

# Annuity Exit Strategies

Thanks to a nascent secondary market, it is becoming easier to cash out your policy. **BY TODDI GUTNER**



**T**URNING YOUR STOCKS, bonds, or mutual funds into cash is easy. But what about an annuity? If the annuity is deferred, you might have to pay steep surrender fees to cash out. In the past, if it had already started making payments, you were stuck with it. Not anymore. A nascent secondary market for annuities is emerging, giving investors the opportunity to sell what was once unsalable or cash in their policies for more than the insurer would give them. These transactions may appeal to you if you no longer need the income from the policy or would rather get a lump sum for another use. “We estimate that up to 10% of annuity holders would sell their policies if they could,” says Michael Vaughan, a managing director of J.G. Wentworth, one of a handful of firms that buy annuities from individuals. In fact, an American Council of Life Insurers (ACLI) survey of 460 annuity holders reports

that 27% are concerned that they may be unable to sell their annuity if they want the money for something else.

Wentworth, along with Peachtree Settlement Funding, Settlement Capital, and Stone Street Capital, are branching out from their traditional business of purchasing structured settlements. Such deals allow those individuals who have received annuity-like payouts in court cases to get a lump sum.

The firms package the purchased annuities into asset-backed securities and sell them to institutional investors. It sounds straightforward, but “it’s a complicated, unregulated new field, and there are so many variables which make the calculations extremely complex and not

transparent to the consumer,” says David Woods, chief executive officer of the National Association of Insurance & Financial Advisors. He suggests that if you’re considering this option, “find an insurance expert or actuary to run the numbers to see if you’re getting a good deal.”

Linda Lanam, the vice-president of annuities and market regulation for the ACLI, recommends that you first approach the insurer that sold you the annuity. “There may be more flexible options in your policy than you originally thought,” she says.

Even with this new market, not every policy can be turned into cash. Those tucked away in tax-qualified retirement accounts are ineligible because the Internal Revenue Service won’t allow ownership to be transferred. Also off-limits are so-called life-only immediate annuities, in which the payout is not guaranteed.

In an annuity sale, the price you fetch will be based on the total dollar amount to be distributed, the time period over which the payout will be made, and the current level of interest rates. Other considerations include the insurance company’s financial strength rating and particular

## Unlocking an Annuity

Holders of annuities can sell all or part of a guaranteed income stream for a lump sum in a new secondary market

<b>THE INSURED</b>	John, 66
<b>ANNUITY AMOUNT</b>	\$1.58 million
<b>MONTHLY PAYMENT</b>	\$7,865 for his life or 20 years guaranteed to his heirs
<b>AMOUNT SOLD</b>	\$4,000 a month for 16 years (he retains \$3,865 a month)
<b>USE OF PROCEEDS</b>	Bought a life insurance policy with a \$1.66 million death benefit that passes to his heirs tax-free

Data: J.W. Wentworth



## Annuities now can be bought and resold as asset-backed securities



terms and conditions such as whether the policy has a death benefit.

Take John, a 66-year-old who owns a single premium annuity that is guaranteed to pay for at least 20 years (table, page 110). If he dies before then, the remaining payouts go to his heirs, and they would be taxed on the built-up interest in the annuity at their current income tax rate. (The value of those payments is also included in the estate tax calculation.) John bought the policy for \$1.58 million in December, 2001, and began getting monthly payments of \$7,865 immediately. Four years later, John decided that he didn't need all of the income and wanted to recapture some of the principal.

With the help of his financial adviser, John sold \$4,000 of his monthly payments for the next 194 months, for a total of \$776,000. Since that's to be paid out over 16 years, the annuity buyers applied a discount rate of 7.76% to the total, so John ended up with a \$448,910 lump sum. (The

discount rate is a key number. Be sure to ask the buyer what it is.)

Using the proceeds, John bought a life insurance policy with a \$1.66 million death benefit, which would pass to his beneficiaries tax-free and not be included in his estate. "He turned taxable money into tax-free money and was able to get funds that were otherwise locked up," says Michael Giffin, a financial planner in McMurray, Pa., who has sold many annuities for clients. For a fee of \$150, Giffin will analyze bids for clients (ensphere-group.com).

In the case of a deferred annuity, a 67-year-old woman had originally invested \$75,000 in late 2000, and it's now worth \$106,433. But she couldn't

get that amount as a lump sum; she could only take it out in payment over a minimum of five years. Surrendering the policy to the insurer would have netted her just under \$80,000.

By selling to Wentworth, she was able to get \$94,346—before taxes.

Another scenario involves an inherited annuity. Earl, 48, inherited an immediate annuity after his father died. Earl's father had bought the policy, which paid out \$262 monthly, to provide retirement income for himself and his wife. When he died, there were still 10 years of monthly

payments left, but Earl wanted to put the money toward his children's college fund. So he sold the remaining 120 months for a lump sum of \$20,450. The annuity buyers applied a discount rate of 9.6% since the total of \$31,440 is to be paid out over 10 years.

Are you interested in selling an annuity? Solicit several bids (table), crunch the numbers, and get the help of a good financial adviser. ■

### Who the Buyers Are

**J.G. WENTWORTH**  
jgwfunding.com

**PEACHTREE SETTLEMENT**  
settlementfund.com

**SETTLEMENT CAPITAL**  
setcap.com

**STONE STREET CAPITAL**  
stonestreet.com

Data: BusinessWeek

CHRIS SHARP