

FACTS ABOUT ANNUITIES

How Can I Protect Against Fraud When Buying a Fixed Annuity?



Fixed annuities are financial products designed to provide consumers with a reliable way to accumulate and use their retirement savings on a tax-deferred basis with guarantees to help protect them against various risks. Every day, fixed annuities offered by financially solid insurance companies are sold by reputable insurance agents, investment advisors and securities brokers to consumers who will benefit from their annuity purchases.

Yet from the Bernie Madoff scandal, it is clear that not everyone can be trusted and those who are not trustworthy are capable of duping and victimizing well-meaning and intelligent people. It is fairly easy for consumers to take a few simple steps to protect themselves from being scammed and ensure the annuity they purchase is suitable for their financial needs using the following tips.

How Fixed Annuities Work

A fixed annuity is a contract with an insurance company that a consumer purchases with a sum of money. The insurance company credits interest to the contract value and provides options for the owner to receive cash from the contract. A particular strength of annuities is that they can provide a way for consumers to receive payments that can be guaranteed to last as long as they live.

Annuities differ in four key ways:

1. How many premiums paid – The money a consumer uses to purchase a contract is called the “premium,” and annuities can be purchased with a single premium or a series of ongoing premiums.
2. When the company makes payments – Payments from the annuity can start immediately or be deferred to some future chosen date.
3. How the money in the annuity earns additional interest – By declaring a rate in advance or by crediting interest to a policy based on the positive performance of a market-based index, such as the Standard & Poor’s 500 index or the Dow Jones Industrial Average, an annuity can earn additional interest.
4. Penalties associated with early withdrawals – Although consumers can earn interest in an annuity, it is not a savings account. If purchasing an annuity, it should be to reach long-term financial goals. All



annuities have surrender charges (also known as withdrawal charges). These charges are meant to discourage the owner from terminating the contract early and from taking out more money (withdrawals) than the contract allows.

The length of time that an annuity owner will be subject to a surrender charge for withdrawals and the amount of the surrender charge varies depending on the annuity purchased. Most annuities offer an option to access some portion of the annuity's value without paying a surrender charge. However, if one withdraws more than the penalty-free amount during the surrender charge period, he or she will most likely pay a surrender charge.

How Fixed Annuities Are Purchased

With fixed annuities, customers make checks payable to insurance companies and receive periodic account statements from insurance companies. The agent or advisor who is proposing the annuity purchase is facilitating a transaction between the customer and the insurance company. Thanks to the availability of information on the internet, it is easy to check on the existence, location, regulatory license and financial strength of the insurance company being discussed by the agent who is proposing the annuity purchase.

Fixed annuities are sold by individuals who must be licensed as insurance agents. As part of their business, they may also be registered investment advisors or registered representatives in a securities firm. For ease of discussion, we will simply refer to annuity salespeople as agents. Agents are typically paid commissions by the issuing insurance company for the annuity sales they make, thus agents do not charge the customer fees for the service they provide. Agents are compensated by the insurance company.

This compensation (also called commission) is a part of the company's overall expenses. These expenses are built into the annuity's benefits and limitations, similar to many other services and products consumers routinely purchase. The full premium paid is applied to the policy.

Tips Before You Purchase

When meeting with an agent or attending an educational seminar given by an agent, consumers should be on the lookout for a few warning signals. For example, there should be no sense of urgency around an annuity purchase. It is relatively unusual for there to be offers or specials with limited time availability in the annuity business. Also, agents should not disparage insurers, regulators, or other agents, as the vast majority of people and entities that operate in the annuity business are reputable.

The annuity business is regulated by state governments, and each state of residence has a Department of Insurance. Information can easily be found on a state's Department website via a search engine or at www.naic.org, the website of the National Association of Insurance Commissioners. An agent must be licensed as an insurance agent, and on most state insurance department websites, the licensing information is easily verified. If information cannot be accessed online, consumers can call the state insurance department to verify an agent's license. Additionally, every agent must be appointed by the insurance company whose product is recommended. NAFA suggests calling the insurance company to ensure an agent is appropriately licensed and appointed by them.



If an agent also represents that he is a registered investment advisor or a registered representative of a securities firm, check his regulatory record by going to the FINRA BrokerCheck website at <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/>.

Also, consumers shouldn't be afraid to bring a trusted friend or family member when meeting with an agent. A friend or family member can often help spot issues or concerns that the consumer may not have considered and minimize any feeling of being pressured into purchase.

Tips When You Purchase

Before buying an annuity, consumers should check to make sure that the insurance company from which they are purchasing actually exists. It is possible to verify that an insurance company is licensed in a given state from the respective state insurance department website, and consumers can visit the insurance company's own website online. Consumers will want to verify that the company's address matches the information on any forms they must sign.

At the time of purchase, any check written or authorization signed should be made out to the issuing insurance company and not to the agent or agency. The purchaser should keep a copy of any forms and paperwork completed and/or signed. For an extra level of protection, the purchaser can choose to mail the check and application paperwork himself to the issuing insurance company.

When considering an insurance company, potential buyers may want to review its financial strength, which can be done in a couple of ways. Many insurance companies receive a financial strength rating from a ratings company such as A.M. Best, Standard & Poor's, Moody's or Fitch. For example, the insurance companies' financial strength ratings are available at www.ambest.com. Also, many insurance companies have their stock publicly traded, and if so, information on the company will be available on any major financial website, such as <http://finance.yahoo.com/>.

Consumers will want to ensure that any annuity product they are considering is suitable for their unique financial situation. This includes understanding how the annuity works and feeling confident that it meets their needs. Because annuities are intended for long-term financial needs, most annuities have significant penalties for early withdrawals, and these penalties can last for a different number of years depending on the policy and issuing company. While most products allow for some access to the money early without penalty, an owner should make sure that other savings are accessible in case a significant financial hardship occurs. It is not advisable for any individual to have all of his money in an annuity. Consider also that while annuities have the advantage of tax deferral, they also have a penalty tax associated with any withdrawals that occur before age 59½. Thus, it's important for a potential buyer to be extremely unlikely to need to withdraw any money put in annuities before that age.

If a concern arises regarding any of the matters mentioned above, one should simply stop the purchase transaction. Remember what we mentioned earlier about having no sense of urgency.

Shortly after an annuity purchase, the customer will receive an annuity contract from the issuing insurance company. In most cases, this will be delivered by the agent. If the contract is not received in a timely manner, he or she shouldn't hesitate to call the insurance company and ask about it. Upon receipt



of the contract, the annuity buyer has a period of at least ten days (and possibly longer) known as the “free look period” to examine the contract and, if dissatisfied, notify the agent and the issuing insurance company for a full refund.

How to Report a Suspected Scam

As we have mentioned, annuity sales are regulated by state insurance departments. The major goal of state insurance departments is to protect the public by ensuring that insurance companies remain solvent, that they deliver on their contractual guarantees, and that the sales process they use has integrity.

Regardless of whether or not the insurance company is actually located in one’s home state, the state’s insurance department has jurisdiction over the carrier’s activities in that state. Thus, if there is any concern at all about a specific insurance company or agent, do not hesitate to contact the state insurance department to discuss said concerns.

For simple access to all of this helpful information and more, visit the following websites:

- ▶ FINRA’s Broker Check
www.finra.org/Investors/ToolsCalculators/BrokerCheck
- ▶ The National Association of Insurance Commissioners
www.naic.org
- ▶ A.M. Best Company Ratings
www.ambest.com
- ▶ Standard & Poor’s
www.standardandpoors.com/SPComIPResolver
- ▶ Indexed Annuity Leadership Council
www.indexedannuityinsights.org