

Equity index annuity insurers are facing more lawsuits

By Gary S. Mogel

May 7, 2007 — New accusations against equity index annuity sellers may lead to regulatory grief comparable to what property-casualty firms suffered during the contingent-commission scandal a couple of years ago, industry observers say.

“Production contracts that EIA insurers make their sales force sign are behind the current problems on the fixed-annuity side of the insurance industry,” said Pasquale Sacchetta, president of Continental Five Insurance Group Inc. in Westport, Conn. Because the contracts are loaded with incentives to push products of certain insurers, producers’ livelihoods depend on placing production goals over the clients’ best interests, he added.

Late last month, Minnesota Attorney General Lori Swanson sued American Equity Investment Life Insurance Co. of West Des Moines, Iowa, charging that it fraudulently marketed EIAs to senior citizens. In January, she filed a similar suit against Allianz Life Insurance Company of North America, which is based in Golden Valley, Minn.

Allianz also is the defendant in a class action in a California federal court alleging that its annuity sales fraudulently targeted the elderly. Beasley Allen Crow Methvin Portis & Miles PC in Montgomery, Ala., has enlisted the help of other law firms around the country to identify investors who wish to opt out of the class action by the May 15 deadline so they can bring individual suits.

Allianz and other insurers are embroiled in EIA litigation in several courts around the country.

The regulatory woes of the EIA industry are similar to the contingent-commission controversy that hit the property-casualty sector not long ago, when many insurance brokers were found to have funneled business to insurers that paid the highest contingent commissions, Mr. Sacchetta noted.

That scandal, which began in late 2004, ensnared many of the sector’s top companies, including American International Group Inc. and broker Marsh & McLennan Cos. Inc., both of New York.

AIG paid \$1.6 billion and Marsh Mac \$850 million to settle contingent-commission suits.

In addition to the standard compensation incentives for favoring their products, some companies hold “fire sales” — brief windows of time during which they raise

commissions and bonuses — creating a mad rush to push products during that period, Mr. Sacchetta said.

Pressure on EIA producers to act in clients' best interests will intensify if the Securities and Exchange Commission finds that the annuities are securities that require sellers to exercise the degree of care required of fiduciaries. The SEC is considering whether EIAs are securities or insurance, but it has yet to rule on the matter.

“The waters are currently muddied” regarding the fiduciary responsibility of EIA producers, due to the regulatory uncertainty, said Tobin Johnson, investment wholesaler for Thrivent Financial for Lutherans in Appleton, Wis. For now, EIAs still are regulated mainly by the states as insurance products and sold by agents who generally aren't considered fiduciaries, he noted.

But if EIA producers become fiduciaries, and fire sales — instead of client needs — are what attract their attention, regulators will take notice, Mr. Johnson said.

The independent marketing organizations through which EIA insurers distribute products share the blame, said Mitchell Maynard, CEO of Premium Producers Group LLC in Santa Ana, Calif., an EIA-rating firm. “The IMOs often split their overrides with producers who send a lot of business to a particular insurer, in addition to paying them their regular commissions,” he said.

“No one is regulating the IMOs,” Mr. Maynard added. “They fall into a regulatory gray area.”

If Washington-based NASD starts regulating EIAs as securities, the IMOs will be “out of a job,” because they can't offer registered products, Mr. Maynard noted.

Some insurers offer vacations for meeting sales goals, which NASD doesn't allow, noted Dave Hinnenkamp, CEO of KDV Wealth Management LLC in St. Cloud, Minn.

“Minnesota's actions will be piggybacked,” Mr. Sacchetta said. “Since many big annuity insurers are headquartered there, other states are influenced by what they do.”

Ms. Swanson's detractors say that the suits are politically motivated and that she is trying to emulate former New York Attorney General Eliot L. Spitzer, who now is the state's governor.

“She is trying to make a name for herself and is totally out of line,” said Richard Dunnagan, owner of Dunnagan Retirement Services LLC in Raleigh, N.C. “Why does she think it's her call as attorney general, when the state has an insurance department regulating these products?”

Ms. Swanson's office didn't return a call seeking comment.

The gist of the Minnesota litigation is that surrender charges of up to 25% and holding periods of up to 16 years make EIAs unsuitable for people ages 75 and older.

American Equity issued a statement emphasizing that its EIAs contain “clear and complete disclosures.” The company didn’t return a call seeking additional comment.

Allianz is working with the Minnesota attorney general’s office to reach “a mutually agreeable solution,” company spokesman Jim McManus said via e-mail.

“We’ve been getting close to 200 calls a day from potential clients age 65 and older who were financially harmed by Allianz,” said David Eisbrouch, a principal of Balkin & Eisbrouch LLC in Hackensack, N.J., which is seeking opt-outs from the class action.

Allianz is the No. 1 seller of EIAs, with a 26% market share, according to Advantage Compendium Ltd., an annuity research firm in St. Louis. American Equity now is No. 6, with a 5% market share, after several years of occupying the No. 2 slot.