

SERVING UP EQUITY INDEXED ANNUITIES

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One of the more popular items being sold on the free lunch/dinner seminar circuit is the equity indexed annuity. It is our opinion that EIA's are a seriously deficient financial product. I do not even like calling it a product; it is more of a high fee/commission gimmick. According to an April 2 report in the National Underwriter, sales of EIA's topped \$25 billion last year. That isn't chump change. Unfortunately people are still buying.

EIA's were first introduced in 1995 and were sold as a way to seize stock market returns on the upside while subsequently receiving guaranteed return on the downside. What a sales pitch, **"No risk! Great return!"** The realities of EIA's are quite different.

Craig McCann, PhD CFA and Dengpan Luo, PhD CFA, of the Securities Litigation and Consulting Group wrote in a 2006 research paper that EIA's carry *"exorbitant and indeterminable costs, lack of federal regulation and an inability to decipher what the investments will earn."* Among other problems, *"EIA's are complicated investments sold to unsophisticated investors without regulatory safeguards afforded to purchasers of similar investments."* The two researchers concluded that, *"We estimate that between 15% and 20% of the premium paid by investors in equity-indexed annuities is a transfer of wealth from unsophisticated investors to insurance companies and their sales forces. The complexity of these products makes it virtually impossible even for brokers and agents to properly evaluate the annuities; salesmen can readily determine that commissions paid for selling EIA are as high as 10% or 12% which are much larger than mutual funds and variable annuities"*.

The following are more issues we have with equity indexed annuities: First, there is usually a cap on how much you can earn, even if the S&P 500 shoots up. Second, they don't measure the gains on the index to include dividends, historically a large part of the S&P return. As we have foretold here in the newsletter and the radio show, more and more companies are issuing and raising dividends. Why would anyone want to give that up? Third, they come up with all sorts of gimmicks, like *"point to point"* which relies on single point in time to calculate interest. Therefore, even if the index that your annuity is linked to is going up throughout the term of your investment, if it declines dramatically on the last day of the term, then part or all of the earlier gain can be lost. Because interest is not credited until the end of the term, you may not receive any index-linked gain if you surrender your EIA early. The bottom line is investors get limited upside, and the downside promise is that you'll break even; for which they charge huge fees to hedge their downside risk with put options. It is also a complete lie that it is impossible to lose money in EIA's. Insurance companies only guarantee that you'll receive 90% of the premiums you paid, plus at least 3% interest. Therefore, if you don't receive any index-linked interest, you could lose money on your investment. One way that you could not receive any index-linked interest is if the index linked to your annuity declines. The other way you may not receive any index-linked interest is if you surrender your EIA before maturity. Some insurance companies will not credit you with index-linked interest when you surrender your annuity early.

"I own an equity indexed annuity, what should I do"?

Unfortunately, there is no easy answer to this question. EIA's often carry hefty surrender charges that make the decision on whether or not to get out a difficult question to answer. If you own one of these products and want an analysis of your options please contact us as soon as possible.

Source Material:
Rowland Mary [What's it Worth?](#) *Financial Planning Magazine* July 2007