I.I.I. Paper Offers Analysis of Indexed Annuity Product Pros and Cons

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Created in 1995, Indexed Annuities Now Account for 33 Percent of Entire Fixed Annuities Market

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NEW YORK, December 11, 2006 - U.S. indexed annuities (IAs) investors are benefiting from the current performance of the Standard & Poor's 500 (S&P 500), to which most IAs are tied, while at the same time being protected from downside risk, an Insurance Information Institute (I.I.I.) report found.

Indexed annuities have only been on the market for 11 years; they were known previously as *equity-indexed annuities* and are currently also referred to as *fixed-index annuities*.

Annuities are fixed or variable insurance company contracts that allow investors to convert premiums, and any tax-deferred earnings generated by those premiums, into either savings or lifetime income.

Ninety-five percent of all IAs sold in the U.S. are tied to the S&P 500, a broad market index that reflects the overall performance of stocks sold in U.S. markets. IAs provide their owners with the potential for larger interest credits than might be paid on traditional fixed-rate annuities. Yet IAs are also structured to minimize the effect of downward market fluctuations, with IA investors realizing a guaranteed minimum return.

"That does not, however, mean that all IA investors with the same tied index achieve equal rates of return, because IA issuers may ?cap' or otherwise limit the amount of the tied index gain that they credit as extra interest," said Dr. Steven Weisbart, an I.I.I. economist. "Yet IA investors are protected from losing any of their principal if they hold the annuity to the end of the surrender period, something that cannot be said for those who invest directly in stocks and mutual funds."

Indexed annuities are a type of fixed annuity, offering a guarantee of principal and a minimum rate of interest, supported by the insurance company's so-called general account. That account includes insurer assets from products such as fixed annuities as well as term, whole life and universal life insurance.

There are many methods for measuring index performance in the IA marketplace but the type known as annual reset is by far the most popular approach in the U.S. today, the I.I.I. paper reported. Under the most basic form of the annual reset provision, the first step in determining the IA's interest-crediting rate is comparing the value of the tied market index at the end of each contract year to where that same index stood exactly one year before. For example, someone who purchased an IA on November 15, 2005 that was linked to the S&P 500 might have received, as of November 15, 2006, a 10-plus percent credit because the S&P 500, not including reinvested dividends, grew at that rate over the previous 12 months.

"In years where gains in the tied index are negative, a ?0' is recorded. So while there can be years where an indexed annuity investor would see no index gains, under the annual reset provision it is impossible to have a ?down' year. Accumulation values will either grow or remain steady from one year to the next, regardless of the amount of volatility in the underlying market index," Dr. Weisbart stated.

Americans invested more than $160 billion into fixed and variable annuity products in 2005, mostly in the form of single premium payments that were often upwards of $50,000. Most annuities bought today are characterized as ?deferred' annuities, meaning that money contributed to them is intended to grow for years before it is withdrawn as a single sum or as a stream of payments.

Surrender charges are a significant issue that investors should consider before purchasing an IA. With IAs and all other types of annuities, insurers impose a surrender charge if a policyholder chooses to liquidate an annuity before a prescribed period of time has passed. The surrender charge helps the insurer offset a portion of the sales and other expenses associated with the issuance of annuities contracts that otherwise would be recoverable in future years had these policies stayed in-force.

Surrendering ?early,' however, can be expensive for a policyholder. An investor with a $50,000 IA, for instance, could pay anywhere from $2,500 to $5,000 to break the contract. The surrender charge period is generally eight to 10 years, although it can be longer.

In contrast to IAs and other fixed income annuities products, variable annuity payments are based exclusively on the performance of a stock portfolio (or other asset class) in which the issuer invests, whether it is an insurer, a charity or a trust. Therefore, the value of a variable annuity may change, depending on whether the value underlying investments go up or down. State and federal regulators require sellers of variable annuities, which are legally considered securities, to register with the National Association of Securities Dealers and the Securities and Exchange Commission, whereas fixed income annuity products are regulated by the state insurance department in which they are sold.

The I.I.I.'s *Equity-Indexed Annuities: Fundamental Concepts and Issues* report can be found online at /media/hottopics/additional/eia/ .

A nine-page Executive Summary of the document is available at /media/hottopics/additional/eiasummaryf/ .

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