

## What Investors should know about Buying and Selling an Annuity

A White Paper from J.G. Wentworth  
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Annuities have become one of the most successful financial products in recent history with annuity reserves now topping \$2.5 trillion according to the American Council of Life Insurers 2008 Fact Book. But, even with all that success (or possibly because of it), consumer finance reporters seem to regularly take annuities to task. Here are a couple recent pearls:

"Deferred annuities are popular because returns are tax-deferred, but if the full cycle of accumulations and distributions are considered, most purchasers would make a different choice."

– *American Association of Individual Investors Journal*

"The big reason annuities sell so well is simple: Sales commissions are lucrative for annuity sales agents, some as high as 14%. As a result, the industry attracts aggressive hustlers with questionable ethics preying on vulnerable customers, especially the elderly, a pattern that gives the rest of the industry a bad name."

– *MarketWatch*

"The great annuity rip-off ... They're stupid investments for nine and a half people out of 10. The only people who benefit from these things are the people who sell them. The average annuity is nothing you would want."

– *Forbes*

"They are the fifth-best option for retirement planning, behind everything else."

– *BusinessWeek*

One of the main criticisms of annuities by planners, advisors, and reporters is their perceived lack of liquidity and lack of flexibility. The common belief is that once someone purchases an annuity, they cannot sell it. And, with most immediate annuities – those in which they begin receiving periodic payments from the insurance company – they are stuck with it for life.

While that was once true, that's no longer the case. The fact is an individual *can* sell their annuity to raise a lump-sum of cash through an established secondary market for annuities (think eBay for selling an annuity).

### ***Why Do Investors Sell Annuities in the Secondary Market?***

Annuity owners most likely to derive satisfaction from a sale in the secondary market include those who have shifted their financial plan toward wealth transfer from retirement income planning, those who have inherited annuities, those who have had a significant life change requiring a lump sum of cash, or those who have determined that their initial decision to purchase an annuity was a regrettable one. There are many reasons for seeking liquidity in the secondary market, but the important thing is that investors know the option is available so they can make the best financial decisions for their personal situation.

### ***Why Do Investors Buy Annuities?***

To understand how an annuity owner can benefit from the secondary market, it's important to understand why people might invest in annuities in the first place.

According to *The Annuity Advisor*, a book published by The National Underwriter Company to serve as an objective and impartial view of annuities, "the problems that annuities solve – the needs that they meet – can be identified and broken into several categories: 1) The need for a known income stream for a specified period or for the life of the annuitant(s), 2) The need for a guaranteed rate of return, 3) The need for a better non-guaranteed rate of return, and 4) The need (or desire) for tax advantages – one of the main appeals to a deferred annuity is tax-deferred growth, although the gain will ultimately be taxed (tax-deferred does not mean tax-free)."

According to the website AnnuityTruth.org, which is operated by H.E.L.P., a community-funded, non-profit resource for older adults, the suitability of an annuity within a specific financial plan "depends on the person's financial, health and personal situation and goals. For some, an annuity can be an appropriate part of an overall financial plan. For others, an annuity can be totally unsuitable. But, protect yourself. Annuities can be confusing. Get the facts!"

AnnuityTruth.com goes on to write, "among the disadvantages of deferred annuities can be high surrender charges during the initial years of a contract and the tax burden they can impose on heirs. With fixed annuities (deferred or immediate) inflation can eat away at the value of the locked-in fixed payments."

With all that said, the notion that an individual can sell their annuity seems like an idea that makes so much sense that the real wonder is why it didn't happen sooner.

***What should investors consider when selling an annuity in the secondary market?***

While the secondary market presents significant potential flexibility and value to annuity owners, this newfound freedom confers upon them the responsibility to do some research and make the right choices. What follows are some tips and strategies to help annuity owners make the most of the opportunity to sell their annuity:

**1. Call the insurance company to verify the cash surrender value, *if there is one*.**

Annuity owners should determine what options, if any, are available to cash out the annuity with the issuing insurance company directly. If it's an immediate annuity, it's important to learn if the annuity has any cash value from the insurance company – in most cases, the insurance company won't provide a lump-sum from an annuity once the periodic payments have started. If it's a deferred annuity, it's important to learn if the annuity has "surrender charges" which lower the current cash value or if the annuity requires that payments be taken over a minimum of 5 or 10 years to get the full value.

**2. Determine which annuities can be sold in the secondary market.**

There are plenty of misconceptions about which types of annuities can be sold in the secondary market, so it's important for an individual to contact a reputable buyer of annuities in this market to verify whether their annuity has any cash value. The language in annuity contracts can be confusing. Specifically, some annuities that appear to have no cash value may in fact be salable in the secondary market for a cash lump-sum. So, while it's important to get information from the issuing insurance company, it's even more important to talk to experts in the secondary market when considering the salability and value of a policy in this marketplace.

The main criterion underlying the entire secondary market for annuities is that they must have a non-qualified tax status. In other words, annuities with a qualified retirement tax status as defined by the IRS (e.g. 401k/403b/IRA Rollovers) cannot be sold in the secondary market. Beyond that, most other annuities can be sold in this marketplace and it's just a matter of determining how much a given policy is worth. As is the case with most other industries, certain players specialize in certain types of policies, so an annuity owner should research multiple providers to get a broad perspective of all their options in this market.

### **3. Contact a reputable buyer of annuities to determine the value of an annuity.**

After determining if an annuity can be sold in the secondary market, annuity owners will obviously want to learn the exact value of their [annuity](#) – this should happen regardless of whether they intend to sell it. This information will help them better prepare to adapt to life's changes in the future. This process should cost nothing and should come with no obligations to sell the annuity. When it comes time to sell the annuity, it's advantageous to work with a company that has a solid track record of providing service and value to annuity owners in this marketplace.

### **4. For annuities in payout, consider how much of the current payment is needed.**

One of the real advantages of the secondary market is how much flexibility it offers annuity owners: they don't have to sell their entire payment or the full term of payments, they can sell just a portion. Suppose there are seven years left on an annuity that's paying \$7,865 a month, but the annuitant could do just fine with \$5,150 per month for the next five years. They could sell, for example, \$2,715 of their monthly payment for five years and get a lump sum of \$105,000 while retaining \$5,150 for that 60-month period and then regain the full \$7,865 for the remaining two years. With this lump sum they could pay for a grandchild's education, buy a second home, pay bills, or invest in something different. At the same time, if they wanted to maximize their current cash value, they could sell the entire annuity, and that full value could be put to use in some other way to better suit their needs today.

### **5. Understand the tax impact.**

While annuities are good for many things, transferring wealth efficiently to heirs is not one of them. Advisors often say: "don't let your client die with an annuity." It sounds morbid until you consider the following: annuities are considered part of the estate, so if the estate value is above the threshold – \$3.5 million as of January 1, 2009 – as much as 45% of the annuity could be lost to taxes. Any person considering the tax implications of owning an annuity should consult with a tax professional because there may be other options to pass proceeds tax-free to heirs outside of their estate.

Compounding the problem for annuities is the fact that all of the gains inside an annuity are passed to the beneficiary and will be taxed at the beneficiary's ordinary income tax rate. Compare this to stocks, bonds or mutual funds in which the step-up in cost-basis for these instruments can allow any gains to pass onto heirs without passing the tax burden for those gains along with them.

Obviously every situation is unique, so this should not be construed as tax advice. Anyone in this situation should consult a tax professional regarding their personal situation and how the secondary market for annuities can help them with their estate planning.

The ability to sell an annuity for a lump-sum cash value may be met with such relief that the immediate reaction is to cash out. However, like any other investment, equal care must be taken when selling, as well as buying, an annuity.

### **About J.G. Wentworth**

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