

Why Big Insurers Are Staying Away From This Year's Hot Investment Product

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One of the insurance industry's hottest products is coming under fire -- from insurance companies.

Sales of equity-indexed annuities have soared, hauling in \$23 billion in 2004 and an additional \$21 billion in the first nine months of this year, according to annuity tracker Advantage Compendium. These products aim to capture part of the stock market's gain, while guaranteeing that investors will at least break even or earn a modest return. That mix of upside potential and downside protection has proven especially popular with seniors.

But even as EIAs attract a heap of assets, they have also attracted a heap of criticism for their mind-boggling complexity, potentially poor performance, the 9% and 10% commissions often paid to salesmen, and surrender charges that can last for 10 years or more. Sound bad? Even insurance executives are complaining.

- **Under attack.** Equity-indexed annuities have been feeling the heat all year. In June, the state of New Jersey limited the surrender charges on tax-deferred annuities sold within the state to 10 years or age 70, whichever is longer.

In August, the National Association of Securities Dealers recommended that broker-dealers tighten their procedures for supervising equity-indexed annuity sales by their financial advisers. Last month, the Massachusetts Securities Division filed an administrative complaint alleging that a broker-dealer failed to supervise its advisers, leading to "unsuitable sales," including selling equity-indexed annuities with long surrender charges to seniors.

Meanwhile, there have been a spate of lawsuits claiming EIA sales abuses. In Florida alone, two class-action lawsuits and more than 40 individual lawsuits have been filed by Fort Lauderdale law firm Gordon Hargrove & James.

Of course, lawsuits and regulatory actions are nothing new for an insurance product. Instead, the big surprise has been the sniping within the usually tight-lipped insurance business. The biggest sellers of equity-indexed annuities are mostly midsize insurers. Many big, well-known companies have steered clear of the product -- and their executives are often more than happy to explain why.

"These products are so complicated that I think it's a stretch to believe that the agents, much less the clients, understand what they've got," contends Rebekah Barsch, vice president of investment products at Northwestern Mutual. "The commissions are extreme. The surrender periods are too long. The complexity is way too high."

Another major insurer, MassMutual Financial Group, has even sent a four-page analysis to its salesmen, detailing the company's concerns. The insurer looked at how an annuity based on the Standard & Poor's 500-stock index would have performed over the 30 years ended December 2003.

In its calculation, MassMutual assumed that annuity investors would have at least broken even in any given year and that they didn't get any benefit from the S&P 500's dividends - both common features with EIAs. MassMutual also assumed that the annuity had a 9.4% annual cap on returns. Equity-indexed annuities typically impose some limit on an investor's annual gain.

- **Result?** Over the 30 years, the equity-indexed annuity would have delivered just 5.8% a year, far below the 8.5% for the S&P 500 without dividends and the 12.2% for the S&P 500 with dividends reinvested. Indeed, annuity investors would have been better off in supersafe Treasury bills, which delivered 6.4% a year.

"There's a high chance that you could have dissatisfied customers, and that's not good for anyone," says **MetLife** President Robert Henrikson. "We have no desire to" bring out the product.

- **Reducing abuses.** So far, many major insurers have made the same decision. Peter Katt, a fee-only insurance adviser in Mattawan, Mich., looked at a list of the 10 insurers with the biggest equity-indexed annuity sales over the three months through Sept. 30.

"You don't see New York Life, MassMutual, Northwestern and Guardian Life on the list," he notes. "Those are the quality companies. And they aren't selling them." In fact, ING Group is the only big seller of EIAs that ranks among the 20 largest U.S. life insurers based on 2004 assets, as calculated by A.M. Best.

In a statement, ING notes that investors have different needs, so it strives to offer a broad array of products. The company says equity-indexed annuities can be a good choice for folks who want protection against market declines, while still having the chance to clock long-term growth.

It isn't just big insurers that are shunning the product. Recently, Donald Moine wrote a series of articles on equity-indexed annuities for MorningstarAdvisor.com, a Web site geared to financial advisers. "I've received over 1,500 emails," he says. "Maybe 1,400 of the emails say, 'You aren't being critical enough.' "

Michael Tripses, who sits on the board of Milwaukee's National Association for Fixed Annuities, dismisses such criticism. "From what I've seen, it's no more likely that an equity-indexed annuity will get missold" than any other investment product, he says.

Meanwhile, Mr. Tripses views the response of major insurers as typical of staid companies faced with an innovative product. "Initially, they ignore it," he says. "Once there's some acceptance by the public, they attack it. And eventually they adopt it."

Let's hope Mr. Tripses is right. If major insurers muscle into the market, it will likely bring down costs and reduce selling abuses. Hartford Financial Services, for one, says it might launch an EIA in 2006.

The annuities "are much more expensive than they need to be," says John Walters, a Hartford executive vice president. "We think there's a good way to do it, if you bring down the costs and bring down the commission and put that back into the value of the product."

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