TO; The SEC
RE: Index Annuity Comments

In my opinion, the best way to put this issue into perspective is to focus more on the Big Picture and not all the infighting that I see in these posts on the SEC website. This is my second post concerning the matter of reclassifying indexed annuities as securities and I want to specifically respond to this below article by Bob Veres in Financial Planning magazine.

Needless to say, Mr. Veres is entitled to his opinions and as you will see as you read his article, he certainly caters to those fee-based planners who make up the majority of the subscribers to his newsletter. And in this article he blasts everyone é the SEC, FINRA, the insurance industry (specifically companies selling indexed annuities) and commissioned salespersons of every sort é securities reps and insurance agents one and all. So please be sure to read his article/tirade before you read my following comments.

In the final analysis, however, he raises some strong points about this entire issue of regulation é and how the regulators themselves seem to be at a loss to bring about meaningful change over the ñpowers that beò in the financial services industry. In other words, at the end of the day the game goes on é and the monies that rightfully belong in the consumerõs pocket continue to be sucked up by these major players é from investments that focus on strategies that are highly suspect; specifically strategies that are based on Modern Portfolio Theory, which the industry treats as gospel but, in my humble opinion, is flawed at its core.

So letõs cut to the chase: How does the SEC and FINRA divert attention from these major problems that they canõt seem to correct?   They instead start what is little more than a turf war over who is going to be paid to police the actions of duly licensed insurance agents who are offering a product that the SEC itself long ago told us met the safe harbor rules and was, therefore, not a security.

So where do we go from here? Only time will tell. I can only hope that my willingness to clearly state my views, and outline the strategies that we use with many of our clients, will help bring these bigger issues into focus. Because we all really need to get back to the work of helping 78 million baby boomers protect their nest eggs due to the numerous and unique challenges these boomer é and our entire country é face.

I do that by offering what I believe is a safer and potentially more profitable method of planning for the future in a strategy where the client has much more control over those totally random negative events (Black Swans) that are such a major detriment to successfully making their money work as hard for them as they have worked for their money. My strategies do protect them from Black Swans and in the process they also offer the client potential double digit returns over time é with absolute downside risk on the combined total portfolio of only 10% in any given year.

Index annuities play an integral rule in this strategy, but you can be absolutely assured that I, for one, will never go back and ñtake another testò just to offer them to my clients (I held a Series 24 with my prior B/D). Iõll simply find another way to help my client. And thatõs just the way it really is!

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FINANCIAL PLANNING

The Big Regulatory Fix

Industry Insight
By Bob Veres
August 1, 2008

If the same few companies are behind virtually every major financial scandal and meltdown, why are the regulators talking about tightening up on the rest of us? **After reading the new Treasury Department regulatory proposal again, I find myself wondering whether Congress, the Treasury and the SEC are truly interested in fixing the persistent problems in the securities industry**. To see what I mean, let's look at the problems we've experienced and see if there's a discernible pattern.

To start, list the firms that dove deep into the limited partnership pool in the late 1980s (Merrill Lynch, Prudential).

Then, add the firm that manipulated the Treasury bond trading system in 1991 (Salomon Brothers, now absorbed into Citigroup).

Which company was indicted in check-kiting schemes in 1980? E.F. Hutton, also now part of Citigroup.

What firms offered self-interested analyst recommendations during the tech bubble? Bear Stearns, J.P. Morgan Securities, Lehman Brothers, Merrill Lynch, U.S. Bancorp, Piper Jaffray, UBS Securities, Goldman Sachs, Citigroup Global Markets, Credit Suisse First Boston and Morgan Stanley.

These 10 firms settled litigation brought by the SEC by collectively paying $1.4 billion and agreeing to give investors independent research along with their own analysts' opinions.

Who reportedly offered IPO shares as bribes? The SEC and NASD investigation included Merrill Lynch, Morgan Stanley, Salomon Smith Barney, Prudential Securities, Credit Suisse and UBS Paine Webber; the issue is still reportedly the subject of many lawsuits.

Which firms allegedly traded against customer orders and may still trade ahead of the orders of their mutual fund clients?

The NYSE itself agreed to pay a $25 million fine in 2005 for failing to supervise a myriad market makers, and Goldman Sachs and Spear Leeds and Kellogg were named in federal suits.

Who gambled with shareholder money on highly leveraged investments in risky mortgage pools and sold them to corporate and municipal clients, and to gullible consumers, as safe paper? Merrill Lynch, UBS Paine Webber, Goldman Sachs and Morgan Stanley.

SOMETHING IN COMMON

Once you've compiled these lists, some interesting things jump out at you.

None of the companies happen to be independent financial planning firms, fiduciary planners, NAPFA members or independent broker-dealers.

There are no regional banks on the list either, and I couldn't find any community banks, thrifts or credit unions.

So as a first step, I think the Next Big Regulatory Proposal ought to forget about those organizations that haven't been involved in any of the problems that this new system is trying to fix. **Instead, let's focus on the companies that are on the list.**

Interestingly, they all happen to be major Wall Street firms and big insurance companies. They make the list again and again.

Now let's step back and name the firms that pay enormous bonuses to their executives and key employees during wild periods of astronomical profits, but don't require the return of this money when scandals hit and these companies take huge write-downs.

Which firms provide incentives to gather assets, but not to benefit customers?

Which firms do not want to be held to fiduciary standards in the marketplace?

Does anyone else think it's interesting that the two lists are identical?

From the results of this exercise, you can infer that the best prescription is not more rules per se.

Looking at the conflicts built into Wall Street firms' revenue models, and executive and broker incentive systems, are you surprised that no matter what rules these companies are required to follow, some firms engage in risky, predatory and short-term-focused activities?

My proposal for fixing the regulatory system is much simpler than the Treasury proposal:

Require firms to reward brokers and executives when consumers earn excellent returns on their investments and on IPOs that launch successful companies.

I'm sure the Wall Street firms would argue that these incentives don't have anything to do with their bad behavior in the past. But if incentives don't guide behavior, why do we need them? **They will also argue that it is impossible to make a profit as a fiduciary**. But the success of thousands of financial planning firms argues otherwise. Finally, these firms will argue that their primary mission is capital formation in the U.S. economy. **In that case, why not require companies that bring IPOs to market to divest their investment advisory services? After all, drug companies can't own doctors' offices, can they?**

I remember back in grade school there were two or three boys who disrupted the classroom and never seemed to follow the rules that applied to the rest of us. **The school wisely focused its disciplinary attention on those few children rather than calling all of us on the carpet or setting new school rules**.

Why can't Congress, the Treasury Department and the SEC take the same approach? I

If they could bring themselves to notice that the problems are caused by the same few firms, perhaps they could devise a more focused, more effective regulatory scheme that might prevent the Next Big Scandal and protect investors.

But maybe we have a bigger problem. One theme of the regulatory debate is that the people who want to rewrite the rules can't tell the difference between advisors who embrace a fiduciary model and those who follow a sales model. This is because the two generally speak the same language and claim to offer the same services-or so the regulators say.

A MODEST PROPOSAL

So, before we increase regulation, we should follow my modest educational proposal.

I would require the Treasury Secretary, the key members of the SEC Division of Investment Management, FINRA executives and certain members of Congress to get their investment advice from top annuity salespeople with the words "financial advisor" on their business cards.

Let them live in a world of 16-year surrender penalties and sly obfuscation about compensation and internal expenses. Let them hear that life insurance policies are really retirement plans, and let them invest in whatever the brokerage firm wants to unload. And then let's see if they have trouble distinguishing between the two.

This might require a certain amount of adjustment. Treasury Secretary Hank Paulson, for example, has served as the CEO of a major Wall Street firm, so he has enjoyed access to investments that are not offered to the average consumer.

I'm pretty sure the annuity salesman would recommend that those be liquidated in favor of a "non-speculative" investment like equity-indexed annuities. Yes, there would be tax consequences, but this might become a learning opportunityð a chance to see how simple and straightforward our tax regime has become, and how well it serves the average consumer of financial products and advice.

There's no reason to exclude the top FINRA executives.

I think it might be beneficial for them to subject their retirement portfolios to the investment advice of a broker who makes unauthorized trades in their account and then have to retrieve their money through arbitration. Maybe they can reach a settlement and sign a document promising never to reveal that they had any problems.

But by the rules of the game, they would have to find another hot-tip broker to work with once this mess was straightened out. So long as these brokerage representatives fill out the right paperwork and keep the right records, they should be able to do pretty much whatever profitable thing they want to these senior regulatory officials. Right?

The key staff members of the SEC and the entire board of governors would get the cream of the crop, the top producersð the people who have been richly rewarded for their sales of in-house products.

I see nothing wrong with SEC staff members paying 3% a year for a separate account that promises, but does not deliver any individual tax management, and whose performance is chronically below the index or low-cost portfolios recommended by those indistinguishable fiduciaries.

For diversification, they should load up on structured products like those 8-1 leveraged muni hedge funds that lost $2 billion for Citigroup's wealthiest customers, even though they were sold as "conservative investments." You can no longer get into those deals, nor the Bear Stearns hedge funds, but I'm sure the Wall Street laboratories are already producing worthy successors.

There's a real difference between fiduciary obligations plus real financial planning and sales or asset gathering.

Regulators who don't understand the difference should be consigned to the fourth circle of investment hell. The sentinels of this financial Hades can be found at their desks at the nearest brokerage or insurance agency. After all, these people are the main reason this part of hell exists in the first place.

They might as well enjoy the benefits alongside the millions of consumers, constituents and fellow human beings who deserve better.

Bob Veres is the publisher of Inside Information*, which keeps advisors on the cutting edge of practice management, marketing and client service issues around the profession.*

Comments to the SEC from Joel M. Diskin, CFP®, RFC®, President: The WealthSpan Companies, Inc – Registered Investment Advisor

Oh, Bob, you were doing so well … then off you went on this ongoing fiduciary trip of yours! Like that will "solve" all the problems! I should have seen that coming!

Let me start my response by following your pitch for fee-only advisors to its immediate logical conclusion:

First, most ñfiduciariesò set their minimums so high that the vast majority of the public canôt ñqualifyò to do business with this bunch.

Second, most of these folks attempt to justify their existence by using a ñcore-satelliteò strategy for managing money when they know full-well that any active management probably just lowers the net return on the portfolio over time.

Third, most of these fee-only ñfiduciariesò are little more than high priests in the Cult of Probability known as Modern Portfolio Theory, which is, at best, flawed at its core.

For more on this I would urge you é and this entire crowd é to read and reread last yearôs best seller The Black Swan by Nassim Taleb. In short, his barbell strategy, which he lays out on page 205 of this book, helps protect against negative ñblack swan eventsò, whereas MPT can and does set up the clientôs portfolio for potential significant losses that can take years to overcome if, in fact, that ever really happens at all.

In other words, this entire concept of ñregression to the meanò or the ñequilibrium of marketsò is pure poppycock, in my humble opinion! And it should be avoided at all costs as the end-all ñfoundationò of the work we do é particularly when we are dealing with current retirees and the upcoming swam of Boomers like you, Bob!

Now let me state for the record that I do run my practice as a Registered Investment Advisor. Iôve been a CFP® in good standing since 1985. And that before I set up my RIA Iôd pretty much made it to the top of the food chain on the Broker/Dealer side, in other words I was a Registered Principal with my old B/D. Further, I left for many of the reasons you mention above. And, yes, it really does bother me that there is so much corruption and greed coming out of the financial services industry. At the same time, Bob, there is always ñmore to the storyò than the viewpoint you are giving here.

Further, let me also state for the record that I canôt for the life of me see why anyone would want to be invested directly in the market when you can use options to control a stock or index for a set period of time with substantially less capital than owning the security outright. I also believe that if the client wants to be invested in the market he or she should be extremely diversified using either passive institutional grade mutual funds like those available through Dimensional Fund Advisors, or ETFs with the same type of tilt towards small cap value and a global mix. In short, Iôll take what the market will give us é but not because Iôm sold on MPT as a tool we can trust to ñget us thereò.

Now let's address your obvious bias and misunderstanding of annuities in general, and from your above remarks, your further bias and misunderstanding of indexed annuities in particular.

In short, Iõve been using these products with my clients since they first came on the scene back in 1995; mostly as an alternative to bonds é because they first and foremost transfer the risk of loss to the insurance company. Also, when we look at the historical returns or this product design, using an annual point-to-point crediting method with an annual reset, we see that index annuities will generally earn between 5% - 7% over time é and that is a net figure to the policyholder. Of course, we donõt really have any idea how they will perform going forward any more than we can know what a one year CD will earn going forward into the future é except we do know they both come with guarantees for the time period in question!

Ok then, so now we have established that an index annuity will give the client about the same net return over time as a typical balanced portfolio managed by a fee only planner after fees. But what will we do with this information now that we know it?

Now, Bob, you seem to have a real ñproblemò with surrender charges. So let me address that misconception of yours first. Above you focused on ñ16 year surrender charges é like that in of and by itself is a bad thing. But would you still feel that way if at the end of that period you were able to earn really superior returns like maybe 15% or 20% annually on your money in exchange for a longer surrender charge? Probably not, right?

In fact, if you could get those kinds of returns with no downside market risk, you would have to agree that longer surrender charges would make a lot more sense even to guys like you, right? Of course we know that no index annuity is going to accomplish those kinds of returns é any more than a typical balanced portfolio after fees. But when we think a little out of the box about this question of surrender charges and look at it in this wider context it helps put your ñobjectionò into better perspective, donõt you agree?

So what is the level of return that would justify these longer surrender charges in your mind, Bob? Further, you donõt mention it because youõre probably not up to speed on all the newer index annuity products out there, but today 16 year surrender charges are, frankly, pretty rare. And they only come with bonus products that pay bonuses of 10% - 12% or more going in. Further, these longer surrender charges are there for a reason. In short, that is how the company pays the combination of commissions on the sale and at the same time is able to recapture the bonus in the event of early surrender.

After all, there is no free lunch here é even if you purists on the advisory side keep implying ñbad-old insurance agentsò sell this product like that was the case é which is nothing but innuendo and total fabrication to ñproveò your point in my humble opinion. And while I will admit that there are always a few bad apples out there operating under any business model, the fact remains that complaints against index annuities sales come to only one complaint for every $109,000,000 of new premium é and that many of those complaints are eventually shown to have no merit what-so-ever. So letõs dig a little deeper here.

If the client does decide to purchase an index annuity bonus product that is offering, say a 10% bonus, and deposits $100,000 dollars, that immediately becomes $110, 000 day one. And if the client wants back, say $50,000 on day 2, that means he/she needs to withdraw $62,500 to net $50,000 if the first year surrender charge is 20%. And remember, 10% of the 20% surrender charge is a direct reflection of the bonus. So the client can get at 50% of his or her money day 2, and still have $47,500 in tact inside the policy out of the $100,000 deposited. And the amount can never drop lower than that é ever! So would the client be worse off than if he/she had put the same amount in a balanced account, made that withdrawal and paid fees on the rest as it grew every quarter é assuming that it did grow?

Further, donõt forget that the client can also access 10% of that $47,500 account balance plus whatever it earns that year on day one of the following year é and each year thereafter with no penalty. Is that enough liquidity for you, Bob? I mean, you do put money into qualified plans, donõt you? Do you rant about the 10% penalty imposed by the government on these type plans prior to age 591/2 the way you do about annuities? I never see that come up in your writings? I mean all kinds of products and plans lack full liquidity, but I digress!

Bob, I ask that question specifically because we both know that Monte Carlo simulations (which all fee-based advisors I know seem to stress) tell us we should keep the drawdown in a retirement plan to about 4% plus or minus inflation for a retiree age 65, isnõt that right?

And why is that? Isnõt it because we know full well that a serious hit on the portfolio of 15% or 20% é or more! é is well within the range of probability at **ANY** time? And isnõt such a hit, in reality, a huge **definite** ñsurrender chargeò imposed by the markets? Of course it is! So we need to keep this in context. Index annuities, after all, are long-term retirement savings vehicles, isnõt that correct?

Then there is the issue of living benefits that are now also available in many index annuity products. Can a balanced fee-based managed account guarantee that the future income stream will be based on a 7% - 8% growth factor? Of course not! But you can get that kind of a guarantee with an index annuity for lot less than the typical ñadvisoryò fees in the managed account é about 35 - 45 basis points a year to be exact!

Now, letõs get back to that 15% - 20% or more serious hit on the market. I know you will tell me that ñisnõt going to happen with a balanced portfolioò, right? **But can you guarantee it? No?**

Further, isnõt it true that Modern Portfolio Theory essentially tells us if we want to reduce the risk of loss we need to increase the ñbonds sideò of the portfolio? And doesnõt that lower our expected returns after fees on the balanced account to the very level of the indexed annuity as I mentioned above? Frankly, a look at returns on stocks and bonds over the past decade clearly shows us that the actual returns on the balanced portfolio after fees makes the net return to the client much less than the indexed annuity!

So who is really the "bad guy" here? The index annuity salesman who gets paid once … or the fee-based advisor who takes his pound of flesh from the account values on a quarterly basis in an account that (we hope!) is growing every year. I can tell you this: Over time I'm going to earn <u>substantially</u> less from an indexed annuity than I will from the monies I have under management in my managed accounts! And in my humble opinion I'm doing a much better job for the client when I incorporate indexed annuities into the mix.

In short, do the math, Bob! Where is the true alpha é after all the management fees é that can justify these additional monies going into the advisorôs pocket before the client gets his piece of the pie? Not to mention the actual market risk you want the client to assume! Frankly, I just donôt see it é no matter how noble you try to make being a ñfiduciaryò seem in this article. Your comments here are, frankly, at the expense of everyone é those who opt for a commission over a fee é and particularly the public at large. In fact, if the ñfiduciaryò ticket canôt stand on its own, which one might imply from your tirade here, you will <u>never</u> get there by ripping the competition. In short, until ñfiduciariesò start <u>in mass</u> working with average middle-class Americans you are just blowing smoke here,

Or are you just keeping your name out there in order to sell your newsletter to your base of fee-only planners?

And, frankly, Bob, I <u>donôt</u> need the government to tell me how to be ethical with my client relationships! My 43+ years in this business without a mark on my record would give some indication that I <u>already</u> know how to do that. But thanks for implying that we all need MORE regulation! God help all of us é <u>particularly the public</u> é in that regard!

Now, let's see how the index annuity product might be incorporated into Taleb's above mentioned "barbell strategy" to provide superior <u>protection</u> against "Black Swans" and <u>superior</u> <u>returns</u> to the client with <u>lower</u> absolute risk … in a <u>conservative</u> format that is really well-suited for most moderate risk Boomers and current retirees:

Let me start by asking <u>you</u> a question, Bob: If the S&P500 Index (without dividends) were to go up 7%, how would you like to earn about 12% on your money? And if the index goes up about 10%, how would you like to earn about 15% on your money?

And even more important, how would you like to <u>protect</u> your nest egg in absolute terms é where no matter how <u>bad</u> things get you canôt lose more than 10% in a given year? And if the S&P500 does average 10% over the next decade, how would you like to earn potential **double-digit returns** on <u>your</u> money é with this <u>absolute</u> downside market risk to the portfolio of only 10% in a given year that I mentioned above?

Do I have your attention yet, Bob? Or are you so close-minded that nothing but MPT and fee-based planning will do for you? I hope not, because you will pay dearly for it when all the chickens come home to roost as this U.S. housing slump and the credit crunch from this subprime debacle reach out into the global markets é as they are doing and will likely continue to do for years to come!

I should also ask: Where was the SEC, FINRA and all the other regulator groups when this subprime mess was growing unabated right before their very eyes? And where were you, Bob? Show me one article where you strongly focused on the problems this mess was going to cause. And ditto that for all the ñfiduciariesò out there that were only too happy to grab some gains for a change after the Dot.com bubble burst and after we came face to face with 9/11 é which has shown all of us that without a doubt we are living in a very unstable world! Talk about ñblack swansó!

OK, here's how you get these above returns:

You put 90% of your money into a bonus index annuity so you can sleep at night because now nothing can destroy your nest egg é and your future security. Time frame: Letõs assume 10 to 14 years on the surrender charges é not 16 as you imply above! Again, there is a reason for these longer surrender charges on these bonus products as I mentioned. And there is definitely a place for them in the great scheme of things! Next: assume a ñcapò on an annual point-to-point crediting strategy with an annual reset of only 7%.

Now, letõs invest the remaining 10% of our clientõs money in a LEAPS debit call spread. In short, why own the S&P500 Index when you can simply control it for a time using options for a lot less money? And letõs buy a 12 month LEAPs to give us time to be right é just like the insurance companies do for the index annuities they sell. Further, letõs get our cost down on these LEAPS and put that 10% specifically into a LEAPS options spread as follows: We will buy a 10% ñin the money callò and sell a 10% ñout of the money callò on the S&P500 Index going out one year. In short, if the index goes up 10%, we get called on the option we sold and sell the option we bought to cover that call. And we collect the spread in the middle é on average about 80% on our money if the index goes up 10% é or about 8% on the 10% gain of the underlying index. Then add that 8% to the 7% payout on the annuity. If the cap on a point-to-point crediting method is 7%, the combination is a 15% return when the index itself goes up just 10%.

Bob, you can have one of you "fee-only planner" buddies do the math for you. It is a pretty easy way to sleep at night and still make potentially make excellent money over time, too. But I'm thinking you probably won't let this get out there with the public because what would you have to write about then?

The bottom line: If the market gives us a ñnormalò return over the next 10 years (whatever that means!), this strategy should generate potential double-digit returns. And if we get hit with a serious ñBlack Swanò in the middle of this 10 year cycle that takes the market down 35% - 40%, guess what happens?

The fee-based advisory account is going to tank … and maybe pay the client 4% - 5% net after fees on average for the entire decade! And that's a BIG maybe!

This strategy, however, has the client 100% out of the market if, at the end of the 12 months, the market is still down 10% … because that is the only way that our "in the money call" expires worthless! And we get a big piece of the upside up to the 10%.

Oh, here's another thing: If the client doesn't want to do the spread in any given year they are in control. They can stay 100% in the "sleep insurance" … i.e. the index annuity … until they feel comfortable with the potential upside of the market again. In fact, if they choose, each year they can even decide to ride out any current storm in the indexed annuity's fixed account, rather than linking to the index.

Further, think about this, Bob: If you lose 35% of your money in a fee-based managed account during one of these nasty "Black Swan" events … which can easily happen … you have to earn 53.85% just to get even! Let's never forget that!

But with this barbell strategy I'm using we only have to see the index go back up by less than 6% to be back to ground zero! So you tell me, Bob: Do you think your fee-based advisors will ever do better than this in a fee-based balanced managed account … after the take their pound of flesh right off the top?

Further, show me any fee-based advisor who is willing to work with average middle-class Americans … who desperately need qualified financial advice … who can build as safe a portfolio for his/her clients and at the same time offer double-digit potential returns over time. They just aren't out there, Bob. And, frankly, if the index annuity is reclassified as a security, the public will suffer more than one might ever imagine.

In short, this strategy that I have just presented is an idea whose time has come and your tirade here against "commissioned-based planning" definitely doesn't help put all this in proper perspective for the folks at the SEC and FINRA as they make their final considerations concerning this product. I rest my case!

SEC's Indexed-Annuity Plan Fuels Debate

The below comments are from Joel M. Diskin, CFP®, RFC®, President, The WealthSpan Companies, Inc., a Registered Investment Advisory firm. The comments are <u>not</u> a part of the original article. This article and these comments were written in response to the SEC's decision to open up discussions regarding the possible reclassification of index annuities as securities. Mr. Diskin has posted this material on the SEC's website for your review.

Dow Jones Newswire - August 08, 2008

DJ Newswire: A war is brewing between the insurance industry and regulators over a proposal that would put equity-indexed annuities under the purview of the Securities and Exchange Commission.

Opposing the idea are some of the biggest sellers of equity-indexed annuities, including Aviva USA, part of Britain's largest insurer Aviva PLC; American Equity Investment Life Holding Co.; and Allianz Life Insurance Company of North America, the U.S. subsidiary of German financial-services conglomerate Allianz AG, along with some state insurance regulators.

> **Comment:** This is actually a very small sampling of those who oppose this and I want to add my voice: It is my opinion that if this vehicle falls under the control of the SEC and FINRA regulators you will see it burdened down with so much additional, needless regulation that even those who are licensed to sell it will simply opt for easier ñsolutionsò to manage the clientõs monies.
>
> In other words, the status quo will remain intact é and the mutual fund industry will continue its quest for the consumerõs monies unabated. And at the end of the day this will be <u>fully</u> at the expense of the consumer. Because the facts are clear: The Index Annuity has shown that it can potentially generate a <u>net</u> 5% - 7% for the consumer based on historical index returns.
>
> Compare this to a balanced portfolio of 60% stock mutual funds and 40% bond mutual funds. Based on Modern Portfolio Theory, this allocation will likely earn ñaboutò 7.5%; again, based on historical returns. But that is <u>before</u> fees and/or commissions! In other words, the client can invest his/her money directly in the market where it is <u>always</u> <u>100%</u> <u>at</u> <u>risk</u> and net about 6% annually in a balanced portfolio after fees **<u>if he or she is lucky and happens to be in the market at the right time</u>!**
>
> Or the client can buy a product <u>designed and created by the insurance industry</u> that offers 100% protection <u>against</u> market risk and <u>also</u> offers the opportunity to earn returns that simply are <u>linked</u> to a stock index like the S&P500 Index; generally up to a cap of about 7.5% on a point-to-point basis in todayõs market and with the potential returns like those mentioned above.
>
> **But there is more:** When the market loses money in a given year, the client doesnõt lose <u>any</u> of their principle in an indexed annuity! In other words, ñzero truly is the heroò. They donõt <u>add</u> to their account values in that given year, but they donõt <u>lose</u> money either. And the following year the company simply buys a new call option at the then prevailing price and adjusts the cap accordingly. In other words, the policy ñresetsò and they never have to crawl out of the hole like they do when they lose money with mutual funds. And remember, those losses can sometimes be <u>extensive</u>, as we have seen so far in this decade!

But there is more: The new income riders available with many index annuities also allow the clientôs ñincome account valuesò to grow at an annual 5% - 8% depending on the contract chosen é even if the actual annuity account values grow at a lower rate. And when they eventually exercise their income privileges they can take an income stream without annuitizing the policy. In other words, they decide é not the insurance company.

Frankly, no asset allocation model using mutual funds can do that for them. With mutual funds they are, in effect, at the mercies of the market (and generally high fees!) from the day they buy the fund until the day they sell it … and if they are retired that is at the very time in their life when safety is a critically important consideration!

ARE WE BEGINNING TO UNDERSTAND WHY THE SEC AND FINRA MIGHT WANT TO CONTROL THIS PRODUCT? I MEAN THINK ABOUT THIS: THERE ARE MILLIONS OF BABY BOOMERS OUT THERE WHO WILL SOON BE ROLLING OUT OF 401(k) PLANS AND OTHER QUALIFIERD PLANS é AND SAFETY IS A HUGE CONCERN FOR THESE FOLKS.

FURTHER, THESE BOOMERS NEED TO BE MORE CONSERVATIVE WITH THEIR MONEY, OFTEN BECAUSE THEY HAVE BEEN POOR SAVERS é AND THAT MEANS BROKER/DEALERS AND THEIR ADVISORS ADVOCATING MUTUAL FUNDS HAVE TO PUT THE CLIENT INTO SOME MIX BETWEEN STOCKS AND BONDS LIKE I EXPLAINED IN MY 60/40 EXAMPLE.

AND WHEN WE FOLLOW MODERN PORTFOLIO THEORY WE INCREASE THE BONDS IN THE PORTFOLIO TO LOWER THE RISK, CORRECT? AND DOESNôT THAT ALSO LOWER THE CLIENTôS POTENTIAL RETURNS? OF COURSE, THESE THEN LOWER RETURNS **ARE LOWERED EVEN MORE** AS FEES AND/OR COMMISSIONS ARE EXTRACTED BY THESE MIDDLE-MEN RIGHT OFF THE TOP é BEFORE THE CLIENT EARNS ONE THIN DIME!

Lastly, in my opinion, this isnôt really an issue of ñone vehicle vs. anotherò as many of the comments on the SEC ôs website would imply. Fact is you can use index annuities as a ñbond substituteò in an asset allocation model and simply put the balance of the portfolio in stock funds using either investment grade passive index funds or Exchange Traded Funds. **This will lower the advisory fees in a managed account … and the index annuity will also very likely outperform bonds in the allocation over time due to today's lower interest rates. Remember: These lower rates directly impact the return on bonds.**

Or we can use a cutting-edge strategy like our ***"Checkmate!"*** strategy where we keep 90% of the clientôs money totally protected from market risk inside the fixed index annuity and then leverage the remaining 10% using a long-term LEAPS Debit Call Spread option strategy. With this strategy losses on the portfolio as a whole are limited to 10% a year in absolute terms. This is about the same as two standard deviations on a 60/40 mix of stock and bond mutual funds. Of course the client has **no guarantees** behind this 60/40 mix, so who can really say how much clients might lose when the market goes against them?

Thatôs far different from a maximum 10% loss on the portfolio in absolute terms like our ***"Checkmate!"*** strategy offers. In short, the client is never going to lose more than they decide to put at risk on the options side of the strategy é even if the market is hit with one of those negative ñBlack Swanò events that can ruin the returns on the portfolio for many years into the future!
Remember: Our strategy is far less risky than owning the index outright in an index mutual fund format!

The bottom line: Over time, the index annuity is ñbetter than bondsò, in my opinion. Because in reality, the foundation under the index annuity is simply monies in an investment grade bond portfolio that is managed by an insurance company é which offers guarantees and credits interest based on a formula that is linked to the return of a stock market index. At no time is the client investing in the market! Yes, there are back-end surrender charges and the client does have limited liquidity during the surrender period. But compare this to cash in the bank, which doesnõ generally even keep up with inflation é or to monies invested in no load mutual funds, which are subject to significant loss at any time! In other words, with indexed annuities safety rules!

And in the final analysis this simply means we need to see the index annuity product in its proper context. Just like we do with any other product we recommend to our clients. As for the returns the client will enjoy: The way interest is credited each year via the link to the index simply gives the client, in my opinion, a better than average chance of earning a better than average return vs. other fixed interest rate products like traditional fixed annuities, CDs and investment grade bonds.

And all of this is accomplished in a way that transfers the risk against market loss to the insurance company!

DJ Newswire: The proposed rule would define equity-indexed annuities as securities, effectively placing them under the supervision of the Financial Industry Regulatory Authority, or Finra, a nongovernment regulator for U.S. securities firms.

Such a move would have far-reaching implications for insurance companies and agents selling these products as well as for consumers, says Rachel Alt-Simmons, a research director in the insurance practice at research firm Tower Group.

Insurance companies that issue indexed annuities would see a drastic decline in sales immediately following the enactment of the rule and many independent insurance agents and marketing organizations will be forced out of the equity-indexed annuity business due to new licensing requirements, she says.

New opportunities for broker-dealer firms and insurance companies to sell indexed annuities, however, will emerge as the products "lose their ambiguous regulatory status," Alt-Simmons says.

Comment: Please see my above remarks. Frankly, I think this is a very doubtful outcome and only time will tell us who is right!

DJ Newswire: "The short-term pain felt by the industry in adjusting to the new regulations will be outweighed by the long-term benefits to consumers and brokers as well as to the insurance industry in general," she says. "Once indexed annuities come under this SEC umbrella, **if they do,** the costs are going to come down for consumers as well."

Comment: **This is a ridiculous assumption**! How in the world can more regulation and another hand in the pot result in lower costs? FINRA will be paid fees to ñregulateò the product and the Broker/Dealers will also take their pound of flesh é which is notoriously expensive given what they actually add to the process! In the meantime, hundreds of marketing organizations and tens of thousands of well qualified insurance agents who have never had a complaint against them will be forced out of the distribution channel for this product unless they choose to get licensed to sell securities when they really donõ want to.

Also, for the record, if these “new” securities reps don’t sell enough of the “other stuff” on the B/D’s shelf they will get a HUGE haircut on their commissions. In other words the B/D will keep a much bigger piece of the full commissions being generated in exchange for their “supervision” of the product! In short, the product will likely fall by the wayside at the expense of <u>millions</u> of Boomers, as well as all of the current retirees who <u>need</u> access to this type of product due to its <u>safety</u> <u>features</u> and its <u>safe</u> <u>money</u> <u>potential</u> <u>returns</u>.

DJ Newswire: The SEC made the proposal June 25 and has received hundreds of comments from both sides. The comment period ends Sept. 10, though some in the industry are requesting an extension.

"The product is being sold like a security," wrote John Napolitano, chief executive of Braintree, Mass.-based U.S. Wealth Management, and Dennis McCarron, chief executive of U.S. Wealth Advisors, an independent broker/dealer. "We would appreciate your oversight and regulation of these products." McCarron says that those who aren't licensed to sell securities aren't qualified to discuss a product linked to a security index.

Comment: If you go to the link at the end of this article you will be able to go on the SEC’s website and read all the comments to date both for and against adopting this rule. Frankly, it looks to me like the author of this particular DJ Newswire article was simply scrolling down the list of comments and saw the comments from these two because it stands out on the page (which it does). Sadly, the author decided to focus on the comments from these two even though what they say is in my opinion an outright lie.

The product is <u>not</u> “being sold as a security”. In fact, that issue isn’t even the basis for most of the complaints that have been levied against indexed annuities. As best I can tell most of these complaints center around surrender charges and liquidity issues. As best as I can tell, only a small number of complaints come from agents “implying” the product is anything close to a security. In fact one can quickly look at the ratio of complaints to new monies going into these products to see how ridiculous this implication really is.

That ratio is one complaint for every $109,000,000 of new monies allocated to these products … which is really quite low!

Lastly, most of the concerns in these prior complaints have <u>already</u> been addressed by state insurance regulators and the insurance companies offering these products. In short, there is an entire new line of much more “consumer friendly” index annuities on the market today than in the past. Further, for someone to say that a professional insurance agent isn’t qualified to offer these products is nonsense! Take me for example. The fact is I left the broker/dealer community and set up my practice as a Registered Investment Advisor when I was at that time a <u>Registered</u> <u>Principal</u> with my B/D. And being a Registered Principal is about as high up the broker/dealer food chain as you can get. Also, I’ve been a CFP® in good standing since 1985.

So I <u>seriously</u> doubt either of these two gentlemen is more qualified to offer these products than I am simply because they are still with a B/D and I am not. The fact is they stay in this distribution channel because they want to earn <u>commissions</u> from selling securities for a living! I do not and therefore I have absolutely no need or desire to be attached to a Broker/Dealer!

Of course, I guess if you are the author of this <u>Dow Jones Newswire</u> article you have to ŏgive voiceö to both sides of this issue in your article to make it look ŏrespectableö. But it sure would be nice to see a little true research and an attempt at some <u>unbiased</u> commentary from the author here. After all there are a TON of comments to choose from on the SECôs website!

DJ Newswire: Insurance agents and financial planners, meanwhile, have made comments alleging that the commission doesn't know what an equity-indexed annuity is and is horning in where it doesn't belong. **"This is a turf war,"** says Steven Delaney, vice president of American Brokerage Services Inc. in Wyndmoor, Pa., and founder of American Annuity Advocates, a Web site created to support fixed-annuity products and educate consumers.

Comment: I think the commission absolutely <u>does</u> know what an indexed annuity is. It is a product that has become a major challenge to the status quo. In short, it <u>clearly</u> has the potential to capture the lionôs share of the Boomer dollars going forward and it is, therefore, a major threat from the commissionôs perspective. As for this being a turf war, well, I couldnô agree more!

DJ Newswire: Delaney and others say the argument ultimately boils down to money. Finra's broker/dealers would receive money from the sale of indexed annuities if they come under the regulator's purview, money that now goes to insurance agents, Delaney said.

Comment: Again, I couldnô agree more!

DJ Newswire: A spokesman for Finra said it plans to submit a comment letter to the SEC, and will have no comment until then.

Most indexed annuities are sold through independent insurance agents, many of whom don't hold a license to sell securities. Adopting the oversight rule would destroy that distribution channel, observers say.

Comment: The author is a little confused here. While it is true that many insurance agents who sell these <u>insurance</u> products may not have a securities license, many individuals are actually <u>duel licensed</u> in both insurance and securities. In fact, the first step in this ŏturf warö came from the NASD (now known as FINRA) when it issued ŏNotice to Members 50-05ö back in August, 2005. This notice told the Broker/Dealer community (the Members) that they needed to supervise the sale of Index Annuities by their reps é even though these products were <u>not</u> securities. ***"This Notice to Members addresses the responsibility of firms to supervise the sale by their associated persons of equity-indexed annuities (EIAs) that are not registered under the federal securities laws."*** But, yes, this <u>would</u> destroy the current distribution channel. And in my humble opinion that would be at a <u>great</u> loss to the consumer both in the short term <u>and</u> the long term!

Now I canô speak with any authority on how all of the Broker/Dealer community responded to this vaguely written notice from the NASD back in 2005, but I can tell you <u>my</u> former B/D really had literally <u>no</u> understanding of how these <u>insurance</u> products work. Of course, that is just my close observation from conversations with the folks in the B/Dôs compliance department.

This much I can say for sure: I <u>sincerely</u> believe that the ŏpowers that beö at my old B/D saw the NASD notice as nothing more than an opportunity to make some easy money. So they simply played ŏCYAö and told compliance to restrict the actual index annuities I could sell to only a handful of ŏA+ rated companiesö, with further restrictions against <u>any</u> bonus products. This was, frankly, not in my clientõs best interest and as a qualified CFP® with 40+ years experience in the financial services industry I was outraged by their actions.

Plus they also arbitrarily forced me to do my indexed annuity business through them and that effectively ended my relationships with the various insurance marketing organizations I had done business with for years on the insurance side of my practice. (Up to that time all insurance business was simply considered an ñoutside business activityò and all I had to do was disclose to the B/D that I was also doing insurance work for my clients.

Also, to add insult to injury, the old B/D set my commissions on index annuities at a lower percentage than what I was earning from my insurance marketing organizations for those exact same products! And they started taking a ñhaircutò on the index annuity commissions at the same percentage of the commissions as they were taking on the securities I sold through them! There was no discussion é just a directive saying ñthis is the way it is going to beò.

Needless to say, this attitude by the B/D, in addition to all of the other petty games that they played, was pretty much the straw that broke the camel's back for me and not long after I decided to leave and set up my own RIA.

I should also add that my former B/D certainly DID NOT restrict the variable annuity products they were selling to just A+ companies. And many of these variable products on their shelf were, frankly, loaded down with high fees and high risk stock subaccounts from active money managers that rarely, if ever, compete with index funds over time … if for no other reason than the high fees and expenses inside these variable products!

But isn't it interesting how the B/D was more than happy to offer these very expensive variable products to the public in exchange for the commissions they earned from selling them?

The fact is I will put my ***"Checkmate!"*** strategy up against any variable annuity or any balanced fee-based managed account at any time! In short, there is definitely a place for index annuities in the financial planning process é but having Broker/Dealers become the last word in indexed annuities will not only stifle competition, but much more importantly, **IT WILL HURT THE RETIREES AND BOOMERS OF THIS COUNTRY MORE THAN ANYONE MIGHT IMAGINE!**

Because I see nothing coming out of the B/D community that shows me these folks will ñimproveò the so-called compliance concerns of the SEC and LIMRA. All we have to do is look at the massive collective fines these very same regulators imposed on the major wirehouses for their ñexcessesô during the tech bubble buildup, the after-hours trading scandals, etc. The total fines to these major wirehouse players alone come to over **$1.4 billion dollars**. But sadly, the regulators only acted long after the damage had been done! And now we are into the subprime debacle é and who knows what will come next! **So you tell me why we should assume these folks will provide better protection to the public than the state insurance regulators that currently oversee the distribution of these products!**

DJ Newswire: Equity-indexed annuities were introduced in the mid-1990s. They are generally viewed as a hybrid of fixed annuities, which pay a set rate, and variable annuities, in which the return is dependent upon the performance of investment accounts. Equity-indexed annuities guarantee an investor's principal and a minimum return, but may pay more based on the performance of a stock- or bond-market index.

Comment: This is totally false. Index annuities may fall somewhere in between fixed annuities and variable annuities based on the potential returns that the client might earn. But they are in no way a ñhybridò of these other two types of products! Nor are they sold that way by insurance companies and the vast majority of agents offering this very unique type of fixed, guaranteed annuity. Even if that seems to be the twist put on this by the SEC, FINRA and the financial press that is **clearly** in the pocket of the mutual fund companies that pay millions to advertise in these financial publications!

One other thought: The indexed annuity is a product that has been on the market for almost 14 years now. Further, the SEC earlier ruled that index annuities meet the safe harbor rules of a fixed annuity and are, therefore not a security.

Now, 14 years later, the productôs popularity is starting to become a threat to the B/D community é and the impact is just beginning. Obviously the B/D community and FINRA can see the handwriting on the wall because it is clear that where index annuity sales are today is the tip of the iceberg vs. the potential sales that will go into this product as the Boomers retire é assuming the product isnôt killed off by this pending regulation!

Thatôs certainly food for thought as to the possible true motives of the B/D community, the SEC and FINRA, donôt you think?

DJ Newswire: Until now, these contracts have been considered insurance products, and have been regulated by state insurance regulators.

Comment: In my opinion state insurance regulators do a very good job overall of protecting the public from any abusive actions by those who sells these products! To think that some other larger, and more bureaucratic, federal government agency is going to somehow do a ñbetterò job at governing the sale of this product than the state insurance regulators is stretching it to the limit! To believe that FINRA is ñever vigilantò in the publicôs defense is nothing but a pipe dream. For more on this please read my below comments. Again, this is just my opinion. Iôll let you be the final judge!

DJ Newswire: But sales of equity-indexed annuities have grown significantly since their introduction, and complaints about abusive sales practices have also increased, according to the SEC. The agency says that those who purchase indexed annuities are exposed to a significant investment riskï ï the volatility of the underlying securities index. That simply isn't true, say those opposing the rule.

Comment: As I mentioned above, the complaints average about **1 complaint for every $109,000,000 of new premium collected**. Further, most individual index annuity complaints are shown to be without real merit. Also, many of these complaints are ñlawyer inspiredò and class action in nature. And many times insurance companies will ñsettleò because it is less costly than dragging it out in court. Unfortunately that is just the way business is done in our society these days é and, sadly, in the case of index annuities it currently gives the ñother sideò an opportunity to say ñSee I told you so!ò But, of course, there is more to the story é

The fact is the securities industry is the real expert when it comes to avoiding potential lawsuits. That's the reason the public can't even open a brokerage account with any B/D unless they sign an arbitration agreement first. In short, it is common knowledge that the B/D community knows how vulnerable they are to lawsuits and they use these arbitration clauses to keep all of the securities complaints out of court … and the public silenced after the fact.

Now compare this **only 1 complaint for every $109,000,000 of new index annuity premium** to the huge number of abuses that took place within the mutual fund industry and the major wirehouses during the Dot.com bubble, and all the after-hour trading, etc that the SEC and FINRA should have been policing during that period. Where were the regulators policing the securities industry then? It seems they only ñshowed upò after the fact because a lot of folks got really burned from all of that!

And where were they during the buildup of the housing bubble and the subprime debacle that is causing our current woes in the markets … which will very likely go on for years to come and may very easily destroy countless lives!

In closing, the index annuity clearly falls under the safe harbor rules due to the minimum guarantees in the policyõs structure. And the various state insurance regulators in my opinion do an excellent job of handling complaints and getting rid of ñbad applesò that donõt offer full disclosure and use abusive sales tactics. In the end I think the facts speak pretty clearly here. This is absolutely a money grab instigated by the SEC, FINRA and the Broker/Dealer community and nothing more than that. Will these folks succeed? We may not actually know that for some time.

In fact recently attorneys for two of the major index annuity companies representing a coalition of index annuity carriers requested an extension to the very short deadline placed on the comment period here by the SEC.

Further, it is my belief that this will eventually be dragged out in the courts unless the SEC rules that the product is not a security and, again, only time will tell how all this eventually plays out.

If you want to add your personal comments concerning this issue please go to the SECõs site at:

http://www.sec.gov/cgi-bin/ruling-comments?ruling=s71408&rule_path=/comments/s7-14-08&file_num=S7-14-08&action=Show_Form&title=Indexed%20Annuities%20and%20Certain%20Other%20Insurance%20Contracts

To simply read comments already posted on the SECõs site go to: http://www.sec.gov/comments/s7-14-08/s71408.shtml

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