'Sometimes the Market Swings Your Way'

By Kerry Pechter *Fri, Jun 4, 2021*

'On average, there will be no double-digit returns," said Don Dady, co-founder of Annexus. 'But once in a while there will be. We have definitely seen some phenomenal returns with vol-controlled indexes.'

Don Dady and Ron Shurts started **Annexus** in 2005. Lack of discipline in the distribution of index annuities, which led to lawsuits and prosecutions over high-pressure sales practices, was threatening to kill that business.

"Independent distribution was broken. The IMOs [insurance marketing organizations] had no control over the insurance agents. Insurers had no control over the agents. Nobody was supervising them. We saw that we could increase the value proposition of wholesale distribution if we handpicked a select group of distributors and gave them something different to offer," Dady told *RIJ* recently.

"We built a virtual insurance company. Annexus performs all the functions of a life insurer except administration and investments. We'll come up with annuity concepts, we'll price them out, and take them to the insurer, work on the marketing story. We vet different indices and help choose the portfolio of indices that we think will work in a particular product. We 'do it all' without the baggage and overhead of a life company."

Dady welcomes hybrid indexes into the indexed annuity business. "In my opinion, a lot of advisers aren't comfortable with hybrid indexes because they're not sure how they work. So they're just going to sell the S&P 500 Index. It will be a safe approach. The options will be cheaper [because of the ample supply] but the volatility of the index and the participation rates will be lower."

Before volatility controls were applied to the indexes in indexed annuities, they were used to dampen the volatility of the investments of variable annuities with lifetime income guarantees. "The control method was 'just get out' [of equities and into bonds or cash]," he said. "Now you have hybrid smart beta indices, which are designed to drive growth using the same algorithms that asset managers use. 'Value' and 'momentum' are techniques that we can incorporate into the index, with dynamic allocation among the asset classes. There has been a learning curve for advisers and insurers. The insurers get it. The advisers still have work to do."

Like Lau, Dady likes the value proposition of registered index-linked annuities, or RILA. "What's driving the sales of RILAs is the distribution," he said. "There are a lot more securities-licensed producers than insurance producers, and registration creates more credibility. The buffer enhances your option budget in a low-rate environment. The beauty of the products is that they insulate you from some but not all of the market volatility. If somebody is willing to be insulated from only the first 10% loss, that fuels our option budget."

More so than Lau, Dady believes that owners of index annuities can expect to enjoy an occasional year of outperformance. "We shouldn't set the consumer up to expect phenomenal returns from such a low-risk product. On average, there will be no double-digit returns," he told *RIJ*. "But once in a while there will be. We have definitely seen some phenomenal returns with vol-controlled indexes. Sometimes the market swings in your favor."

Annexus is currently partnering with **The Index Standard**, a fintech startup whose founder, Laurence Black, has developed an index evaluation tool for Dady's distribution partners. "With The Index Standard, somebody for first time is pulling the curtains back and explaining the mechanics of the indexes.

"Some of the indices have been reverse engineered to look good in the past, but not necessarily to perform in the future. All of the 10-year look-backs look good. We vet the indexes to see how well-positioned they are on a forecasting basis. Black is asking questions like, 'What drove the past performance of the index?' and 'Does the index have survivor bias? and 'What percent of the index returns came from capital gains on bonds?' We know that the likelihood that interest rates will fall by 300 basis points in the future is very low.

"With The Index Standard, we'll be able to caution advisers about those things. We also want to make sure the contracts allow the adviser to create buckets, where they can diversify across non-correlated indexes. We remind advisers that the product is not designed to outperform equities. In the end, the FIA is a fixed income product. Using an equity index is a way to create a fixed income 'alt.'

"We do not believe that the carriers have done that work for the adviser, We see indices that have been put in products that have not been vetted. Advisers need better tools to evaluate them. Three or four years from now, the industry will have better processes. They'll build a framework to help advisers select indices.

“The low interest rates are definitely a challenge. But it’s all relative. We’re competing against fixed income. Now that the larger world is waking up to the risks of retirement, that’s really opening up our world. We have a major initiative with Nationwide for September in the in-plan space. We reinvented the annuity to make it look like a security. It’s a target date fund that generates a 6% income, designed to kick off income starting at age 65.”