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SEC draws ire with indexed annuity misstep

The regulator issued an investor bulletin about indexed annuities that instead described a different product — a buffer annuity

By Greg Iacurci | *August 16, 2019 - 1:16 pm EST*

The Securities and Exchange Commission caused concern among the financial advice and insurance communities this week when it published an inaccurate investor bulletin about indexed annuities.

The communiqué, issued Tuesday by the SEC's Office of Investor Education and Advocacy, centered on indexed annuities but proceeded to describe an entirely different — though similarly marketed — type of annuity known as a buffer or structured annuity.

The SEC's primary faux pas, according to insurance experts, was its characterization of indexed annuities as products that can lose money if a market index goes down. The bulletin describes product features such as a "buffer or shield" that limit an investor's downside in the event a market index like the S&P 500 loses money.

These features, however, do not apply to indexed annuities — they are inherent to structured annuities, a sort of cross between indexed and variable annuities. The mix-up is especially egregious, critics said, because the SEC regulates structured annuities, which, unlike indexed annuities, are securities products.

"There's no excuse to be disseminating misleading and inaccurate information like this," said Sheryl Moore, president and CEO of an insurance consulting firm. "You are the department of investor education, and you need an education on what you're talking about."

SEC spokeswoman Judith Burns declined comment on the mischaracterization and whether the agency intends to issue a correction.

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The bulletin comes at a time when structured annuities, first introduced in 2010, are rapidly gaining popularity among investors. First-quarter product sales of $3.5 billion were up 60% over the same period a year earlier, according to market research firm Wink Inc. Insurers sold an aggregate $11.2 billion of structured annuities in 2018.

Indexed annuities are similar to structured annuities, in that both have a limit on their upside interest gain but also restrict losses to the downside. But indexed annuities can't lose money based on market performance, whereas structured annuities can.

Indexed annuities have a 0% annual floor, meaning insurers can't credit less than 0% interest to a policy in any given year. (Investors could technically lose money if they have a rider and fees are deducted from their account value.)

Structured products, however, have features such as buffers and floors that allow investors to lose money, but the insurer restricts the loss. If the S&P 500 were to decline 25% one year, an investor in a product with a 10% buffer would net a 15% loss. (The insurer would eat 10% of the loss.)

Scott Stolz, senior vice president of private client group investment products and wealth solutions at Raymond James & Associates Inc., is concerned that the mischaracterization of indexed annuities as products that can lose money as a result of market performance will lead to a sticky situation for financial advisers.

Investors, he said, may think they're getting conflicting information from the SEC and their adviser.

"I'm worried if it doesn't get fixed, somewhere down the road people will misunderstand how the products work," Mr. Stolz said.

Similarly, David Kinder, a California insurance agent, said investors might think, "My rep is trying to pull one over on me."

Other regulators have expressed confusion over buffer annuities in the past. At an industry conference in 2017, one official with the Financial Industry Regulatory Authority Inc., the brokerage industry watchdog, said, "We have some individuals who really understand [variable annuities] and they were struggling with this. You have to wonder, does the firm understand it? Does the rep?"

While the SEC's notice was "completely off," its mischaracterization may have been intentional, Mr. Kinder said.

Some insurance companies market structured annuities similarly to indexed annuities. Because of this, the SEC may have been attempting to present information to the public in the way they're being pitched structured-annuity products by agents and advisers, Mr. Kinder said.

"They titled [the bulletin] according to what consumers might be pitched," he said. "I could see both sides of it. I just wish there was more clarification in the alert."