I believe defining the characteristics of an indexed annuity that is exempt from registration is long overdue. However, broadly defining all indexed annuities as securities is not only unnecessary, but will greatly damage a retirement savings vehicle that fills a very important need.

There is no question that consumers sometimes end up with unsuitable indexed annuities. However, this is more a reflection of product design and sales practices than the actual concept of the product. At the end of the day, an indexed annuity is a savings vehicle that allows the consumer to earn over the long run an extra 1.5-2.5% per year over other savings vehicles such as certificates of deposit and traditional fixed annuities. To gain this extra return, the consumer must be willing to give up some of the guaranteed interest provided by the other savings vehicles. This is an extremely valuable option for consumers that can not or do not want to settle for the 3-4% paid on more traditional savings vehicles.

The problem with indexed annuities is not the conceptual design, but rather the multitude of products that are designed by insurance companies with an emphasis on benefiting the selling agent more so than the ultimate consumer. This problem then gets magnified when some of these agents position this product as an alternative to a variable annuity or mutual fund rather that what it is meant to be – a savings vehicle. Consumers then end up with a poorly designed product that has little chance to meet the expectations that have been set.

The answer to this problem however is not to classify all indexed annuities as securities, but rather to more specifically define the required guaranteed portion of the return. A contract that guarantees 2.5% on 75% of the initial investment, or even 3% on 87.5%, is clearly not a savings vehicle. How can it be considered a savings vehicle if the consumer must wait 5 years or more to be assured of a full return of his or her principal? On the other hand, to classify an indexed annuity that guarantees 2% on 100% of the purchase amount as a security simply because the ultimate amount of interest is tied to an index and/or is likely to exceed the guaranteed amount, is equally unjustified.

It is my suggestion that an indexed annuity continues to be exempt from securities registration provided that it guarantees a full return of principal – either by surrender, death or annuitization – within 36 months of purchase. A simple change such as this would eliminate many, if not all of the consumer unfriendly products that exist in the marketplace today. In addition, such a product design will greatly reduce the amount of commission insurance companies can afford to pay, thereby eliminating much of the incentive for less scrupulous agents to sell the wrong products to the wrong consumers simply due to the compensation involved.

It's important that the SEC remember that a properly designed and sold indexed annuity is a savings vehicle, not an investment vehicle. Changing the rules as proposed would change this distinction. A handful of companies have attempted to sell a registered index annuity. None have been successful. It becomes impossible to convince a consumer they are purchasing an alternative to a certificate of deposit when you have to hand him or her a detailed prospectus. Indexed annuity sales would disappear over night, thereby eliminating a valuable option for consumers looking to save for retirement.