# The Fight Against Inappropriate Annuities for Seniors and How Elder Law Attorneys Can Help

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At the National Academy of Elder Law Attorneys Advanced Elder Law Institute last fall in Memphis, Tennessee, Andrew Friedman, a specialist in class actions against the insurance industry, described how insurance companies convince the elderly to purchase inappropriate deferred annuities, how these practices are being combated in the courts and what individual elder law attorneys can do to help in the fight against the products.

Friedman, who is with the Phoenix firm of Bonnett, Fairbourn, Friedman & Balint, estimates he has sued between 30 and 40 insurance companies for various sales practices, primarily involving financial fraud. He is currently lead counsel in about eight class action suits against insurers in a number of states on behalf of seniors who have purchased inappropriate deferred annuities.

Calling deferred annuities "uniformly horrendous products," Friedman said they are unsuitable for people over age 75 and arguably not for people at much younger ages as well. But half or more of annuities are being sold to individuals 65 or older, and probably 15 to 20 percent are sold to those 75 or older. Some of the insurance companies have maximum issue ages as high as 90.

Sales, Friedman said, "are just astronomical." Minnesota-based Allianz Life Insurance Co. of North America is the largest in the field of equity indexed annuities (discussed below), selling tens of billions of dollars worth of annuities.

Friedman said the abuse has two elements: the products themselves and the process by which they are sold.

Deferred annuities are "highly illiquid, highly expensive and very poorly performing," Friedman noted. A principal reason why the products are so inappropriate for older Americans is that heavy surrender penalties apply if the money is needed before the annuitization phase kicks in. If you buy at age 65, you're generally looking at a 10- to 15-year surrender period, with a penalty as high as 25 percent at the front end. (These surrender penalties are often characterized to prospects as "liquidity features.")

Sales agent commissions are often as high as 15 percent and are priced into the products, while the companies' own internal rate of return is typically 12 percent on top of that. Deferred fixed annuities often pay an attractive "teaser" interest rate that lasts only for a short time. In addition, Friedman says, these annuities assess maintenance fees and other creative "administrative" fees to reduce the amount the annuitant actually receives. All this means that these products can be far outperformed by a simple portfolio of stock and bond funds, Friedman claimed.

## Worst of a Bad Lot: Equity Indexed Annuities

Probably the biggest-selling deferred annuities are highly complex products called equity indexed annuities. Theoretically, these are annuity accounts tied to a stock index like the NASDAQ sp 500. There is more protection against a down market than with a variable annuity, but policyholders pay for this: they can share in the growth of the market only up to a predetermined cap and returns are often further limited by the "participation rate" that allows the annuity holder to reap only a percentage of the market's total gains. Other provisions allow the company to further skim off gains.

Moreover, equity indexed annuities are extremely complex and difficult even for professionals to understand. When Friedman asked a former financial economist for the Securities and Exchange Commission (SEC) to review a typical contract, it took him two days to understand it. But most retail customers don't have to worry about this; they won't even see the contract until after the purchase is made.

## Fierce Sales Pitches

Most deferred annuities are sold by independent agents motivated by their own financial self-interest, Friedman said. The insurance companies, he said, "encourage agents to sell inappropriate deferred annuities to seniors by offering enormous sales incentives, commissions, and other promotions in order to maintain or increase market share." But the insurers claim to know nothing about unethical sales practices on the part of agents.

By this time, most elder law attorneys are familiar with the typical sales scenario: ads in local papers heralding free advice on living trusts (and perhaps a free meal) at seminars held in a retirement community, senior center, church or other place where seniors feel comfortable; the implied promise of unbiased financial advice, when in fact the people running the seminar are simply insurance agents; an appeal to fears like another Great Depression or being a burden on children; the distribution of questionnaires asking attendees for personal information about their assets, which agents later use for home visits, still under the guise of a financial planner; and, if the prospect balks, a bombardment of phone calls and high-pressure sales tactics. And always the solution is the same: an annuity. These agents also boast bogus certifications like "certified senior advisor" or "senior specialist," which are usually the product of one-day Internet courses with tricky questions like, "What is the retirement age: 65 or 25?"

But the agents in fact dispense financial advice, telling prospects their current investments are worthless and that an annuity is a completely safe hedge against loss of principal (true if you can hang on for 15 years). They also make blatant misrepresentations about their product, Friedman charged. For example, they may claim the product includes "nursing care benefits," which is really a waiver of surrender penalties if the policyholder is confined to a nursing home for 90 days (on average).

"One of the worst and most pernicious practices that we see," Friedman said, "is people being rolled from one annuity to another. I have class representatives who have been rolled from two, three or four companies. You're seeing people having to pay surrender penalties to get out of one product only to lose more money in another product."

## The Pending Class Actions

The class actions that Friedman is involved in allege consumer fraud, elder abuse, breach of fiduciary duty and racketeering claims â€“ the latter because it's easier to have one uniform law that applies in all 50 states if you have a nationwide class of consumers. The cases are currently in the discovery stage. Among the internal documents Friedman has obtained is sales instructional material exhorting agents to treat the elderly like "a 12-year-old who is blind yet smart" and to advise prospects to "not mention a word about this to your kids" until monies have been successfully transferred to the insurance company.

The class in the case against Allianz has been certified, while cases against Midland, Fidelity & Guaranty, American Investors, American Equity Investment, Conseco and Jackson National are wending their way to class certification. (Friedman, speaking in early November 2007, said they should know the fate of class certification in the other cases within the next three to four months.)

Class actions are difficult, Friedman said, because each plaintiff has relied on something different. In allowing the Allianz class, the court concluded the products were so bad that no rational senior citizen would buy them.

Friedman said that both regulators and the media have finally woken up to this problem. The attorneys generals of Minnesota, California, Massachusetts, Colorado have taken action against annuity sellers. Media attention is equally important, Friedman said, because "the only thing these insurance companies care about is their reputation, their ability to sell more junk to people."

## Elder Law Attorneys Can Play a Pivotal Role

Friedman said that while it may not make economic sense for elder law attorneys with clients stuck in these products to bring litigation, "I do think you can effectively take early and swift action, at least demand letters and beating the doors down of the [insurers'] compliance and legal departments to rescind. The fact we have these class actions has, I think, sensitized them to the point where you may meet with success because they're a little concerned now that it has become such an issue."

In fact, a session attendee reported that his battles with an insurer have paid off for clients. Five times this year he has corresponded with American Investors Life Insurance on behalf of holders of annuities ranging from about $50,000 to $85,000, arguing that the product was unsuitable, unconscionable and egregious.

"I would have an affidavit from my client stating they didn't understand the product, and in all cases I got their principal back, and they paid me a relatively small attorney fee," the attendee said. "I billed $1,500 in each case but in all cases I had to prove to the company the client didn't understand the product. I'm willing to fight those fights."

Michigan attorney Robert Anderson, who assisted in the session, said elder law attorneys "need to work as private attorneys general for our clients, but also appear at these so-called seminars to smoke them out." He suggested filing complaints with the insurance commissioners, even though they might not get very far, as well as unauthorized-practice-of-law complaints with state bar associations.

Anderson added that the average waiver of surrender penalties seems to be 90 days confinement in a nursing home. If attorneys encounter policies that don't have even this minimal amount of waiver, then they have an even better cause for getting a policy rescinded. "We have to continue to write those demand letters and threaten, threaten, threaten," he said.

"As an elder law attorney and independent certified financial planner," Anderson told his audience, "I think all of you ought to take from this one very simple thing: counsel all the people you see to get independent financial advice before buying any deferred annuity. Make it a habit to say: 'Have you heard about any of these deferred annuities out there? Get independent financial advice before you buy.' "

All the states have adopted what Anderson characterized as a "very poor, ineffective" model regulation put forth by the National Association of Insurance Commissioners (NAIC) ("Senior Protection in Annuity Transactions"), which he said NAELA needs to attack. He noted that Charles Sabatino of the ABA's Commission on Law & Aging is interested in getting NAELA members together to try to draw up corrective rules governing these products.

Friedman agreed that the NAIC's model regulation "has no teeth whatsoever," likening it to putting a health warning on a pack of cigarettes, serving only to insulate the companies from liability. Friedman said that one of the best things that could happen is for state legislatures to say that insurance companies owe fiduciary duties to consumers. Insurers have convinced lawmakers that these are "insurance products" to avoid federal regulation.

"When we try to prove fiduciary duty, we run into this buzz saw of case law saying there's no fiduciary duty between an insurance company and his client, and it's [expletive]. These are not insurance policies; these are investment products and they should be regulated like investment products."

"NAELA members need to weigh in at the state level with insurance departments," Friedman said.

In fact, according to Friedman, the SEC has been gathering information on insurer marketing practices to determine whether these products are in fact securities. This, he said, would be a "phenomenal breakthrough" that would solve a lot of disclosure issues and provide other causes of action. But he's not very optimistic given the current administration's influence over the SEC.

"The big hope would be if the SEC were to keep its mouth shut until the next election and there's a change in administrations," Friedman said. "At that point you may see some congressional action to regulate at the federal level instead of this 50-state patchwork of ineffective regulation that we have right now."

Another audience member asked Friedman what individual cases against insurers can garner in the way of damages. Friedman said such cases will work only if very large sums are involved and there are extraordinary circumstances that will allow for punitive damages. He told of one case where an elderly individual with Alzheimer's was induced to buy a deferred annuity. The original award was $35 million, later reduced to $5 million.

"I wish more people would bring individual lawsuits," he said, "but it's tough unless you're willing to take a case to trial and have jurisprudence that allows you to get a large measure of punitive damages."

### Banks as Sellers

In answer to a question about the role of banks in selling deferred annuities, Friedman said they're bad products as well, but not quite as bad. When people's CDs mature, the bank sends the client next door to the investment side and puts them into a deferred annuity because the banks make more profit than on a CD. But because the bank's own employees are doing the selling, the commissions are lower, so it's not as bad a deal for seniors.

"We're trying to figure out what legal theories we can successfully prosecute with," Friedman said. "I think some of the banks are blatantly violating Glass-Steagall, which requires them to keep their businesses separate."

### Coming Next: Reverse Mortgage Abuse?

Friedman thinks we're seeing the "beginning of a wave" of abuses involving reverse mortgages.

"I think reverse mortgages are abusive in many cases -- putting the equity of the home into a high-cost loan," he said. Typically loan companies will require exorbitant repairs to be done to the home, he claimed. Then they flip what's left of the loan proceeds into a deferred annuity, on which another commission is paid, and the homeowner is locked into that. He said the class representative in one of his cases is an elderly Hispanic widow whom an agent convinced to take a reverse mortgage out on her home and use the proceeds to buy a deferred annuity.

"I think you're going to see a lot more of that litigated, particularly with the current credit crisis," Friedman said. "You're going to see a lot more reverse mortgages with a lot of fees and costs that are not properly disclosed to people."

"Lord knows what the next abusive financial product will be," Friedman concluded. "For someone like me who litigates these cases, it's kind of like that 'Wack-em-all' game at the mall. One abuse ends and they come up with another product. I'm not particularly optimistic that this will ever end, but I am optimistic that ultimately these cases will meet with success."