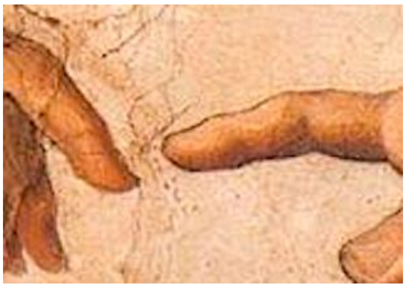
The Point of Indexing (in Annuities)

By Kerry Pechter *Fri, Jun 4, 2021*

Every June, RIJ focuses on indexed annuities. Last year, we studied options in indexed annuities. This year we consider the indexes themselves, especially 'hybrid' and 'volatility-controlled' indexes. Bryan Anderson, Don Dady and David Lau weighed in.



When Jack Bogle introduced indexing to the investing public in the 1970s, competitors mocked him. Investors won't settle for "average" returns, they said. But they were wrong. By 2020, index funds (including exchange-traded funds or ETFs) were worth over $11 trillion worldwide.

Indexing has even saved the annuity industry. Using the equivalent of about 2.5% of a client's premium to buy options on an equity index, life insurers can offer fixed and variable indexed annuities that can outperform bonds at times (like now) when bond yields are down and equity returns are up.

Today, a single indexed annuity contract might include as many as 15 different index choices. About 48% of all fixed indexed annuity (FIA) sales are still allocated to the S&P 500 Index, according to **Wink**. But almost 40% now gets applied to "hybrid" indexes that blend the performance of stocks and bonds or dynamically allocate between asset classes in response to market volatility.

Every June, *RIJ* focuses on indexed annuities. Last year, we took a deep dive into the use of options in variable index-linked annuities. This year we want to find out what the proliferation of indexes—especially hybrid and volatility-controlled indexes—means for advisers and clients.

For instance, if an FIA contract offers multiple indexes, how does the adviser help the client decide which ones to use, and in what proportions? How do volatility-controlled indexes work, and by what financial alchemy can they offer such generous performance limits? For answers, we went to the people who work with these indexes every day.

For answers, we turned to agent Bryan Anderson of **Annuity Straight Talk** in Whitefish, Montana, to Don Dady, co-founder at **Annexus**, an annuity product designer and distributor in Scottsdale, AZ, and to David Lau, founder of the **DPL Financial Partners** annuity platform and a pioneer in marketing fee-based annuities to Registered Investment Advisors.

These experts gave us three nuanced perspectives.

Our three specialists agreed on one thing: That indexed annuities offer people who are nearing retirement a source of higher yields (on average) than bonds provide in today's low interest rate environment, while also insulating their principal from volatility during early retirement.

With respect to the hybrid or volatility-controlled indexes in indexed products, however, they hold different views. Lau regards them with skepticism; he believes they can be manipulated to give investors unrealistic expectations of potential gains.

Anderson welcomes the flexibility that a large selection of indexes gives him. He finds real value—not the illusion of a free lunch—in the higher caps and participation rates that volatility-controlled indexes are able to offer. Dady is working with Laurence Black of **The Index Standard** to create a tool that, he believes, can forecast the performance of the indexes well enough to enable advisers to make an optimum selection among them.

For their comments, see the stories on today's home page.

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