June 16, 2011

Letter to the Editor of National Underwriter Life & Health
Re: “What Would You Think? A close look at a popular annuity sales presentation begs the question: is it misleading” by Brian Fechtel in the June 6, 2011 issue

Dear Editor,

Why did the National Underwriter print a story filled with allegations and no facts to back them up - a lot of smoke but no fire? The author’s whole story centers around the purported miscalculation of the internal rate of return on a guaranteed payment stream. In fact the author makes no claim that any other aspect of a “typical” presentation was inaccurate - not the payments, not the company’s rating, not the bonus amount…

He claims that both the agent and the customer were unable to accurately calculate the internal rate of return, yet the author had no difficulty doing so. And he correctly points out that insurers are held to very strict advertising laws. To comply with those laws, insurers require producers to submit all material used in prospecting, educating or selling for approval prior to its use. Anything not submitted and approved whether it is a calculator, a spreadsheet or abacus, is not acceptable. State regulators pour over thousands of marketing materials and presentations to monitor insurers’ and producers’ compliance with and enforcement of the law. In fact, NAFA has produced a detailed guide to Advertising and Advertising Principles to help producers comply and understand their responsibility.

The author seems to believe that the internal rate of return is the most important aspect of the income rider. Why? The millions of consumers who have bought fixed annuities with a guaranteed income rider or feature have done so on the basis of its primary appeal – a steady, reliable retirement income that is guaranteed to continue for the rest of the owner’s life. This income cannot be outlived, is known years in advance and guaranteed. We know of no other product that can assure them TODAY – fifteen years in advance – that when they retire at age 65, their retirement savings will produce a payment stream of $17,447 annually that is guaranteed to continue for the rest of their lives. And, since the elements of the income formula – the compounding and the payout rate – are fully guaranteed, if Paul and Mary choose to add money to the annuity contract, they know how much income the additional money will create.

Perhaps the income should be viewed as something other than a financial services product where return is the only benchmark. In fact, the income rider purchase could be viewed as a risk management vehicle. If this was the typical life insurance product the author sells, it would be frowned upon to tout the fantastic IRR for an insured who perished 3 years into a policy. Instead the life insurance provides financial protection against an event (death) an individual cannot predict. Similarly, the income rider provides financial protection against an event (long life leading to increased length of needed retirement income) an individual cannot predict. It’s a risk management vehicle. It pays for the unpredictable event against which it protects. The value of the provided risk mitigation does not lessen if the vehicle does not pay out the largest “return” from a cash flow standpoint.

It’s in this framework that we might wish to lessen the emphasis on IRR.

How can the National Underwriter print the article’s profusion of unsubstantiated claims in the guise of questions? He asks questions about “this widespread and blatantly problematic practice” and yet provides no empirical evidence to prove this is true. He asks if “insurer sales materials [should] be tested on groups of consumers” and has not checked with insurers or consultants to find out if they do. He claims the product is “widely sold” and yet brings us no evidence that it is “widely misunderstood.”

If the agent did portray his simple interest calculation as an internal rate of return, he was wrong and should be corrected. The remainder of the article boils down to a missed opportunity, one in which you could have educated your readers on the true uses of and need for guaranteed lifetime income.

Sincerely,

Kim O’Brien, Executive Director
The National Association for Fixed Annuities