FIAs Come In From the Cold-Sort Of

By Kerry Pechter *Thu, Mar 6, 2014*

In this first of a series of RIJ articles on the evolution of fixed indexed annuities, you'll hear from people at three broker-dealers: One who embraces them, one who still avoids them and one who sells them with mixed feelings.

As fixed indexed annuity (FIAs) sales have risen over the past decade—to a record $11.9 billion in the fourth quarter of 2013, according to LIMRA—the product has gained some respect from those in the securities industry who once disdained it.

Solid numbers are hard to come by, and the complexities of annuity sales distribution make it difficult to generalize. But, increasingly, more registered reps with insurance licenses are selling FIAs, a product that insurance agents used to regard as largely their own.

In short, distribution of this structured product—basically a fixed-rate annuity with a fraction of its assets used to buy call options on the S&P500 or another equity index—is broadening. It has spread from the agents to the banks to the independent broker-dealer reps (though not to the wirehouses). Even the most conservative broker-dealers are holding internal meetings about approving certain FIAs..

But the data is fuzzy. Advisers may wear both insurance and securities hats, and some can choose to send an FIA purchase through their broker-dealer or through an insurance wholesaler. "The percentage of FIA sales that is going through broker-dealers is elusive," FIA expert Sheryl Moore, CEO of Wink, told *RIJ*. "None of the sales tracking groups have been able to track that data. We have done surveys, and about 55% of the insurance agents who respond also identify themselves as registered reps."

"My own experience, and I think it's representative, is that a third to a half of FIAs are sold by registered reps," said Paul McGillivray, who leads CreativeOne's FIA wholesaling efforts and broker-dealer relationships in Kansas City, Mo. "That number doesn't show up because the sales go through IMOs (insurance marketing organizations), and we count that as [insurance] agent distribution."

To be sure, the FIAs that are sold by insurance agents through FMOs aren't necessarily the same products that are sold by registered reps through broker/dealers. Manufacturers tend to build more conservative products for the broker-dealer channel. Nor are they always sold in the same way.

Historically, insurance agents and wholesalers have been accused of exaggerating FIA benefits and, judging by some of the ads on the Internet, some still do. But broker-dealer reps remain under FINRA-pressure to position them as safe fixed income investments with more potential yield than a certificate of deposit.

The obvious reason for the spillover of FIA sales from the pure insurance agent and bank adviser channels to the independent broker/dealer channel is the traction that FIAs have gotten in the marketplace. But that only raises the question, why are FIAs getting traction?

Their success is mainly a function of the low interest rate environment. In times like these, when risk-averse older investors are starved for yield and nervous about the stock market, FIAs have a story that helps melt their resistance to act. Contract owners can't lose money, and in the event of a bull market, they won't be entirely left out. Ultra-low rates helped boost FIA sales in the early 2000s, and they're helping today.

The financial crisis and the Boomer retirement wave have also worked to FIAs' advantage. VA manufacturing capacity dropped after the crisis, and FIAs have helped fill the vacuum. Overseas insurers divested their U.S. life insurance properties after the crisis, opening the door to acquisitions by private equity firms, which have brought energy and innovation to the FIA market. And, importantly, FIA manufacturers have added lifetime income riders at a time when Boomers are looking for guaranteed income.

In this first of a series of *RIJ* articles on the evolution of FIAs, you'll hear from people at three different broker-dealers who have responded to the rising popularity of FIAs in different ways. These include Scott Stolz, senior vice president at Raymond James Financial, Nicholas Follett, annuity consultant at Commonwealth Financial Network, and an executive (who requested anonymity) at a broker-dealer that doesn't yet offer FIAs.

'We've stayed away'

For one broker-dealer executive, it's difficult to imagine the ideal customer for an FIA.

"We have stayed away from FIAs in the past. If an advisor asks us about offering them, we say, 'We're looking to see if there's value for them here, but we're not comfortable bringing them to market yet,'" said an executive at an unnamed broker/dealer whose registered reps do not sell FIAs.

"There's been some negativity about them here, partly because of confusion about what they can do. But lately they have a little more clarity," he added. The participation rates have gone up to 100% on some products, rather than 80%. They've added GLWBs. Those developments have made us think more about them. We just have to make sure we understand them and think about how they could work best for us."

This particular manager doesn't see FIAs as no-risk products, because the client faces the risk of a zero return if the equity markets go down. Ipso facto, they're riskier than a fixed-rate annuity that's guaranteed to deliver a specific yield. He's aware that the Achilles heel of "best-of-both-worlds" products is that, under the wrong circumstances, they can flip into "worst-of-both-worlds" products.

For that reason, it's difficult for him to see where FIAs into the risk-tolerance spectrum that financial advisers use to guide their recommendations. "Our problem is identifying whom this is for," he said. "When you think about a client's risk profile, if they are conservative investors, then they can buy a fixed-rate annuity. With the FIA, the challenge is that there's the potential to get nothing. That's our biggest issue."

This broker/dealer is also hesitant to do an about-face on FIAs. "Our advisers haven't been trained on indexed annuities," he said, adding that not so long ago the advisers were commiserating with new clients who’d been saddled with FIAs with long surrender periods and disappointing returns.

“That’s the philosophical challenge we have. [If we start selling these,] some of our advisers will say, ‘We’re finally doing this! This is what I’ve wanted for years.’ But others will say, “I can’t believe we’re doing this! I’ve had terrible experiences with these products.’ In reality, everybody wants everything. The challenge is setting expectations.”

Selectivity reigns at Raymond James

Raymond James sells FIAs, but according to Scott Stolz it is selective about the issuers it represents and the products it offers. The firm has two kinds of advisers, its full-time “wirehouse” advisers and its independent advisers. Of the two, generally speaking, only the independents have embraced FIAs.

“The independents are more insurance-oriented,” Stolz said in an interview. “The experience that most registered reps have had with indexed annuities has been negative. They hear the words indexed annuities and they assume it’s a crappy product. It took us three years to get our wirehouse channel advisers to look at that product.”

But, over the seven years since Stolz first hired an FIA product manager at Raymond James, and started sending advisers through a day-and-a-half FIA training course, the sales force has gradually bought into them and level of FIA sales has, after a slow start, steadily grown.

“We were one of the first broker/dealers to proactively market them,” Stolz said. “The first year of training, everybody left the room saying, ‘Why are they telling us about this product?’ The second year they listened, thinking, ‘I better know how these things work, because other people are pitching them to my clients, and maybe I can sell against them. But it was four years before we saw the needle move.

“We started at zero sales. Then we got to a couple million a month. We sat at $4 million a month for a year, until we began to think $4 million was the limit. Around Year Four—2011—we began to see a significant increase. After the second quarter of last year, we saw an immediate doubling of FIA sales. Now we’re doing $500 million a year. If interest rates start to rise over time, we’ll do $1 billion a year.” That’s not a huge number for Raymond James, which manages $441 billion, but it’s all new business.

“Some of them don’t speak our language,” Stolz told RIJ. “An issue we have is that the FIA industry—particular the companies that have been in indexed annuities for a long time and most independent agents—is that they try to position the FIA as a product that’s halfway between variable and fixed annuities.

“We’ve seen charts where they have overlapping circles where one circle is fixed and the other variable. They always want to stick it in the middle. We blatantly disagree with that. It’s a fixed product and it’s going after the same money as a fixed product. In the long run, the insurance companies say the FIA will average 4.5% a year. But is the client willing to give up a fixed rate in order to get another 1.5% or 2% a year?

“Now, after last year’s equity market, we’re seeing uncapped, monthly-averaging products. These had good returns last year, so now they’re out there saying, ‘You should buy these products because they have almost unlimited upside. You can earn 12% or 15%. But if you say that, you’re creating the wrong expectations,” Stolz told *RIJ*.

“We’ve had no complaints on a single policy. We make the expectation a 4.5% return, and tell people that in some years they’ll get nothing and in other years they’ll get 6%. With that expectation, it’s hard not to be happy. But if the investor is told that he’s buying an equity alternative, he’s not a happy camper unless he gets 10% or 15%. Don’t talk about this as if it’s a ‘safer’ equity play.”

When an FIA has no cap on the upside, Stolz said, it’s difficult to pretend that equity performance isn’t part of the equation. “One manufacturer showed us a product with two-year point-to-point crediting method, uncapped but with a spread of 2.5%. [The client receives all returns in excess of 2.5%.] We said, ‘Why are you taking that approach?’ They said, ‘This allows the client to capture more of the upside when the market does well.’ But then, how do we explain all this to the adviser without a long discussion about equities? You’ll have to talk about equities.”

Raymond James sells FIAs manufactured by Genworth, Protective, Pacific Life, Symetra and Great American. It doesn’t sell Security Benefit FIAs because, despite that company’s rich GLWB rider, the issuer, a unit of Guggenheim Partners, doesn’t quite have an A rating from A.M. Best.

Raymond James advisers also try to use the simpler crediting methods. “We lean toward annual point-to-point and the S&P500 Index,” Stolz said. “It’s easy to understand and we don’t have to explain why they got what they got. Fifteen months ago, we had a case where a husband and wife bought FIAs five or six days apart with 1035 exchanges. The adviser put them into a monthly average product, and one got a 9.25% return and the other got 4.5%. Both were happy, but I couldn’t understand how five or six days could make such a big difference. The monthly average [method] is a crapshoot.”

Commonwealth’s in-house annuity experts

Advisers affiliated with Commonwealth Financial Network, which is based in Waltham, Mass., are selling a lot of FIAs. “Even in the past month it’s been ramping up more and more,” said Nicholas Follett, an annuity specialist at the privately-held independent broker-dealer. “We’re absolutely hearing from more advisers who didn’t sell FIAs before. An adviser will say, ‘I’ve been shying away from indexed annuities but I hear they’re getting better. We say, ‘I understand why you have that feeling.’”

Follett is one of the in-house annuity counselors on whom the firm’s 1,487 advisers rely for guidance when trying to pick a suitable annuity—any type of annuity—for a client. “Commonwealth demands that my position serves as an active consultant to the advisors. I’m like a shoe store salesman that makes sure the client gets a perfect fit,” he told *RIJ*.

A conversation with Follett about FIAs elicits none of the ambivalence toward that product that’s heard at other broker-dealers or from some registered reps. Commonwealth is picky about the FIAs that it approves for its advisers: it has a formal due diligence process, it uses the consultant ALIRT to vet FIA manufacturers, and it screens each sale for suitability. But there’s no hint of disdain.

One sign of liberality: Commonwealth advisers can sell Security Benefit’s FIA even though the company has a B++ financial strength rating from A.M. Best (but A- from Standard & Poor’s) that keeps it out of, for instance, Raymond James. “We prefer an A rating. The lowest rated company we sell is Security Benefit. But we felt compelled to put them there because of their living benefit. We need to be competitive,” Follett told *RIJ*.

“More than any other type of investment products, annuities are ‘horses for courses,’” he added. “You’ve got to pair the right client with the right strategy at the right time. I do a lot of FIA counseling one-on-one with advisors on the phone, walking them through the different crediting methods and cap rates. The simplest method, after the fixed-rate option, is the point-to-point with a cap. It’s easy too explain: ‘You can’t lose money but you can only earn up to a certain point.’”

The same factors that are driving FIA sales elsewhere are driving them at Commonwealth. Fixed-income investors are frustrated with low yields and are looking for alternatives. Retirement income clients and advisers have watched as FIA living benefits “have gotten more robust, while the VA living benefits have been getting weaker,” Follett said.

The interest shown by big-name Wall Street firms in FIAs has only helped the category, Follett added. The presence of Berkshire Hathaway (an investor in Symetra since 2004) and Guggenheim Partners (a 2010 acquiror of Security Benefit), in the FIA business has helped raise advisers’ comfort levels with the product, he said.

“Anecdotally, it’s easier to convince advisers [about FIAs] when you have names like that behind the product, and it makes it easier for the adviser to introduce the products to their clients. They can say, ‘You may not have heard of Symetra, but you’ve heard of Warren Buffett.”

This is the first of an intermittent series of articles about fixed indexed annuities.