Indexed Annuities, A Perfect Investment During Recession

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Nov. 27--A wobbly economy, low interest rates and cautious investors are the perfect conditions for selling indexed annuities. So what is this investment product, which is neither a fixed annuity nor a variable annuity?

Dana Pedersen, vice president responsible for annuity product development and pricing for The Phoenix Cos., explains why indexed annuities are selling so well and what they offer to customers:

Q: *So, what is an indexed annuity?*

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

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

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

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

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

A: I think indexed annuities have definitely been gaining in popularity. So, 2009 was certainly a record sales year for indexed annuities and 2010 is on track to do as well if not even better. I think what happened is, coming off all the financial turmoil 18-24 months ago, people were really looking for a vehicle that provided them some level of safety.

Q: *What is driving sales growth of indexed annuities?*

A: It's a combination of two things: time, which allowed us to educate the consumers out there, and just the appetite of consumers in that they're really looking for something that's a little bit safer. ... They're not willing to take as much downside risk as they may have been willing to take two years ago.

Q: *What is it about a volatile equity market and low interest rates that makes indexed annuities appealing, so much so that there were high sales in the third quarter?*

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

So, as more people are approaching retirement, they're definitely interested in securing a guaranteed level of income through retirement. Whereas 3, 4, 5 years ago guaranteed living benefits were not prevalent on indexed annuities, now they are prevalent on indexed annuities. So, to layer some type of guaranteed income protection on top of a vehicle with no downside risk certainly is a great combination for a lot of consumers.

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

A: The majority of the products in the market are single-premium (products) although some insurance companies do offer flexible-premium products. In general, what we tend to see is even on flexible-premium products, the initial deposit is usually the most significant.

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

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

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

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