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National Association for Fixed Annuities

Securing the Future!

Talking Points

Response to *Money* magazine article "The Safety Trap" – January/February 2011 Issue

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The following are talking points you can use for your own education and to answer questions you may receive from clients who have read the *Money* magazine article authored by Lisa Giibs about fixed indexed annuities and entitled "The Safety Trap." The article appeared in the January/February 2011 edition of the magazine.

Summary

The article does state some positive aspects of fixed indexed annuities and offers a rebuttal by industry experts to many of the negative aspects. Unfortunately the conclusion clearly advises consumers to not purchase fixed indexed annuities, which is unfortunate for retirees seeking safety and protection from market fluctuations.

These talking points are provided to you by the National Association for Fixed Annuities (NAFA). NAFA is the only association whose sole purpose it to educate regulators, legislators, consumers, members of the media, industry personnel, and distributors about fixed annuities (including indexed annuities) and their benefits to retirees and those planning retirement.

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Talking Points

The talking points that follow address assertions that were made in the Money Magazine article “The Safety Trap” that NAFA believes were either biased or inaccurate.

Assertion: Surrender penalties are onerous, both in duration and amount.

Response: The surrender charges are necessary to allow the carriers to invest in long-term financial vehicles which can provide higher credited interest rates than investments with shorter durations. It naturally follows that those customers who break the time commitment cost the carrier money, because the carrier has already credited bonuses or annual interest credits not possible without the lengthier time commitment. That loss could be recovered in a variety of aggregate ways, but the surrender charge method only asks those customers who break the time commitment to bear the loss. Surrender charges are necessary and fair.

Consumers can choose from a wide variety of surrender periods. There are fixed indexed annuities with low surrender charges and short surrender periods (as short as three years). However, because a longer, higher surrender charge typically provides higher interest potential and because the charge is completely avoidable if customers follow the annuity’s liquidity rules, products with longer, higher surrender charges tend to be more popular with consumers. The most popular surrender charge duration selected by consumers is about 10 years.

Assertion: The bonuses provide no real value to consumers.

Response: Products with lower and shorter surrender charges have no/ lower bonus interest credits, and products with higher and longer surrender charges have higher bonus interest credits. For a consumer who holds the annuity longer than the surrender charge period, the bonus annuity results in more interest earned.

Assertion: The products are overly complex.

Response: We are reminded of Henry Ford's famous expression that consumers could have the 1909 Ford Model T painted in any color they like, as long as it is black. The reality is that having choices is good for consumers. We don't criticize the automobile industry for its variety when we struggle to find the headlight switch in every rental car.

All fixed indexed annuities share the same basic chassis, which is very simple: in periods (typically one-year) where the index declines, they protect principal and all previously credited interest from loss – the annuity owner earns zero interest. In periods where the index increases, they credit an interest rate which is a simple calculation of the index increase. Each annuity owner can easily calculate their own interest or view their annual report which is simple and easy to understand.

Assertion: The FIA performance is inferior to a portfolio consisting of 85% bank CD's and 15% an S&P 500 index fund, or taxable bond funds, or 5-year CD's.

Response: Fixed indexed annuities should not be considered investments nor should they be compared to risk-based investments. Fixed indexed annuities are not securities. Fixed indexed annuity owners do not invest in underlying markets and do not own any securities as part of the product. Fixed indexed annuity owners do not lose principal – including previously credited interest - due to market fluctuations. This is the clear difference between fixed indexed annuities and securities.

It is entirely possible to take a look at the past and find financial vehicles that historically have provided a superior return to fixed indexed annuities or that have historically provided a satisfactory level of safety relative to fixed indexed annuities. However, there a number of favorable economic conditions in the past that may not necessarily hold true in the future.

In theory, consumers could replicate the performance of some fixed indexed annuities, but only by buying what insurance carriers purchase to back fixed indexed annuities: a combination of bonds and stock index options. The reality is that few consumers have the financial sophistication to actually do so, nor do they have the buying power that carriers have. Thus, insurance carriers are essentially making the benefits of this sophisticated strategy available to the average consumer, which is a wonderful service to the marketplace.

Assertion: The FIA performance is inadequate because the caps are low and can change every year, and because they exclude the dividend yield.

Response: It is unfortunate that the article makes a direct comparison here between the potential returns offered by stocks versus fixed indexed annuities. Because of the guaranteed safety features provided by fixed indexed annuities, it is entirely unfair to compare them directly to holdings of stock. Fixed indexed annuities – by protecting consumers from fluctuations in market value – are not only much safer than stocks, they are even safer than bonds and bond mutual funds.

There is no financial product anywhere that provides stock returns, including dividends, yet fully guarantees that the effect of a down year in the stock market will be immediately eliminated.

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Assertion: That the lifetime income feature is inferior to (or at least no better than) an immediate annuity.

Response: Many people don't know or can't predict when they will need income. While an immediate annuity is an excellent consideration for someone who needs income ***today*** a fixed deferred indexed annuity is the choice for someone who wants to DEFER the choice for income until they need it – and if they need it. Meanwhile they enjoy peace of mind knowing that their deferred annuity guarantees an income for life if needed. In addition, if a consumer chooses, they can simply exchange the deferred annuity for an immediate annuity that offers a more competitive payout.

Another appealing feature of fixed indexed annuities is the promise of guaranteed lifetime income at a future date while providing accumulation potential and continued access to most if not all of their initial premium through a guaranteed lifetime withdrawal or income benefit that is a very common feature on fixed indexed annuities today.

Assertion: The tax deferral aspect of FIAs is redundant for the 58% of buyers whose annuity is an IRA.

Response: The fact that annuities are tax-deferred does not mean that they offer inferior returns to other safe financial products. For consumers who want to have all or a portion of their IRA in safe financial products, if a fixed indexed annuity offers some appealing characteristic – such as the guaranteed lifetime withdrawal benefit or the index-based interest crediting with guaranteed safety features – then a fixed indexed annuity can make sense in an IRA. The most important attraction of the fixed indexed annuity for both IRAs and non-qualified funds is the zero percent interest-rate floor that protects the money from market disasters or simple corrections.

Assertion: FIAs are sold in a deceptive manner.

Response: As fixed indexed annuities have become more popular, insurance regulators and insurance carriers have consistently increased the effort that they put into ensuring that consumers are more likely than ever before to understand the financial product they have bought and that agents are more likely than ever to follow a process that prevents unsuitable sales.

The NAIC Suitability Model approved by the NAIC last March requires that all fixed annuity sales, including sales of fixed indexed annuities, be sold using prescribed suitability determination criteria that was designed after the FINRA suitability standards. In addition each and every sale must be reviewed ***a second time*** by the insurance company to ensure that the standards have been addressed by the producer's review process and suitability determination.

Assertion: FIAs pay unusually high commissions to sales agents that lead to abuses in the sales process.

Response: All financial vehicles have to cover the provider's sales and marketing expenses. Over time, the margins built into an annuity to cover commissions are not necessarily higher than the sales and marketing expense margins built into competing financial vehicles.

Consider, for example, the typical fee-based financial advisor. Such an advisor will often charge a fee of around 1% of assets annually, in addition to the expenses and fees built into the product itself. Now compare this to one of the best-selling fixed indexed annuity in the marketplace, which gives agents a choice of being paid a 7% commission in year 1, or a 2.25% commission in year 1 followed by a 1% annual trail commission. The 7% commission is hardly egregious, as it is about the same as the present value of fees charged by security advisors.

Despite the fact that fixed indexed annuities pay no more and no less than fee-based financial products over comparable time horizons, the state insurance departments' standards for suitability determination leave no room for abuses resulting from commission-driven sales. The regulation states that "an insurer shall not issue an annuity recommended to a consumer unless there is a reasonable basis to believe the annuity is suitable based on the consumer's suitability information."

Assertion: FIAs are inadequately regulated by state insurance regulators.

Response: State insurance regulators have a long history of protecting the public and responding to their concerns. Many annuity owners are very comforted knowing that if they have a problem with an insurance carrier or a producer, they can seek redress from a regulator who is charged with protecting all insurance customers in their home state and who holds the power to assess fines, revoke licenses and file criminal charges. And, unlike security regulation, they do not have to submit to a lengthy and costly mediation process.