

ARTICLE: "The Truth About Equity-Indexed Annuities"
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BYLINE: Mel Lindauer
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<http://www.forbes.com/2010/08/10/truth-about-equity-indexed-annuities-personal-finance-bogleheads-view-lindauer.html>

Dear Forbes Editor,

I recently had an article on your website forwarded to me, which is very misleading and inaccurate. "The Truth About Equity-Indexed Annuities," by Mel Lindauer reflects poorly on *Forbes* because of the misinformation in the article. I am quite angry at this point, as this is the second time in a one-month period that I have had to bring your attention to inaccurate articles that Mr. Lindauer has written on indexed annuities. Because of your apparent lack of concern, I am also copying a large portion of the insurance industry on this correction. Perhaps hearing from a few insurance company CEOs and owners of powerful financial services firms will persuade you to make appropriate corrections to this article and use a reliable source for fact-checking in the future (such as myself). As an aside, I would have copied Mr. Lindauer on this correction, had I access to his email address.

As you have been made aware in the past, I am an independent market research analyst who specializes in the fixed and 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 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.

First and foremost, 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; ensuring that they realize that these are not equities products. 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.

Mr. Lindauer purports that indexed annuities are "extremely complex." Despite the fact that complexity is relative, indexed annuities are merely fixed annuities with a different way of

crediting interest. If someone can understand that they have the ability to deposit their money with an insurance company, defer taxes on the monies until they begin taking income, receive 10% withdrawals of the account value annually without being subject to penalties, and have the ability to pass on the full account value to their beneficiaries upon death- then they can understand nearly every indexed annuity sold today.

Furthermore, indexed annuities are not “touted to provide equity-like returns” and are not marketed as providing “market-like returns with no risk.” Indexed annuities are marketed as allowing the purchaser to have LIMITED participation in the market’s gains, while avoiding the downside risks associated with the stock market. These products traditionally compete against traditional fixed annuities and certificates of deposit (CDs). 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. However, these products are not marketed as providing “market-like returns,” as the insurance industry has been careful to draw a very clear line between these products and equities. Mr. Mel Lindauer would do well to note these inappropriate suggestions in the future.

In addition, it is preposterous for Mr. Lindauer to suggest that indexed annuities are “the most complex of all the annuity products offered.” As an individual who has developed, marketed, and purchased all types of annuities, I must admit that variable annuities are the most complex annuities offered. One must also consider that the disclosure on variable annuities- which typically is a prospectus that averages more than 200 pages- is overwhelming to consumers when compared to the average indexed annuity contract which is 26.7 pages long. In addition, the prospective purchaser of indexed annuities is provided marketing materials and plan-language disclosures that (along with the annuity contract itself) provide a clear overview of the product

that they are purchasing (in laymen's terms). This is head and shoulders above the disclosure provided on variable annuities.

Interestingly, there are insurance companies that call and survey purchasers of indexed annuities after their purchase, to ask about their satisfaction and comprehension of the product they purchased. Those results are very favorable, contrary to what Mr. Lindauer alludes.

Laughably, Mr. Lindauer points out that the consumer does not receive the dividends from the S&P 500 in the indexed crediting calculation on indexed annuities. What he is not educated enough to know is that the insurance company never receives the benefit of the dividends on the index on an indexed annuity because *the purchaser is never directly invested in the index*. The insurance company invests the indexed annuity purchaser's premium payment in the general account, which protects them from declines in the index. The premiums are never invested in a pass-through account, which would provide the benefit of the dividends, but also expose the purchaser to risk should the market decline. For this reason, the dividends cannot be passed on to the purchaser. **So you see, the insurance company cannot pass on the dividends if they do not have them to begin with.** This is clearly not a detriment to indexed annuities, but it is not surprising to see someone who is unfamiliar with these products, as Mr. Lindauer is, making such a mistake.

Further proving how little Mr. Lindauer knows about these products he writes about, he purports that indexed annuity "projections" don't show the guarantees on the product. He is wrong. Despite the fact that they do show illustrated values on a current basis (based on current rates), they also show illustrated values on a guaranteed basis (for a worst-case scenario comparison).

In addition, the guarantees on indexed annuities apply from day one of the contract. He inaccurately believes that they "only apply if you hold the annuity until...the end of the surrender period."

The maturity date on indexed annuities is not the same as the end of the surrender period either, despite what Mr. Lindauer purports. The end of the surrender period is the point at which the purchaser can access 100% of the account value, without being subject to penalties. The maturity date is the latest point at which the purchaser MUST take lifetime income from the contract. So yet again, Mr. Lindauer lacks knowledge on the products he claims to be an authority on.

You cannot lose money in an indexed annuity as a result of market downturn; this is a widely-known and highly-marketed feature of indexed annuities. However, Mr. Lindauer is twisting this feature to mean something it does not: that the purchaser of an indexed annuity cannot lose money in any event. While it is true that purchasers of indexed annuities can get back less than what they paid into the product, if they cash surrender the product prior to the expiration of surrender charges, this is true of all annuities. It is silly to suggest that the purchaser of ANY ANNUITY would be able to cash surrender, and receive back 100% of their monies, during the surrender charge period. *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. For Mr. Lindauer to suggest that the products are illiquid is simply absurd.

Despite what Mr. Mel Lindauer says, there are no “guaranteed minimum income benefits” on indexed annuities. This is a feature that is not necessary, as a GMIB provides principal protection on risk money products (such as variable annuities). Indexed annuities inherently offer principal protection, without the aid of any living benefit riders such as GMIBs.

Contrary what Mr. Lindauer believes, there is only one indexed annuity available today that provides a higher value that is only available upon annuitization. Sales of this product accounted for a less than 1% of total 2Q2010 sales. For him to suggest that all indexed annuities function in this manner is absolutely irresponsible.

My biggest complaint with Mr. Lindauer’s article is that he has very little understanding of indexed annuities’ product features, marketing and regulation. Specifically, he cites that the SEC had “attempted to improve protections” for purchasers of indexed annuities. This is untrue. Purchasers of indexed annuities are already quite amply protected by the 50 insurance commissioners that comprise the National Association of Insurance Commissioners (NAIC). The former proposed regulations on indexed annuities that the SEC offered would merely have provided a second set of duplicative and unnecessary regulations on indexed annuities. This would have resulted in increased costs (which would have ultimately have been passed-on to indexed annuity purchasers). Mr. Lindauer believes that those selling indexed annuities should be licensed to sell securities when in fact, indexed annuities are insurance and not securities at all. Furthermore, he is unaware of the fact that there are strict training requirements for agents selling indexed annuities, which ensure that the agent thoroughly understand the product that they are selling. In addition, we already have strict suitability requirements in the indexed annuity industry through the NAIC, and have since 2003; yet Mr. Lindauer alludes there are no such protections in this industry.

And while Mr. Lindauer is correct in stating that the U.S. District of Columbia Appeals Court decided that the SEC does in fact “have the authority to classify this product as a security,” he appears to be quite ignorant of the facts behind that statement. In actuality, the SEC has the authority to classify **donuts** as securities if they feel like, as the U.S. Constitution gives Congress

the authority to appoint governmental organizations (such as the SEC) to act on their behalf. So, the SEC certainly does have the authority to do this, but what Mr. Lindauer fails to realize is that the SEC must also prove that they have good reason for declaring regulation over a product that they currently hold no authority to regulate. Fortunately, Mr. Lindauer didn't pick-up on the fact that the court ruled that the SEC's actions were "arbitrary and capricious," and that they needed to provide evidence that regulating indexed annuities would improve "competition, capital formation, and efficiency." The SEC was not able to do this and the SEC's rule was thereafter vacated by the Court as a result.

Providing further evidence of just how little Mr. Lindauer keeps-up with information on the indexed annuity market, the issue of the SEC trying to gain regulatory authority over indexed annuities had been settled for nearly two months at the time his article was published. The Court vacated the SEC's Rule 151A on July 12, 2010. In addition, the fixed insurance status of indexed annuities was thereafter permanently secured on July 21, 2010 when President Obama signed the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. It appears Mr. Lindauer needs to verify his data before publishing it in the future.

Mr. Lindauer points to the Financial Industry Regulatory Authority (FINRA) for information on indexed annuities, when he should not. Sadly, the Financial Industry Regulatory Authority (FINRA) has been contacted and corrected numerous times on the inaccuracies in the Investor Alert on Indexed Annuities (see attached), which Mr. Lindauer references in his 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 or Mr. Lindauer 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.

I have neither the time, nor the energy, to go over the myriad of inaccuracies in Mr. Craig McCann's paper on indexed annuities. Not surprisingly, he has a background in securities and compares indexed annuities to securities products, which is completely inappropriate. He has neither product knowledge or mechanical knowledge of the indexed crediting on these products and I have found that his paper is not credible. Despite the fact that he has a Ph.D., he is not an authority on indexed annuities. Reference to his paper in this instance is incredulous. Furthermore, Mr. McCann used to work for the SEC, who had a vested interest in regulating indexed annuities as securities products. I would hardly find his "analysis" on these products to be credible or unbiased.

Lastly, it is horrific that Mr. Lindauer would suggest his readers "just say 'no' when someone tries to sell" them an indexed annuity. For him to make such a blanket statement without considering proper suitability on an individual basis is dangerous. What he fails to realize is that not everyone has the risk tolerance for stocks and bonds. Millions of Americans are far better-

suited for a product which provides principal protection, minimum guarantees, and the ability to outpace traditional fixed money instruments.

I sincerely hope that you will reconsider allowing Mr. Mel Lindauer to continue publishing articles in your fine periodical. *Forbes* readers deserve accurate information- particularly on financial services products. Never has there been a greater need for reliable information on retirement income products, than in the wake of the market collapse. Your magazine has the ability to be a beacon of light, to help aid in your readers' financial literacy during a time when they are searching for answers. I pray that you will choose to take the high-road this time, and tell Mr. Lindauer that it is NOT OKAY with *Forbes* that he publish inaccurate information in your magazine in the future.

Thank you sincerely for your time and consideration; and should you have a need for hard facts and information on indexed insurance products in the future, please do not hesitate to reach out to me or my firm. We are always more than happy to serve as a resource on indexed annuities.

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