



With Annuity Sales, It's All About the Rates

with Jeremy Alexander, CEO of Beacon Research

In this interview, fixed annuity analyst Alexander discusses sales trends in 2009 and beyond.

INN: Although 2009 turned out to be another \$100 billion year for fixed annuities, there seemed to be some signs of difficulty. What is your take on that?

ALEXANDER: It has been a struggle. It is interesting because the demand is there. When we see carriers putting out competitive rates, annuities are really selling quite well. But it has been a struggle for the industry on a couple of fronts. The one that is happening right now for carriers is buying and selling investments. In selling, some of the carriers have had to write off some investments. Then you have the issue that you have to buy investments to back your fixed annuities. The carriers have this tremendous need for quality debt, and there just does not seem to be that much supply out there. Carriers are just not able to put the product they would like to out on the street.

INN: Is the need for debt different for traditional fixed and indexed?

ALEXANDER: The indexed business still needs quality bonds, but the reserve requirement is lower. So when you lower the supply of fixed investments and you are in the sort of market we have now with a tremendous amount of risk and volatility, the industry tends to move toward the indexed market.

INN: LIMRA is saying the quarterly drop in traditional fixed sales is likely to continue into 2010. Do you see that also?

ALEXANDER: Yes. Our biggest leading indicator really has been the risk over Treasuries. In other words, is there a nice, big spread of corporate bonds over Treasuries for carriers? That spread has been disappearing month by month as the risk premium is taken out of the market.

INN: In 2008 we saw carriers cut supply of indexed annuities because they hit their annual quota early in the year. Given that the demand for indexed has remained strong, did you see that happen again in 2009?

ALEXANDER: Yes, I think the carriers were running up against that in many cases as well, going toward the end of the year. But it was not quite as dramatic as what we saw at the end of 2008, because that last quarter was just unbelievable. The carriers that did not blow out their numbers at the end of 2008 had already blown them out in the first quarter of '08.

INN: Are carriers holding back now because of reserves?

ALEXANDER: That is part of it. But mostly it is just not having the investments to back their new annuity sales. They might have the reserves, but the problem is that when you go out and sell \$100 million in annuities, you have to go find \$100 million in bonds.

INN: What were some of the interesting aspects of individual carrier performance last year?

ALEXANDER: Pacific Life. Pacific Life came on from almost nowhere. Now they are one of the big providers.

INN: What is the story there?

ALEXANDER: Well, they have a fantastic organization and very good distribution, and they stepped into the market and decided they were going to be a dominant force and were. They went from \$878,000 a quarter, almost nothing, to the \$1 billion range. So that is a great success story. It shows you that if you have got the capital and you have got the distribution, you can do some good things.

INN: What is their distribution?

ALEXANDER: Their primary distribution

of fixed products is actually in the bank channel.

INN: So, between Pacific Life and Western National going great guns in the bank channel, it seems like a great time to be selling annuities in a bank.

ALEXANDER: Banks are a good place to be for annuities. The risk characteristics are very similar. It is a pretty straightforward sale. And what has happened to the ratings of these banking companies has opened up some spots on the shelf for quality carriers to step in and provide product.

INN: So what do you see in 2010?

ALEXANDER: I see continued strong demand for product, and depending on what happens with the interest rate environment, there will be ebbs and flows. But I think we are still in the \$80 billion to \$100 billion range for '10. I think what we have here is a permanent change in the risk tolerance of most investors. I do not see those who have been burned going back to very aggressive portfolios. And that bodes very well for the industry.

INN: If it turns out to be \$80 billion to \$100 billion, that would be lower than 2009, which was lower than 2008.

ALEXANDER: I guess it depends which scenario you sort of throw out. If rates remain similar going forward, then we are probably in the \$80 billion to \$90 billion range. But if rates rise, you will see larger sales down the road.

INN: Do you see that happening?

ALEXANDER: Yes, I think over the next six months as the Fed starts taking liquidity out of the market, some economists are pointing toward around 4 percent inflation. And if that were true and rates rose to the 5 to 6 percent range, I think you'd see an explosion in fixed sales. **INN**