TRICKS OF THE TRADE?

Question:

After having watched the *NBC Dateline* “hidden camera investigation” on annuities, I do not know what to think. (Tricks of the Trade aired 4/18/08) Are annuities bad and are the people who sell them really ripping me off?

Answer:

Annuity sales, especially to senior citizens, have increased. 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 (such as those captured by *Dateline*) employed by companies and agents looking to take advantage of uninformed consumers.

As with any financial decision, it is extremely important to take the necessary precautions in order to make an informed decision that is right for you and that is in your best interest.

What is an Annuity?

In its most basic form, an annuity is a contract between you and an insurance company. The company promises to make periodic payments to you starting immediately or at some point in the future. If payments are delayed to the future, then you have a deferred annuity. If the payments start now, then you have an immediate annuity. Either you buy the annuity with a single payment or a series of payments called premiums.

Annuities come in two types: fixed and variable. With the fixed annuity, the insurance company guarantees both the rate of return and the payout. A variable annuity on the other hand does not have a stable rate of return. Instead, your results will vary with the stock, bond and money market funds (called sub-accounts) that you choose as investment options.

Unlike fixed contracts, which are solely an insurance product, variable annuities are both an insurance producy and a security product. As a security product, variable annuities must be registered with the Securities and Exchange Commission (SEC). Anyone selling a variable annuity must also have the appropriate securities licenses in addition to the insurance license needed for fixed annuities.

Dateline examined the sale of a type of fixed annuity product called an Equity Indexed Annuity (EIA). EIAs are complex financial instruments that have characteristics of both fixed and variable annuities. The investment return on EIAs varies more than a fixed annuity but not as much as a variable annuity. So EIAs give you more risk (but more potential return) than a fixed annuity but less risk (and less potential return) than a variable annuity.

You can lose money on an EIA. It is also possible that early termination of a fixed annuity contract could cost you. Likewise, a variable annuity could decline in value. This fact does not make the contracts "bad". Rather it does illustrate how important it is for you to know how they work.

Among the many important facts *Dateline* did not disclose in its so-called investigation was that agents for fixed annuities and equity-indexed annuities are not securities licensed. It is generally more difficult to obtain and maintain a securities license. This is not to say that agents with a securities license are better; they simply undergo more scrutiny.

Is an Annuity Right for You?

Dateline also failed to ask the "customers" why they considered an annuity in the first place. What are your financial goals? What percentage of your money are you willing to invest in an annuity and how much of a monetary risk are you willing to take? Do you have other income and assets available? What other investment options have you considered?

Check with our Washington State Insurance Commissioner, NAIC and/or FINRA to confirm the credibility of a company or agent. Call me if you would like their phone numbers or web addresses.

Avoid being fooled by Deceptive Sales Practices:

1. High-pressure sales pitch offering a "limited time" deal that makes you feel uncomfortable. Trust your instincts and steer clear.

2. Quick-change tactics agents use to prey on your "time fears" without giving you the opportunity to perform adequate research.

3. Unwilling or unable to prove credibility. A licensed agent will be more than willing to show verifiable credentials. Ask for credentials that have meaning such as Certified Financial Planner (CFP) Chartered Financial Consultant (ChFC) or Chartered Life Underwriter (CLU). These designations require ongoing continued education and an adherence to a Code of Ethics.

Finally, remember if it seems too good to be true, it probably is!

James D Hallett, Investment Advisor Representative, offering advisory services through Hallett & Associates, P.S., a Registered Investment Advisor. Registered Representative, securities offered through Cambridge Investment Research, a Broker/Dealer (Member FINRA/SiPC) Cambridge and Hallett & Associates, P.S. are not affiliated.

This column is for informational purposes only and should not be used as the primary basis for an investment decision. Consult an advisor for your personal situation.