If It Ain't Fixed Indexed, It's Broken

By Kerry Pechter *Thu, Jul 30, 2015*

Fixed indexed annuities remain a niche product, representing only about 10% of annuity sales. But that the niche has grown into an almost $50 billion-a-year business. Sales of FIAs have grown especially fast at independent broker-dealers since 2013.

Except for fixed indexed annuities, sales of all annuities declined in the first quarter of this year. You might say that, if it ain't an FIA, it's broken.

A survey of 15 broker-dealers by the Insured Retirement Institute shows that fixed indexed annuities remain a niche product, representing only about 10% of annual annuity sales, but that the niche has grown, with the equity-linked insurance products finding a home at independent broker-dealers.

To be sure, sales of variable annuities still dominate. They account for two-thirds of total annuities sales, the survey showed, and about two-thirds of those are sold lifetime income guarantees. But sales of variable annuities fell to a five-year low in the first quarter of 2015.

FIAs are the only annuity category that grew in 1Q2015 (by 3%). They have helped fill the VA vacuum for registered reps who, too new to have developed a large enough book of business to support a fee-based revenue model, rely heavily on commissions.

The retreat of variable annuities has puzzled some observers. Rising equity prices have provided a reliable tailwind for VA sales in the past. But not this time, for several reasons:

A number of once-major issuers have stopped making VAs, and fewer contracts are 1035-exchanged (because new contracts aren't as rich as the older ones). More than a few advisers say they still feel betrayed by the contract buyback offers tendered by a few insurers, who were desperate to shrink their exposure to the unknown-unknown liabilities lurking in their VA books.

In addition, the shift by some life insurers toward selling low-cost IOVAs (investment-only VAs) has made some broker-dealers skittish. They say it's difficult to demonstrate to their in-house watchdogs that it's suitable to sell an insurance product without insurance features. (IOVAs are built for tax-deferred trading, and typically have no death or living benefit.)

B/D FIA sales growing

An FIA is a structured insurance product. Most of the purchase premium is used to buy bonds, but a small percentage used to buy options on equity indexes. If equity indexes rise, the value of the options rises and the gains are credited to the contract. If equity indexes fall, the options are worth nothing but the underlying bonds grow enough to support a principal guarantee.

Despite their indirect exposure to equity risk, FIAs are not securities; the courts established that in 2009 after SEC commissioner Chris Cox, alarmed by media reports of predatory sales practices, tried to put them under federal jurisdiction. As insurance products, they've been distributed mainly through state-regulated insurance marketing organizations and sold by insurance agents.

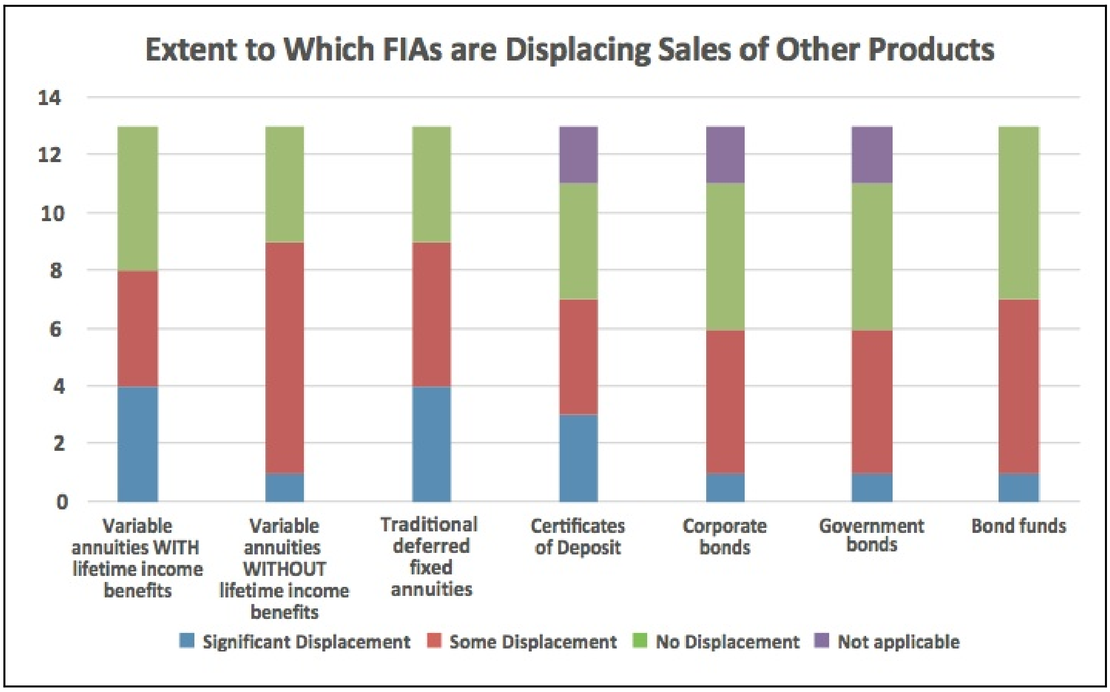
But FIA sales through b/ds have been growing. Some b/ds, such as Edward Jones and Ameriprise, continue to keep FIAs off their product shelves. Others, like Commonwealth Financial Network, have embraced them.

In 2012, independent insurance agents accounted for 84% of $32 billion in FIA sales, while b/ds sold only 4%. In 2013, those numbers were 78%, 4% and $36 billion, and in 2014 independents agents sold 66% and b/ds sold 15% of $48 billion.

Almost all of the growth in the b/d channel has been among the independent b/ds, according to the Saltzman Associates, a Charlotte, NC-based consultant. In the first quarter of 2015, 87% of the $1.52 billion in FIAs sold in the b/d channel was at independent b/ds, with only $67 million at the national and regional broker dealers and $164 million at the wirehouses (Morgan Stanley, Merrill Lynch, UBS and Wells Fargo).

Of the 15 b/ds polled by IRI, six said sales were growing "significantly" and six said sales were growing "modestly." The remaining three said sales were "steady." About one in three expected sales to grow significantly in the future, and seven of 15 expected FIA sales to represent a higher percentage of their annuity sales in the future.

FIAs were found to displace sales of other annuities at b/ds—mainly cannibalizing VAs with lifetime income benefits and traditional fixed annuities. According to the survey (see chart below), executives at four of 15 b/ds said that FIA sales "significantly" displaced sales of each of those two products. Three b/ds said FIAs significantly displaced sales of certificates of deposit.



Of the many crediting strategies that FIAs offer—and which make the product confusing to some people—the b/ds clearly preferred some to others. Asked to consider 13 different strategies, b/ds ranked "annual point-to-point," "monthly point-to-point," "monthly averaging," "multiple index strategies," and "fixed with multi-year" as the most popular.

The least widely used crediting strategies were "daily averaging," "inverse annual point-to-point," "term end-point," "multiple point-to-point" and "fixed with an equity kicker," according to the survey.

Most b/ds work with five or more FIA suppliers. Some work directly through FIA issuers, some through IMOs and some with both IMOs and issuers. The top manufacturer of FIAs has historically been Allianz Life, with Security Benefit Life rising into second place since its purchase by Guggenheim Partners, the private equity firm.

A product for all interest rate climates

IRI asked b/ds what factors they believe would drive FIA sales in the future. The factors most frequently mentioned were higher interest rates, the availability of lifetime income riders, "concern that lifetime income benefits might be less generous in the future," "value of principal protection with some upside potential," and, ironically, "persistent low interest rates."

"Both higher interest rates and persistent low interest rates were cited as potential sales drivers, which seems paradoxical but in fact is simply viewing the product from two different perspectives," the IRI survey said.

"In a persistent low interest rate environment, sales are boosted by the product being an attractive alternative to low interest products such as CDs. As rates rise, index options become less expensive and FIAs are able to provide more upside potential, making the product more attractive from a growth standpoint."

Part of the appeal of selling FIAs has traditionally been the high commissions paid by manufacturers. According to the IRI survey, 64% of FIAs pay gross up-front commissions of 5% or less, but 36% pay 6% or 7%. Invented at Keyport Life in 1995, FIAs were marketed aggressively during the low-interest period after the 2000 dot-com crash by Allianz Life of North America, under then-CEO Robert W. MacDonald.

The products have thrived during the two periods of historically low interest rates since 2000. At such times, they can provide safety with more upside potential than fixed deferred annuities or certificates of deposit. The addition of lifetime income riders to FIAs has helped boost their appeal and their sales in recent years.