SEC, NASD ALERT SENIORS ON VARIABLE ANNUITIES

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The Securities and Exchange Commission and the NASD have three words for investors purchasing variable annuities: Watch your back.

OK, they didn't exactly say this, but that's essentially what a new report by the two organizations recommends.

Variable annuity products combine features of insurance and securities investments. While variable annuities are appropriate for some, be careful if you're considering investing in these products. They are complex with language and fee structures near impossible for the average consumer to understand. And by average, I mean people who don't have Einstein-level IQs, and even then there's no guarantee.

The report by the SEC and NASD (formerly the National Association of Securities Dealers) was released earlier this month and is the result of an examination of the way variable annuities are sold. The study itself was triggered by the growth in annuity sales and the large number of complaints from individual investors.

"The report outlines a number of weak practices identified during the examinations, and provides a road map to investors of sales practices to watch out for," said Susan Wyderko, the SEC's director of the Office of Investor Education and Assistance.

NASD said that among the more disturbing weaknesses identified were instances of brokers making unsuitable recommendations to senior citizens and to individuals who could not afford the products without mortgaging their homes. Brokers also failed to fully disclose various fees or risks, and overstated the tax benefits associated with annuities.

In one complaint to the SEC that I was allowed to review (minus any identifying information), an elderly couple produced an e-mail in which a salesperson told them that having an annuity as part of their tax-deferred investment account (an Individual Retirement Account, or IRA), was the same as a "double tax-deferred investment."

That's utter nonsense. It's true that one key benefit to purchasing variable products is that earnings on the invested money accumulate tax-deferred.

"But purchasing a variable annuity within a tax-advantaged account will provide no additional tax savings," Wyderko said. "It will, however, generate fees and commissions for the securities salesperson."

The report also found that firms repeatedly went back to the same customers and switched them to a new variable annuity product every few years.

Here's the problem with that, according to Wyderko. A new annuity may impose higher fees, may reduce your death benefit, and you may have to pay a surrender charge on the old product.

A surrender charge is what you have to pay if you withdraw money from a variable annuity within a certain period after your purchase (typically within six to eight years, but sometimes as long as 10). Generally, the surrender charge is a percentage of the amount withdrawn. The percentage you pay declines gradually over time. Some contracts will allow you to withdraw part of your account value each year -- 10 percent or 15 percent, for example, without paying a surrender charge.

In another complaint to the SEC, one elderly woman unfortunately discovered that if she wanted to get out of her annuity, it would cost her a $4,400 surrender charge. And that news was actually the first time she realized she had invested in such a product.

The 70-year-old woman said she had thought she was rolling over $98,000 from a 401(k) plan into a mutual fund.

"Under no circumstances did I want anything that I couldn't get out of in a year -- two at the most," she wrote in her SEC complaint. "I was in total shock as my investment had lost approximately $12,000 [and] I was tied into an annuity for seven years. This was my first inkling of having invested in an annuity."

High fees and surrender charges combined with other factors make variable insurance products inappropriate for many investors, both the SEC and NASD warn.

So before purchasing this investment product, the two groups recommend answering the following questions:

Will you need the money in the next few years? Variable products are long-term investment vehicles. If you even vaguely think you'll need the money in the short term, don't go this investment route.

Do you have enough money right now to purchase this product? It's downright dangerous to your financial health to mortgage your home in order to purchase a variable annuity or variable life insurance product. If a salesperson pressures you to do so, call the SEC at 800-SEC-0330.

Are you being told to purchase a variable annuity or variable insurance as part of your IRA, SEP-IRA, Keogh or some other tax- deferred retirement account? Remember those products already have a tax advantage.

What are you paying in fees? Variable annuities have high commissions, typically above 5 percent. The various annual fees on variable annuities can reach 2 percent or more of the annuity's value, according to the NASD. So don't sign any paperwork until you know exactly what fees and expenses you will have to pay.

For more information about variable annuities read the SEC's Variable Annuities: What You Should Know at www.sec.gov/investor/ pubs/varannty.htm. Also check out Variable Annuities: Beyond the Hard Sell at www.nasd.com/Investor/Alerts?alert-variable- annuities.htm and Should You Exchange Your Variable Annuity? at www.nasd.com/Investor/Alerts/alert-annui tyexchanges.htm.

Given the right investor, a variable annuity may make sense for people who have contributed the maximum to a 401(k) and other before- tax retirement plans, don't need the money for a long time want an investment product with a death benefit and a payout option that can provide income for life. As you can see those are a lot of conditions. So please, please don't buy a variable annuity without doing some research. There are just too many complex features and fees that you need to watch out for.

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Abstract (Document Summary)

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