



Open MIC is open for anyone. It is place where the sharing of information helps everyone

9:00: AM Pacific Thursday 800 504-8071 Code is 5556463

Questions?

Anthony Owen at Tony@annuity.com

www.annuityagentsalliance.com



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Jack Marrion White Paper from Wharton is attached...Important Read

Here is some information that might be helpful to you when you doubt the recommendation of an annuity.

Betty and I have a client (11 years now) who used the GALIC Valor II for important money.

Money that had to be there for her future.

Her overall investment portfolio of under \$200,000.

She deposited some of her IRA into the Valor II. Last year, her balance was \$97,000 and this year on her anniversary date (2-3-11) she had an overall return of \$7,344.

Her allocation was 50% point to point and 50% monthly averaging. The monthly point to point returned \$3,808.

The important point in this is simple; this is important money and money that MUST be there for her.

I would say we did OK!

Hot News

- **SEC Charges AXA with Securities Fraud:**
http://www.planadviser.com/SEC_Charges_AXA_Rosenberg_Units_with_Securities_Fraud.aspx
- **Annuities VS Social Security:**
<http://www.bankrate.com/financing/retirement/annuities-vs-social-security/>
- **Reuters advice, Buy an annuity:**
<http://www.reuters.com/article/2011/02/02/us-column-personalfinance-idUSTRE7116O120110202>
- **IRA Assets Prohibited:** <http://www.sfgate.com/cgi-bin/article.cgi?f=%2Fq%2Fa%2F2011%2F02%2F01%2Finvestopedia6221.DTL>
-

This was on Open MIC last week.....additional link at bottom.....BB



Teacher's Union...gets kickback! What?

My parents were teachers and members of NEA.

This is truly disgusting. If you find a prospect who has a 403b.....might want to look and see if it is invested in the "Valuebuilder Plan"BB

Federal Court Tells Frustrated Annuity Investors to 'Get Lost'

by Mark Nestmann
Sovereign Society

Recently by Mark Nestmann: *Estate Tax Reform Provides New Opportunities for Expatriation Tax Savings*

If you're a member of a professional association or labor union, can you count on its leadership to act in your best interests?

Unfortunately, you can't. A case in point is a recently concluded lawsuit brought against the National Education Association, a labor union representing more than three million public school employees, by its members.

Here, the NEA marketed a **variable annuity** it called the "NEA Valuebuilder Plan" to its members. It told its members that the Valuebuilder Plan was "**the only annuity nationally endorsed by the NEA.**" But, the NEA never fully disclosed that the **fees for these plans were as much as ten times as high** as those charged for comparable contracts.

The NEA also received a portion of these fees as commissions from the annuity providers.

(Valuebuilder Plans continue to be marketed to NEA members, but I don't know if the current versions have the same fee structure as the ones that were the subject of recent litigation.)

In their lawsuit, NEA members alleged that their **union intentionally misled them into buying unattractive annuities by preying upon their trust.** They sued under terms of the Employee Retirement Income Security Act (ERISA).

Unfortunately, the court disagreed. It ruled that ERISA didn't apply to the variable annuities and that the members couldn't sue under its provisions. The members still have the option of bringing a lawsuit based on other legal theories, but in the meantime, the legal bills continue to mount.

Here is the link to the article: <http://www.lewrockwell.com/nestmann/nestmann19.1.html>

I found it on their website....www.NEA.org:

http://www.neamb.com/xchg/neamb/xsl/hs.xsl/-/home/1199_905.htm

Here is the prospectus link:

https://nea.securitybenefit.com/ProductDocs/SB/Prospectuses/VA_PDFs/NEA_VA_TSA.pdf

Our friend Tyson Lang forwarded this link with more info....Thanks!

Below is a link you can find product information on the NEA ValueBuilder VA you mentioned on Open Mic. When you click on the product, there will be another pdf link for the prospectus.

<https://nea.securitybenefit.com/#1135>

Tyson Lang

PHONE: 800.992.2642 x475

Yet another insurer bows out of LTC biz

“Guardian Life” beats relatively swift exit from long-term-care business

By Darla Mercado

February 7, 2011 3:50 pm ET

Does anyone want to write long-term-care insurance policies anymore?

Increasingly, the answer to that question looks like a resounding ‘no.’ Today, yet another carrier — Guardian Life Insurance Company of America — announced it will cease sales of its LTC insurance products by the end of the year. Instead, the carrier will concentrate on life and disability insurance.

The company, which has been issuing LTC insurance through its subsidiary Berkshire Life Insurance Company of America, decided to get out of the business after five years in the market. Its departure follows on the heels of **MetLife Inc.'s exit from the LTC market and a large rate hike announced by John Hancock Life Insurance Co.**

Guardian was a small player in the LTC insurance market, according to Gordon Dinsmore, president of Berkshire Life. “We weren't terribly large to start with, and we were relatively new to the market,” he said in an interview. “To some extent, it was a question of whether we really wanted to stay in for enough years to have a bigger presence.”

The insurer had about \$12.6 million in LTC sales through 2009, according to data from Milliman Inc.. By comparison, Genworth Financial Inc., the biggest seller of such policies, sold \$107.5 million in annualized premiums in 2009, according to data from LifePlans Inc.

Guardian informed its sales force last week about the insurer's exit from the LTC market, Mr. Dinsmore said.

Issues that have plagued Guardian's larger rivals — **low interest rates and low lapse rates** — weren't really a problem for Guardian because of its LTC insurance book's small size and short tenure, Mr. Dinsmore noted. Low interest rates cut into the returns that carriers get on their investments — and those returns go toward paying claims. Meanwhile, low lapse rates — insured individuals living too long and thus receiving claim payments for longer periods of time — **strain carriers' ability to make payments.**

Last week we had an article about SEC investigating Life Partners....here is more...BB

Embattled Life Partners sued by shareholders

Claim life settlement provider harmed investors by using **flawed** actuarial statistics

By Darla Mercado

February 4, 2011 3:00 pm ET

Life Partners Holdings Inc. is the subject of two lawsuits filed this week by angry shareholders, who claim that news of the life settlement provider's brush with regulators dented the firm's share price.

Shareholder Selma Stone filed suit yesterday against Life Partners Holdings Inc., its chief executive, Brian D. Pardo; and general counsel, R. Scott Peden, in U.S. District Court for the Western District of Texas.

That lawsuit follows on the heels of a similar complaint filed Wednesday in the same district court by Life Partners shareholder Gerald A. Taylor.

The plaintiffs in both cases are seeking class-action status.

Both suits allege fraud on the part of life settlements provider Life Partners, pointing to a string of stories from The Wall Street Journal that called into question the validity of the company's life expectancy estimates. The Journal also reported on Jan. 20 that the firm was under investigation by the Securities and Exchange Commission, which Life Partners later confirmed.

The suits claim that Life Partners not only relied on life expectancy projections that were much too short, but that the underestimation allowed the company to charge investors larger fees when brokering life settlements.

Generally, life insurance policies on those with short life expectancies sell on the secondary market at a premium because the policies are expected to pay out to the investor sooner.

Since Life Partners' revenues had benefited from the use of these alleged business practices, the firm's financial statements were false and misleading, the suits allege.

The plaintiffs claim that Life Partners' share price was artificially inflated, and thus shareholders suffered when the value of the company's stock plummeted.

On Jan. 20, the day that the firm confirmed it was under investigation by the SEC, Life Partners' share price **dropped by more than 17%**, closing at \$12.46.

“The price of Life Partners' securities significantly declined when misrepresentations made to the market and the information alleged herein

to have been concealed for the market were revealed, causing investors losses,” Mr. Taylor claimed in his suit.

Ms. Stone and Mr. Taylor are suing for damages, plus interest and coverage of their legal fees.

Calls to Life Partners Holdings and its attorney, Ida Draim, were not immediately returned.

Skimpier living benefits could kill interest in VAs, advisers warn

Lack of investment choices slammed; fee-based variety may be next step

By Darla Mercado

February 6, 2011 6:01 am ET

Financial advisers are calling on insurers to enhance their suite of variable annuities, saying that clients are turned off by falling accrual rates on living benefits and insufficient investment choices.

“There's going to come a point in time where not only will the investor not want to [purchase a product with a reduced living benefit], but the adviser will give push-back, too,” said Doug Lockwood, principal of Harbor Lights Financial Group Inc., an LPL Financial affiliate.

He spoke on a panel of advisers at the Insured Retirement Institute's 2011 marketing conference in Washington last week.

The advisers on the panel said that the reduction in living benefits, along with higher fees, ultimately might force them to stop recommending variable annuities to clients.

“Living benefits are so crucial and important, and we believe it's right for the client in many situations,” said panelist Jason Tawney, a financial adviser with Edward Jones.

Advisers lamented some of the more drastic product changes that have taken place.

Panelist Scott McCaskill, a partner at Voso Financial Advisers LLC, said that a wholesaler told him that the insurers view their annuity businesses as liabilities and not assets. He also said that insurers will dangle a tantalizing product feature and then yank it from the market.

“A company will offer a living benefit and then it's gone; you might see benefits offered for a short period of time,” Mr. McCaskill said. “They'll say that this is their comfort level [of sales] and then close off.”

During a speech at the same conference, Robert Benmosche, chief executive of American International Group Inc., said that insurers that face problems have placed too much weight on variable annuities offered with certain features. Offering advisers a variety of products and riders, including withdrawal, income and death benefits for variable annuities, “helps you to be an evergreen player in the market,” he said.

In 2008, insurers struggled with books of VA business that either had been **mispriced or poorly hedged**, leaving them vulnerable to low interest rates and high volatility in the equity markets.

In the past, “we only had to deal with mortality, and now we're asking people to deal with interest rates, mortality and equity markets,” Mr. Benmosche said. “You're starting to see some companies starting to withdraw, and I'm worried on whether other companies have too many eggs in that one basket and can't diversify the risk.”

Certainly, low interest rates have led some life insurers to pull back on certain product features on their variable annuities. **For instance, Prudential Financial Inc. reduced the compounded growth on the protected value in its variable annuities to 5%, from 6%.**

MetLife Inc. will also reduce the annuitization rate in its income benefit for new sales as of Feb. 28. Compared with the old annuitization rate, the change would lower the amount that a client could get once he or she annuitized the contract after the account value fell to zero.

Noting that the number of investment options on older contracts has dwindled, Mr. Lockwood called for an open-architecture investment program “so that we're not restricted to 100 options — maybe we can have something similar to what's on our fee-based platform.”

One insurer, which he wouldn't identify, cut down its selections to 12 subaccounts.

“Having 40 isn't even close to what we need,” Mr. Lockwood said. “We're in the grow-and-protect mentality, and we need those asset classes to be able to do that.”

Mr. Lockwood also said that he is a proponent of fee-based variable annuities. His broker-dealer, LPL Financial, is expanding its platform to accommodate more of these products.

But none of the advisers thinks that adoption of fee-based annuities will come easily.

“It's going to take a lot of work from all of us,” Mr. Lockwood said.

“It depends on the adviser and if they have a profitable business and can afford to take less compensation,” he said. “I think it's going to take a forced action, that this is the way it's going to be done and that this is the only way.”

Last week I spoke about Prudential and their 12 year wait for access to their income rider...Bob Bierstadt corrected me on the finer points and added details....here is his email....BB

Dear Bill,

I am writing to clear up some mis-conceptions contained in today's "Open

Mic." The new version of the Pru income rider "locks in" the highest daily value of the underlying investment accounts and credits 5% on top of that going forward. (The previous version credited 6% on top of the highest daily value.) The annuity owner can start their guaranteed lifetime income at any time. They do not have to wait for 12 years. For purposes of calculating their guaranteed income value their investment is guaranteed to double in 12 years regardless of their investment account value. If they invest \$120,000 it is guaranteed to be worth \$240,000 after 12 years. If they are between 59 1/2 and 79 years of age they will receive \$1,000 per month for life even if their investment account value has fallen to zero.

The former version guaranteed a double in 10 years and a quadruple in 20 for the guaranteed income value. The clients that chose this variable annuity in 2009 are now up on average 62% "locked in" and earning 7% on top of that until they turn on their lifetime income. The majority of my clients like to put a portion of their assets in a fixed index annuity for no downside and a portion in a VA for upside potential with a guaranteed income rider.

I hope this clears up your mis-understanding regarding the 12 year period.

Bob

Robert C. Bergstedt

This can't be good....or a shift in how we receive our info...BB



National Underwriter, Summit Media File for Bankruptcy

By: Andrew G. Simpson

Summit Business Media and its affiliates including **The National Underwriter** insurance publisher have filed for Chapter 11 bankruptcy to address more than \$250 million in debt and unsecured claims.

The company said that it had already worked out an agreement with most of its lenders to cut its debt obligations by \$135 million before it made the voluntary bankruptcy filing.

The reorganization plan provides for Summit's continued normal operations.

The Internet.....let's all get leads! Easy right?

From: Mark Smith [REDACTED]
Sent: Wednesday, January 26, 2011 10:19 AM
To: Joe Agent
Subject: 1st Page Google Local Listing Guarantee/D.Barnard

Hi Joe,

It was a pleasure speaking with you earlier.

Attached is the Service agreement and CC Auth Form. Please review, sign, and fax it back to me. I will call you **tomorrow morning**. In addition, you'll have to make yourself available for a time on **Tuesday** when you are available(AM or, PM) to take a 1 minute automated Google phone call for your 5 digit pin code.

Remember, 90% of searchers who search for **Financial Advisor** click onto Google Local Listing Practices first because it is the only place where you can have your telephone number, website, and Practice name all in one place. A full 90% of these searchers never make it to the 2nd page. This listing will not touch nor optimize your website. This is the difference of being on the first page of Google. It completes your internet marketing presence. The impact on your traffic and the quality of your traffic is dramatic. Our clients enjoy the best ROI out there, and we have clients in the largest, most competitive and aggressive markets in the country. Out of more than hundreds of thousands of listings we bring our clients to the top 7 and keep them there 24/7. Guaranteed in writing.

We only place one Financial Advisor per city. We never have Practices compete for the same business. You will own the **Financial Advisor** for the entire length of the Service Agreement, and with the right of first refusal upon expiration. 100% of our clients always renew.

Our pricing, guaranteed service agreement, legal knowledge to target the right clientele, and your ROI are the best in the business. In fact, a few new clients from this will pay for the year let alone for the month. Again, I will speak with you on **tomorrow morning**.

The words he had selected were:

- **Financial Advisor**
- **Annuity**
- **Financial Consultant**
- **Annuity Investment**

- Annuities

Sounds like a winner doesn't it....but the catch was this...the words of the town.....

”Calistoga California” needed to be added to the search.

While there might be 1000's of searches daily for annuity, how many would there be for

“Annuity Calistoga California?”

These searches are tracked and the information is available....in last 12 months there was **0 (zero)** searches for “Annuity Calistoga California.”

The cost for this service was \$1,800 a year, a total waste of money. Don't be sucked into this marketing scam, you might be on the first page of Google but no one will find you!

.....If you want to be in the internet lead business be in that and **not** the annuity sales business.

Outsource the leads to experts and be an expert in selling annuities.



This is how a professional lead generation looks....

And here are some fresh numbers on the results of our Radio Show....

SMR Hosts and Key Partners,

Our partners in FL, Alan J. Schuh, has a great question that I want to share with all of you, "What is a reasonable conversion rate for the SMR leads to appointments?".

What I want all of you to take away from this is that the lead system works as long as you can convert. If it is not working for you then it's just a matter of improving your conversion skills assuming you have sufficient air time to generate leads.

Here are some stats for last year.

2011 Results:

Agent Name	Leads	Appts	Sits	Apps	Appt %	Sit %	App %	Written \$ per App	Sold
Chad	472	206	133	75	43.64%	64.56%	56.39%	\$126,954.22	\$9,521,566.49
Agent	147	84	58	17	57.14%	69.05%	29.31%	\$36,666.49	\$623,330.38

The stats above demonstrate both sides of the spectrum. Chad did SMR all of last year and started SMR in 2/09. Bret only got his license about a year and a half ago and started SMR around May of 2010 (Basically a rookie, no offence). Bret is going to easily go over 2 million this year and his confidence and skills are improving on a weekly basis. Very proud of him and what he has done starting from nothing in 2009.

- Appts = Appointments includes re-appointments with the same client.
- Sits = Times when we were able to meet with someone and do business face to face. Basically a presentation or fact finding session. Includes re-sits.
- Apps = Number of applications including multiple applications with the same client. For example, if we wrote 3 apps with the same client that would equal 3 out of the 75 apps Chad wrote.

For every two leads you should have roughly 1 appointment, one site, and 1 app as an experienced agent. Because we include re-appointments, re-sits, and multiple apps with the same client the numbers can be difficult to interpret unless they are compared over a significant period of time. If you look at Bret's application % you can clearly see the result of the learning curve. He is great getting the appointment but his conversion skills are still under development.

If you look into the stats further we can also see that some other details. Chad worked around 40 weeks last year. That means he had about 5 SMR appointments per week when he was working. SMR has almost no no-shows but it does have reschedules and cancelations just like any lead system so he only sat down on his appointments on average 3.3 times per week. For you guys, that means that you need to be doing around 4 new presentations or re-sits per week just to keep it simple.

On the app percentage keep in mind that we use a process called "Divide and Conquer". We write a separate app for each source of funds so if any one of the apps get held up in conservation the other apps continue to get processed.

Here are 2009 results also (Starting in March):

Agent Name	Leads	Appts	Sits	Apps	Appt %	Sit %	App %	Written \$ per App	Sold
Chad	285	133	105	38	46.67%	78.95%	36.19%	\$132,586.55	\$5,038,288.89

One final point.

We don't keep stats just to impress you guys. Keeping track of your business is vital for growth and decision making. It doesn't matter if your expenses are \$40,000 per year or six digits like us. Either way, you need to have numbers to show you what is working and what is not. This can also be a huge confidence booster when you see improvements from one year to the next or a warning sign when your numbers are declining. For example, we used to be in the mortgage protection industry. Because of my diligent stat keeping I was able to measure our issue rate going from 70%, to 60%, and then finally in 2009 it dropped below 50%. Knowing those numbers made it easy for me to pull the plug on that marketing system.

I run into agents all the time that can't even tell me how much volume they did last year and what their income and expenses were.

Unbelievable.

Remember, you are a business owner, not an agent!

Hope this helps,

Anthony R. Owen
 Vice President, [Eagle Shadow Financial, LLC](#)
 Co-Founder, [Annuity Agents Alliance](#)
 Annuity Marketing Consultant, [Annuity.com](#)

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Of course they do...and how wonderful it will be for us and our target market to have them do to us what they did for the mortgage market....just can't wait....BB

Wall Street Eyes IAs

February 08, 2011

**By Linda Koco
AnnuityNews.com**

Feb. 8, 2011 -- The indexed annuity market is about to get some new competitors — from Wall Street.

Jack Marrion, president of Advantage Compendium, St. Louis, says at least a couple of big Wall Street securities firms are already preparing to make filings for their indexed annuity products, perhaps by spring or summer.

The products will be indexed annuities (IAs) and sold as insurance products, not securities, he says.

To make that possible, the as-yet undisclosed firms have developed business relationships with insurance companies, says Marrion, who consults with some securities firms on indexed product development.

The development may surprise IA professionals who have battled with many securities interests over whether indexed annuities are securities.

When the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was enacted with an amendment saying indexed annuities are not securities if the products meet certain conditions, many industry watchers believed that the securities industry involvement with IAs had become a non-issue.

They further believed that that the securities industry would not have any interest in marketing indexed annuities because:

- Securities firms don't like the products; and
- Securities firms that do want to offer an indexed annuity — for, say, competitive or customer needs purposes — would likely offer a *registered* indexed annuity to sell as a security.

Marion says neither argument holds water. The big Wall Street firms did not engage in the battle over whether IAs are securities, he explains.

“It was the stock brokerage firms, their various associations, some variable annuity carriers, and some securities regulators that pushed to have the product declared a security,” he says. “They said they wanted to control the sales practices related to IAs.”

The brokerage interests “never liked the products and they still don't like them,” he says. **But the big Wall Street firms don't necessarily share that view.**

As for the expectation that the big securities firms would probably only be interested in offering registered indexed annuities, Marrion says this is not the case. The firms appear to be product-neutral, he says. “They are considering all options right now.”

Jim Pedigo, a consultant with Financial Rate Watcher\$, Inc., Longwood, Fla., terms the potential entry of big Wall Street firms into the IA market a “great” development for the business.

“The big securities firms will disseminate more information to the public about indexed annuities,” he explains. “A more informed public will make for a better buying public.”

Some of those firms have been pulling back on their variable annuity business over the past year, Pedigo points out. They will likely begin to focus more on the fixed arena instead, he says. If they launch their own IA, they will likely position it as a “crossover product” for their reps to use.

Because it is a hybrid product, sitting between fixed and variable annuities,

the reps can use it when moving from selling securities to selling insurance, he explains.

This approach should appeal to older clients at the big securities firms, Pedigo says. In particular, it should appeal to clients who are seeking potentially higher returns than available in today's bank certificates of deposit but with downside guarantees. The same clients may also like the product's guaranteed lifetime withdrawal benefit (GLWB) rider, if the firms decide to offer on with their product, he says.

Pedigo thinks the big Wall Street firms that enter this market will initially offer their IAs through their own distribution networks. That will pose a competitive threat to IA professionals in the independent agency system, he says.

But once the firms are sure their products work, "they will start coming after us in the independent agency system," he predicts. That's because many independent agents are already comfortable selling IAs and they will be able to expand distribution.

Linda Koco, MBA, is a contributing editor to InsuranceNewsNet, specializing in life insurance, annuities and income planning. Linda can be reached at linda.koco@innfeedback.com.

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The Other Side of the Table

.....it's all based on your view.....



Sometimes it is how you look at things that can make the difference. The other side of the table is all about that....how you look at things!

From an actual stockbroker to a prospect of mine who went to their planning seminar in Palm Springs....

“Don’t use conventional products to plan for retirement, instead us the new modern approach...Targeted Date Funds. TDF will provide more income and more available funding at a specific date than any previously available product. Nothing can compare and no one would ever buy anything else when they are planning for a retirement date.”

“The future of retirement planning is Life Cycle Funds (TDF!)”

(Life Cycle Funds was a dreamed up marketing slogan)

What Does *Target-Date Fund* Mean?

A mutual fund in the hybrid category that automatically resets the asset mix (stocks, bonds, cash equivalents) in its portfolio according to a selected time frame that is appropriate for a particular investor. A target-date fund is similar to a life-cycle fund except that a target-date fund is structured to address some date in the future, such as retirement.

Investopedia explains *Target-Date Fund*

These funds have become popular with 401(k) plan investors. While proponents cite the convenience to investors of putting their investing activities on autopilot in one fund, critics are wary of these funds' one-size-fits-all approach.

Target Date Retirement Funds

Target-date retirement funds, also known as **Life-Cycle Funds**, are designed to streamline the investment process and have often been termed **“set it and forget it funds.”** To put it simply, investors who opt to place their money in target-date retirement funds, do so with a specific retirement year in mind. **For example, if you plan on retiring in 25 years, your target-date retirement fund should reflect that specific time frame.**

The set it and forget it concept reflects the fact that once you invest in your target-date retirement fund, you don't have to worry about the allocation of that fund as it will automatically change over the years to reflect a more conservative risk tolerance. This is a fairly common strategy for retirement investments where it becomes more important to save and protect your assets the closer you get to retirement, as you have fewer years remaining to recover should your investments take a turn for the worse.

This gradual reallocation over the years is known as the **glide path**. (**now there is a term I wish I had invented.....BB**) The target-date retirement funds glide path begins on a more aggressive level in the early years and changes toward a more conservative path with the intention of providing added security as the year of retirement approaches.

As with all other investment strategies there are both benefits and drawbacks that accompany target-date retirement funds. To determine if this type of investment is right for you it is important to understand these pros and cons and compare them to the advantages and disadvantages of other retirement vehicles. Here we look at what makes a target-date retirement fund a good choice and what might make it a bad choice.

Pros and cons of using Target Date Retirement Funds

Benefits:

- **Hands off investment strategy.** Since target-date retirement funds are set up to automatically adjust the allocation of investments, there is little effort needed on the part of the investor once the fund has been established. This may appeal to investors who do not have the time or confidence needed to actively manage their portfolio.
- **Little to no maintenance.** Due to the very nature of a target-date retirement fund, there is little if any maintenance required by the investor.
- **Minimum investment requirements.** This allows for a broader allocation to include various asset classes.

Drawbacks:

- **There is no such thing as one-size-fits-all.** You understand this concept when you buy clothing and you should certainly consider this when selecting an investment strategy. Each person is different with varying risk tolerance as well as financial goals. Unfortunately the very thing that makes target-date retirement funds hassle free also require that the strategy treat each portfolio the same way. This may result in an investment strategy that does not reflect your unique situation.
- **Higher fees.** Expect to pay **slightly higher fees** for this type of investment than you might for other investment vehicles.

Fees? You mean on a buy and hold until retirement I have to pay fees?....BB



Target Funds Under Fire

By Bob Frick, Senior Editor

What's destined to become the most popular retirement-savings investment is sporting a **bull's-eye**. A growing chorus of critics have put target-date funds in their cross hairs, accusing them of being **inflexible, too risky** or too hidebound. Oh, yes, naysayers also say the funds lull you into a false sense of security.

That these fast-growing funds are catching flak from experts and each other isn't surprising, considering the vast amounts of dollars at stake. "All these new products need to differentiate themselves," says Luis Fleites, director of retirement research for consulting firm Financial Research.

But don't let debate shake your faith. Much of the noise surrounding target-date funds is the industry overthinking a sweet and simple concept.

Target-date funds simplify long-term investing. Choose the year you wish to retire, then pick the fund with the date closest to your target. So, for example, if you're 35 and plan to retire in 2038, you'd choose a fund with 2040 in its name. These funds are a balanced meal of investments, complete with big-company stocks, small-company stocks, bonds and often less-traditional assets, such as emerging-markets stocks and real estate stocks.

As the fund approaches the target date, **it becomes more conservative**, lowering the percentage of assets in stocks in favor of more bonds and cash. **This "glide path"** is meant to dampen the fund's volatility, helping reduce the likelihood of big losses as you near retirement.

Money in target-date funds has grown like kudzu since their introduction around the beginning of this decade -- from \$12.3 billion in 2001 to \$168 billion at last word. The number of fund families offering target-date funds has jumped from a handful five years ago to 35 today.

That number is bound to rise, thanks to a recent ruling by Uncle Sam. The U.S. Department of Labor recently issued guidelines that place target funds on the short list of approved default investment in employer-sponsored retirement plans.

Getting aggressive

In an effort to **improve performance and break from the pack**, many target-date funds have boosted their holdings in **riskier investments**. While more-aggressive target-date funds topped out at 80% stock allocations three years ago, some now have as much as **94% in stocks**, says Hewitt Associates, a human-resources consulting firm.

The growing slice of foreign stocks, in particular, underscores the push toward performance and the divergence among target-date funds. In recent years, one of the best ways to crank up a portfolio's performance has been to look overseas. The MSCI EAFE index, a widely used barometer of performance in developed foreign markets, returned an annualized 22% over the past five years to December 3. Standard & Poor's 500-stock index gained 11% annualized over that period.

Hmmmm....it starts to get stickier....BB

These two target-date fund families missing the mark: Morningstar

Alliance Bernstein, Oppenheimer Funds occupy bottom rung in latest ratings; Fidelity slips

By **Robert Steyer, Pensions & Investments**

February 8, 2011 10:55 am ET

Morningstar updated its quarterly ranking of large target-date fund families, raising its rating on TIAA-CREF and MassMutual, while lowering its rating on Fidelity Investments, confirmed spokeswoman Alexa Auerbach.

Morningstar's ranking features five categories — top, above average, average, below average and bottom — based on five measurements, Ms. Auerbach explained in a telephone interview.

The five categories are people, parent, performance portfolio and price. The first two measurements reflect qualitative assessments of fund management, and the other three reflect analyses of investments made and fees charged, she said.

Among the 21 target-date fund families in Morningstar's ranking, Vanguard, T. Rowe Price and American Funds placed in the top category while target-date funds from **Alliance Bernstein and Oppenheimer Funds were in the bottom category.**

TIAA-CREF moved to an above-average rating from average because of “a greater share of assets in its cheapest share class as well as improved target-date transparency,” according to e-mailed comments from Laura Lutton, editorial director at Morningstar. MassMutual rose to average from below average “based on the gradual improvement in its portfolio quality and performance,” she added.

Fidelity slipped to average from above average. “We lowered the rating in the parent company category because recent hiring and organization changes have not resulted in better performance, and we continue to see high manager turnover,” Ms. Lutton wrote.

Morningstar also said it has begun analyzing the target-date fund series from BlackRock, which debuted with an average rating.

(This article first appeared in Pensions & Investments, a sister publication of *InvestmentNews*.)

Let's have a look at the fees....This is a very large mutual fund company with a target date of 2030....BB (an actual fund, just xxxx it out because of disclosure issues, if you want to know, call)

XXXXXXXXXX 2030 Life Cycle (type) Mutual Fund

- Fees and Expenses

Annual Expenses as of 02/26/10

Total Expense Ratio	3.15%
Net Expense Ratio	1.22%
Management Fee	0.00%
12b-1 Fee	0.25%

Minimum Investment

Minimum Investment	\$1,000.00
Minimum Subsequent Investment	\$50.00

Minimum Investment IRA	--
Minimum Subsequent Investment IRA	--
Fiscal Year End	10/31/10
Open To New Investors	YES

Front-End Sales Charge Schedule*

Less than 25,000	5.25%
25,000 but less than 50,000	4.75%
50,000 but less than 100,000	4.00%
100,000 but less than 250,000	3.00%
250,000 but less than 500,000	2.50%
500,000 but less than 750,000	2.00%
750,000 but less than 1,000,000	1.50%
1,000,000 and over	0.00%

All breakpoints represent dollar values.

* There is no initial sales charge on purchases of \$1,000,000 or more of Investor A Shares ; however you will pay a CDSC on the offering price or the net asset value of the shares on the redemption date (whichever is less) for shares redeemed within 18 months after purchase.

This is from their disclosure page

XXXXXX Lifecycle Prepared Portfolios

Data as of date noted. The fund is actively managed and its characteristics will vary. Any holdings shown are for information only and should not be deemed as a recommendation to buy or sell the securities mentioned. As a fund of funds, the fund is subject to the risks associated with the underlying XXXXXXXX funds in which it invests. **Stock and bond values fluctuate in price so the value of your investment can go down depending on market conditions.** The two main risks related to fixed income investing are **interest rate risk and credit risk.**

Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. **Investing in derivatives entails specific risks relating to liquidity, leverage and credit that may reduce returns and/or increase volatility.** International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation, and the possibility of substantial volatility due to adverse political, economic or other developments. **These risks are often heightened for investments in emerging/developing markets or smaller capital markets.** Asset allocation strategies do not assure profit and do not protect against loss. Non-diversification of investments means that more assets are potentially invested in fewer securities than if investments were diversified. Therefore, risk is increased because each investment has a greater effect on performance.

Wow....look at those disclaimers.....BB

At least with history we will be able to feel comfortable about our funds being there in the future....a glorious thought...BB

% Average Annual Total Returns (12/31/10)¹
Since fund inception returns

Investor A — (**— 0.57**) (they did better in different time slots 3 years etc.)

I omitted all the other returns as well as the disclosures....my point is this....even those these funds are dressed up and focused on a target date....they are still not guaranteed and there is risk....plus there is fee risk.

So let's pretend the fund earned a nice rate of return and now it is time to convert them to income....what vehicle do you think they would recommend? An annuity?

No...because an annuity ends their fee income stream, they would suggest a slow dissolution of the fund based on the slow conversion to a bond portfolio....

Remember the disclaimer above?

“Typically, when interest rates rise, there is a corresponding decline in the market value of bonds.”

Why not approach the issue with guarantees. Guarantees against fee risk, market risk and liquidity risk. Instead of a target dated fund....let’s use the new annuity product now available

Target Date Annuity

What is a target date annuity?

It is a brand new creation of the industry; it was first developed at a time when safety and security was in the forefront of everyone’s mind. It was created when it was important that future dollars be available for future use in a guaranteed form.

It was created when the exposure to “risk” was not an option.

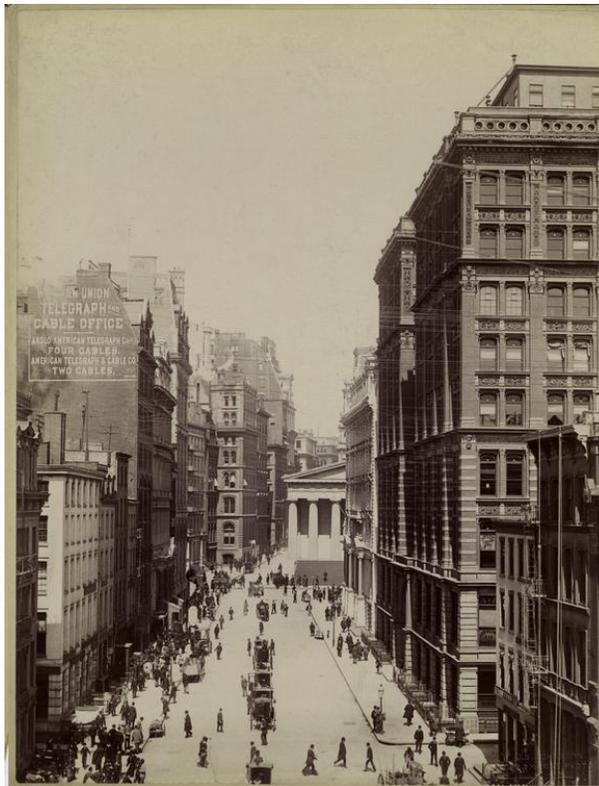
When was this new product developed? And who had the foresight to even think it up?

2001 after 9-11?

2009 after the meltdown?

1903, in New York...and it was invented by New York Life and the insurance industry! What is this radical new product that provides income for life and never any exposure?

Income annuities



New York 1903

1903, how is that for new? Target Dated Annuities. At almost any date an annuity can provide safety and security.

Here is an example.

\$100,000 male age 70.....monthly income for life of **\$731.78**, every month for as long as he lives....month after month after month.

And we also have a secret the **Target Dated Funds** don't have; we know that every year a person ages, the amount of income will increase.

\$100,000 male age 71.....monthly income of **\$754.44** every month for as long as he lives.....month after month after month.

One other point, our products always have their target on and ready to roll, annuitize anytime for any time period.....You don't have to wait for any maturity date.



Target Dated Annuities

Guaranteed

And finally..... Here is an article published in Philadelphia Newspaper you can copy and hand out if you are concerned about explaining the State Guarantee Association. Using 3rd party reference adds credibility.

Safeguards for Fixed Annuities and Life Insurance

By: Submitted by PETER HOFFMAN
phillyBurbs.com

Bankruptcy, slashed ratings, federal buyouts and takeovers; headlines of the last few weeks have painted a relatively bleak picture of our current financial environment. In light of this, it's understandable that you'd be concerned about your possible exposure. Various investment products that the financial community has positioned as risk management—fixed annuities, fixed life insurance—now seem vulnerable to loss. I wanted to take a moment to discuss frankly with you the risks and the safeguards in place to help protect your policies against those risks.

Information for fixed and variable policyholders: Annuities are long-term, tax-deferred investment vehicles designed for retirement

purposes. There is a distinction between fixed and variable annuities (two common types of annuities). For investors holding variable annuities, those assets are typically invested in diversified sub accounts. The funds are separate from the funds of the insurance company and protected from their creditors. The investment returns and principal value of the available sub-account portfolios will fluctuate so that the value of an investor's unit, when redeemed, may be worth more or less than their original value, so, clearly, there is market risk associated with separate accounts, which is why the more conservative of us may opt to invest in fixed annuities.

These fixed annuity investments, while offering the consistency of fixed returns, have their own risks. These annuity contracts are held at the insurance company and could be subject to creditors should the company fail, especially since guarantees are based on the claims paying ability of the issuer. The good news is that state and federal regulators have historically taken quick action to prevent ailing companies from failing to fulfill their obligations.

The safeguards: Depending on the size of the company, larger insurers may take over the obligations to policyholders. For companies that are more distressed, the state insurance commissioner may take over under a program of rehabilitation until the company is positioned for a sale. Further protection is offered for fixed annuity and life insurance products by their state's guaranty fund. Most states cover claims up to \$100,000 in cash values and \$300,000 in death benefits. In most cases, the guaranty fund never has to step in because the claims of small, insolvent companies are taken over by stronger, larger companies. With larger companies, the regulators may step in as administrator to handle claims against the policy.

Typically, death benefit claims are paid immediately. If the company is large enough, however, the guaranty funds can become over-taxed, and claims on the cash values can be delayed for several years. For cash value surrenders, you may need to apply for hardship withdrawals in the interim.

A strong track record: There are risks with any type of investing, and we do our best to align ourselves with top-rated insurance companies. I want you to know that the insurance industry as a whole has a very strong track record of meeting its obligations. Over the years, many companies have stumbled—and some have fallen—but the majority have kept the promises they made to investors. There are risks, but there are also safeguards.

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Personal Finance

Real World Index Annuity Returns

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Abstract

- We offer the first empirical exploration of fixed indexed annuity returns based upon actual contracts that were sold and actual interest that was credited.
- Annuity returns have been competitive with alternative portfolios of stocks and bonds.
- Their design has limited the downside returns associated with declining markets.
- They have achieved respectable returns in more robust equity markets.
- Studies that have criticized FIA's are typically based on hypothesized crediting rate formulae, constant participation rates and caps, and unrealistic simulations of stock market and interest rate behavior. When actual policy data are used, the conclusions change.
- Our study is exploratory, because although it is based on actual contracts and actual crediting rates, our policy data set is neither randomly selected nor comprehensive, based upon data provided by 19 FIA carriers.

Keywords: Indexed annuities, retirement, optimal asset allocation

JEL classifications: G11, G22, G23, J26

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Real World Index Annuity Returns

Jack Marrion, Geoffrey VanderPal, and David F. Babbel

Introduction

Financial advisors and financial planners have sought various programs to provide clients protection from systematic risk, also known as market risk. Various asset allocation strategies have been used with limited success when extreme market movements and “black swans” occur (Taleb, 2007). It has been known for close to 50 years that equity market returns do not conform to a Gaussian, or Normal (bell-shaped) probability distribution (Mandelbrot, 1963; Fama, 1963).ⁱ Rather, probability distributions of market returns are typically skewed positively or negatively and leptokurtic (fat-tailed – i.e., higher chances of extreme positive or negative returns than suggested by a bell-shaped distribution). When these leptokurtic events occur on the positive side of the distribution, clients are delighted, but the opposite is true when these events occur on the negative end of the two-tailed distribution.

Principal preservation products have evolved to address the needs of many risk-averse consumers by providing them a safety net for their investment/savings capital. The products are structured in a way that reduces correlations with other asset classes. To illustrate better the extremes of market returns, we can examine the Russell 3000 index that accounts for nearly 98% of the publicly traded U.S. equity market. A study by Eric Crittenden and Cole Wilcox (2008) at Blackstar Funds was conducted using Russell 3000 data from 1983 through 2006. The findings were that “about 40% of the stocks had negative returns over their lifetime, and about 20% of stocks lost nearly all of their value. A little more than 10% of stocks recorded huge wins over 500%” (Richardson, 2009). These data indicate that most of the positive market return over time comes from relatively few performers, which lends support to the use of stock index strategies as part of an overall portfolio. Furthermore it supports the notion that there is significant risk in the stock market and thus, for moderately to highly risk-averse clients, the need for principal protection programs such as fixed indexed annuities (FIA’s). Nearly 96% of FIA’s possess reset (or ratchet) features that allow for locking in positive returns each annual or biannual period. By eliminating the prejudicial effects occasioned by significant stock market declines, and locking in returns annually or biannually, there is less of a need to try and capture large upside market swings to recover from the declines.

As financial professionals, we are tasked with assisting our more risk-averse clients to protect themselves from black swans and many of us have a fiduciary responsibility. One of the significant developments for principal or asset preservation vehicles has been the fixed index annuity (VanderPal, 2004). During the past few years various articles have been written regarding the value in FIA’s and some people relying upon these studies have drawn misleading inferences from them.ⁱⁱ

After reviewing the size and growth of the FIA market in recent years, we turn to dispelling two basic errors that people often make in assessing the message of FIA studies. We will illustrate these misconceptions by using actual crediting rates on various kinds of FIA policies. With these data we are able to show actual returns on FIA's rather than make inferences from hypothetical crediting rates derived from assumed (and often constant) rate caps, assumed crediting rate formulae, and hypothetical participation rates, often coupled with theoretical stock market and interest rate moves. This should help inform the public and correct the inaccurate information portrayed by some journalists and industry professionals.ⁱⁱⁱ Furthermore, the article will delve into additional FIA features that provide advantages not found in ordinary securities and various principal preservation programs.

FIA Market Growth

The table below indicates the growth in sales of FIA's since 1997. Overall sales of FIA's in 2009 of \$30.2 billion are small compared to total fixed and variable annuities sales of \$235 billion in 2009 (Koco, 2010), and dwarfed by securities sales.

Equity Index Annuity Sales

Year	In billions of dollars
1997	3.00
1998	4.20
1999	5.15
2000	5.25
2001	6.50
2002	11.70
2003	14.01
2004	23.00
2005	27.26
2006	25.30
2007	25.20
2008	26.70
2009	30.20

Sources: Various reports from The Advantage Group, and (Koco, 2010)

Although the FIA market may be small relative to more established markets, it has nonetheless attracted several performance studies. We have noticed two basic limitations that typify most studies and articles that attempt to describe potential index annuity performance. The first of these is assuming crediting formulae that are rarely used and crediting rates that are seldom observed. While this type of exploratory exercise is fine in and of itself, a problem arises when readers assume the theoretical results are somehow representative of the index annuity world. The second limitation is making assumptions about stock market and interest rate behavior that are not well supported. This can lead people to make inferences about actual FIA behavior that are unjustified. Our study examines these limitations and shows how actual index annuity returns are at odds with many of the hypothetical conclusions.

Are Hypothetical Returns Realistic?

A number of studies and popular press articles have been disseminated recently on the performance of FIA's.^{iv} These studies have been based on hypothetical elements in one or more of: annuity contract designs, product parameters, economic environments, stock market behavior, and interest rate behavior. While it is common for economists and others to develop models in order to get a handle on product performance, unfortunately most of the models to date have created theoretical annuity products whose performance has little relation to FIA's sold in the real world.

As we will discuss in greater detail in the Appendix to this article, the main areas of concern with these models relate to the following dubious assumptions that underlie the model designs. First, some models posit crediting methods or combinations of contract elements such as assumed participation rates, interest caps, and pricing spreads that have never been observed in available contracts. Second, some models assume behavior over time of the pricing elements that is unlike the dynamic behavior characterizing FIA's in practice. For example, the economic models typically assume constant participation rates and interest caps that remain constant throughout the life of the contract. Third, they may select a time period in the economy that is not representative of the time period within which FIA's were offered, and therefore cannot couple the chosen time period with realistic product parameters that would have prevailed over that time period. Fourth, in some cases they construct completely hypothetical dynamic behaviors of the stock market and interest rates that have not been observed before and couple them with an imaginary FIA contract whose features are simply assumed, and somehow develop comparisons between the performance of the imaginary FIA and an assumed investment portfolio in the hypothetical economy. Fifth, the models do not include any accommodation for managerial discretion in adjusting the product pricing levers to be responsive to economic conditions and competitive forces.

While such exercises are instructive, they shed little light on how actual FIA's have fared under real world conditions. In the following section, we will attempt to remedy these deficiencies – at least insofar as available data will permit.

Reality

Index annuities have been producing returns since the first one was purchased on February 15, 1995. Unfortunately, most of the articles and studies ignore these data and attempt to portray how index annuities should have performed while ignoring actual results. What we show below are actual results. They are not intended to be a prediction of how index annuities will perform in the future, nor are the results intended to be representative of overall industry performance. They results are what they are. Let us be very clear on this. Our data set does have serious limitations, which we describe presently so that readers may draw their own conclusions, but unlike the numbers shown in the studies previously mentioned these results are real and not hypothetical. We believe this to be the most comprehensive data ever assembled for actual FIA performance data to date.

These results are based on copies of actual customer statements received with personal information blacked out, for each of the preceding five-year periods, requested on an annual basis since 2002. The return data reflect contract periods closest to 30 September with the exception of the 1997-2002 period that uses a 2 January date. The returns reflect the results of products with term

end point, high water mark, and annual reset designs with and without crediting rate caps, and with and without averaging. The returns do reflect any fees charged, but not surrender penalties. Annuitization was not required to receive these returns.

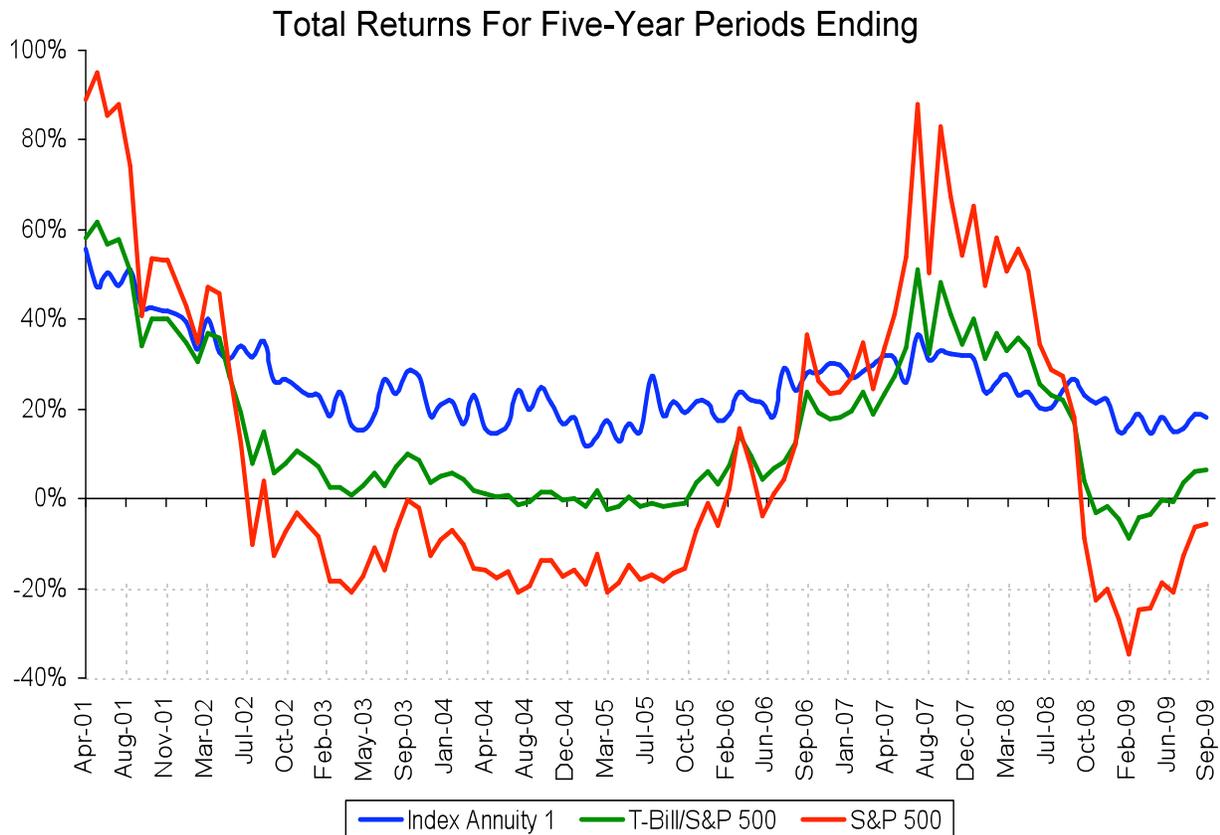
Annualized Five-Year Returns

Period	S&P index return	FIA avg. return	Number of FIA's	Return Range
1997-2002	9.39%	9.19%	5	7.80% to 12.16%
1998-2003	-0.42%	5.46%	13	3.00% to 7.97%
1999-2004	-2.77%	4.69%	8	3.00% to 6.63%
2000-2005	-3.08%	4.33%	28	0.85% to 8.66%
2001-2006	5.11%	4.36%	13	1.91% to 6.55%
2002-2007	13.37%	6.12%	23	3.00% to 8.39%
2003-2008	3.18%	6.05%	19	3.00% to 7.80%
2004-2009	-1.05%	4.19%	27	2.25% to 6.83%
2005-2010	-1.47%	3.89%	36	2.33% to 7.10%

Note: All returns shown above are annualized (geometric) rates of return. The S&P index returns are not meant to proxy for index mutual fund returns, which would include dividends, expense ratios (the least costly have featured approximately 20 b.p. per year), trading costs (another 30 b.p. per year), tracking error and taxes; rather, they are to reference what happened to the most popular index to which many FIA's are linked through some formula. Later, we consider total returns (including dividends, but not expenses and trading costs) on the S&P 500 stocks.

There are several limitations with the data above. The main one is that they are derived from carriers that chose to participate and that chose the products for which they reported returns. This could have imparted some bias in returns, and may differ from what a larger, more random sample would have produced for the periods. Although some of the annuities had contract years ending on the 30th, the contract anniversaries encompassed a three-week range around that end date. The data collected are very few for some periods. And the data reflect results across a very small spectrum of time, only looking at 1997-2010 and then only at one day out of each year. Nonetheless, the 172 contracts for which we have data are real contracts and reflect actual crediting rates that were provided to annuity owners over time under twelve different crediting rate structures used in FIA designs.

This next data set reflects the actual real-world total five-year returns credited to annuity owners for an annual point-to-point with cap structured index annuity. Assuming an annuity is purchased on the 21st of every month beginning April 1996 with a final purchase on September 2004. This annuity was selected because it has been steadily offered every month for 14 years and its performance is publicly available. It is not intended to be representative of anything except itself. The chart below compares the FIA returns with the total returns of the S&P 500 over the same period, and a blended return composed of 50% of the S&P 500 total return and 50% of the compounded return for a series of one-year, U.S. constant maturity T-bills. To render our study more comparable to other studies (cited previously), we have not rebalanced our portfolios each period. Moreover, we have not deducted from these alternative portfolios any of the annual expenses that typify mutual funds, thereby biasing the comparison to favor mutual funds. (Note that the vertical axis on the next two charts shows accumulated returns over five years, which are not expressed in annualized terms.)

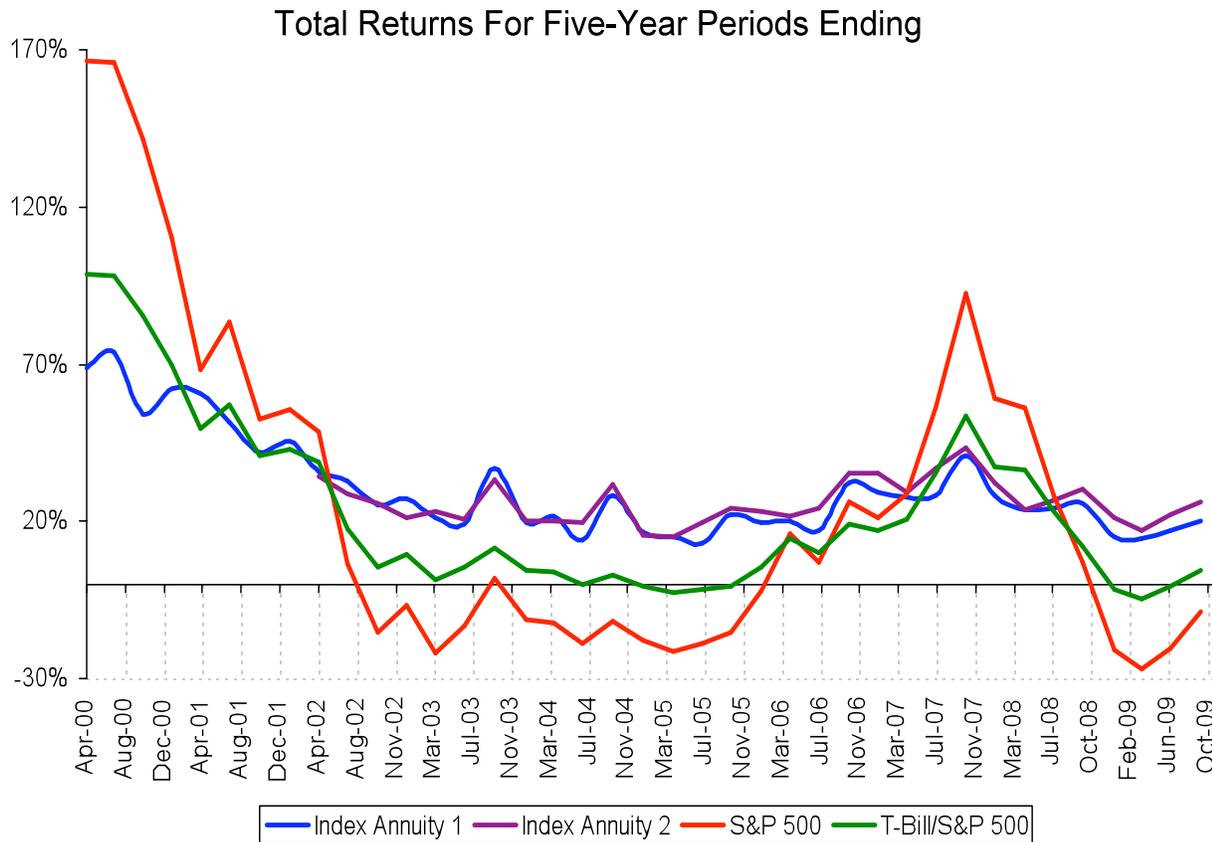


This next data set reflects the actual real-world total five-year returns credited to annuityowners for two other index annuities using annual point-to-point with cap structures. (These data are shown separately from the prior chart because the data for these annuities were available only quarterly, whereas the prior chart is based on monthly data.) It shows the actual returns of the annuities if purchased quarterly since inception of the product in April 1995 on the one annuity and since inception of the other in April 1998 with a final purchase in October 2004.

These annuities were also selected because they have been steadily available for fifteen years in the first example and twelve years in the second and their performance is readily available. The chart on the following page compares the FIA returns with the total returns of the S&P 500 over the same period, and a blended return composed of 50% of the S&P 500 total return and 50% of the compounded return for a series of one-year, U.S. constant maturity T-bills. We have not deducted from these alternative portfolios any of the annual expenses that typify mutual funds, thereby biasing the comparison to favor mutual funds.

Collins, Lam and Stampfli (2009) attempted to predict the future by using the past and creating “a rich set of probable future results [that] is available for inspection.” Based on these “probable” futures they found the index annuity minimum guarantee to be beneficial at times, but that the index annuity payoff “always lags the investment portfolio’s payoff for returns.” McCann (2008) created his own hypothetical annuity structure and in the future he created, he stated that “99.8% of the time the investor would be better off with the Treasury securities and stocks than with the equity-indexed annuity.” However, if your future included all of the 141 actual 5-year periods from April 1995 through 2009, and you had purchased any of these real-world-still-being-

marketed index annuities month after month, the not-pretend index annuity results bested the S&P 500 alone over 67% and a 50/50 mix of one-year Treasury Bills and the S&P 500 79% of the time.^v



These returns should not be viewed as representative. The annualized range of returns in the graph are from annuity carriers that chose to submit their return data, and although overall *a majority* of index carriers did provide actual return data (reaching 83% of all carriers selling FIA's at one point), self-reporting bias may have resulted that skewed the returns higher than would be seen with a more comprehensive data set.

The two charts showing total returns are much more comprehensive. The first chart shows the actual returns of one annuity purchased month after month since April 1996. The second chart shows the actual returns of two annuities purchased at the same time each quarter beginning in April 1995. All in all, actual results for 172 five-year periods are shown. However, it should be noted these three annuities all use an annual point-to-point with cap interest crediting method.

We fully realize the limitations of the data. We wish that we could show actual index annuity returns for a multitude of products and crediting methods going back a half century, but the data are not there. Again, due to these limitations the return data should not be considered representative of how index annuities perform, but neither should it be dismissed.

Exercises conducted by McCann, Reichenstein, or Collins, Lam and Stampfli (discussed later in the Appendix) created hypothetical worlds that either use crediting methods that are, at best, extremely rare (to the best of our knowledge, as we have never encountered them), or dubious as-

assumptions that do not reflect the actual pricing environment, and yet these studies have been used by some to condemn index annuities as a failed financial concept. In the interest of fairness, the actual results from 344 five-year returns representing close to two hundred different index annuities should be seen for what they are and that is showing that at least some index annuities have been competitive.

Liquidity and Risk

According to Collins, Lam and Stampfli (2009), FIA's are not liquid investments and have "formidable" surrender charges. Although the authors did not define what they mean by "liquidity," in a financial sense it usually refers to (1) the ability to buy or sell an asset with minimum disturbance of its market price; (2) the ability to buy or sell with relative ease; or (3) the ability to easily convert into cash.

With regard to definition (1), we note that unlike some assets that are traded in the open market, FIA's are private contracts, similar in that respect to nonnegotiable bank CD's. They are not traded in the marketplace, and hence have no market price. Hence, the first definition of liquidity does not fit. (Of course, many stocks and bonds have very thin markets and may require quite a lengthy time to find a buyer, and then only if a steep price discount is offered, but those assets that are quickly tradable rarely have guaranteed price schedules over time and may be sellable at only a small fraction of their original purchase price. Nonetheless, under this definition of liquidity, the original purchase price is not a factor.)

Under definitions (2) and (3) we note that unlike some stocks and bonds but similar to bank CD's, FIA's may be easily "cashed in" with the issuer at any time and at prices that are formulaically pre-specified in the contracts. There is always a willing buyer. Both CD's and FIA's have surrender penalties for premature withdrawal or early surrender, but both are easily convertible into cash. In the case of some CD's, the early withdrawal penalty may depend on how early they are liquidated, yet with other CD's the penalty may be fixed regardless of how early they are cashed.^{vi} In the case of FIA's, the early surrender penalty is almost always a function of how early the surrender occurs.

Moreover, the authors failed to take into account the various free withdrawal provisions in all FIA's. Generally a 10% withdrawal is allowed annually without surrender penalty and some contracts allow 15% annually. A 10% withdrawal is about triple what you can withdraw from a Treasury bond portfolio in today's interest rate climate without subjecting yourself to losses of principal occasioned by bond price fluctuations, and even more so when the alternative portfolio includes common stock. Most articles analyzing appropriate withdrawal rates for retirees range in the 4-6% range annually, depending upon various methods of thought. This being said, a 10% withdrawal privilege should not be an issue for most retirees and individuals. If more liquidity than that is desired, it should be sought through additional types of portfolio assets.

Nearly all FIA's provide a full surrender value (i.e., all surrender charges are waived) upon death of the owner or annuitant. Many FIA issuers offer full surrender without penalties for nursing home stays, extended hospital visits and terminal illness (VanderPal, 2008). Several carriers offer full surrender without penalties for unemployment if under 65 years of age. The surrender charges when applied outside of the free withdrawal provisions typically depend on the mini-

imum term of the annuity and whether any bonuses are paid, and usually decline each following year.

Another difference is that in the case of a non-qualified annuity purchase, the accumulation value grows tax deferred, whereas with a non-qualified portfolio of stocks and bonds, taxes are incurred along the way. Babbel and Reddy (2009) have shown that the difference between these two tax treatments can ultimately produce after-tax income potential from the annuity that would require alternative taxable mixes of stocks and bonds to produce annual returns that must be substantially higher, in some cases 200 basis points or more higher, than the annuity returns in order to provide for an equivalent after-tax income.^{vii} This missing element in our comparison biases the result in favor of the alternative portfolio. In short, tax-deferred annuities including FIA's provide a tax advantage and potential return advantage that standard stock and bond investments would not provide unless held in a retirement account. Moreover, FIA's in almost all states are protected from creditors and against seizure in situations of litigation, which is not typically true of stock and bond mutual funds unless held in a protected vehicle.

FIA opponents commonly cite surrender fees as an issue. However, surrender fees are generally required by state insurance regulators in order for policies to qualify for sale. Inadequate surrender fees have attracted hot money in the past and often led to insurer insolvency (Babbel and Merrill, 2005). FIA's provide a guaranteed minimum return along with principal preservation at each point in time and other options, which mutual funds and other similar investments do not provide. These guaranties can be costly to secure. The existence of surrender fees also helps an insurer recapture up-front costs on products that were designed to be held for several years, and protects persisting policies from the imposition of extra costs by those who choose to surrender early.

Fees and Expenses

“Although FIA's do not provide complete participation in an index, based on various crediting methods and market anomalies, returns may actually be better over time than in mutual funds or variable annuities. Consider that variable annuities with mortality and administration expenses (M&E), sub-account management fees and other various charges can account for up to 4.00% of annual expenses that erode market returns on variable annuities” (VanderPal, 2008). According to Morningstar the average mortality and expense and management fees are 2.08%. For example, a variable annuity sub-account that earned 10% in the market would net less than 8% to the client's account after internal fees are deducted from earnings.

Unlike mutual funds, an FIA does not deduct sales charges, management fees or 12b-1 marketing fees. Instead, the insurance company uses a small amount from the underlying portfolio which lowers participation in the market index to cover administrative costs and commissions to brokers (VanderPal, 2008). Because the FIA provides policy crediting rate formulae and periodic annuityowner reports net of any fees and management expenses, it does not separately disclose them. All distribution and management costs are already “baked in” the products' terms and parameters. No study has been published to date that shows whether these costs exceed those of retail mutual funds (taking into consideration that some of these FIA costs are not comparable, as they are incurred to provide protection against downside returns).

Consumer Risk Aversion

Finally, most of the aforementioned fixed indexed annuity studies have failed to take into account the level of risk aversion of an individual consumer.^{viii} An exception to this pattern is the study of Babel, Herce and Dutta (2008) that explicitly takes into account the level of consumer risk aversion. Using the criteria of multiperiod utility analysis, they find that for moderate and strongly risk-averse individuals, the fixed indexed annuity is judged superior in performance to various combinations of stocks and bonds. This is not surprising because a risk-averse consumer will penalize an investment alternative that does not avoid downside risk in a quest to achieve superior returns. Because FIA's are designed in a way to avoid downside risk, they tend to produce preferred return patterns for such consumers when compared to alternative investment strategies that expose consumers to significant levels of that risk.

Conclusion

Much of the analysis published on index annuities is based on hypothetical annuities and completely fabricated returns, often calculated over periods that were decades before they were even introduced, or over simulated future periods whose characteristics do not conform well to economic conditions that we have ever encountered. Some studies are generated by using selected time periods and crediting criteria to produce the preordained conclusion desired. If the analysis is produced for the annuity industry the conclusion is positive, if it is directed towards the securities industry it is negative.

The present study, in contrast, has examined some annuities that have actually been sold, and has tracked them over their lives, including all of their periodic changes in contract "levers" such as evolving interest caps and participation rates, and their actual credited interest. While we were relegated to using a relatively short time period, at least we used the actual time period over which FIA's have existed. We cannot say whether our data are representative of all FIA's, although we assembled the largest database of actual returns that has yet been used in a published study. Our rather modest conclusion is that at least some index annuities have produced returns which have been truly competitive with certificates of deposit, fixed rate annuities, taxable bond funds, and even equities at times (Marrion, 2008). This is in contrast with assertions in other studies (discussed further in the Appendix), based on no actual return data, that the structure of FIA's necessarily relegates them to being inferior or unsuitable products.

How will index annuities perform in the future? We do not know. We do remind the reader, however, that FIA's were not designed to be direct competitors of index investing nor have FIA's been promoted to provide returns to compete with equity mutual funds or ETFs. The FIA is designed for safety of principal with returns linked to upside market performance.

Appendix on Hypothetical Returns Studies

As stated earlier, the studies and articles that have been most critical of FIA's are based entirely on hypothetical returns. Such treatments provide interesting illustrations of how an FIA could operate. However, problems arise when people begin to extrapolate from these hypothetical FIA return studies and assume that they are somehow representative of FIA contracts that are typically sold. They are not. This is because the hypothetical returns are based upon hypothetical contract structures, hypothetical product parameters, and hypothetical economic environments that are built upon dubious assumptions. Below we identify five of these dubious assumptions. There are many others that we do not discuss here, but they have been discussed at length elsewhere in sources that we identify.

Dubious Assumption #1: Real world contract designs are similar to hypothetical designs

Collins, Lam and Stampfli (2009) created a term end point structure (they call it a multi-year, point-to-point) that applied a 75% participation rate to any gain over a seven-year period. They then calculated the annual return, deducted a 1% spread, and finally compounded the lower of 8% or the calculated annual yield to produce the total gain for the period. This is a rather cumbersome structure, and one we cannot find was ever used on any index annuity.

In reviewing specifications on the over 400 index annuities marketed since the first index annuity sale in February 1995 (Marrion, 2003), we failed to find any term end point product that used a crediting method which had a participation rate of less than 100% combined with both a cap and a yield spread greater than zero. Indeed, in reviewing all of the product information we have assembled since 1995, the only annuity we found which had a participation rate of less than 100% that could change each year and deducted a yield spread or asset fee and had a cap was the Americo FlexPlus annuity marketed around the turn of the century. However, it did not use a term end point design; instead this product used an annual reset or ratchet design, the performance of which differs radically from a term end point structure (Marrion, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007).

Often a financial columnist or an occasional other writer will dismiss the index annuity concept by proposing that a consumer purchase a long-term zero-coupon bond together with an index fund instead of an index annuity (Clements, 2005; Pressman, 2007; Warner, 2005; McCann and Luo, 2006). These columnists and other writers often posit the term end point crediting method as the representative interest crediting structure. However, all term end point designs account for less than 4.5% of sales over the last four years and term end point design using two crediting components represents even less (Marrion, 2006, 2007; Moore, 2008, 2009). Indeed, Collins, Lam and Stampfli (2009) base their conclusions on a term end point that uses a cap, but less than 1% of the products have ever placed a cap on a term end point crediting method (Marrion, 2009). Such a product is certainly not representative of index annuity crediting methods in practice.

The assumed index participation rates may also not be representative. For example, for their chart of seven-year periods starting in December 1988 and with the final seven-year period beginning in December 2000, Collins, Lam and Stampfli (2009) assume a term end point participation rate of 70% to 75%, depending upon whether the seventh-year index values are averaged, and place an 8% cap on any yearly gain. Since index annuities were not around until the mid-

1990s we cannot decisively state what rates would have been for the early years used. However, one can gather the actual participation rate data from when products did appear. We can state that based on actual FIA's offered, if you had purchased every available index annuity using a term-end point annuity with a seven-year term on the first business day of each month from January 1997 through December 2000 your average participation rate would have been 72% without a cap (Marrion, 1997, 1998, 1999, 2000).^{ix}

Looking at "representative" annual reset methods, Collins, Lam and Stampfli (2009) assume 55% index participation with a 7% annual cap or 60% averaged index participation with a 7.5% cap. McCann (2008) compares returns from 1990 through 2007 of the S&P 500 with a hypothetical annual reset point-to-point design that assumes a constant 6.5% cap. However, in reviewing actual new money rates for annual reset designs from 1996 to the present, one would have encountered effective participation this low at only a few points in 2003 and 2004 and in 2007 and 2008. Indeed, many averaging products were offering 100% first-year participation without a cap in the late '90s, and many annual point-to-point products have offered 100% participation allowing for possible double-digit gains (Marrion, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007).

There is nothing wrong with showing how a term end point method might have performed under these assumptions. However, we must keep in mind that the results of the Collins, Lam and Stampfli (2009) study are not representative of FIA's performance, as they depend upon a crediting rate method not used in over 95% of sales, and combinations of other contract features not observed in practice.

Dubious Assumption #2: Participation Rates and Caps Never Change

Collins, Lam and Stampfli (2009) assumed an averaging method had a 60% participation rate with a 7.5% cap and applied it to the past. McCann (2008) assumed a constant 6.5% cap for all of his index annuity performance calculations, which appears to have been a cap on the date his story was completed, when interest rates were heading toward historic lows. On the day he completed his story the constant maturity rate of a 10-year U.S. Treasury Note was 3.64%; by contrast, during the 1990 until 2000 period (within the time frames of both studies) the 10-year Treasury rate was nearly twice as high, averaging 6.66% (Federal Reserve Board, 2009). Lewis (2005) assumed either a 5% or 9% cap on an annual reset design and ignored the interest rate environment that might change these caps, but allowed for the returns to positively affect the T-bill comparison he made. Higher bond yields generate more interest income thus allowing carriers to buy or synthesize more options to increase index participation, which is why some annual point-to-point products were able to offer 100% participation and 14% caps in the previous decade (Marrion, 1996).

Lewis (2005), McCann (2008), and Collins, Lam and Stampfli (2009) assume constant index annuity participation rates, while holding caps and spreads steady over long periods of time. Reichenstein (2009) attempts to remedy this by considering a matrix of renewal cap rates (always constant or descending over time) while ignoring the actual evolution of cap levels on real contracts. He assumes that a particular annuity whose terms were observed in the late 1990s would have had similar parameters beginning in 1957 and continuing for almost 40 years before the first FIA arrived on the scene. (Indeed, there were not even any index funds available to individual investors until 1977, yet his study assumes that individual investors would have secured

better returns over that period by investing in them. His study also assumes that these funds were held together with five-year Treasury bonds that were held for only one month and then liquidated, replacing them with new five-year bonds every month for 52 successive years.)

The flaw in these studies is that they do not take into account the real world effect of changes in interest rate environments and market volatility's effect on the cost of providing the index participation. One cannot assume today's product parameter levels would have existed in the past because the financial conditions of the past were often quite different. One cannot simply posit a participation rate or cap on crediting rates, hold it constant or have it worsen formulaically over time, and then attempt to make conclusive comparisons with actual stock index returns. Clearly the reach of the conclusions is limited by the unrealistic assumptions underlying the annuity modeled.

Not every study adopts these simplifying assumptions. Gaillardetz and Lin (2006) note that when interest rates increase participation rates also go up, unless offset by increased volatility. One carrier suggested that the uncapped guaranteed participation rates on their seven-year averaging annual reset product from 1980 through 1995 would have ranged from 135% to 260% based on bond yields and call option prices in effect (Physicians Life, 1996). They understand that index participation is driven by bond yields and option costs and these change over time.

Dubious Assumption #3: Annual Stock Market Returns of 17.6% Are Normal

Collins, Lam and Sampfli (2009) mention that many attempts to show index annuity comparisons are exercises in data mining and we quite agree. One way to data mine is to make long-term predictions based on using low participation rates that do not represent the reality of long-term rates. Another is to intentionally select periods that favor one choice over another.

McCann (2008) makes a performance comparison over a 30-year period that happens to start in a year with the lowest end-of-year S&P 500 value over the previous 45 years. Using the correct December 2004 index values, the annualized growth rate of the S&P 500 for McCann's selected comparison period is 10.05%. By contrast, the S&P 500 growth rate from December 1954 to December 1984, another 30-year period, was 5.25%, and the average annual growth from December 1964 to December 1994 was 5.79%.

In the 30-year period that McCann selected for constructing his comparisons, the S&P 500 ended at 1211.92. If you used a monthly averaged annual reset method to compute where a monthly averaged S&P 500 would have ended at you get an ending value of 591, which is 49% of the actual S&P 500 level. By contrast, if your 30-year period ends December 1984 the S&P 500 level is 167.24; however, the monthly averaged S&P 500 computed value is 161.37, almost equal to the actual S&P 500 level. Many performance comparisons pit index annuities against stock market investments over the '80s and '90s when stock market returns averaged 17.6% and ignore the preceding eight decades with their average return of 8.5% (Bogle, 2003).

Dubious Assumption #4: Stock Market Returns Conform to a Normal Distribution, Interest Rates and Volatility Are Constant

A more egregious problem in some of the studies that simply simulate hypothetical stock market return scenarios in order to generate hypothetical policy crediting rates is that the simulations are

often based on an assumed distribution of stock returns that cannot be supported. For example, McCann and Luo (2006) have conducted studies of hypothetical crediting rate behavior assuming that equity market rates of return conform to a Normal distribution. When Babel, Herce and Dutta (2008) re-examined that study but used an empirical distribution that matched the historical record, while keeping in tact all of the other assumptions of McCann and Luo, they found that annual crediting rates in the range of 5-15% were about twice as common as what were being credited under the Normal distribution assumption. This implies that FIA's were far more valuable than was being represented under the hypothetical distribution of stock market returns.

In a similar vein, several studies assume that interest rates and volatility are constant throughout an annuity's life, in order to construct their performance comparisons. Of course the simplifying assumption has never occurred in the marketplace, and the alternative investments to which FIA's are compared have their returns affected by interest rate movements as well as volatility changes.

Dubious Assumption #5: Managerial Discretion Is Not Involved

Over 95% of index annuity sales are in products that may change at least one element of their interest crediting methodology after each reset period. Two primary factors affecting subsequent index participation are bond yields and the price of call options (Gaillardetz and Lin, 2006). However, the ultimate determining factor in setting index participation in future years is not the interest rate environment or the cost of options, it is what carrier management decides to do. This human element introduces a random variable that cannot be quantified, thereby making any attempt to project any returns ultimately subjective.

On the other hand, although the insurer does have discretion periodically to change certain contract parameters, such as the cap levels or participation rates, it does not have unfettered discretion to alter them, because the contracts themselves have minimum guaranteed levels for both, as well as state minimum nonforfeiture value schedules. Moreover, and more importantly, the insurer faces the discipline of the market. If it tries to credit less than a competitive and fair rate, it will face the dissatisfaction of its consumers, the rancor of its agents, the cost of lapsation and policy surrender, and the hesitancy of agents to ever put future clients in such products. This would essentially be the death knell of its future business. Therefore, consumers have at least three layers of protection – contractual minimums, state minimum nonforfeiture values, and competition enforced by both consumers and, more importantly, agents (because they are more aware of what other companies are offering and have a financial incentive to replace underperforming policies) – which should assuage the risk aversion of many.

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Endnotes

- ⁱ A recent confirmation of this finding is in Babel, Hecce and Dutta (2008). In their study, the authors found that there was less than one chance in a million that monthly stock market returns from 1926-2008, and various sub-periods during that time interval, conform to a Normal distribution, whether measured by a Jarque-Bera, an Anderson-Darling, or a Kolmogorov-Smirnov goodness of fit test.
- ⁱⁱ See, for example, Collins, Lam and Stampfli (2009), Lewis (2005), McCann and Luo (2006), McCann (2008), Reichenstein (2009) and Warner (2005). These will be discussed in depth in the Appendix.
- ⁱⁱⁱ Refer again to all of the articles indicated in endnote ii as well as Clements (2005) and Pressman (2007).
- ^{iv} Again, we refer the reader to the articles cited in endnote ii.
- ^v A more direct comparison with McCann's 14-year hypothetical periods is provided by Babel, Dutta and Hecce (2009).
- ^{vi} For example, in 2010 the flat premature withdrawal interest penalty on its five-year CD's ranged from 60 days to two years of interest, regardless of how early or late one makes the premature withdrawal.
- ^{vii} Their study showed that an alternative portfolio would have to generate an additional pre-tax return that in some cases reached over 200 basis points per year. The ultimate size of the tax benefit from tax deferral depends on the length of time the annuity is held during the accumulation and decumulation phases of ownership, whether a deferred annuity is annuitized at the end of the surrender period, or taken as a lump sum distribution, the level of yields net of expenses, the marginal tax rates on ordinary income of the investor, and the differential between tax rates on ordinary income and tax-preferred treatment of dividends and capital gains. McCann and Luo (2006) claimed that the benefits of tax deferral were "de minimis."
- ^{viii} Some unpublished studies have been performed in a litigation context where long-term zero-coupon bonds are used, together with index funds, to craft an alternative portfolio and compare its returns to hypothetical FIA's. We used Treasury bills in this study to make it conform to most of the published studies.
- ^{ix} To be precise, the average term end point participation rates for seven-year periods were: 1997-87%, 1998-71%, 1999-61%, 2000-70%.