Annuity Designed to Battle Volatility Is Also Hurt by It

WSJ 12/7/98 C1

ANNUITIES WATCH

By Bridget O'Brian
Staff Reporter of The Wall Street Journal

The stock market has been wacky. The bond market has swung wildly. Commodities have gotten killed. What better environment could there be for a financial product aimed at risk-averse investors?

Enter the equity-index annuity, a three-year-old investment product designed by insurance companies, whose big selling point is that it does two things at once: It contains a guarantee, in a falling stock market, of a minimum return as well as protection of an investor's principal. Yet it also allows investors to dip their toes in the stock market, by taking advantage of a rise in the Standard & Poor's 500-stock index.

"This is for the investor who typically buys certificates of deposit and fixed annuities," says Jack Marrion, president of Advantage Group, an insurance consulting firm that tracks sales of equity-index annuities.

But here's the rub: The very volatility that these products are meant to shield against is cutting returns to some investors while squeezing profit margins for the insurers who sell them. While consumers aren't losing money, some are getting substantially less from their investment than they might have expected given that the S&P 500 index is up about 21% year-to-date. For unlike other index products, which mimic the performance of a particular index, equity-index annuities give holders only a *portion* of the S&P increase, excluding dividends. In short, some equity-index holders will have returns of as little as 7% this year.

The reason: As the market got more volatile in the late summer and fall, the cost of offsetting the risk with hedges jumped for the insurance companies that sell these annuities. Tumbling interest rates were a further blow, because the insurers had to set aside even more money to pay the minimum guarantees.

option prices ↑

So, on new equity-index annuities sold, and on some existing ones with rates that are periodically reset, virtually every insurance company has lowered the percentage of the index's gain that investors receive, although the minimum guarantee, typically 3% a year, remains unchanged.

There are some notable exceptions. **Citigroup**'s Travelers Index Annuity gives investors 100% of the S&P's gains, including dividends, while charging them a total fee of 3.2%. That is because the product is registered with the Securities and Exchange Commission, and thus must be structured differently from most equity-index annuities. Also, investors who choose to put their money into index investments in variable-annuity products—such as **Metropolitan Life Insurance**'s Preference Plus Account, which allows investors to pick any of five indexes to invest in—will get the same return as their index.

Some of the companies themselves are actually losing money on equity-index annuities. For instance, the soaring cost of hedges forced **Safeco** Corp.'s Safeco Life

Please Turn to Page C22, Column 1

128