determines how the annuity funds are invested. Others, use ***separate accounts*** which allow the annuity owner to have substantial control over the investment of funds.

Variable Annuity Options

The insurance companies' investment managers buy and sell these investments on a continuing basis. Like mutual fund managers, the insurance company tries to invest the money wisely and profitably so that it will generate a competitive return for its investors. In addition, the insurance company must meet both state and federal regulations regarding investment practices for these products. (Variable annuities are subject to regulation by the Securities and Exchange Commission, Internal Revenue Service and state regulatory bodies.)

One of the better-known company-managed variable annuities is the College Retirement and Equities Fund, or CREF. Designed by the Teachers Annuity and Insurance Association, it was the first variable annuity, appearing on the market in 1952. Because of CREF's relatively long history, it has been the subject of many detailed studies.

For an example of a hypothetical company-managed variable annuity, see Illustration 1 at the back of this book. The investment portfolio for this annuity consists of a combination of stock, bonds and money market instruments.

Note that at different times, the insurance company's investment managers varied the mix of investments based on the perceived market potential for each type of investment used in the plan. For example, on December 31, 1992, the mix was 37 percent stocks, 18 percent bonds and 45 percent money market instruments. The fund managers decided that by June 30, 1993, they would sell all the stocks and switch to bonds (63 percent) and money market instruments (37 percent). By the concluding period, the fund consisted of a fairly balanced mix of 39 percent stocks, 36 percent bonds and 25 percent money market instruments. The above sequence of investment decisions demonstrates the continuous management of assets placed in variable annuity funds.

Investment managers consider various economic indicators in making decisions that they believe are timely and will lead to maximum profits.

Self-Directed Variable Annuity

With the self-directed variable annuity, the contract owner can choose from several investments . . . ***subaccounts*** . . . each with different goals. This allows an investor to diversify his holdings and select investments based on his or her objectives in much the same manner that a mutual fund investor does. Following are some typical choices:

Equity-Based: Funds are invested in steadily growing, strong companies with a history of growth potential. The goal is long-term growth.

Risk-Based: Exposure to companies on the cutting edge of innovation. The goal is to capture significant investment opportunities with the potential for greater price volatility (more risk).

Fixed Options: The fixed portion of a variable annuity emulates the fixed annuity. So, anytime an investor has had enough of choices or decides its time to move from equity- or risked-based position, he can move his funds here.

In effect, the contract owner may construct a personal investment portfolio within the annuity and his selection of investments can generally be made during both the accumulation and distribution periods.

Senior Citizen Considerations (CIC 10127.10)

In California, a senior citizen investor (age 60 and above) in variable contracts receives special consideration during the 30-day free look period. During this 30-days, the premium for a variable annuity may be invested only in fixed-income investments and money-market funds. This assures that upon a cancellation of the contract the owner will be refunded ***all*** premiums in full, as though the contract was never purchased.

Where the senior investor has specified his funds immediately invested in mutual funds, a cancellation will entitle him to a refund of the account value within 30 days.

Choosing an Annuity Investment Portfolio

The annuity application form lists the selection of investments that the insurance company offers. Based on his investment objectives, the customer indicates, usually in percentage units, how each premium is to be allocated among the selected accounts. Most contracts allow an unlimited number of percentage combinations. The applicant can even allocate the entire premium to a single investment choice.

A typical offering might include four mutual funds with differing objectives, plus a fixed account. The fixed account offers guaranteed safety of principal and specifies a fixed interest rate. (Interest rates on the fixed account may be guaranteed for periods ranging from one calendar quarter to one or two years or even longer.)

Changing the Investment Mix

One distinguishing characteristic of self-directed annuities is the owner's ability to change the composition of the annuity portfolio. Three major factors that affect how individuals invest their assets are their investment objectives and philosophies, and their financial standing and economic conditions. Since each of these factors may change over time, it is advantageous to the investor to be able to change the way in which his or her money is invested.

As an individual progresses through life, his or her investment philosophy and objectives often change. Many people who previously might have been inclined to take investment risks may become more cautious as they grow older. For the owner of a variable annuity, a change to more conservative investments may mean moving money from stock funds to funds composed of government securities or even a fixed fund. The typical self-directed variable annuity offers the contract owner the opportunity to redirect the investment of funds as his or her investment objectives change.

The owner may also make transfers to and from a fixed account. IN some cases this is done through an 800 number, via internet or through a stock broker.(Note, however, that transfers

from the funds to the fixed account, or the reverse, are more limited than transfers among the funds.) These rules provide ample opportunity for changes in investment directions.

Changes in one's financial standing may also alter an individual's willingness to accept risks. For example, some individuals may invest in more aggressive and risky funds only after they have accumulated what they consider an adequate nest egg. Similarly, some individuals move their variable annuity funds into conservative options if they experience losses in their other investments.

Economic conditions and forecasts may also lead an individual to take advantage of a variable annuity's flexibility. When stock prices are expected to fall, some individuals direct their money out of stock funds and into other types of funds. When yields on other investments are falling, investors often move their money into bond funds because these generally are considered good investments during such periods. Thus, variable annuities allow the investor to react in the face of changing market conditions.

Examples of Self-Directed Plans

To better understand the implications of investment choices in a self-directed plan, look at some hypothetical investors and their choices of investment mixes from the options outlined on Illustration 2.

Young Executive: Ruth is a 25-year-old upwardly mobile executive. Her preferred investment mix looks something like this: 60 percent Emerging Growth Fund; 40 percent Growth Stock Fund. Ruth figures that she can invest in these rather speculative funds because if she makes some incorrect decisions and sustains some losses, she has plenty of remaining years in which to deposit additional funds and still accumulate an ample nest egg. Also, as Ruth grows older, she may become more conservative with her investment choices and less inclined to speculate.

Empty Nester: Charlie, age 55, is a university professor. He chooses an investment mix as follows: 50 percent Financial Bond Fund; 40 percent Cash Management; 10 percent Growth Stock Fund. Charlie's rationale for these relatively conservative choices is that he wants to be on the safe side -that is, accumulate as much as possible and expose only a small portion of his investment to risk. Perhaps, at an earlier age, he would have indulged in greater speculation, but now it seems wiser to be more conservative.

Retiree: Frank, age 66, is a retiree with a conservative investment mix: 50 percent Fixed Account; 50 percent Financial Bond Fund. Now that Frank is retired and receiving his lifetime payments, he wants to ensure a steady flow of income. He has split his choice right down the middle: half in the fixed account, with its designated interest rate and guaranteed safety of principal, and half in the bond fund, with its high current income yield and emphasis on capital preservation. Barring any drastic changes in the economy, Frank will probably continue to rely on this investment selection for his annuity income.

Computation of Annuity Accumulation and Payments

Owners of variable annuities receive regular statements on the value of their investment accounts. Like CD owners and other investment holders, annuity owners want to know the current values of their holdings.

Computing the value at any given time of a variable annuity contract can be complex. With a variable annuity, one is dealing with fluctuating stock market investments. The process, therefore, is more complicated than calculating the value of a CD, which has a guaranteed interest rate over a specified time period.

Most insurance companies have adopted a unit method of expressing annuity values. Generally, two types of units form the variable annuity contract. These units correspond to the two basic time classifications for annuities: the period during which dollars are being accumulated (accumulation period) and the period in which the insurance company makes the annuity payments (distribution period).

Accumulation Units

During the years in which premiums are paid into the contract, the annuity owner acquires accumulation units. Accumulation units have a designated initial price at the time of the annuity purchase, but fluctuate in value thereafter. In the case of company-managed products, the changing values will correspond to the performance of the pool of investments. This is similar to the way mutual fund values are expressed. With a mutual fund share, each accumulation unit of a variable annuity has a designated value on a given day. In the case of self-directed annuities, the values of the fund or combination of funds the policy owner has chosen are totaled. The value of each accumulation unit is then calculated from this total.

Under both company-managed and self-directed plans, each premium payment purchases a certain number of accumulation units. The number of units varies according to the unit's current market value. The number of units continues to increase as additional purchases are made, although each unit's value will vary over the life of the contract, according to its worth in the marketplace. This, too, is similar to the manner in which mutual fund share values are calculated.

The following example illustrates how this works out in practice:

Initial Value of Accumulation Unit on 1/1/04	$5
Monthly Premium Payment	$100
Initial Number of Units Purchased	20

Subsequent Accumulation	Unit Values	Number of Units Purchased
2/1/04	$5.05	19.80
3/1/04	$4.87	20.53
4/1/04	$4.94	20.24
5/1/04	$4.99	20.04
6/1/04	$5.12	19.53

At the end of the six-month period, the owner will have a total of 120.14 accumulation units. As stated above, the value of these units will continue to fluctuate according to the unit's market value. With each premium payment, the contract owner adds to the total of accumulation units. The accumulation unit price will probably continue to fluctuate. When the annuity matures, the contract owner will have been credited with a specified number of accumulation units.

Annuity Units

In order for the insurance company to begin paying out income from the annuity, accumulation units are converted into annuity units.

An annuity unit is a measure of value that an insurance company uses when it calculates the amount of income to be paid to an annuitant. At retirement, the annuitant is credited with a designated number of annuity units.

The exact number of annuity units to be credited depends on four basic factors.

The first factor is the annuitant's age. As described earlier, the insurance company calculates from its mortality tables all charges in order to provide a designated amount of lifetime income at a specified age.

The second factor is the number of guaranteed payments. If the annuitant chooses a period certain life income option, the extra charge for that benefit will be reflected in the calculation of the annuity unit.

The third factor is the interest rate that the insurance company projects. If the company predicts a fairly high interest rate, the annuity unit will have a greater value than it would with a lower rate. Interest rates typically are projected annually to determine the projected investment return.

Finally, there are administrative expenses to be incorporated into the unit cost calculation.

Fluctuating Value of Annuity Units

The calculated number of annuity units remains constant over the payment period. The annuitant has the option of choosing a fixed or a variable payment, or, as is often the case, a combination of both.

With the variable payout, the annuity unit's value may fluctuate, just as it does during the accumulation period. The value will continue to vary according to the performance of the underlying investment portfolio and the general administrative costs that the company incurs. Obviously, the amount of periodic income also will fluctuate.

For example, suppose that on January 1, the date the annuitant retires, he or she has collected a total of 10,000 accumulation units. Assume further that at that time the 10,000 units have a market value of $50,000.

Using the above process, the insurance company then converts the annuitant's 10,000 accumulation units to 100 annuity units.

On the first payment, each annuity unit is worth $10. If the annuitant chooses the fixed payment option, the $1,000 monthly payment, as listed in the example below as of January 1, would remain constant for the balance of the payout period.

Assume that the annuitant chose a variable mode of payment. In that case, a six-month projection of monthly payments would be as follows:

Date	Annuity Unit Value	Monthly Payment to Annuitant

1/1	$ 10.00	$ 1,000
2/1	10.17	1,017
3/1	9.73	973
4/1	9.89	989
5/1	10.11	1,011
6/1	10.57	1,057

There are two important reasons for the continued fluctuation in variable annuities after the retirement income period begins.

The first is that the portfolio's value constantly changes to reflect current market conditions. The second is that the investments funding the annuity contract also change continually, just as they do during the accumulation period. The various stocks, bonds and other financial instruments that make up the portfolio continue to be bought and sold. In a company-managed plan, the insurance company's investment managers continue to supervise this process. In a self-directed plan, the contract owner may frequently change the contents of the portfolio.

Charges and Fees

Each contract typically has its own schedule of fees and other charges, and the investor should carefully assess these before making a purchase. Some companies impose management charges. Fairly typical contract charges are from $0 to $50 per year for administration, plus a few assess an investment management fee of 1 percent or more of the variable account's total value. Funds held in a fixed account usually escape the investment management fees. The insurance company typically justifies these fees by providing for a guaranteed death benefit and covering the administrative expenses involved in providing a life income.

Variable contracts are also known to charge a mortality fee which pays for the guaranteed death benefit. The purpose is to cover the insurer's overhead and commissions. These charges generally run from .15 percent to 2.0 percent annually and it is usually a fixed rate that will not increase over time.

Example: Joan invests in a variable annuity and learns from the prospectus that a 1.25% mortality charge will be deducted from her account. In the first year her account value is $20,000 resulting in a mortality charge of $250. In the second year her account grows to $25,000 resulting in a $312.50 mortality charge and so on. It is interesting to note that even though the mortality charge is expressed as an annual charge it is calculated and subtracted from the contract value ***each day***.

Dollar Cost Averaging

Investors who are little unsure of their ability to choose portfolio winners can invest using a simple risk-reduction technique called dollar cost averaging. The ***concept*** behind dollar cost averaging is that by spreading purchases over several types of variable subaccounts, potential highs and lows in each subaccount will be spread and ultimately averaged over time. Further, because units are bought at specific intervals, some units will be bought at low prices and some will be bought at high prices. The average is likely to be fairly constant.

Like fixed annuities, there are bonus plans that lure investors. When funds are placed in the fixed side of the variable plan, investors must be wary of their true yield since many offer teaser rates that later, when rates drop below base or promised levels, represent poor yields.

Death Benefit Guarantees ***(CIC 10168.4)***

Most variable annuities include a guaranteed death benefit that pays out upon the death of the annuitant. The amount the beneficiary receives is typically the ***greater of*** . . .

- The original invested amount plus additional contributions less any withdrawals OR
- The value of the account less any withdrawals

Example: Bob invests $150,000 in a variable annuity and later adds another $100,000. Along the way, however, Bob withdrew about $50,000 to cover some unanticipated taxes. At the time of the annuitant's death, Bob's account was valued at over $500,000. What is his death benefit? The greater of the investment or account value would be $500,000, less the $50,000 or a death benefit of $450,000.

Of course, the death benefit does not last forever. When the annuitant reaches annuitization age . . . anywhere from 75 to 90 . . . the death benefit ceases. Furthermore, some companies charge a mortality fee to pay for the death benefit guarantee ranging from .15 to 2.0% per year of the account value.

Many companies also offer the ability to improve the death benefit amount to an amount equal to the account value or many times the account value as an incentive to purchase. Others allow investors to ***step-up*** the death benefit by periodically renewing an owner's contract with a new surrender penalty schedule.

Example: Fritz purchased a $100,000 variable annuity with a penalty period of five years. During the time Fritz owned his contract his account value bounced around from $150,000 to $250,000. At the end of five years, Fritzs' withdrawal penalties have faded away and the value of his account is $200,000. Fitz is concerned that his account value could fluctuate more over the next five years so he accepts his insurer's offer to step-up his death benefit to a minimum of $200,000 . . . his current account value. In exchange, the insurer restarts another five-year withdrawal penalty schedule.

California, like many states, has passed minimum nonforfeiture laws. The purpose of such laws is to make sure that contract owners receive ***something*** when and if he stops making premiums. Most annuity contracts provide cash surrender values benefits prior to maturity. California law states that in no even shall any cash value surrender benefit be less than the minimum nonforfeiture amount at that time. And, the death benefit under such contracts shall be at least equal to the cash surrender benefit.

Living Benefit Guarantees / Benefits

As the market for variable annuities becomes more competitive, insurers are "sweetening the pot" to attract more business. One such perk is to offer living benefit guarantees. Such a guarantee might protect your mutual fund investments against losses if you hold the investment for a period of time. Other living-benefit guarantees might promise to pay a guaranteed retirement income, regardless of the investment account performs, long term care expenses, etc. It is important to know if what you must do to “earn” this benefit, e.g., convert the contract to an immediate annuity or annuitize. Like any form of insurance, there is usually a cost.

Example: Joan's variable annuity includes a living benefit option that guarantees a minimum future amount of income. Regardless of how her investment options perform, on her 10th or later contract anniversary, she can convert her contract to a guaranteed amount of income.

Living benefits are optional and exercisable at the discretion of the policyholder. The more these benefits come into play, the more the pricing is challenging. There is also discussion on the effect these options may have on insurers. More aggressive companies, for example, could experience problems if the stock market continues to perform poorly for an extended time period. In a catastrophe, the cost they charge for the benefits would be inadequate."

Performance and Investor Considerations

Determining which type of variable annuity is suitable for an investor depends mainly on two factors. One factor is the potential purchaser's investment sophistication. The other is the extent to which the person wishes to become involved in investment decisions.

The first consideration applies to the inexperienced investor with limited knowledge of the stock market. In this case, a company-managed variable annuity is probably the better choice, since the insurance company will make all the investment choices and manage the portfolio.

The second consideration concerns whether the contract owner wishes to continually monitor changing economic conditions and be responsible for changing the direction of investments in the annuity portfolio. With the self-directed type of variable annuity, the investor decides on the mix of investments in the portfolio. It is the contract owner's responsibility to periodically review these investments to see whether their performances are still in tune with his or her investment objectives, and adjust the portfolio accordingly. The self-directed plan is probably more suited to an investor who is accustomed to making these types of decisions.

The initial objective of the variable annuity concept was to design a financial instrument that would combine the guaranteed features of annuities and the growth possibilities of equities.

One popular theory was that the cost of living and common stock prices tend to move in the same direction over the long run. During the 1950s and 1960s, there did seem to be a definite correlation between rising stock prices and the cost of living. However, a comparison of the consumer price index and Standard and Poor's index of 500 stocks from 1970 to present day shows wide fluctuation, even during periods of accelerated inflation. In the 1970's some variable funds dropped by almost 40 percent in a matter of a few years at the same time inflation was skyrocketing. Individuals who already had started drawing their annuity benefits saw their payments decrease, while the cost of living increased. Not only did the downturn affect retirees, it also affected those who were still investing for the future. Therefore, even those who were still accumulating retirement funds were disappointed to learn that fund values did not appear to conform favorably to current economic conditions.

Some financial authorities have explained this phenomenon by proposing the existence of a definite relationship between inflation and stock prices. They point out that when prices rise rapidly, there is a corresponding increase in interest rates. When interest rates rise sharply, the stock market reacts by moving in the opposite direction. Therefore, when the cost of living takes a sudden jump, it seems that the value of the variable annuity unit tends to fall.

Proponents of the variable annuity, however, assert that they have never viewed this product as a temporary hedge against sudden inflation. To them, the variable annuity is based on the assumption of a long-term correlation between inflation and investment returns.

Based on this principle, a variable annuity would be a favorable investment because it would allow investors to enjoy a rise in income as the economy's productivity increases.

The variable annuity, with its combination of traditional guarantees and investment flexibility, offers great promise as a financial planning tool. It has the potential to be more responsive to economic trends than the conventional savings account or even the traditional fixed annuity.

However, the savings customer who has basically considered only fixed investments should be aware of the special concerns connected with the purchase of a variable annuity.

SECTION V
Fixed Annuities

A fixed-rate annuity is a contract between a policyowner and an insurer that requires a policyowner to pay either a lump sum or periodic payments to the insurer to establish the principal, from which the insurer guarantees the policyowner a fixed or promised rate of return. The insurer allocates all of the principal invested by the policyowner to a general account, and, in return, makes guaranteed periodic payments to the annuitant out of the insurer's earnings from its investment portfolio held in the general account.

Common Contract Provisions

In a ***fixed-rate annuity***: the cash value accumulation (or the annuity income) is a stated dollar amount that is guaranteed by the insurance company and on which (or with respect to the annuity income) the insurer pays a specified or determinable rate of interest. In effect, it is a fixed-dollar, guaranteed-principal kind of investment medium that is in some ways analogous to CDs. The ***investment authority and investment risk*** are on the insurance company because it is the insurer that guarantees the cash value (or annuity income) and specifies the interest rate currently being paid on cash value accumulations.

Consequently, unlike variable annuities, fixed-rate annuities have little or no investment risk, because the payout is guaranteed by the insurer/issuer as part of its general account obligations. It is this reason that prompts many insurers and agents alike to compare them to CD's and even name them similarly as CD Annuities. Be advised, however, while they sometimes offer better rates and helpful tax advantages, they are also much harder to get out of, and they are not protected by the Federal Deposit Insurance Corp. Some experts advise against CD-type annuities because of the interest costs and IRS penalties involved in getting out. If rates go up, you're locked in at a lower rate.

Some CD-type annuities are different from other fixed annuities in that the guaranteed rate matches the penalty period. In other words, if you buy a five-year CD-type annuity at 4 percent, you're guaranteed to get 4 percent annually if you hold the CD for five years.

Other fixed rate annuities have no maturity date and often guarantee a rate only for the first year. The interest rate usually drops after the guaranteed period and is adjusted annually. Those annuities tend to have a bad reputation, even among people in the insurance industry -- the only people licensed to sell annuities.

The bottom line with fixed annuities is that tax-deferred earnings or a promise of an income you can't outlive are attractive features to many investors. Other issues to examine, however, include long-term risk, current liquidity, effective earnings (after penalties and bonus interest) and taxes down the road.

Death Benefits

Principal in a fixed-rate annuity contract is guaranteed everyday. This means that the beneficiary receives the greater of the principal or the value of the account as of the date of the annuitant's death.

Lump Sum vs. Annuitization

Beneficiaries may also have options as to how they receive a death benefit, e.g., ***a lump sum or over a period of years (annuitization)***. Accepting a five-year pay, for example, out can ease taxes slightly and result in a larger balance due to accumulated interest paid by the insurer.

Provisions

Typical death benefit provisions might last until the contract is terminated, annuitized or the annuitant reaches the age of annuitization . . . anywhere from 75 to 85.

Charges and Fees

Other than surrender charges (discussed above), most fixed-rate annuities have no associated fees or charges. Some have minimal annual contract fees of $30 or so. And, in low interest rate markets, even these must be considered in calculating overall yield.

Interest Rates

Fixed rate contracts may offer a set return for specified period of time. The rate can be ***guaranteed*** for this period or simply ***promised***. And rates can also vary widely between companies and products for a variety of reasons. Choosing a suitable rate means uncovering the length of time invested, the promised rate of interest, the guaranteed rate of interest as well as consideration for potential surrender charges if an early withdrawal is required.

Annual vs. Multi-Year

While it is important to assess the ***annual*** rate of interest credited, it is more likely that a ***multi-year*** strategy must be adopted to analyze the effective return of any fixed annuity. The longer the term, the more easily a surrender or MVA charge can be absorbed.

Example: Dave is considering an $100,000 annuity contract offering a current base rate of 5% with an additional 2% bonus in the first year but it will only apply if the client annuities his payout. Surrender penalties are 5-4-3-2-1-0 expire at the end of five years with a market value adjustment in place. The minimum guaranteed interest rate is 3%. As an ethical agent you need to point out to Dave that the rate of 5% is not promised and it is likely to be lower in subsequent years. Also, the 2% first year bonus will be lost unless Dave agrees to receive his money back over a period of years (typically 5 years). Finally, if Dave needs his money sooner and rates in the market have risen, it is likely that he will pay the applicable surrender charge plus additional penalties in the form of a MVA adjustment.

Crediting of Interest

The crediting of annuity interest rates is also effected by the nature of the product and company. Here are some basic designs to understand:

Portfolio Rate Annuities

These contracts offer a guaranteed interest rate for an initial period of time, such as one, three or five years. After the initial rate period, renewal rates are based on the earnings of the underlying investment portfolio. In other words, all policyowners are lumped in a single group and given the same rate. When market rates are declining in the market, the portfolio type of contract would seem to be advantageous.

Banded or New Money Annuities

The banding approach will segregate different bands of contracts and assign different rates to each. Older contract monies might be earning one rate of interest, while newer contracts earn another. When interest rates are rising in the market, a new money plan would seem to be more advantageous.

CD-Type Annuities

These work basically the same as bank CDs in that the company will typically guarantee a rate for a given period of time. At the end of the guarantee period, the policyowner may surrender the annuity for its full value, transfer the full value to another annuity or renew for a new period of time. Of course, early withdrawal penalties may apply.

Two Tier Annuities

This type of product are the most difficult to explain and in some cases downright misleading. These plans may offer a large, up front bonus on top of the normal interest rate. However, the bonus may be forfeited unless the contract owner annuitizes. Or, a two-tier plan may credit the contract with a lower rate of interest if a partial or total liquidation is made. These plans often have much higher surrender charges . . . some never disappear. Interest crediting may also be lower if the owner chooses a minimum payout plan, e.g., choosing to annuitize over three years instead of five years. Rates during annuitization may also be artificially low to offset seemingly higher rates during accumulation.

First Year "Teaser Rates

Many companies offer a first year bonus or teaser rate which can drop considerably in the subsequent years. In some cases, the only way to keep the bonus is to ***annuitize the contract***. Further, a fair amount of companies are now applying market rate adjustments to any potential surrenders (see below) to reflect current market conditions.

Interest Rate Calculations

When selling annuities, it is extremely important that you correctly explain to the buyer how the contract is designed to work. Companies today are more likely to credit interest quarterly, monthly or even daily. This allows insurers to be more competitive and react quicker to interest rate fluctuations in the market. Insurers are also using market rate adjustments (discussed

above) to negatively or positively adjust a client's surrender charge where early withdrawal of funds is desired. Both factors eventually effect your client's yield.

What is critical to understand about any annuity interest rate is whether it is ***guaranteed*** or just ***promised***. Some companies offer a higher rate but only "promise" to continue paying it. For example, a company may offer a ***base rate*** or ***first-year bonus teaser rate*** that appears to increase the overall yield. Always look for how long it is offered (one years two years, etc) and what it resets to after it expires. Bonus annuities can "guarantee" to offer a minimum, however, the ***annualized interest rate calculation*** (average yield to maturity) may not be known at the time of purchase because the rate can fluctuate after any fixed bonus expires. *Also, be aware that really great sounding rates are typically offset by higher and longer surrender charges*.

Minimum Guaranteed Interest ***(CIC10168.25)***

Beginning January 1, 2006, the state of California, created legislation (AB 284) regarding minimum guaranteed interest for fixed annuities. The primary goal of the law's revision is to provide a means to permit lower interest rate guarantees than the current law allows in low interest rate environments. Legislators agreed on a cap equal to the ***existing three percent*** interest rate. However, in order to provide some minimum level of guarantee to the consumer, a ***floor of one percent*** was also established. Finally, flexibility was provided to the companies by allowing for the re-determination of the minimum interest guarantees on a periodic basis by using the five-year Constant Maturity Treasury Rate, less 125 basis points

AB 284 also significantly reduces the maximum expense loads that may be charged by an insurer by limiting annual contract fees to $50. This bill, however, is ***does not*** affect any contract now in effect.

Low Interest Rates

The passing of this bill is a strong indication that the current low interest rate ***markets*** are having an impact. Annuities are one of the few savings products that offer guaranteed lifetime income, ensuring that a person will not outlive their assets. Extremely ***low rates*** have had negative effects on the ability to accomplish this.

SECTION VI
Indexed Annuities

In a general sort of way, the equity index annuity combines the traditional features of a fixed annuity which include;

- Guarantee of principal
- Tax deferral
- Free withdrawals
- Surrender charges when applicable . . . with;
- Current rates credited which are linked to the equity markets.

This type of annuity provides a rate of return that is determined as a defined share in the anticipated appreciation of a major stock index. The annuity will provide a guaranteed minimum return as do regular fixed annuities.

One of the major keys to the equity annuity is to allow the investor to participate in interest rates that are linked to the equity markets but avoiding the possibility of downside market risk.

So, a Equity Indexed Annuity (EIA) is a fixed annuity with traditional guaranteed minimum interest rates, with an excess interest feature that is linked to an equity index such as the S&P 500 (explained below).

The contractual features of the annuity fit within the general definition of a non-security that mark it as an insurance product not requiring a securities license.

What Is Indexing?

An ***indexed annuity*** is an investment that seeks to match the performance of a defined group of securities with ***client needs***. This group of securities forms a recognized market measurement called an "index." An index is a benchmark or relative measurement of performance. One example is the Consumer Price Index that tracks the changes in prices of consumer goods from year to year.

Indexing seeks to match overall performance of the index, so the particular securities held and the quantity of each is pre-determined by the composition of the index. Investment managers for a S&P 500 Index fund will purchase each of the 500 stocks in proportions that match the index in order to replicate the performance of the index itself. Indexing is often called "passive investing" because the type and amount of each stock is decided by the index composition. This is in contrast to "actively managed" investing where a professional money manager devises unique strategies and investment philosophies in order to select individual securities. Indexing emphasizes diversification and by definition results in reduced trading activity.

Indexing arose from the "efficient market" theory of the 1960s, so it is not a new concept. If, as efficient market theory suggests, markets naturally tend toward optimum efficiency, it is questionable as to whether any strategy or philosophy can consistently outperform the market (at least do so by a significant margin.) If efficient market theory holds true, then simply "buying the market" (or, indexing) will be the least risky and most effective investment strategy.

The historical performance of the stock market is clear - over the long term it has simply gone up. However, while the trend has been decidedly upward, there has been significant volatility with some extreme highs and lows over short-term periods. This daily volatility means that investors may experience significant increases or decreases to their principal within the course of a few days.

Indexing is a "buy and hold" investment strategy. "Buy and hold" (in the context of the S&P 500 tends to outperform an "active trading" strategy for the average investor. We know that the average investor over time has exhibited a "buy high, sell low" behavior that is detrimental to long term investment returns.

The advantages of indexing can be evaluated by considering the indexed mutual fund, one of the most popular investment vehicles of the '90's.

Interest Crediting

What is important to understand are the differences between the various Equity Index Annuities and how the index or interest calculation is made. There are also substantial variation between company designs, and quite frankly, no two products are alike.

Modern equity index annuities are currently utilizing the Standard & Poor's 500 Composite Stock Price Index more commonly known as the S&P 500 Index. This index is a widely recognized measure of equities in the US stock markets.

While the S&P Index is the most widely used index today you should also be familiar with other indexes that are and can be used. Some of these other indexes include the following;

- Standard & Poor 100 also known as the OEX Index
- S&P 400
- Nikkei National Index which represents the Tokyo stock exchange
- DAX Index which represents the German Exchange
- FTSE Index which represents the Financial Times Stock Exchange in London

There are also a number of insurance carriers that use some sort of internal operations to create the needed annuity returns using their own investment department instead of a major index. Others even may use a reinsurer to create the returns.

Monthly 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.

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.

The averaging modifier (modifiers serve to limit the Index Benefit by affecting the amount, timing and crediting of Index interest credits) serves to limit the S&P 500 Index growth to which the participation rates are applied. For example, if the market gained 1% per month each month for one year, (e.g. from 500 to 563) it would be up a total of 12.67% at year-end. The average index value would be 532 or a 6.74% average annual increase.

Point to Point

Compares the change in the index at two discrete points in time, such as the beginning and ending dates of the contract term.

Advantage: May be combined with other features, such as higher cap and participation rates, that may credit you with more interest.

Disadvantage: Relies on single point in time to calculate interest. Therefore, even if the index that your annuity is linked to is going up throughout the term of your investment, if it declines dramatically on the last day of the term, then part or all of the earlier gain can be lost. Because interest is not credited until the end of the term, you may not receive any index-link gain if you surrender your EIA early.

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

Possibly the most basic type of equity index method is the ***Long-Term Point-to-Point*** method.

As the name implies, there are only two days in this index calculation method, the starting point and the ending point. For example, if Point A (the starting point) is 500 on an index and Point B (the ending point) is 550, then an unadulterated or pure Point-to-Point method would register a gain of 10 percent. That number would then be multiplied by the participation rate to determine the index gain for that period.

The ***annual point-to-point*** method uses an annual measure for calculating index returns.

So far, two pure Point-to-Point basic designs have emerged, the "Annual Point- and the "Long Term Point-to- In the classic unadulterated version of the Long Term Point-to-Point index method, the only days that count in the index gain calculation are the first day (the issue date) and the last day of the index term. Whatever the market did in between is IRRELEVANT. Only the first and last day of the entire index term count.

High-water Mark Designs

Looks at the index value at various points during the contract, usually annual anniversaries. It then takes the highest of these values and compares it to the index level at the start of the term.

Advantage: May credit you with more interest than other indexing methods and protect against declines in the index.

Disadvantage: Because interest is not credited until the end of the term, you may not receive any index-link gain if you surrender your EIA early. It can also be combined with other features;

such as lower cap rates and participation rates that will limit the amount of interest you might gain each year.

Annual Reset

Compares the change in the index from the beginning to the end of each year. Any declines are ignored.

Advantage: Your gain is "locked in" each year.

Disadvantage: Can be combined with other features, such as lower cap rates and participation rates that will limit the amount of interest you might gain each year This design, in all its variations, counts gains by the year, recognizes those gains, and locks them in so they are not lost in market downturns. All three zones of gain are counted.

Thus, you can see that Annual Point-to-Point designs of greater than one year generally have an annual reset of the starting point feature. Gains are registered below the initial starting point, which can be about half of the total possible gains. Also, all annual gains are added or combined together for a term total, as opposed to Long Term Point-to-Point, Average End, or High Water Anniversary Mark, Look-Back designs, where ONLY ONE point is derived from the index formula, and then a number and an effective annual yield are calculated.

Combination Methods

In an effort to give consumers even more choice, companies are assembling combination contracts that use many of the methods described above.

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%, your 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.

Cap Rates and Participation Rates

Another trade-off to consider is the long-term guarantee of the participation and cap rates.

A ***cap rate*** is the explicit maximum account value percentage increase allowed. The cap for an annual reset product is the maximum account value percentage increase allowed for a given policy year. A cap serves to set an upward limit on the client's Index Benefit. Cap rates are clear state limits on the index growth.

Participation rates represent the percentage of the increase in the index that will be credited to the accumulation value, which may be subject to the cap in some of the contracts. To add to some of the confusion already created, a contract with a 100% Participation Rate does not necessarily produce a greater Index Benefit than a contract with an 85% Participation Rate.

If guaranteed for the term, an 85% participation and 14% cap would become 65% and 12% respectively. Realize, you have a design similar to a traditional interest based annuity and a long term guarantee of these participation and cap rates would create significant surplus strain (just like it does for an interest based fixed annuity. Ever notice that traditional interest based annuities' long term rate guarantees are lower than the current, year to year guarantees?) Similar to "company practice" with interest based annuities, it is the company's intention to maintain the participation and cap rates for the length of the term. The bottom line ... if you deal with a reputable carrier with a reputation for fair and honest renewal rates, the annual reset design will provide the intended benefits and results.

Caution: Some EIAs allow the insurance company to change participation rates, cap rates, or spread/asset/margin fees either annually or at the start of the next contract term. If an insurance company subsequently lowers the participation rate or cap rate or increases the spread/asset/margin fees, this could adversely affect your return. Read your contract carefully to see if it allows the insurance company to change these features.

Minimum Interest Guarantee

One of the EIA features that is most commonly misunderstood is the minimum contract value. This value is an underlying secondary guarantee or "safety net" that ensures a guaranteed minimum cash value is available to the consumer.

The minimum contract value is guaranteed regardless of how the index performs. (Index performance is reflected through index increase credits to the current accumulation value.) So if the index stays flat or declines over the entire term of the contract (so that effectively, no index increases are earned) this minimum contract value comes into play. Of course, the likelihood that the Index will remain perfectly flat or consistently decline over a long period of time is statistically small. However, this guarantee exists to accommodate that scenario.

When calculating "cash value" benefits, such as a surrender value, death benefit, annuitization - value or withdrawal the buyer always receives the greater of the current accumulation value or the minimum contract value guarantee. In non-registered products, this value must comply with minimum Non-Forfeiture Regulations, which for single premium contracts equals 90% of the premium at 3% interest compounded annually. (The regulation for flexible premium contracts is 65% at 3% interest compounded annually.) Today, the most common minimum contract value provision is 90% at 3% interest, which, for example, would equal 110% of principal at the end of a seven-year term. However, there are contracts that now guarantee 100% of premium at 3% interest and some flexible premium contracts guarantee less than 90% of premium at 3% interest.

Some contracts "top up" the minimum contract value at the end of a term to equal the current accumulation value as of the just ended term. This effectively increases the minimum contract value guarantee to reflect previously earned index credits.

In and of itself, the minimum contract value is not a particularly meaningful feature with which to compare the competitiveness of a product. In reality, this value will only be meaningful:

- Upon early surrender.

- If the index is flat or declines over the entire term.

Premature Surrender

If your client withdraws all or part of the value in his annuity before the end of the term, a withdrawal or surrender charge may be applied. A withdrawal charge is usually a percentage of the amount being withdrawn. The percentage may be reduced or eliminated after the annuity has been in force for a certain number of years. Sometimes the charge is a reduction in the interest rate credited to the annuity.

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.

Like fixed and variable contracts, EIAs may have a limited "free withdrawal" provision. This lets you make one or more withdrawals without charge each year. The size of the free withdrawal is limited to a set percentage of your annuity's guaranteed or accumulated value. If you make a larger withdrawal, you may pay withdrawal charges. You may also lose index-linked interest on amounts you withdraw.

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

Charges and Fees

Other than surrender charges (discussed above), most equity indexed annuities have no associated fees or charges. However, where participation rates are involved, administrative fees may be charged ranging from 1 percent to 2.5 percent annually. Contracts with less than 100 percent, however, typically do not charge such fees.

SECTION VII
Annuity Riders

In an effort to be a competitive as possible, many annuity companies offer a myriad of annuity rider options. Some are available only at the time the contract is issued, others can be added later.

Life Insurance

Most contracts offer a standard death benefit payable upon the death of the annuitant. For additional fees, a rider can be purchased to enhance death benefit amount . . . say to double the amount of the original premium or total premiums invested. Others allow investors to ***step-up*** the death benefit to the account value of the contract by periodically renewing an owner's contract with a new surrender penalty schedule.

Living Benefits

Living benefits are optional and exercisable at the discretion of the policyholder. Such a guarantee might protect your mutual fund investments against losses if you hold the investment for a period of time. Other living-benefit guarantees might promise to pay a guaranteed retirement income, regardless of how the investment account performs.

Long Term Care Riders

A new crop of variable annuity insurers are offering riders that pay LTC benefits up to a maximum monthly limit for a certain period of years. Investors designate a portion of initial purchase payments to cover the benefits.

Terms

The benefits wouldn't be reported as taxable income, in line with the Pension Protection Act of 2006. These policies function more like ***long term care policies***. More traditional style contracts included long-term care riders that paid benefits when a serious illness occurs, even when no nursing home care is needed. For example, victims of strokes, heart attacks, cancer, coronary artery surgery, and renal failure can collect benefits while they are still living. Sometimes the policy holder can receive as much as 25 or 50 percent of the policy's face value up front, rather than in regular monthly payments.

Crisis Waiver vs. Long Term Care Rider

If your client becomes seriously disabled or needs to go to a nursing home, their annuity contract may hopefully contain a waiver that triggers payments or withdrawals that are ***not subject*** to the usual surrender fees. Serious health changes, such as a chronic long term are illness, may also trigger annuity payments.

Not all annuity permit crisis waivers. In general, they seem to be more common and generous in fixed annuities, rather than variable contracts. And, situations that trigger the waiver and

allow your client to make early annuity withdrawals vary from company to company. For instance, one insurer might require a 90-day nursing home confinement before your benefits are activated, while another might call for 60 days. In addition, one company may consider that your client is disabled if you're unable to work in any occupation, while another may require that he be unable to work in your current occupation. (A surgeon, for instance, may be deemed disabled by one insurer if he or she cannot operate because of, say, arthritis in the hands. Yet another company might decide that the doctor can still see patients in an office setting, without performing surgery.)

It is important to differentiate between a crisis waiver and a long term care benefit rider. The crisis waiver merely allows the client access to his funds to be used without penalty. A true long term care rider provides benefit payments to the client, above and beyond his annuity account, i.e., the client would receive funds to pay for his condition rather than invade the principal of his account.

Skilled Nursing Home Riders

A skilled nursing home rider would provide money for nursing home benefits . . . normally two percent of insurance coverage per month. By this rule, a $100,000 policy would pay $2,000 per month. However, if the policy is over $150,000, the policy holder may get less than two percent. For example, suppose the policy holder has a $300,000 life insurance policy with a long-term care rider, and he is confined to a nursing home. This insured may get two percent of the first $150,000 ($3,000) plus one-half percent of the next $150,000 ($750) for a total of $3,750 per month. Also, some policies place a limit on the monthly payment amount. . Most polices require that the policy holder pay at least for the first 60 days of nursing home care before a long-term care rider kicks in. With some riders, the policy holder will have to make out-of-pocket payments for at least 180 days before he can collect. Some long-term care riders will not pay until the policy holder has been paying the extra premium for at least three years. For example, if an individual buys a long-term care rider in 1997, he may not be able to collect before 2000, 2002, or some other date.

Most long-term care riders will pay for skilled care or intermediate care nursing home stays. However, some riders do not pay for custodial care. Others will pay only after a specified number of days in a hospital or a specified number of weeks in a skilled care or an intermediate care home. The problems with funding long term care coverage through an accelerated death benefit policy are obvious: Benefits may be slower than a stand alone policy, benefit triggers can be tricky and there is typically no inflation protection other than by expensive inflation riders. Furthermore, the death benefits that could have gone to an insured's estate are usually "eaten-up" in long term care costs thus defeating the purpose of buying a life insurance policy. Also, agents must be sure to differentiate between actual coverage and a simple ***crisis waiver***, which allows the waiver of certain fees should a special illness develop.

Home Health and Hospice Rider

Some innovative plans pay up to 100% of allowed charges for home health care and up to 100% for hospice care. Many, however, come with lifetime maximums that can be as low as $5,000.

Loan Provisions

Many annuity companies permit loans up to the contracts cash value. However, there are usually many statutory regulations, regarding maximum interest charged, repayment, disclaimers that the loan will offset any cash value or death benefit, etc.

When an annuity is inside a qualified plan, these requirements are even stricter where loans are limited to 1/2 of the current present value with a maximum repayment period of 5 years. In addition, loans must have a level amortization (repayment) plan.

SECTION VIII
Penalties

The seriousness of new and recent legislation surrounding annuity sales and suitability is underscored in the penalties assessed for violations: Agents need to understand the following consequences:

Misrepresentation of Policy Terms or Benefits (Sect 780, 781, 782, 789.3 CIC)

Misrepresentation of policy terms, benefits, privileges, dividends; or to induce someone to buy one policy then sell another; or to mislead someone to forfeit his policy based on a false comparison is a crime and punishable by a fine not exceeding $25,000 or 3 times the amount lost by the victim and / or by imprisonment not exceeding one year. The commissioner may also require rescission of any contract found to have been marketed, offered, or issued in violation of this article.

Deceptive Advetising / Duplicate, Unnecessary Coverage (Section 1738.5, 10509.9 CIC)

Seniors who are abused via inaccurate, duplicated or unnecessary coverage. Or, who are deceived by an agent representing himself to be someone he is not will results in still penalties, including an administrative penalty of no less than five thousand dollars ($5,000) for the first violation; $5,000 to $50,000 for a second violation. If the Commissioner at anytime believes the agent can be reasonably expected to cause harm to seniors, his license may be suspended. Further violations for the same offense can result in another $10,000 fine for the agent and form $30,000 to $300,000 for the insurer. Further, based on the outcome of a hearing, the agent's license could be suspended or revoked.

Unreasonable Replacement / Informed Decision

Annuity buyers are entitled to information to make an informed decision and the reasonable expectation that the consequences of a replacement of their existing policy is made. Agents not providing this are subject to an administrative penalty of no less than one thousand dollars ($1,000) for the first violation; $5,000 to $50,000 for a second violation. If the Commissioner at anytime believes the agent can be reasonably expected to cause harm to seniors, his license may be suspended. Further violation can result in another $10,000 fine for the agent and form $30,000 to $300,000 for the insurer. Further, based on the outcome of a hearing, the agent's license could be suspended or revoked.

Failure to Refund A Contract Refund To A Senior

Seniors (age 60 and older) are now entitled to a 30-day free look and a total refund of their premiums. Insurers that fail to make these refunds in a timely manner will pay the applicant interest from the date the insurer or entity received the returned policy or certificate.

Day in Court

Any allegations of misconduct perpetrated against a person age 65 or over shall result in a hearing to be held within 90 days after receipt by the department of the notice. Based on the outcome of a hearing, the agent's license could be suspended or revoked.

ADDENDUM
Penalties

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

<table>
<tr><td>Section 1668.1
Acts that constitute cause to suspend re revoke any permanent license issued pursuant to this chapter</td><td colspan="2">no violations or penalties cited in this section
(see page 5 for actual language)</td></tr>
<tr><td>Section 1738.5
A proceeding held pursuant to section 1668, 1668.5, 1738, 1739, or 12921.8</td><td colspan="2">no violations or penalties cited in this section
(see page 5 for actual language)</td></tr>
<tr><td>Section 10509.9
Administrative penalties:</td><td>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)</td><td>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</td></tr>
<tr><td>Section 10509.916
Insurer responsibilities</td><td colspan="2">violations and penalties to be determined
(see page 7 for actual language)</td></tr>
</table>

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 therefor 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.

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