The Cry Over Indexed Annuities: FACT OR FICTION NAFA Sets the Record Straight

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National Association for Fixed Annuities

Securing the future!

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Declared rate and indexed annuities are under attack on multiple fronts including: inaccurate, one-sided stories in the consumer and business media, class action lawsuits and last but not least, the National Association of Securities Dealers (NASD). While these outlets are entitled to their own opinion, NAFA, the National Association for Fixed Annuities, would like to set the record straight on fact versus fiction and ask your assistance in making the facts better known.

Fact #1 - Annuities are NOT SECURITIES

The NASD concedes that it is not their role to determine the securities status of an insurance contract or other financial instrument. Still, in their August notice to members (NTM 05-50) they publicly stated their strong recommendation that indexed annuities be treated as securities by member firms. There has been no demonstration of public concern sufficient to warrant such statements, nor are there an unusual number of complaints that would suggest a public demand or need for increased regulation. NAFA maintains that indexed annuities are NOT per se securities and that the various positions of the NASD and others fail to consider the core features of Indexed Products that make them eligible for exclusion from registration as a security. The exclusive focus on a selection of inappropriate sales practices by a segment of the sellers does not provide a balanced and legally vigorous securities law analysis. Furthermore, NAFA contends that the NTM creates an anti-competitive climate because, in the absence of guidance from the SEC, NASD members may fear disciplinary action for all past and future sales of a perfectly viable, suitable and appropriate insurance product. The 7% decrease in indexed sales last quarter may well be attributable to this unfavorable climate.

Fact #2 - Annuities ARE suitable for seniors

Many journalists and commentators assume the maturity of an annuity makes it unsuitable for seniors. The truth is that "maturity date" means practically nothing in an annuity. This term carried over from when companies patterned annuity contract language after life policies, which paid a death benefit or endowment at maturity. All it means in a modern annuity is the date when the company would automatically convert the owner to income payments or full distribution from product. In fact, consumers usually want longer maturity dates, and most if not all carriers grant them upon request. Extending the maturity means the owner has a longer period to allow cash value to accumulate and keep their options open.

The annuitization misconception is that many older clients may die before they could ever annuitize the policy. Most annuity policies, however, allow early annuitization regardless of any stated date in the policy. The only question is whether the company applies the full value or value net of the stated surrender charge to generate the payouts. In many cases, the policy is a good deal even net of the surrender charge. Many policies allow payout to begin earlier than the end of term (on a guaranteed or company practice basis) without any surrender charge. Many of these start as early as one year after issue.

The key to the suitability of an annuity for a particular client is whether the client can get money out when he/she needs it through annuitizing, withdrawals, or at nursing home admission, terminal diagnosis or death. The job of a qualified insurance or financial adviser is to inform annuity clients when and under what conditions they can get their money and educate them about the suitable match between client needs and product liquidity. If a client is likely to want shortly after issue, an income stream either greater than the free partial withdrawal or a lifetime income, most agents make sure it is allowed (and preferably guaranteed) by the product without surrender charge. Many annuities provide for this need.

Fact #3: Most Seniors ARE NOT "duped" into buying an annuity and the majority of sales ARE NOT unscrupulous or misleading

We have seen some states and some lawsuits contend that when people reach the age of 65 they are suddenly incompetent and unable to make a quality purchase decision about this product. The assumption is that seniors, as a class, are influenced and deceived into writing the check for a safe and secure product. The assumption ignores that these same products are highly regulated by each individual state and features are fully disclosed on state approved and required forms. Apparently, these same seniors are competent, however, to purchase cars, houses, stocks, and other high-dollar items. The bottom line: there are no medical, psychological, emotional or other reasons to assume that seniors cannot make informed financial decisions. A good agent will fully explain and document the key annuity features that govern when and how clients can get their money.

There is a small minority of agents who have used unscrupulous or misleading sales methods, and their misdeeds have fueled the fires of criticism. NAFA does not condone or approve those individual actions and in fact acts to educate the industry on the suitable sale of these products. However, NAFA does not agree with the implication that these activities are widespread or endemic. The vast majority of entirely appropriate sales should not be vilified when there is ***NO consumer evidence*** to support it!

Fact #4: Not all annuities carry long surrender charges and not all long surrender charges are unsuitable for investors

How long is too long for surrender charges, and how old is too old for any surrender charge? It depends. A typical 65 year-old, female annuity purchaser today lives 22.5 more years. All companies have maximum ages for issuing annuities. Nevertheless, let’s assume that an 80 year-old female with a life expectancy of 10.8 years, purchased a 15-year, high surrender charge product. Is there harm or unsuitability? Not always. If a basic needs analysis of the client determined that she has no foreseeable income needs from the money in question and she wants to pass the money to her heirs, her income needs are nominal and usually fully met by liquidity provisions. Also, in many cases surrender fees may be ***waived*** at death. Treating all seniors as having the exact same financial needs and requiring that they only buy annuities with a short surrender period is like making all seniors buy a Yugo so no one goes too fast or prohibiting everyone over the age of 65 from buying stocks because some might lose money!

Fact #5: These products DON’T all pay high commissions

Many journalists have sounded the alarm that these products pay "exorbitant" commissions. The compensation for indexed annuities is paid similarly to many other insurance products and for most the producer or broker only receives compensation in the year of the sale. Insurance products are not the only savings and financial products that pay compensation. At this time of the year, the financial news is replete with stories regarding the bonuses payable to investment bankers. Most annuities today pay an agent less than 10% commission (and that only for longer-term annuities) at the time of sale. Considering the agent is responsible to servicing the needs of the policyowner for the life of the annuity, this single payment also compensates for the long-term commitment. In fact, the NAIC model law recently passed and adopted in most states will effectively prevent the sale of annuities with agent commissions higher than 10%.

What NAFA Is Doing

NAFA feels that there are legitimate issues to debate, but the critics are hampering an objective hearing of the facts.

NAFA's position is clear and substantiated. These are insurance products not per se securities; and they are an important, appropriate, and suitable part of a sound retirement or savings plan. It is important that this message reaches both the regulators and the public in general, and NAFA intends to move in that direction through a broad dissemination of the facts.

Sincerely,

NAFA Board of Directors
