life annuity specialist

Fixed-Indexed Annuities

# ‘Too Good to Be True’ Annuity Illustrations Spur Criticisms

By Warren S. Hersch March 1, 2021

Life insurers need to rein in unrealistically high rates of returns in product illustrations for fixed-indexed annuities, according to a financial advisor.

**Anil Vazirani**, the CEO of **Secured Financial Solutions**, says too many products with proprietary indexes — from Fidelity, JPMorgan, Merrill Lynch, Morgan Stanley, Putnam and others — dangle the lure of double-digit yields without a track record to justify them.

*Secured Financial Solutions CEO Anil Vazirani*

“If somebody tells you that I can help you generate 10%, 11% or 12% annualized returns without any risk to your principal, it’s too good to be true because indexed annuities have never delivered on those types of returns,” says Vazirani.

How insurers illustrate performance has been a hot issue for indexed products, especially for universal life insurance. But the concern has been prominent for fixed-indexed annuities as well.

In the third quarter of 2020, the most recent period for which data is available, 51.7% of indexed annuity sales were with a hybrid, or proprietary index, according to **Wink**’s Sales & Market Report. That’s up from 39.2% in the fourth quarter of 2019.

The products often are projected to perform well but also have very little history, so critics argue the illustrations are misleading.

A white paper by Vazirani observes that illustrations often don’t clearly explain that a product’s performance is hypothetical and based on backtesting against historical returns. In actuality, the paper notes, most of the products pay zero percent after a two- to five-year term.

Often, proprietary fixed-indexed annuities "restrict the potential for earning by setting caps on annual gains and/or excluding dividends from the calculation of payouts, thereby limiting what consumers can earn even if the particular index performs extremely well," the paper states.

Vazirani thinks indexed annuities should show only guaranteed rates of return or be treated as securities and be registered with the **Securities and Exchange Commission**.

*Jonathon Armstrong, an advisor at Armstrong Financial Planning*

**Jonathon Armstrong,** an advisor at **Armstrong Financial Planning** says proprietary indexes should have a track record of 10-plus years before a carrier can use them for an annuity.

Another problem is that consumers are being sold the products by agents who really should have a securities license. As it is, agents don't have to because indexed annuities are regulated by state insurance departments.

"If you can pitch a product that shows a 50% return that is linked to the stock market — and that in the consumer's mind works like the stock market — then why would that life insurance agent ever get a different license?" he asks.

**Arizona Law**

Vazirani and Armstrong helped to spearhead legislation carrying a 10-year back-testing requirement that was incorporated into an Arizona law passed in 2019. The law stipulates that an index can't be used to illustrate the value of a fixed-indexed annuity if it hasn't existed for at least 10 years.

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The Arizona law mirrors an annuity disclosure model regulation of the **National Association of Insurance Commissioners** that prohibits the illustration of indexes that have been in existence for fewer than 10 years.

Still, many states haven't adopted the requirement. If they did, it would severely curtail the availability of certain products.

"There are more than 120 different indices available on indexed annuities today," says Wink CEO **Sheryl Moore**. Fewer than a third of the indexes "have been in existence for at least a decade," she adds, citing Wink's Index Intelligence Report.

*Wink CEO Sheryl Moore*

*Finseca CEO Marc Cadin*

But even for indexes that have been around that long, a 10-year look-back period may not be enough to judge their merits. **Tamiko Toland**, head of annuity research for Cannex, observes that the recent bull market hasn't been a good model to show how a product might perform in "bad return years."

An NAIC working group has been considering revisions to its annuity disclosure model regulation, but hasn't reached a consensus on changes, according to the association.

**Finseca** CEO **Marc Cadin** says in an e-mailed statement that the industry and policymakers need to work closely to ensure that consumers have a consistent set of rules regardless of which state they reside in or which product they're using.

"We are deeply committed to ensuring that consumers understand illustrations and will work with state regulators to ensure they continue to be an educational tool that helps them better understand their financial security," he says in an email.

**Other Issues to Tackle**

For **Ethan Schwartz**, a consultant and author, one problem is that product illustrations don't emphasize that contractual terms may not stay the same after the product is sold, as the insurer has a unilateral right to change the terms and incorporate a new formula for crediting interest.

He sees as an even bigger issue that the illustrations don't show policyholders what they could have earned instead with an equally safe alternative investment.

"One can usually design a mutual fund investment that is arguably just as safe, if not safer, than the annuity — and that historically would beat the returns on the annuity 90% of the time," he says. "And that is not illustrated anywhere."

Improved disclosures in illustrations — like displaying in "big red letters" the annuity issuer's right to change a contract's terms — would help consumers make informed annuity purchases, says Schwartz. He also supports stronger best interest rules that "would force financial advisors and insurance salesmen to show and discuss at length when there was a better option."