

1. Backlash Hits Annuities Tied To Stock Market

Wave of Lawsuits Take Aim At Sales Practices, Suitability Of Equity-Indexed Products

By KELLY GREENE

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Sure Thing?

Sales of equity-indexed annuities have surged in recent years, but consider this advice before investing.

- **Keep it simple.** Can you explain the way the interest is calculated within the equity-indexed annuity you're considering in three sentences or less? If not, "run away," advises Jack Marrion, president of Advantage Compendium, an annuities-consulting firm.
- **Study the withdrawal rules.** Betsy Barnett and Mitzie Bradbury bought equity-indexed annuities two years ago while they were still working full-time. But after Ms. Bradbury had a stroke and Ms. Barnett decided to move recently, they investigated ways to draw immediate income from the products—and learned that their annuities charge withdrawal penalties that they say weren't highlighted by their insurance agent.
- **Alzheimer's alert.** Florida prosecutors have handled a number of cases where agents sold equity-indexed annuities with high surrender charges to older people with dementia. Kenneth LaValley of Lake Worth, Fla., says his 77-year-old mother, a dementia patient, two years ago replaced other annuities that had no surrender charge with equity-indexed annuities charging 19% for withdrawals in the first year. He got her money back—minus some gains—after providing the insurer with documentation of her illness.
- **If all else fails, complain to everyone.** Most policies have a "free-look" period that ranges from state to state. If you get cold feet, contact your insurer immediately to see if there's still time to get your money back. If the period has ended, start the complaint process by writing a letter to the insurer. If that fails, contact your state insurance department, securities regulator and attorney general, because different regulators handle complaints about equity-indexed annuities in different states.

Equity-indexed annuities are among the hottest products sold through seminars, infomercials and free-dinner events that target older adults with investment pitches. Now, insurers that sell them are facing growing legal claims from investors and state regulators who allege that the companies or their agents are using deceptive marketing or targeting consumers who are too old to benefit from the products.

FAIR WARNING

Equity-indexed annuities can be complex. Here's what to consider:

- *Make sure you understand how gains will be calculated.*
- *Check for hidden penalties for early withdrawals.*
- *These annuities may not be suitable for older adults because funds may be locked up for several years.*

In the biggest such case, the Eighth U.S. Circuit Court of Appeals in St. Louis last month upheld the class-action status of a lawsuit that covers more than 400,000 investors who bought equity-indexed annuities from Allianz Life Insurance Co. of North America, a unit of

Munich-based **Allianz** SE and the top seller of this type of annuity in the U.S. More than a dozen federal lawsuits against a number of insurers also are seeking class-action status in courts across the country. Meanwhile, attorneys general and regulators in Illinois, Minnesota and California are pursuing claims against insurers selling the products.

"Equity-indexed annuities have emerged as the vehicle of choice for unscrupulous insurance agents," says Roxanne Rehm, assistant general counsel for the Florida Department of Financial Services. Older investors, she contends, "don't realize they're long-term investments, and once they realize they can't access the funds, it's usually too late."

An equity-indexed annuity, as the name indicates, is one whose performance is tied to the stock market. A person invests a lump sum, or makes a series of payments during a "deferral period" that is often five to six years, and is guaranteed a minimum return based on changes in an equity index (like the Standard & Poor's 500-stock index). If stock prices rise, returns can increase; if stocks fall, investors at worst realize no gains. When the deferral period ends, investors can take either a lump-sum payment or "annuitize" the account, meaning they would get a series of payments over a set period, or for life.

The promise of potential gains and little downside risk has fueled sales of equity-indexed annuities, which climbed to \$25.3 billion in 2006 from \$6.5 billion just five years earlier, according to Advantage Compendium Ltd., a consulting firm that tracks annuity data.

But critics say equity-indexed annuities do, in fact, carry risks, especially for older investors who may need access to their money before the investment's term ends. Some of these annuities are structured to provide only a small portion of market-index gains; carry high surrender, or early withdrawal charges (12.5% for some of the more popular products) that can last for much or all of a contract's term; and often involve relatively rich sales commissions that regulators say can make it tough for consumers to get unbiased advice.

Like some other types of annuities, equity-indexed annuities can be useful for investors seeking guaranteed income. But equity-indexed products also offer some potential for gains tied to the stock market. It's important for investors to understand such terms as how the interest will be calculated and if there are hidden penalties. There is controversy whether equity-indexed annuities are appropriate for older people because their money is typically locked up for several years.

Some advisers suggest investors compare returns on equity-indexed annuities with other products such as certificates of deposit, which can yield around 5% these days, and variable annuities with guaranteed minimum income benefits, which offer a similar downside safety net.

The big class-action case against Allianz centers on the marketing of so-called immediate bonuses that are paid to people when they buy an annuity, typically an amount between 5% and 10%. Plaintiffs say investors actually have to wait years for the money, if they can get their hands on it at all; Allianz responds that the bonuses are immediate because their value is credited to investors' accounts the day they buy the annuity, meaning they can start earning interest based on a bonus's value right away.

In September, Michael Altschul, a 60-year-old sales representative in Laguna Niguel, Calif., paid \$250,000 for an equity-indexed annuity from Allianz after hearing it described in a radio infomercial. "The protection of principal was a huge draw for me," he says, as was the \$25,000 bonus. Mr. Altschul says the agent who sold him the policy told him he could withdraw 10% of his initial investment each year for 10 years, and then withdraw the balance.

But in June, he noticed an online article about the Allianz product he bought, posted by a financial planner, and realized he can withdraw 10% a year only for the first five years,

although this would cut into his gains. After that, unless he annuitizes the balance for 10 years, he would lose the promised bonus and much of the interest his money could earn, and could be subject to hefty surrender charges. "That was news to me," he says.

An Allianz spokesman says that privacy laws prevent the insurer from discussing Mr. Altschul's individual situation, but the materials the insurer provided "at the point of sale clearly explain the product," and the insurer encourages customers with concerns to "contact us so that we can conduct a thorough review."

A lawsuit filed by Illinois Attorney General Lisa Madigan last year in Sangamon County Circuit Court alleges that "deceptive" mailers sent to older people offering help with estate planning and Medicare were used to schedule appointments with agents selling annuities for American Investors Life Insurance Co., now part of **Aviva** PLC. Mary Menges, a 70-year-old retired nurse in Collinsville, Ill., says she responded to a postcard offering help in "understanding your money situation" two years ago and was persuaded to move her individual retirement account, \$170,000 in mutual funds, into an equity-indexed annuity.

"I didn't know this was an insurance company at all," she says. After her son learned about the move and explained the restrictions on withdrawals to her, the mother and son wrote a letter to the company and also reported her experience to the attorney general's office. She got her money back, she says.

Michael Vaughan, a Kansas City, Mo., attorney representing American Investors, says the company has "seen no evidence that this is a broad-based issue." He declined to comment further.

The California Department of Insurance has taken a close look at Allianz's marketing to older people, specifically examining sales to 126 people who were at least 84 years old, and who replaced existing annuities with equity-indexed or immediate annuities. Elderly customers incurred new surrender charges in more than 100 such cases from Jan. 1, 2004, through July 31, 2005, the department says in a regulatory filing.

Allianz says age is only one of a number of factors involved in determining whether an annuity is appropriate for a customer, and that its "business conduct was proper."

Insurers selling equity-indexed annuities are starting to face challenges from securities regulators as well. Debate has raged for at least two years among securities regulators, insurance departments and industry trade groups over who should have oversight. So far, the Securities and Exchange Commission hasn't weighed in, but it could deem the products securities if it chose to do so.

In December, Massachusetts's top securities regulator, Secretary of the Commonwealth William F. Galvin, fined Investors Capital Corp., a unit of Investors Capital Holdings Ltd., \$500,000 for allowing its representatives to use "unregistered investment advisory services to sell equity-indexed annuities to unsuspecting elderly customers." Steven Preskenis, Investors Capital Corp.'s chief operating officer and general counsel, said in a statement the company was pleased to resolve the issue and take part in restitution, and it looked forward to working with state officials to improve "oversight, understanding and education of these financial products."

And Joseph Borg, director of the Alabama Securities Commission, has found a new approach: "If the agents are advising people to sell mutual funds or get out of 401(k)s, they are acting as investment advisers. And in my state, being an unregistered investment adviser is a felony." In "dozens" of equity-indexed annuity sales the state has investigated in the past few years, he says, insurers have "paid the money back, plus 6% interest."