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South Dakota Division of Insurance
Consumer Alert

Annities and Senior Citizens

Senior Citizens Should Be Aware Of Deceptive Sales Practices When Purchasing Annuities

Annuity sales to senior citizens have significantly increased in recent years. However, as annuity sales have risen, so has a sense of confusion among consumers. This is due, in part, to questionable or deceptive sales practices employed by companies and agents looking to take advantage of uninformed consumers. It is extremely important, when considering whether or not to buy an annuity, to take the necessary precautions in order to make an informed decision that is best for you.

What is an Annuity?

An annuity is a contract in which an insurance company makes a series of income payments at regular intervals in return for a premium or premiums you have paid. Annuities are most often bought for future retirement income, and can pay an income that can be guaranteed to last as long as you live.

What are the Different Kinds of Annuities?

There are several types of annuities, all of which carry varying levels of risk and guarantees. To get the most out of an annuity, it is imperative that you know the different options available to you, as well as the benefits each type provides.

- **Single Premium Annuity**: An annuity in which you pay the insurance company only one premium payment.
- **Multiple Premium Annuity**: An annuity in which you pay the insurance company multiple premium payments.
- **Immediate Annuity**: An annuity in which you begin to receive income payments no later than one year after you pay the premium.
- **Deferred Annuity**: An annuity in which you

Understand the Product You are Buying

When it comes to annuities, inappropriate sales practices can occur in many ways and come from a variety of sources. Anyone can be a victim, but senior citizens remain a prime target. Here are a few ways to protect yourself:

- Always review the contract before you decide to buy an annuity. Terms and conditions of each annuity contract will vary.
- You should understand the long-term nature of your purchase. Be sure you plan to keep an annuity long enough so the charges don't take too much of the money you invest.
- Compare information for similar contracts from several companies. Comparing products may help you make a better decision.
- Ask your agent and/or the company for an explanation of anything you don't understand. If you question what you are being told, ask that it be put in writing.
- Remember that the quality of service you can expect from the company and the agent should be an important factor in your decision.
- Verify that the company and agent are licensed. In order to sell insurance in your state, companies and agents must be licensed. To confirm the credibility of a company or

begin to receive income payments many years later.

- **Fixed Annuity**: An annuity in which your money, less any applicable charges, earns interest at rates set by the insurance company or in a way specified in the annuity contract.

- **Variable Annuity**: An annuity in which the insurance company invests your money, less any applicable charges, into a separate account based upon the risk you want to take. The money can be invested in stocks, bonds or other investments. If the fund does not do well, you may lose some or all of your investment.

- **Equity-Indexed Annuity**: A variation of a fixed annuity in which the interest rate is based on an outside index, such as a stock market index. The annuity pays a base return, but it may be higher if the index increases.

Is an Annuity Right for You?

To find out if an annuity is right for you, think about what your financial goals are for the future. Analyze the amount of money you are willing to invest in an annuity, as well as how much of a monetary risk you are willing to take. You shouldn't buy an annuity to reach short-term financial goals. When determining whether an annuity would benefit you, ask yourself the following questions:

- How much retirement income will I need in addition to what I will get from Social Security and my pension plan?

- Will I need supplementary income for others in addition to myself?

- How long do I plan on leaving money in the annuity?

- When do I plan on needing income payments?

- Will the annuity allow me to gain access to the money when I need it?

- Do I want a fixed annuity with a guaranteed interest rate and little or no risk of losing the principal?

agent, contact your state insurance department.

- Check the company's credit rating. Legitimate insurers have their "creditworthiness" rated by independent agencies such as Standard & Poor's, A.M. Best Co. or Moody's Investors Services. An "A+++" or "AAA" rating is a sign of a company's strong financial stability. You can check a company's rating online or at your local library.

- The proof is in the paperwork. As you complete your research and decide to purchase a particular policy, it's important to keep detailed records. Get all rate quotes and key information in writing. Once you've made a purchase, keep a copy of all paperwork you complete and sign, as well as any correspondence, special offers and payment receipts.

Avoid Being Fooled by Deceptive Sales Practices

Watch for the following red flags, which serve as warnings of possible deceptive sales practices:

- *High-pressure sales pitch*. If a particular group or agent has contacted you repeatedly, offering a "limited-time" deal that makes you uncomfortable or aggravated, trust your instincts and steer clear.

- *Quick-change tactics.* Skilled scam artists will try to prey on your "time fears." They may try to convince you to change coverage quickly without giving you the opportunity to do adequate research.

- *Unwilling or unable to prove credibility.* A licensed agent will be more than willing to show adequate credentials.

- Remember, if it seems too good to be true, it probably is!

- Never make your annuity payment out to the agent; always make your check payable to the insurance company

- If you suspect you've been a victim of deceptive sales practices, or you have a specific question and can't get the answers you need from an agent or the insurance company, contact the South Dakota Division of Insurance by phone at (605) 773-3563, by mail at 445 E. Capitol Pierre, SD 57501 or online at their website www.state.sd.us/insurance

Never Put All of your Eggs in One Basket

Regardless of the type of financial investment it is rarely a good idea to put all of your money into one investment or in one type of investment. This is every bit as true with annuities. Do not cash in all of your investments and dump them into an annuity.

Look Out for Extra Charges and Penalties

- Do I want a variable annuity with the potential for higher earnings that aren't guaranteed and the possibility that I may risk losing principal?
- Or, am I somewhere in between and willing to take some risks with an equity-indexed annuity?

Be Aware of Teaser Rates

Some annuities offer very attractive first year rates of return. If the rate of return being advertised in only guaranteed for the first year, the rate of return in the second and subsequent years may be substantially lower and leave you with an overall interest rate that is less competitive.

Annuity/Long Term Care Options

Annuities can be purchased as a means of financing a person's long term care needs. A person having this type of product will be able to withdraw a certain percentage of their annuity each month to fund their long term care costs such as costs of residing in a nursing home. The long term care received typically must meet certain qualifications in order to use the annuity to fund the care. Of course, any annuity funds used for long term care will reduce the value of the annuity accordingly.

Annuity Tax Issues

While earnings in an annuity accrue on a tax-deferred basis, they do not provide all the tax advantages of a 401(k) and other before-tax retirement plans. Most investors should consider an annuity only after they make their maximum contributions to their 401(k) plan. Income from annuities are taxed as ordinary income rather than lower capital gains rates applied to investments in stocks, bonds, and mutual funds. Annuities also do not receive a "step-up" in cost basis when the owner dies. Stocks and bonds do receive a stepped up basis upon the owner's death.

Annuities like other investments can charge annual fees which effectively reduce your rate of return. Most annuities have surrender charges that apply if you withdraw more than 10% of your annuity value. These surrender charges can be very high; some surrender charges or penalties are in the range of 20% for the first few years that you have the annuity. There can also be Mortality and expense risk charges, administrative fees, underlying fund expenses and charges for special features such as stepped-up death benefits and guaranteed minimum income benefits.

Equity Index Annuities, A Complicated Product

Equity indexed annuities operate to tie your rate of return to a certain market index. However, do not expect to automatically have the gains in the index reflected in your annuity account. The inner workings of how much interest is credited to your annuity account is an extremely technical calculation normally understood only by sophisticated investors and can be capped by the terms of the annuity contract.

Variable Annuities Can be Risky Investments

If you are looking to buy an annuity as a safe dependable source of income, then a variable annuity is not for you. As is the case with any investment, you not only may not get the expected rate of return, your principal is at risk as well.

Look Out For Annuities That Require You to Annuitize

Some annuities have features that do not allow you just to keep your annuity as a long term investment and draw your money out in later years as needed. Those annuities that require you to annuitize, will mean that you will only get the monthly annuity payments in the amount specified by the contract. What is meant by annuitizing your contract is to begin the monthly annuity payments.