How Conflicted Fixed Indexed Annuity Recommendations Can Harm Retirement Savers

Retirement savers suffer harm as a result of conflicted investment advice—advice that puts the financial professional's interests ahead of retirement savers'. Retirement savers who rely on bad advice by financial professionals can be exposed to higher costs, lower returns, greater risks, and excess illiquidity, which can undermine their retirement security. The harms to retirement savers can be particularly acute in fixed indexed annuity (FIA) markets.

"Trusted Advisors" Ofter Steer Retirement Savers to Fixed Indexed Annuities (FIAs) That Aren't in Savers' Best Interest.

Without particular expertise in retirement investing, many retirement savers turn to financial professionals, many of them who use titles such as "trusted advisor."[1] These "trusted advisors" often recommend that the investor purchase an FIA. Because these recommendations typically occur on a one-time basis, often as a result of rollover recommendations, they do not meet the current regulatory definition of fiduciary investment advice under ERISA. In addition, because FIAs are not regulated as securities, they are not subject to the Securities and Exchange Commission's (SEC's) Regulation Best Interest (Reg. BI). This has resulted in a fractured regulatory environment and weaker protections for FIA investors than for other investors in insurance products that are regulated as securities. As a result, financial professionals can steer retirement savers to the FIA that provides the maximum compensation to the professional, rather than the annuity that is the best fit for the retirement saver.

The Costs and Conflicts in the FIA Market can be Particularly Acute for Retirement Savers.

FIAs can be complex, opaque, and have features that are detrimental to retirement savers, including suboptimal crediting methods based on complex and obscure factors, such as

[1] A few years ago, NAIFA launched a consumer advertising campaign called "Trust a NAIFA Advisor," and their website carried the heading "Advisors You Can Trust." See Micah Hauptman & Barbara Roper, Consumer Federation of America, Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways at 13 (January 18, 2017), http://bit.ly/2jKUbFD. The homepage of the website featured the following statement in large capital letters and bold font: "TRUST YOUR FUTURE WITH A NAIFA ADVISOR." Id. There was a video advertisement on the website, with voiceover stating: "Contact a NAIFA member for advice you can trust." Id. The clear intent of these communications is to convince investors that they should trust that their "advisor" will be looking out for their best interests and to encourage them to rely on their expertise and recommendations.

proprietary indices, participation rates, interest rate caps, and spread, margin, or asset fees. They can also impose substantial surrender charges that persist for years. Worse, insurance companies generally reserve the power to unilaterally change terms and conditions to lower an FIA investor's effective return, leaving the investor with little or no recourse. The shared complexity and opacity of these products fosters a dependence on professional advice, creating an environment in which conflicts of interest are more likely to thrive.

Many FIAs Follow Complex and Gimmicky Indices that Look Impressive, but Provide Questionable Value and They Can be Used to Limit Investors' Returns.

When they were originally introduced, FIAs were typically tied to well-known indices, such as the S&P 500 or Russell 2000. However, insurance companies have recently launched complex proprietary hybrid indices, which often claim to provide impressive results, but in reality, offer questionable and unproven benefits over traditional indices.[2] It is often virtually impossible to understand these indices' properties. Many of the indices that are used are often promoted based on hypothetical "back-testing," which are often the result of data mining based on the benefit of hindsight.[3] Presenting imaginary returns that no investors actually received as if they are real is inherently misleading. By its very nature, it creates unrealistic expectations by investors.

Participation Rates Can Limit Investor Returns.

Some FIAs have participation rates, which credit a percentage of an index's returns to the investor, typically on an annual basis. For example, if an FIA has a 50 percent participation rate and an index returns 10 percent, the FIA would credit the investor with 50 percent of 10 percent, or provide a 5 percent return.

Interest Rate Caps Can Limit Investor Returns.

Some FIAs have interest rate caps, which cap the percentage of returns that the investor receives. For example, if the cap is 5 percent and an index returns 10 percent, the FIA would credit the investor up to the cap of 5 percent.

Spread/Margin/Asset Fees Can Limit Investor Returns.

Some FIAs have spread, margin, or asset fees, which decrease the amount that the investor receives. For example, if the spread/margin/asset fee is 3.5 percent and an index

[2] Today, only about one-third of fixed annuity premium is pegged via options to the S&P 500 Price Index. Kerry Pechter and Sheryl Moore, Fixed Indexed Annuities: What's Changed (or Not) in Ten Years, Retirement Income Journal (June 8, 2022), https://bit.ly/3RDIqBP. Almost 60 percent goes into hybrids, of which there are dozens. "When I started in this business, there were 12 indexes," Moore said. "The last time I counted, there were 150." See also Greg Iacurci, Have Indexed Annuities Become Too Complicated?, InvestmentNews (December 16, 2016), http://bit.ly/2pBAaU3.

[3] All too often, what worked in a back-test does not work going forward, in which case the product manufacturer may just come up with a new index. Put simply, hypothetical performance represents imaginary, not real returns that any investor ever actually received. See, e.g., Spencer Look, Be Wary of Fixed Indexed Annuity Illustrations, Morningstar (August 2, 2023), https://bit.ly/48zxWua.

returns 10 percent, the FIA would subtract 3.5 percent from 10 percent, and the investor would be credited with only 6.5 percent.

Volatility Controls Can Limit Investor Returns Opaquely and Potentially Deceptively.

Many proprietary indices are designed with volatility controls that limit FIAs' performance and investor returns. They can do this in an opaque and potentially deceptive manner. An index with a lower volatility control, such as 5 percent, would rise or fall less than an index with a higher volatility control, such as 10 percent. While investors often prefer assets with lower volatility since potential losses are reduced, in this case, gains are also reduced. Given that FIAs don't lose value based on index losses, an FIA with a lower volatility control would inherently limit index gains and therefore the amounts investors receive. According to industry experts, "Because the controls are internal and unseen, the issuers don't need to declare strict external performance limits, such as interest rate caps or sub-100% participation rates, which effectively limit investor returns. Such features are 'particularly attractive to investors, because gains appear unlimited.'"[4] Some FIAs combine volatility controls and participation rates greater than 100 percent, which can also look extremely attractive, but in practice, the volatility controls can limit the amounts investors receive.

Some FIAs Combine the Features Discussed Above, Which Can Enhance the Complexity and Opacity of These Products, Making it Virtually Impossible for Investors to Understand How These Products Work.

Some FIAs combine complex proprietary indexes, participation rates, interest rate caps, spread/margin/asset fees, and volatility controls to limit investor gains. Combining these features makes it even more difficult for investors to understand how these products work and make informed FIA purchasing decisions. As a result, investors become even more reliant on financial professionals for product recommendations.

For example, one of the most popular indexes, the BNP Paribas Multi Asset Diversified 5 Index,[5] combines a complex proprietary index,[6] a spread fee, and a volatility control. The index is marketed based on back-tested performance results.[7] Specifically:

[4] This is "a big sales incentive," according to Sheryl Moore. See Pechter and Moore, Fixed Indexed Annuities: What's Changed (or Not) in Ten Years, Retirement Income Journal (June 8, 2022), https://bit.ly/3RDIqBP.
[5] Athene, BNP Paribas Multi Asset Diversified 5 Index (last visited June 12, 2024), https://bit.ly/4cD4B3P.
[6] BNP Paribas, MAD 5 Index, Risks and Considerations, https://bit.ly/4cuzfN2 ("The BNPP MAD 5 Index has limited public information. The BNPP MAD 5 Index is a custom index developed by BNP Paribas, the Index Sponsor. There is limited information relating to the BNPP MAD 5 Index that is publicly available. In addition, publicly available information on the BNPP MAD 5 Index, its methodology and its Equity Futures Indices, Bond Futures Indices and Commodity Indices is limited.").
[7] Athene, BNP Paribas Multi Asset Diversified 5 Index (last visited June 12, 2024), https://bit.ly/4cD4B3P ("Index performance reflects back-tested results, which is not actual performance, but is calculated by applying the index methodology (designed with the benefit of hindsight) to historical financial data.").

- The index is “based on eight underlying components—three equity futures indices, three bond futures indices, and two commodity indices;”[8]
- The index “dynamically rebalances its weightings to these underlying components daily, based on momentum investing principles;”[9]
- The embedded fee for the index is 0.50 percent per year, deducted daily;[10]
- The index imposes a 5 percent volatility control;[11] and
- BNP Paribas “reserves the right to amend or adjust the BNPP MAD 5 Index methodology from time to time and accepts no liability for any such amendment or adjustment.”[12]

Other similar indexes include the J.P. Morgan Mozaic II℠ Index,[13] the NYSE Zebra Edge II Index,[14] the Bloomberg US Dynamic Balance II ER Index,[15] PIMCO Tactical Balanced ER Index,[16] BlackRock iBLD Claria® Index,[17] and the Morgan Stanley Dynamic Global Index.[18]

The vast majority of retirement savers would not be able to make sense of these product features, alone or in combination. Furthermore, it is highly likely that the vast majority of financial professionals would not be able to evaluate these product features effectively to be able to prudently recommend FIAs with such features.

FIAs Often Lock Up Retirement Savers’ Money for Well Over a Decade. If Savers Want Earlier Access to Their Money, They Must Pay Significant Penalties That Erode Their Savings.

FIAs also often have surrender charges that effectively lock up an investor’s money for years and make it costly to reverse the investment decision. FIAs with surrender periods longer than 10 years and surrender charges higher than 10 percent of premiums are not uncommon, including:

- Athene Performance Elite® 15: 15-year surrender period, surrender charge as high as 15 percent of premiums;[19]

[8] Id.
[9] BNP Paribas, MAD 5 Index, Risks and Considerations, https://bit.ly/4cuzfN2 (“On any given day, this methodology will allocate a greater percentage of the BNPP MAD 5 Index towards components of the Hypothetical Portfolio that would have resulted in the Hypothetical Portfolio with the highest past returns [Computed based on a trend indicator that compares current component level to past component level over a 1 year period] subject to a certain level of volatility and weighting constraints.”).
[10] Id. (“These costs reduce the potential positive change in the BNPP MAD 5 Index and thus the amount of interest that will be credited to the fixed indexed annuity that includes the BNP MAD Index.”).
[11] Id. (“Because the index applies a volatility control mechanism, the range of both the positive and negative performance of the index is limited.”); (“The BNPP MAD 5 Index’s target volatility feature may reduce is appreciation potential.”).
[12] Id.
[13] J.P. Morgan Mozaic IISM Index, Nationwide Life and Annuity Insurance Company, February 2024, https://bit.ly/4eHWipa.
[14] NYSE Zebra Edge® II Index, NYSE (last visited June 26, 2024), https://bit.ly/3VXJio5.
[15] Allocation options, Allianz Life Insurance Company of North America (last visited June 26, 2024), https://bit.ly/3KYMJVc.
[16] Id.
[17] Id.
[18] Morgan Stanley Dynamic Global Index, Morgan Stanley, https://bit.ly/4bt9FqM.
[19] Athene, Athene Performance Elite® 15 Fixed Indexed Annuity, Product Guide (Rates effective December 30, 2023), https://bit.ly/48mxEHq.

- Fidelity and Guaranty AccumulatorPlus14: 14-year surrender period, surrender charge as high as 14.75 percent;[20]
- Midland National Life MNL IncomeVantage 14: 14-year surrender period, 10 percent surrender charge for the first five years;[21]
- North American Charter Plus 14: 14-year surrender period, surrender charge as high as 12 percent;[22]
- American Equity Retirement Gold: 10-year surrender period, surrender charge as high as 12.5 percent;[23] and
- Nationwide New Heights Select 12: 12-year surrender period, surrender charge as high as 10 percent.[24]

With FIAs, the Longer the Surrender Period and the Higher the Surrender Charge, the Greater the Insurance Professional's Commission.

FIAs' hefty surrender charges are positively correlated with the lofty commissions that these products pay to financial professionals to encourage and reward them for recommending and selling them. Stated differently, higher commission products typically have longer surrender periods, while lower commission products typically have shorter surrender periods.[25] For example, according to New Horizons Insurance Marketing's "A Beginner's Guide to Selling Fixed Indexed Annuities," "the longer the FIA contract, the higher the commission. For example, the 14-year pays a lot more than a 7-year."[26] This means investment professionals have a strong incentive to recommend retirement savers lock up their money for longer than is necessary. In short, what's better for the investment professional is worse for the investor.

According to financial planner and blogger Michael Kitces, "In fact, the whole purpose of surrender charges on annuities is simply to ensure that when an insurance agent is paid a commission upfront, the annuity funds will remain invested long enough with the ongoing interest rate spread extracted from the investor return to allow the insurance company to recover that commission cost from the investor (or else he/she pays a surrender charge to make up the difference!)."[27] This structure explains why commission-based annuities

[20] Fidelity & Guaranty Life Insurance Company, At-a-Glance: Accelerator Plus® 14, Product Brochure (Revised November 2023), https://bit.ly/3H0VKLz.
[21] Midland National, MNL RetireVantage® 14, Product Brochure (Revised March 2023), https://bit.ly/41FG75K.
[22] North American, North American Charter® Plus 14, Product Brochure (Revised August 2023), https://bit.ly/3S2pQF0.
[23] American Equity, Retirement Gold Fixed Index Annuity, Product Brochure (2017), https://bit.ly/47gRW3x.
[24] Nationwide, Nationwide New Heights® Select 12, Product Brochure (2023), https://bit.ly/47e3Bjv.
[25] Cyril Tuohy, Rise in Shorter-Term Surrender FIAs Means Commission Declines, InsuranceNewsNet (June 20, 2017), https://bit.ly/3tCXAzg.
[26] New Horizons Insurance Marketing, A Beginner's Guide to Selling Fixed Indexed Annuities (FIAs), https://bit.ly/3xCYg9R (last visited Dec. 27, 2023).
[27] Michael Kitces, The Myth Of "Free" No-Expense Fixed Or Equity Indexed Annuities, KITCES.COM (March 18, 2015), https://bit.ly/48fClmd ("[I]n the case of fixed or equity-indexed annuities, investors only see their contributions into the account, and a return on the account, leading many to believe (and many insurance agents to claim) that such annuities are 'free' or have no cost (and that any commissions paid to the agent are 'paid by the insurance company, not the client,' and will not adversely impact their long-term retirement accumulations. Yet the reality is that fixed annuities do still have an ongoing cost that reduces long-term returns…").

more often include longer surrender periods and larger surrender charges than fee-based annuities.[28]

In addition to receiving high commissions for recommending and selling FIAs, financial professionals can receive non-cash compensation, such as all-expense paid vacations to exotic locations, entertainment, golf outings, meals, and jewelry, which further encourage and reward them for recommending and selling these products.[29] These kinds of incentives create financial headwinds that would be challenging for even the most ethical financial professional to overcome.

The DOL Retirement Security Rule Will Ensure That FIAs Are Only Recommended When They Are Genuinely in Retirement Savers' Best Interest.

Under the new DOL Retirement Security Rule, when recommending FIAs to retirement savers, insurance professionals must act in retirement savers' best interest. This requires that they: give advice to retirement savers about these products that is prudent (they must act like a professional); give advice to retirement savers about these products that is loyal (they must not put their own interests ahead of retirement savers); charge no more than is reasonable for their services (they can't charge excessive, unreasonable amounts); and avoid making misleading statements.

According to a Morningstar analysis, "the rule will likely lead to significant savings for retirement investors rolling into fixed index annuities."[30] Specifically, "retirement investors rolling into fixed-index annuities will save over $32.5 billion in the first 10 years and over $32.5 billion in the subsequent 10 years, in undiscounted and nominal dollars."[31]

Given the harms that retirement savers currently face with regard to conflicted FIA recommendations, it's critical that the DOL Retirement Security Rule go into effect so that any FIA recommendations satisfy a true best interest analysis and retirement savers receive the protections they need and deserve.

[28] See, e.g., Jackson, Fee-Based Annuity Solutions, https://bit.ly/41FGn4I (last visited December 30, 2023) ("No surrender charges, withdrawal charges, or contingent deferred sales charges. Your clients' money is not locked up, because the insurance company doesn't have to recover commissions or penalize clients for ending the contract too soon.").
[29] See Office of Senator Elizabeth Warren, Villas, Castles, and Vacations: Americans' New Protections from Financial Adviser Kickbacks, High Fees, & Commissions are at Risk: 2017 Edition (February 2017), http://bit.ly/2l3OUbl.
[30] Spencer Look and Lia Mitchell, Morningstar, The Final DOL Fiduciary Rule Has Arrived. Here's What It Means for Investors, April 26, 2014, https://bit.ly/3L5MS9m.
[31] Id. ("When the new rule goes into effect, we think fixed-index annuity commissions will decrease due to insurance producers following the impartial conduct standards. This will result in lower implicit costs, leading to better returns for investors….We also believe the new rule will likely result in lower surrender fees paid by investors when liquidating an annuity. Since the recommendations to purchase these products will need to be in the investor's best interests, the products that are bought should better fit with the investor's circumstances and preferences.").