Variable annuity sales raising concern: Finra official

Product remains at top of investor complaint list and the self-regulator wants to ensure investors understand what they're getting into

By **Mark Schoeff Jr.**
Jun 30, 2014

A Finra official on Monday expressed concern over the sale of variable annuities, as investors look for higher returns and the products become more complex.

Carlo di Florio, chief risk officer and head of strategy at the **Financial Industry Regulatory Authority** Inc., said variable annuities are taking on features that resemble complex structured products. For instance, they have caps that limit how high returns can go during market rallies and buffers that put a floor on how far they can fall during market slumps.

The broker-dealer self-regulator wants to ensure investors understand what they're getting into when they buy these vehicles.

“That's something we're very focused on,” Mr. Di Florio said at the Insured Retirement Institute Government, Legal and Regulatory Conference in Washington. “Variable annuities remain one of the products that's always at the top of the [investor] complaint list.”

Investors have frustrations about disclosures, sales practices and surrender rules with variable annuities, according to Mr. Di Florio.

During a question-and-answer session, a conference participant pressed Mr. Di Florio on why Finra does not provide a specific rule on how much variable-annuity weight is too much in a portfolio.

“The thing that keeps us from issuing very prescriptive guidance is that when we get into these firms, it really is [a] facts-and-circumstances [review],” Mr. Di Florio said.

Whether a variable-annuity portion of a portfolio is appropriate depends on the client's objectives, Mr. Di Florio said. He stressed the importance of a broker's discussing those parameters before putting a customer into a complex variable annuity.

“The dialogue and disclosures are critical,” he said.

He also mentioned complex products and interest-rate-sensitive products as other vehicles Finra is monitoring.

James S. Shorris, executive vice president and deputy general counsel at **LPL Financial**, said financial advisers are put in a tough position when clients demand returns in the current low-interest-rate environment.

“You don't want to chase people into equities,” said Mr. Shorris, who moderated Mr. Di Florio's session. “Where do you send them? Where do they get that yield? We're struggling on that front. It's hard to find a reasonable yield if you're a retiree, and so we are seeing more equity … which creates more risk.”

New annuities offer exposure to equities and downside protection

As sales of indexed annuities surge, insurers look for the next best thing

By **Darla Mercado**
Jun 11, 2014

For life insurers, the next big area for product development is the uncapped indexed annuity: a strategy that purports to allow nervous clients to benefit from surging equity indexes while having downside protection.

The last six to 12 months have been hot on the development front for life insurers that sell indexed annuities. Their enthusiasm is not unfounded: agents and brokers are pretty excited to sell them as either a fixed income piece of the portfolio or as a vehicle for guaranteed lifetime withdrawal benefits. First quarter sales of indexed annuities hit $10.9 billion, according to Wink's Sales and Market Report, up by approximately 39% from the year-ago period.

Say hello to the uncapped indexed annuity, a product that purports to give normally jittery clients a way to benefit from surging equity markets without actually being in the market.

“It's been a game-changer, no question about it,” noted Tom Burns, chief distribution officer at Allianz Life Insurance Co. of North America. The company began incorporating the Barclays U.S. Dynamic Balance Index, an uncapped strategy, in its line of preferred indexed annuities last August. In March, the company began making this strategy available on the Allianz Life Pro+ index universal life insurance policy.

“It resonates well for that adviser who is securities-licensed,” Mr. Burns noted. And the strategy is getting results. The average-size indexed annuity ticket is about 20% larger for sales using the Barclays uncapped strategy compared with sales of indexed annuities that aren't using uncapped strategies, he added.

In a typical indexed annuity, clients' accounts receive a minimum guaranteed rate of interest. Carriers will also credit an interest rate that's tied to the performance of an index. The client isn't actually invested in the index.

Normally, clients don't capture the full amount of the index's performance because carriers use a cap. For instance, a contract could have a cap that allows the account to capture 5% of the gain, so if the index rises 20% in a given period, only the 5% portion will be used to calculate the interest. Carriers also have other tools they can use. They can limit the extent to which a client participates in an index.

Uncapped indexes, as the name suggests, don't use index caps to limit returns. But that doesn't mean that clients are now able to grab equity-like returns from this fixed income product. Rather, carriers use another lever to limit the returns in the form of a spread. This spread is set for a period of time and then reset by the carrier, normally on an annual basis, but this can vary based on the product.

Insurers can update the spread for new contracts on a going-forward basis. This way, the spread for products sold in a given month is calculated based on a set of interest rate and options market assumptions, plus other components. Should those factors change the following month, the spread and the assumptions will be updated for new contracts sold afterward.

Indeed, spreads for the uncapped strategy with Allianz's Core Income 7 indexed annuity were set at 90 basis points at the beginning of the year for new contracts. That number is now at 200 basis points, according to Mr. Burns.

“If you turn back the clock to December, the [10-year] Treasury was around 3%,” he noted. “For the second half of this year, people are saying that the 10-year will be at 3% to 3.25%, so if the yields look better, we can bring the spread back down [for new products going forward].”

Allianz isn't the only one in the uncapped indexed annuity game. In February, Nationwide Life Insurance Co. launched its New Heights uncapped indexed annuity, building it in collaboration with the Annexus Group, a firm that specializes in product design.

This annuity uses a “balanced allocation strategy” wherein some of the performance is attributed to the movement of the equity index, while another component of the performance is based on a declared interest rate set by the carrier and there's also a spread.

In “down” years for the index, Nationwide won't apply the spread, noted Mike Morrone, associate vice president of business development and product management at the carrier. “The uncapped strategy helps against inflation,” he noted. “You'll have a risk averse or conservative client, and they'll have the ability to have a little more protection against inflation risk.”

At broker-dealers, the product is viewed as a different way to collect interest, but product gatekeepers are wary of clients misunderstanding the uncapped indexed annuity as an equity product that will give them the same level of returns.

“We've been successful in the indexed annuity market because we've been able to meet clients' expectations. They go in knowing they will get no more than 5% to 6% on a cap strategy and they just want to beat fixed annuities or CDs,” said Scott Stolz, senior vice president of Raymond James' Private Client Group-Investment Products.

“With uncapped strategies, if the market is up by 30%, by the time you work through the formula and subtract the spread, the client will get about 8% or 9%,” he said. Clients need to understand that “uncapped” doesn't mean that they'll get equity-like returns, but rather they may beat the capped strategy by 1% to 1.5%.

Other firms are analyzing the offerings at the moment, as is the case with Janney Montgomery Scott.

“We're dipping our toes into the water cautiously,” said Bob Steinke, head of managed and insured solutions at the firm. “Clients are interested in more upside and sharing some of it, rather than being capped in an upmarket and seeing the excess growth go to the house, even with the downside protection,” he added. “But on that particular product, [carriers] do raise the spread.”

The ideal candidate for this product is a conservative investor, or what Mr. Stolz dubs “a chicken equity buyer.” “They want equities until their statement goes down,” he said.

Darla Mercado

Darla Mercado covers life insurance, annuities and retirement products for InvestmentNews, and she's looking for advisers' informed opinions, plus chatter on products and other industry developments.