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# **CONSUMER ALERT**

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ATTORNEY GENERAL**

The Attorney General provides Consumer Alerts to inform the public of unfair, misleading, or deceptive business practices, and to provide information and guidance on other issues of concern. Consumer alerts are not legal advice, legal authority, or a binding legal opinion from the Department of Attorney General.

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## **ANNUITIES – ARE THEY THE RIGHT INVESTMENT FOR ME?**

**2009 UPDATE**

Today's financial marketplace offers a broad array of investment products. Choosing the most suitable product - in light of your age, other investments, and current economic situation - is not an easy decision. Adding to this difficulty is the money to be made, in the form of commissions and other compensation, by those selling investment products. Unfortunately, sometimes this financial incentive may outweigh concerns about whether the product being sold is appropriate for your situation. At worst, this financial incentive can lead to less-than-full disclosure or outright misrepresentations about the terms and conditions applicable to the product being sold. Even if there has been full disclosure, failing to completely understand an investment product before purchasing it can result in you paying unnecessary taxes, early withdrawal penalties, administrative fees, and other expenses that could have been avoided.

One investment product of special concern, particularly for senior citizens and those approaching the age of retirement, is the annuity. Generally, annuities are sold by insurance companies and constitute an agreement where you make a lump-sum payment or series of payments in return for the insurer's agreement to make periodic payments to you beginning either immediately or at some future date. These periodic payments may last for a definite period (for example, 20 years) or an indefinite period, such as your lifetime or the lifetime of you and your spouse.

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## **FIXED AND VARIABLE ANNUITIES**

Annuities come in two basic forms - **fixed** and **variable**. A **fixed annuity** guarantees payment by the insurance company of a minimum rate of interest and periodic payments in a definite amount per dollar invested in your annuity account. In contrast, a **variable annuity** allows you to allocate your purchase payments among a range of different investment options or "subaccounts" within the annuity, usually mutual funds. With a variable annuity, the rate of return on the amounts you invest and the amount of the periodic payments that you receive will vary depending upon the performance of your investment selections within the annuity. There is, therefore, no guarantee that the money you invest in a variable annuity will earn any return, and there is a risk that your investment will decline in value.

## **EQUITY INDEXED ANNUITIES**

An equity-indexed annuity is a special type of contract between you and an insurance company. During the accumulation period – the period when the annuity is generating a return on your investment – the insurance company credits you with a return that is based on changes in an equity index, such as the S&P 500 Composite Stock Price Index. Thus, if the index does well, the annuity will generate higher returns. If the index does poorly, the annuity will generate lower returns. But, the insurance company typically guarantees a minimum return. Guaranteed minimum return rates vary. After the accumulation period, the insurance company will make periodic payments to you under the terms of your contract, unless you choose to receive your contract value in a lump sum. For more information about equity-indexed annuities, see information provided by the U.S. Security and Exchange Commission (SEC) at <http://www.sec.gov/investor/pubs/equityidxannuity.htm>.

## **"FREE LOOK" PERIOD**

Michigan law requires most annuity contracts delivered or issued for delivery in this State to provide a "free look" period of at least ten days during which you may cancel the contract without paying any surrender charges and receive a refund of any premium paid for the contract, including any policy fee or other charges. The "free look" period begins from the date that you, the purchaser, receive the annuity contract. If you sign a document indicating that you have received the annuity contract, make sure that you have the contract in hand - otherwise, your "free look" period may be running even though you do not have a copy of the contract to review.

Throughout the "free look" period, you may continue to ask questions to ensure that you understand the annuity contract and to ensure that the investment is right for you. If you decide that you want to cancel the annuity contract during the "free look" period, you

must surrender the contract to the insurance company by mailing or delivering it to the company's home or branch office or to the agent who sold you the annuity. In addition to surrendering the contract itself, you must provide the insurance company with a written request to cancel your annuity contract.

## **ADVANTAGES AND DISADVANTAGES**

Under certain circumstances, an annuity can be an appropriate product for your investment portfolio - it offers tax-deferred growth of earnings and provides a regular income stream once the periodic payments begin. Annuities also typically provide for the payment of a death benefit that will pay your beneficiary a guaranteed minimum amount upon your death.

However, there are restrictive features of annuities that may render them ill-suited to your investment needs, especially if you are a senior citizen or nearing retirement age. In particular, the periodic payments to be made under an annuity may be delayed until a date far off in the future. This type of delayed-payment annuity is called a **deferred annuity**, as contrasted with an **immediate annuity** where the periodic payments begin immediately.

Additionally, annuities carry several charges and fees that reduce the value of your investment and should be fully understood before you decide to purchase. Among these charges and fees are **surrender charges** that apply if you withdraw the money invested in the annuity within a certain time period after it is purchased. These surrender charges operate as "early withdrawal" penalties and may be significant - as much as 25% on withdrawals made within the specified period. Withdrawals from an annuity before you reach the age of 59½ are also generally subject to a 10% tax penalty, in addition to any gain on your investment being taxed as ordinary income (as opposed to a capital gain). The period during which these surrender charges apply, or **surrender period**, may also be long in duration - up to 20 years after you purchase the annuity.

Features such as these make annuities a long-term investment option that typically cannot be used for immediate financial needs without substantial penalties. For this reason, annuities often are not appropriate investment products for senior citizens, who will not realize any benefits from their investment for many years. In addition, if you are funding the purchase of an annuity by liquidating other assets such as stocks or certificates of deposit, you may incur tax, early-withdrawal, and other penalties in connection with this liquidation process. These "liquidation costs" should be carefully considered as part of the equation when deciding to purchase an annuity. Finally, the tax-deferred earnings offered by annuities may not be necessary for senior citizens who have limited incomes and pay little or no taxes.

## **SUITABILITY REQUIREMENT**

Michigan law requires that, prior to selling an annuity, the salesperson must have reasonable grounds for believing that it is a suitable investment for the client. In order to make this determination, the salesperson should inquire about several aspects of your finances and investment objectives. At a minimum, the salesperson should ask for details about your assets and liabilities, your tax status and your investment objectives. Using the information, the salesperson is required to make a determination as to whether an annuity is a suitable investment for you.

Remember, annuity salespeople are required by Michigan law to make a determination about the suitability of annuities before they recommend them. A salesperson who recommends an annuity without first discussing your individual financial situation is violating this obligation. Any legitimate salesperson should be able to explain why they believe that an annuity is an appropriate fit for you, and how it fits with your current finances and your investment goals. You should not purchase an annuity from a salesperson who doesn't analyze your individual situation or who cannot explain why an annuity is right in light of your finances and goals. Such tactics should be immediately reported to the Office of Financial and Insurance Regulation for appropriate action.

## **SENIOR CITIZENS GET THE HARD SELL**

Despite the legal requirement that salespeople only recommend annuities after determining they are suitable for individual clients, stories about unscrupulous sales of annuity products to elderly and otherwise unsuitable customers are abundant. Sellers of these products often use hard-sell techniques and scare tactics to convince unwitting senior citizens to buy annuities that will lock up their retirement savings for 20 years or more. To make matters worse, the commissions paid by insurance companies for the sale of annuities are generally higher than those paid for other investment products, providing annuity salespersons with a strong personal financial incentive to sell their products, irrespective of whether they represent a sound investment choice for their customers' needs.

## **PRECAUTIONS TO TAKE BEFORE PURCHASING AN ANNUITY**

Whenever you are approached to invest your money in an annuity product, be sure to observe the following precautions:

- Consult with an independent financial advisor and/or attorney before purchasing an annuity or similar investment product.
- Remember that the person selling you an annuity will personally profit from your purchase of the annuity and may not have your financial best

interests in mind. Any estate planning attorneys or other individuals working with the annuity salesperson may also have a financial interest in selling you an annuity product. Ask the annuity salesperson and anyone else he or she is working with whether they will be paid a commission or other compensation for selling you the annuity and, if so, how much they will be paid.

- Remember that the person selling the annuity is required to determine that it is a suitable investment for you. In order to make this determination, the salesperson should inquire about your financial situation and investment objectives. Do not purchase an annuity from a salesperson who does not analyze your individual circumstances, or who cannot explain why an annuity is a suitable investment for you, in light of your circumstances and objectives.
- Bear in mind that annuities are long-term investments that will generally tie up the amounts you invest for a significant period of time. If an emergency occurs and you need to withdraw money from the annuity early, the amount withdrawn may be subject to large surrender charges and tax penalties. Ask the person selling you the annuity about the time period during which these “early withdrawal” penalties apply, as well as how much they will cost you.
- If you are considering purchasing a variable annuity, ask about the risks that your investment could decrease in value.
- Ask about any other fees and expenses that will be charged by the annuity you are considering purchasing, including **mortality and expense risk charges, administrative fees, underlying fund expenses, and “special feature” charges** for benefits such as stepped-up death benefits, bonus credits, guaranteed minimum income benefits, and long-term care insurance.
- If you are funding the purchase of an annuity by liquidating other assets such as stocks or certificates of deposit, carefully consider the tax, early-withdrawal, and other penalties that you will incur when liquidating those assets.

## **ADDITIONAL INFORMATION ABOUT VARIABLE ANNUITIES**

Because of the investment risk associated with variable annuities, they are classified as securities and are regulated by the SEC. Certain equity-indexed annuities are also securities regulated by the SEC, while fixed annuities are not securities regulated by the SEC. You can learn more about variable annuities in the SEC's publication, "Variable Annuities: What You Should Know," available at [www.sec.gov/investor/pubs/varannty.htm](http://www.sec.gov/investor/pubs/varannty.htm), or by calling the SEC toll-free at 1-800-SEC-0330 (1-800-732-0330). Additional investor information is available at the SEC's homepage: [www.sec.gov](http://www.sec.gov).

In addition, the Financial Industry Regulatory Authority (FINRA), an independent self-regulatory organization charged with regulating the securities industry including sellers of variable annuities, maintains a Web site containing alerts and other information about variable annuities. The FINRA Web site is: [www.finra.org](http://www.finra.org).

## **COMPLAINTS**

### **Michigan's Office of Financial and Insurance Regulation**

Insurance companies and agents doing business in Michigan must be licensed with the Michigan Office of Financial and Insurance Regulation (OFIR). To find out if an insurance company or agent is licensed in Michigan, you may contact OFIR by telephone at 1-877-999-6442, or you may obtain this information from the OFIR Web site at <http://www.michigan.gov/cis/0,1607,7-154-10555---,00.html>. Any complaints regarding the sale of an annuity product by an insurance company, insurance agent, or any other business or individual should be sent in writing to OFIR at the following address:

Michigan Office of Financial and Insurance Regulation  
Consumer Services Division  
P.O. Box 30220  
Lansing, Michigan 48909-7720

A copy of OFIR's Insurance Complaint form is also available online at:

[http://www.michigan.gov/documents/cis\\_ofis\\_comp\\_all\\_25074\\_7.pdf](http://www.michigan.gov/documents/cis_ofis_comp_all_25074_7.pdf).

### **U.S. Securities & Exchange Commission**

You can also contact the SEC with complaints about variable annuities and equity-indexed annuities. There are several ways to file a complaint with the SEC:

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- Complaints – Use one of the SEC's online forms to file your complaint electronically (forms available at: [www.sec.gov/complaint/selectconduct.shtml](http://www.sec.gov/complaint/selectconduct.shtml)).
- Tips – Report a potential violation of the securities laws directly to [enforcement@sec.gov](mailto:enforcement@sec.gov). Please do not use this e-mail box for general comments or questions.
- Spam – Forward investment-related spam e-mails to [enforcement@sec.gov](mailto:enforcement@sec.gov).

If you do not want to communicate electronically, either print and fill out a form (again available at: [www.sec.gov/complaint/selectconduct.shtml](http://www.sec.gov/complaint/selectconduct.shtml)) or write a letter, then send or fax the form or letter to:

SEC Complaint Center  
100 F Street, N.E.  
Washington, D.C. 20549-0213  
Facsimile: 202-772-9295

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