



“Safe Money Report”

Steve Pomeranz, CFP

Host, *On The Money!* WXEL 90.7 FM

Questions to ask before buying an equity-indexed annuity

by *Insure.com*

Since every equity-indexed annuity is different, be prepared to ask your agent or broker plenty of questions before deciding if you should invest. Here are seven important questions to ask:

1. What is the annuity's term?

In general, equity-indexed annuities (and other annuities, for that matter) require you to tie up your money for anywhere from five to 10 years. Like any stock market investment, the shorter the term, the greater your risk that the market won't perform well over the holding period.

2. What exactly do you earn when the market goes up?

Equity-indexed annuities credit you with anywhere from 50 to 100 percent of the price gain of the market — excluding dividends. Since you're not earning dividends, you won't earn as much as you might by investing directly in the market. The percentage rate you earn (called the participation rate) may change from year to year. Make sure you check with your agent.

3. At the end of the term, how does the company calculate your gain?

Some equity-indexed annuities use the market price on the day your annuity matures. Others look at the market price on each policy anniversary and pick the highest one. Some policies credit you with a portion of each year's market gains — if there are any. Others simply average the gains. Make sure you ask which method the policy you're considering uses.

4. Are there any limits to how much you can earn?

Often equity-indexed annuities put a cap on how much you can earn during the year. (Some policies also allow the insurer to change the cap each year.) If, for example, your policy has a 12 percent cap and the market rises 15 percent, you'll only get 12 percent.



“Safe Money Report”

5. What happens if stock prices decline?

If the market drops one year, you'll be credited with no gain that year. (Of course, if you "surrender" before the maturity date, you'll have to pay the surrender charge, so you may end up taking a loss.) The crediting method the company uses will determine what happens in subsequent years, especially if the market doesn't return to previous levels.

6. What happens if you want to quit the annuity early?

Some policies will give you the guaranteed minimum return, while others will credit you with all or even part of your earnings, minus whatever surrender fee was established when you bought the policy. Getting out early may mean taking a loss.

7. What if everything crashes?

Equity-indexed annuities do carry a guaranteed minimum return, but only if you keep the policy until its maturity date. The guaranteed return is usually at least 3 percent, but that may not be 3 percent of what you paid into the policy in the first place. Some companies guarantee you'll get at least 3 percent of 90 percent of what you spent. Also make sure you check on how that minimum return is computed.

Steve

Steve Pomeranz, CFP
“The Investor’s Advocate”
November 28, 2001