'A Perfect Investment During Recession'

Article on Index Annuities (November 27, 2010)

We have condensed this article by Matthew Sturdevant from The Hartford Courant Group to make it shorter and easier to read. He is asking questions of Dana Pedersen, vice president responsible for annuity product development for The Phoenix Cos. This is a good simple explanation of how these annuities function.

Q: So, what is an indexed annuity?

A: It's not a fixed annuity and it's not a variable annuity. A traditional fixed annuity provides a specified rate of interest that's guaranteed. When you purchase this type of annuity, you know exactly how much you're going to earn. There's certainty on your investment earnings, whereas with a variable annuity you are investing in the sub-accounts of the variable annuity, which are very similar to investing in mutual funds. The investment earnings are completely variable and they're based on the performance of the sub-accounts.

With an indexed annuity, you have the potential for upside, because your investment earnings are directly correlated with the performance of some outside, usually an equity index. So you have the potential for investment earnings, but if the equity index doesn't perform positively then there is no downside risk. So, there's no potential to lose money like there is with a variable annuity.

Q: How is there no potential to lose money? How is that guarded against?

A: The insurance company hedges the performance of the outside index. If the index were to go up, you're going to get positive interest credited to your annuity, whereas if the index were to go down, you're not going to get any index credit, but you're also not going to lose any money. What the insurance company does is hedge that risk.

Q: Is the shift to annuities a reaction to what happened in the markets, or is it that people know more about them now than in the past?

A: Indexed annuities have definitely been gaining in popularity. Record sales were recorded in 2009 and it looks to be the same for 2010. There is no question that all of the financial turmoil 18-24 months ago has people looking for a vehicle that provides them with some level of safety.

Q: What is driving sales growth of indexed annuities?

A: It is a combination of two things: time, which has allowed the consumer to be educated and their appetite in looking for something that's a little bit safer. They're not willing to take as much downside risk as they may have been willing to take two years ago.

Q: What is it about the volatile equity market and low interest rates that makes index annuities appealing?

A: I definitely think people are becoming more aware of them. I think the other key feature that we are seeing across the market on indexed annuities is guaranteed income riders.

As more people are approaching retirement, they're definitely interested in securing a guaranteed level of income, which will last their life time. Three, four and five years ago guaranteed living benefits were not prevalent on indexed annuities, now they are prevalent. To layer some type of guaranteed income protection on top of a vehicle with no downside risk, certainly is a great combination for a lot of consumers.

Q: What is the typical behavior of deposits? Do people deposit one lump sum, or payments in over time?

A: The majority of the products in the market are single-premium vehicles, although some insurance companies do offer flexible-premium products. In general, what we tend to see is consumers repositioning existing assets in single-premium products.

Q: What is the time period that most people are typically investing them for?

A: Most of the products right now have a 10-year surrender charge period. When you are buying it in conjunction with a guaranteed living benefit, it really is a long-term investment product because the idea is you're going to be drawing a guaranteed income stream out of the annuity for the rest of your life. It is suggested that it be in there for at least 10 years.

Q: Is it designed to draw down on the entire amount, or to leave a principal that would be given to a family member?

A: Basically what happens is you're going to draw on your account value until that account value is depleted. If the consumer were to pass away before the account value is depleted, then any remaining account value would go to a beneficiary.

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