The Latest Chapter in the Indexed Annuity Saga

By Editor Test *Wed, Nov 25, 2009*

In Mooney vs. Allianz Life, the jury didn't award damages because the plaintiffs couldn't prove that they lost money on their investments in indexed annuities.

A federal jury in Minnesota decided in mid-October that Allianz Life Insurance Company of North America used deceptive practices in selling billions of dollars worth of indexed annuities between 2000 and 2007.

But, in the case of Mooney vs. Allianz Life, the jury found no reason to award damages to the estimated 340,000 people who joined the class-action suit against Allianz Life, because they didn’t lose money on the products.

The verdict didn’t necessarily vindicate Allianz Life, but the company doesn’t appear to have suffered from the publicity. Its MasterDex indexed annuity was the top-selling product of its type in the third quarter, and the top-selling fixed annuity in the independent producer channel.

Allianz Life sold $1.4 billion worth of fixed annuities (which include indexed annuities) in the third quarter, second only to industry leader New York Life’s $1.7 billion.

The jury’s decision was, however, a modest vindication for indexed annuities, whose enthusiasts have long insisted can be higher-yielding alternatives to bonds when the Federal Reserve drives short-term interest rates to levels lower than the inflation rate, as it has done twice during the past decade.

“They’re good as an alternative to a bond fund, and they should be viewed as a separate asset class,” said Jack Marrion, who co-authored a recent paper “Real World Index Annuity Returns,” with Geoffrey VanderPal and David Babbel. It was published by the Wharton Financial Institutions Center.

The paper argues in scholarly detail that, despite the negative publicity they have attracted, indexed annuities have done what they were designed to do: protect principal and offer the potential for higher returns than bonds or CDs during low-interest climates.

From 2003 to 2008, for instance, the 19 indexed products that Marrion and his co-authors surveyed provided an average annual return of 6.05% while the S&P 500 returned 3.18%. The average returns masked a wide variation in returns, which ranged from 3.0% a year to 7.80% a year over that period.

That variability or unpredictability, Marrion concedes, is a weakness of indexed annuities. But he says that this weakness stems not from the product design, but from th rate renewal policies of the issuers of the contracts. They have the right to change the terms of the product each year, and may do so to the disadvantage of the contract owner.

“That’s the tough part,” Marrion told RIJ. “You have to rely on the integrity of the carrier. It all comes down to how the company treats you when they re-set. I tell people to get the [issuer’s] renewal history. If they won’t give it to you, don’t buy the product.”

Marrion also concedes that the product has at times been mis-sold as a safe way to invest in an equity index. When someone buys an indexed annuity, about 95% of the premium goes into bonds and the remaining five percent is invested in equity index futures.

“Yes, some people buy this as an alternative to stocks. But if they do, then it’s been mis-sold,” he said. The beauty part of the product, he pointed out, is the fact that each year it can only ratchet up in value and can never slide back. Related products, such as 10-year structured products consisting of zero-coupon bonds and equity index options, do not have annual check valves that prevent the account from giving up its gains, but indexed annuities do.

The controversy over indexed annuities is far from ended, as anyone who has followed this product’s history knows. In mid-2008, the Securities and Exchange Commission passed a rule that would allow it to regulate indexed annuities as securities beginning in 2011. This change would mean that indexed annuities would be sold through broker-dealers instead of through insurance marketing organizations.

But last July, a federal appeals court ruled that, while the SEC had the authority to regulate indexed annuities, the SEC had failed to evaluate the impact that would have on the indexed annuity market. The court sent the matter back to the SEC for further work, and that’s roughly where it stands today.