SmartMoney

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Will Your Insurer Be Able to Pay Your Annuity?

With their guaranteed payouts and protection against market dips, annuities promise investors a bit of peace of mind. For those reeling from wounded retirement portfolios, that's no small thing.

An annuity -- a contract sold by an insurance company -- provides payments to the holder at specified intervals, usually after retirement. As a product, annuities have their allure, but they are also complex and often misunderstood. Consumers should take their time to understand exactly what they're buying and how to fit annuities into their larger retirement picture (if they do at all).

But your due diligence shouldn't stop there. Would-be investors need to take a look behind the annuity – at the insurance company that issues it. Purchasing an annuity essentially means you're putting faith in the insurance company's ability to pay out your investment for the rest of your life.

Here are a few questions you should ask before buying an annuity.

How do you assess an insurance company's financial strength?

The main barometer for financial soundness is the company's rating. The main ratings agencies are A.M. Best, Standard & Poor's, Fitch and Moody's. (A.M. Best focuses almost solely on the insurance industry.) "That gives you hard, objective, factual information to work with," says Noel Abkemeier, a principal at the actuarial firm Milliman, and a fellow with the Society of Actuaries. Ratings are largely based on the strength of the company's capital.

Generally, a consumer should be comfortable with something that's A-rated or better in terms of financial strength, he says.

The life and health insurance industry has a "negative" outlook from A.M. Best. Is this cause for concern?

In September 2008 *A.M. Best*[1] revised its rating outlook on the life/health insurance industry to negative (from stable), where it remains today. Although there is concern from an industry standpoint, it's still important to analyze the individual company for financial strength and its ability to pay out its claims – which is where the ratings come in.

Also, bear in mind that just because "the headlines look gruesome for a company and the stock is plummeting, it doesn't necessarily mean that the insurance affiliates are in trouble," says Bryan Place, a fee-only certified financial planner and owner of Place Financial Advisors in Manlius, N.Y. The assets of the insurance arm stand independent from the publicly traded company.

Should you worry if the company is weak?

The state insurance regulators monitor companies' capital strength. Their main focus is ensuring company solvency and consumer protection, Abkemeier says.

If the insurance company has a solvency problem or becomes undercapitalized, states' life and health insurance guaranty associations will step in. These regulators would initiate a rehabilitation process and try to find a financially strong purchaser to pick up the weak company's liabilities, says Abkemeier. If that happens, the customer is now a customer of the strong company and they're in good shape. Your annuity contract and its provisions still apply, he says.

What if the insurance company fails?

To the extent there is some shortfall – if the company became insolvent and there were fewer assets to cover the reserves and liabilities – then the guaranty association comes into the picture, Abkemeier says.

In a worst-case scenario, a state insurance department could be forced to liquidate an ailing insurer. If that happens, the level of protection you receive depends on how much you've invested and the type of annuity you own.

The individual benefits guaranteed by the associations vary by state. You can check with your state's fund to see which policies are covered and up to what limits through the National Organization of Life & Health Insurance Guaranty Associations' *web site*[2] or the National Association of Insurance Commissioners *here*[3].

For example, in New Jersey, death benefits are guaranteed up to $500,000, and cash values are protected up to $100,000. (A death benefit feature allows you to designate a beneficiary to receive either whatever is left in the annuity account or a guaranteed minimum amount when you die.)

What if you've already bought an annuity and your insurance company gets downgraded?

A downgrade by itself is not reason to panic (after all, the entire industry currently has a negative outlook). If there is a concern that the company may not survive, first look into the state guaranty fund to find how much coverage exists, Place says. "You want to be careful before selling an annuity in a panic because many of them have surrender charges," he says.

What if you do want to take your money out?

Many policies allow policyholders to withdraw up to 10% of the account value per year without a penalty, or "surrender charge." Beyond that, a charge will generally be levied if the policy is still within the surrender charge period, often around seven years, says Scott Witt, an actuary and fee-only insurance advisor at Witt Actuarial Services in New Berlin, Wis. (A surrender charge is not relevant in the case of an immediate annuity, which turns a lump sum premium into lifetime income. Once the principal is paid, there's no getting it back.)

Surrender charges are typically highest in the first year you hold the annuity, and phase out after a set number of years. For instance, charges may start at 8%, and drop by 1% each year, so you withdraw cash in the ninth year with no penalty. "So if you decide early on you don't want to stick with the policy, it is going to cost you," Abkemeier says.

[1]http://www3.ambest.com/frames/frameserver.asp?site=press&tab=1&altsrc=29&altnum=&refnum=65494652775546526648
[2]http://www.nolhga.com/factsandfigures/main.cfm/location/stateinfo
[3]http://www.naic.org/state_web_map.htm
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