

ARTICLE: “An Annuity You Really Should Avoid”  
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<http://kiplinger.com/magazine/archives/an-annuity-you-really-should-avoid.html>

The following email was sent to Kimberly Lankford of *Kiplingers*, in addition to her editors.

Ms. Kimberly Lankford,

I recently had the occasion to read an article that you authored for *Kiplinger’s Personal Finance*. “An Annuity You Really Should Avoid.” This article was quite inaccurate and reflects poorly on *Kiplinger’s Personal Finance* because of the misinformation in the article. I am contacting you, as the expert in the indexed annuity market, to ensure that you can make appropriate corrections to this article and have a reliable source for fact-checking in the future.

I am an independent market research analyst who specializes in the indexed annuity and life markets. I have tracked the companies, products, marketing, and sales of these products for over a decade. I used to provide similar services for fixed and variable products, but I believe so strongly in the value proposition of indexed products that I started my own company focusing on IAs and IUL exclusively. I do not endorse any company or financial product, and millions look to us for accurate, unbiased information on the insurance market. In fact, we are the firm that regulators look to, and work with, when needing assistance with these products.

I would first like to bring to your attention the fact that these products have not been called “equity-indexed annuities” since the late 1990’s. The insurance industry has been careful to enforce a standard of referring to the products as merely “indexed annuities” or “fixed indexed annuities,” so as not to confuse consumers. This industry wants to make a clear distinction between these fixed insurance products and equity investments. It is the safety and guarantees of these products which appeal to consumers, particularly during times of market downturns and volatility. Your help in avoiding any such confusion is so greatly appreciated. Thank you.

It is also important to note that one should not refer to these products as “investments.” Variable annuities are the only type of annuity that can be called an “investment,” as these products place the purchaser’s principal and gains at risk due to market volatility. Stocks, bonds, and mutual funds are also investments. The Securities and Exchange Commission (SEC) is responsible for the regulation of such investment products. Fixed and indexed annuities, by contrast, are insurance products- similar to term life, universal life and whole life. Insurance products are regulated by the 50 state insurance commissioners of the United States (collectively referred to

as the National Association of Insurance Commissioners, or NAIC). Insurance products do not put the client's money at risk, they are "safe money products" which preserve principal and gains. Investments, by contrast, can put a client's money at risk and are therefore appropriately classified as "risk money products;" they do not preserve principal. The NAIC does not permit the use of the word "investment" when discussing indexed annuities, as such.

It appears that you are not aware that indexed annuities are promoted as allowing the purchaser to have LIMITED participation "in the stock market's upside," while avoiding the downside risks associated with the stock market. All gains on indexed insurance products must be limited through the use of a participation rate, cap, or spread. (These are merely three different ways of limiting interest.) Perhaps it would help if I first started with a brief overview of how indexed insurance products work. Because indexed annuities are a "safe money place," they should be compared against other safe money places. Investment products such as stocks, bonds, mutual funds, and variable annuities subject the purchaser to both the highs and the lows of the market. It is inappropriate to compare any safe money place, such as an indexed annuity, to risk money places and it is most certainly not appropriate to compare safe money places to the market index itself. **Indexed annuities are not intended to perform comparably to stocks, bonds, or the S&P 500 because they provide a minimum guarantee where investments do not.** Indexed annuities are priced to return about 1% - 2% greater interest than traditional fixed annuities are crediting. In exchange for this greater potential, the indexed annuity has a slightly lesser minimum guarantee. So, if fixed annuities are earning 5% today, indexed annuities sold today should earn 6% - 7% over the life of the contract. Some years, the indexed annuity may return a double-digit gain and other years it may return zero interest. However, what is most likely to happen is something in between. Were the indexed interest NOT limited, the insurer could not afford to offer a minimum guarantee on the product, and THAT is a variable annuity- not an indexed annuity. On the other hand, the client is guaranteed to never receive less than zero interest (a proposition that millions of Americans are wishing they had during that period of 03/08 to 03/09) and will receive a return of no less than 117% worst-case scenario on the average indexed annuity. **In addition, no indexed annuity owner has ever lost a penny as a result of market downturn.** This is a strong value proposition that cannot be offered by any securities products.

You say that agents selling indexed annuities "collect lucrative commissions." Did you do any research on this matter before writing this article? In reality, indexed annuity commissions are quite low. The average commission paid on indexed annuities as of 2Q2010 was a mere 6.35%. In addition, this commission is paid one time, at point-of-sale, despite the fact that the insurance agent services the contract for life. Compare this to the consistent, generous commissions that are paid on products such as mutual funds, and I think you'll find that indexed annuity commissions are quite modest. It appears that you need to perform some more careful fact-checking, Ms. Lankford, before you decide to publish such information in the future.

The perfect client for an indexed annuity is someone who wants the ability to outpace traditional fixed money instruments, while still having a downside guarantee. However, it is not appropriate to say that these products are targeted to those who are "fearful of the stock market and frustrated with bonds' low interest rates." People who invest in stocks and bonds are risking their principal and gains in these vehicles, whereas indexed annuities never risk principal or gains. A more

appropriate comparison for indexed annuities would be fixed annuities or certificates of deposit (CDs).

You say that indexed annuities are “costly.” What on earth do you mean by that? Indexed annuities do not have any explicit costs like variable annuities do. The “cost” that the client pays on an indexed annuity is merely time; via a surrender charge. *The surrender charge on a fixed, indexed, or variable annuity is a promise by the consumer not to withdraw 100% of their monies prior to the end of the surrender charge period.* This allows the insurance company to make an informed decision on which conservative investments to use to make a return on the clients’ premium (i.e. 7-year grade “A” bonds for a seven-year surrender charge annuity or 10-year grade “A” bonds for a ten-year surrender charge annuity). Investing the consumer’s premium payment in appropriate investments allows the insurance company to be able to pay a competitive interest rate to the consumer on their annuity each year. In turn, it also protects the insurance company from a “run on the money” and allows them to maintain their ratings and financial strength.

Meanwhile, the annuitant is still provided access to a portion of their monies in the event of emergencies. Every indexed annuity permits penalty-free withdrawals of 10% of the annuity’s value annually. Some even allow as much as 50% of the annuity’s value to be withdrawn in a single year. Plus, 9 out of 10 indexed annuities provide a waiver of the surrender charges, should the annuitant need access to their money in events such as nursing home confinement, terminal illness, disability, and even unemployment. Couple this with the fact these products pay the full account value to the beneficiary upon death, and it is clear that these are some of the most liquid retirement income products available today.

It makes me angry to see that you have done so little research on these products prior to publishing this article, Ms. Lankford. You say that indexed annuities’ “protection against loss is minimal.” This is absolutely false. Indexed annuities protection includes, but is not limited to:

1. **Protection of principal-** the purchaser will not lose any of their payments as a result of market downturn
2. **Protection of gains-** the purchaser will not lose any interest on their principal as a result of market downturn either
3. **Protection via floor-** the purchaser is guaranteed to never receive less than 0% interest in any given year
4. **Protection via guaranteed minimum surrender value-** the purchaser is guaranteed to receive premiums paid plus interest, regardless if the market consistently declines
5. **Protection against living too long-** the purchaser is guaranteed an income that they cannot outlive
6. **Protection in the event of death-** all indexed annuity purchaser pass-on the full account value to their designated beneficiaries in the event of death

7. **Protections via guaranteed benefits-** offered on fixed and indexed annuities, not just variable annuities!

So, the protections in this product are phenomenal. Yet, you suggest that one “consider buying a deferred variable annuity with guaranteed benefits.” Do you understand that guaranteed benefits on variable annuities merely give principal protection to a risk money product? So, this strategy attempts to provide the protection that is already inherent to indexed annuities, without having to provide an optional guaranteed benefit rider. The difference, however, is that the variable annuity purchaser is subject to loss of gains and principal, and the indexed annuity purchaser is not.

While you are quick to point out that indexed annuity purchasers with a 6.5% cap would only receive 6.5% credited interest during a one-year period, as opposed to 26% (which was the market’s gain in 2009), you fail to point out the other side of the story. When the market collapsed in 2008, the stock market declined nearly 50%. Savers who owned products such as variable annuities, stocks, and 401(k)s correspondingly lost nearly 50% of their retirement savings. Savers who owned indexed annuities, on the other hand, lost none of their retirement savings when the market collapsed. **So you tell me- is it worth having the ability to gain the full 26% at the risk of losing 50% or more?** Indexed annuity purchasers think not, and I happen to agree with them.

In addition, indexed annuities have the potential to return much more than you give them credit for. Despite the fact that these products are only intended to outpace fixed money instruments by 1% - 2% on a consistent basis, sometimes purchasers “hit a home run.” I have actual policyholder annual statements on my desk, showing one-year gains as high as 47.65%! What is more- these products protect their purchaser’s payments from declines due to market fluctuations; this combination of protection and upside potential is something that cannot be offered with any other retirement savings product.

And while it is true that insurance companies *reserve the right* to change the caps, participation rates, and asset fees on indexed annuities in years two plus, it does not mean that insurance companies do. I can name numerous companies that have never reduced their renewal rates on their indexed annuities. However, this provision is no different than that of a fixed annuity, where the insurance company has the discretion to change the credited rates in years two plus. Not to mention the fact that variable annuities have the ability to increase fees if necessary in years two plus. All fixed and indexed annuities are subject to minimum rates, as approved by the state insurance divisions that approve the products for sale in their respective states. Insurance companies are smart to protect themselves by filing products that have the ability to change rates annually, in the event of a volatile market. I personally feel much more confident that the companies offering these products today will be able to make good on their claims-paying ability, considering such flexibility in the event of unforeseen circumstances.

Ms. Lankford, indexed annuities have surrender charges as short as three years, so it is disingenuous to allude that purchasers are “locked in to the investment for seven to ten years.” You make it seem like all indexed annuities are like this, when that is not the case.

You also appear to be unaware of the differences between securities and insurance regulation. Are you familiar at all with insurance regulation? It appears not, as you believe that there is little disclosure on insurance products, when that is simply not the case. The insurance industry has done a very good job of imposing strict regulations to ensure proper disclosure, market conduct, suitability, product development, and sales practices in the annuity industry. The currently regulatory structure that indexed annuities operate under is very thorough and effective. The insurance commissioners regulate indexed annuities with rigorous standard non-forfeiture laws, disclosure requirements, advertising guidelines, suitability regulations, and other rules. The states hold the authority to take sanctions against insurance agents including, but not limited to, license revocation, penalties and fines. An interesting comparison of state and federal regulation exists relative to annuity complaints specifically. If I need to make a complaint on an indexed annuity, the state insurance division has to respond to me within ten days; and I incur no cost in my efforts to resolve the problem. Compare this with the exhaustive complaint process on the securities side; delays, lawyers, and a lot of my money spent. Yes, Ms. Lankford, SEC regulation is different, but it most definitely is not better than insurance regulation.

In addition, requiring SEC regulation of a product that is already regulated by the NAIC would add an unnecessary, duplicative, second layer of regulation to this product. This would only result in increased expenses which would ultimately be passed-on to the purchaser.

I also think that you should know that the Financial Industry Regulatory Authority (FINRA) has been contacted and corrected numerous times on the inaccuracies in their Investor Alert on Indexed Annuities (see attached), which you reference in your article. FINRA is not a credible source of information on indexed annuities. They are responsible for the oversight of broker dealers and member firms that sell securities. They have no regulatory authority on insurance products such as indexed annuities, and in fact have a vested interest in indexed annuities being regulated as securities so that they can increase their revenue and job security. In the future, if you are looking for a reliable regulatory resource on fixed insurance products (such as indexed annuities), I encourage you to seek out Susan Voss or Jim Mumford at the state of Iowa Insurance Division (Susan is the commissioner and Jim is the deputy commissioner). Not only are they credible, but 41.59% of indexed annuity sales flow through Iowa-domiciled insurance companies; for that reason they have become authorities on indexed insurance products.

While I am disappointed with the inaccuracies in your article, I welcome the opportunity to build a relationship with you, so that you can be ensured access to accurate information on these products in the future. Please, if you have a need to check facts on indexed annuities; do not hesitate to reach-out to me or my firm. We are always happy to help ensure proper understanding of indexed insurance products.

Thank you.

*Sheryl J. Moore*

**President and CEO**

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