Annuities: Beware of Unsuitable Investments for Seniors

From the Office of Minnesota Attorney General Keith Ellison

The senior citizen population is large, growing, and by some estimates, hold two-thirds of the individual wealth in the United States. By the year 2030, the number of seniors is projected to be twice as large as it was in 2000. Since many seniors have been able to save up a nest egg for their retirement years, they are often targeted with fraud in a way that younger people with no savings are not.

With billions of dollars in sales to be made, insurance companies may offer commissions as high as 10 percent to agents to sell products like long-term deferred annuities to senior citizens. In this environment, consumers should arm themselves with information to protect their interests. The Attorney General provides the following tips to consider before purchasing an annuity:

What kind of annuity is it? Annuities are complicated investments. Some bear complex qualities of both insurance and securities products. Annuities can be structured as variable annuities, fixed annuities, immediate annuities, deferred annuities, etc. Before investing, investors should determine which, if any, of these products suit their future plans and financial needs. Review the terms, ask detailed questions, talk to friends and family, talk to multiple advisors, and shop around before agreeing to invest.

Fixed annuities vs. variable annuities. While fixed annuities typically guarantee a minimum rate of interest and minimum periodic payments, variable annuities fluctuate with the market and may be made up of a variety of investments, such as stocks, bonds, and mutual funds. Specific investments of a variable annuity are defined by the prospectus. Consumers should read and understand the prospectus, and the volatility of each investment listed in the prospectus. Investors should ask their broker to explain all terms and conditions in the prospectus, and ask questions about anything they do not understand. Fixed annuity products may also carry risks, such as long-term deferral periods, barring investors from accessing all of their money.

Immediate annuities vs. deferred annuities. While immediate annuities may begin payments to the investor within the first year, deferred annuities may lock up an investor's money for years before they can receive payments. Investors who need to access their money before the end of the deferral period typically pay hefty surrender penalties, even if the money is needed for emergency medical treatment or changes in living arrangements. A surrender penalty means that if the person needs access to their money during the surrender period, they lose part of their principal. Surrender penalties may be as much as 25 percent of the principal. The Attorney General has filed lawsuits against insurance companies that sold unsuitable deferred annuities with over 15 year deferral periods to investors not expected to live that long, or who need access to their money for health care or assisted living expenses. Investors should make sure they know the long-term consequences of any annuity purchase.

Equity-indexed Annuities. One type of deferred annuity is an "equity-indexed annuity." The returns of equity-indexed annuities fluctuate based in part on the stock market. In an equity-indexed annuity, the rate of return is based on a stock market index such as the Standard & Poor's 500 Index. This rate typically is capped at a certain percentage return.

Beware high-pressure sales tactics and seminars. Some unscrupulous sellers use high-pressure sales pitches, seminars, and telemarketing. Beware of agents who "cold call" you, contact you repeatedly, offer "limited time offers," show up without an appointment, or won't meet with you if your family is present. Beware of estate planning "seminars" that are actually designed to sell annuities.

Beware of seminars that offer free meals or gifts. In the end, they are rarely free. Beware of agents who give themselves fake titles to enhance their credibility.

Beware of high surrender charges. The most significant fee associated with annuities is often the surrender charge. This is the percentage that a consumer is charged if he or she withdraws funds early. For instance, one of the insurance companies that the Attorney General's Office sued charged a retired farmer on a fixed income $6,800 in surrender penalties when he needed access to his $24,000 (most of his net worth) placed in annuities. Another Minnesota woman was sold an annuity with surrender charges lasting for 16 years, or until she was 95 years old, with the surrender penalty being 17 percent of her investment.

Annuities may not protect your investment. Sellers may aggressively market annuities as a way to defer taxes in a "safe" investment. This may not be the case! According to the SEC, investors purchasing an annuity connected with a 401(k) plan or IRA receive no tax advantage. The SEC notes that those who withdraw funds from a variable annuity before the age of 59 1/2 may be charged a 10 percent federal tax. Consumers may wish to consult a tax consultant before investing in an annuity. Furthermore, the "safety" of the investment depends on the annuity. Beware of agents who aggressively market annuities as being as safe as or better than CDs.

Beware of agents urging you to switch annuities. The SEC warns consumers that some sellers of annuities products urge customers to switch to another annuity, a practice called "churning." Unfortunately, agents may not adequately disclose fees associated with switching investments, such as new surrender fees (which typically start over from the date the product is switched), or significantly altered benefits. Consumers should scrutinize the investment to find out whether the benefits outweigh the costs of switching their investment.

Be on guard against "bonuses." Agents and insurance companies may offer bonuses to entice investors, such as additional interest points on their return. The benefits of such "bonuses" are often outweighed by increased fees and administrative costs to the investor. "Bonuses" may be simply marketing gimmicks.

Don't make investments you can't afford. Some unscrupulous agents encourage consumers to make unrealistic investments they can't afford, or buy a long-term deferred annuity, even though they will need access to their money for health care or living expenses. Don't be lured into risky investments by fast talking agents and insurance companies.

Deal with reputable financial agents. Consumers may wish to ask friends and family for advice on finding a reputable agent. Investors should be on guard against telemarketers who "cold-call" consumers with "investment tips."

The SEC, Financial Industry Regulatory Authority (FINRA) and Minnesota Department of Commerce have some authority to regulate parties that sell annuities, and can be contacted as follows:

Securities and Exchange Commission
Office of Investor Education and Advocacy
100 F Street, NE
Washington, D.C. 20549-0213
(800) SEC-0330
(800) 738-0330
www.sec.gov

Financial Industry Regulatory Authority
1735 K Street
Washington, D.C. 20006
(301) 590-6500
www.finra.org

Minnesota Department of Commerce
85 East Seventh Place, Suite 280
St. Paul, MN 55101
(651) 539-1500
www.mn.gov/commerce

Or contact the Attorney General's Office at:

Office of Minnesota Attorney General
Keith Ellison
445 Minnesota Street, Suite 1400
St. Paul, MN 55101
(651) 296-3353 (Twin Cities Calling Area)
(800) 657-3787 (Outside the Twin Cities)
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