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Annuity Surrender Charges

House Bill 2467

Background: An individual deferred annuity is an insurance contract typically used in retirement planning. Consumers make premium payments into the annuity and its value accumulates, usually on a tax-deferred basis. The insurance company agrees to pay out money to the policy holder or beneficiary later in a series of payments. Most annuities use surrender (withdrawal) charges to discourage people from early withdrawal.

Insurance companies can calculate surrender charges on payments made within the past 10 years by one of two methods:

- First-in, first-out (FIFO) – calculating whether surrender charges are due based on the original date the contract was issued.
- Last-in, first-out (LIFO) – calculation based on the most recent premium payment.

The surrender charges can end up being significantly higher when applying the LIFO method. For example, a person who paid annual premiums for 20 years who then makes a withdrawal equal to five years' annuity value would have no surrender charges under the FIFO method, because the withdrawals would count against the payments made more than 10 years ago. But with the LIFO calculation, the person could be subjected to a surrender charge calculated on the five most recent years of premium payment. LIFO-calculated surrender charges may also penalize beneficiaries if a death occurs years after the annuity is purchased.

Concept: HB 2467 grants the Department of Consumer and Business Services (DCBS) authority to establish rules to regulate the use of surrender charges, such as requiring that insurance companies use only the FIFO method of calculating surrender charges in individual deferred annuities.

As an alternative to filing products directly with DCBS, life insurance carriers may file annuities to be sold in Oregon with the Interstate Insurance Product Regulation Commission (IIPRC) for approval. The IIPRC standards require carriers to calculate surrender charges using the FIFO method. DCBS anticipates that in order to protect Oregonians who buy individual deferred annuities, rules adopted pursuant to HB 2467 would make Oregon requirements consistent with those of the IIPRC.

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