

Fixed Annuity Sales Hit Fourth Consecutive Quarterly Record

For consumers it's now about the return of the money

BY JEREMY ALEXANDER

U.S. SALES OF FIXED ANNUITIES continued strong in first quarter 2009. Estimated sales of \$34.9 billion were 78% ahead of a year ago, 2% above the prior quarter, and the largest in six years—the fourth consecutive quarterly record shown in the *Beacon Research Fixed Annuity Premium Study*.

There was continued first quarter demand for conservative investments in response to difficult economic conditions. Unemployment rose and gross domestic product shrank at a 5.75% annual rate—an improvement over fourth quarter's 6.2% decline, but still grim. The S&P 500 dropped 18% over the quarter.

With the highest savings rate in 19 years, many consumers had the funds to buy fixed annuities and the conservative-minded had an incentive to do so. A steepening Treasury bond yield curve gave fixed rate annuities a continued advantage over bank certificates of deposit, money market funds and Treasuries.

But in other ways, conditions were

less favorable than in fourth quarter. Credited, cap and participation rates fell, mainly because of less favorable yields on the corporate bonds used to back fixed annuities. The spread in their yield over Treasuries narrowed with an easing of the flight to safety. In addition, the one- to 10-year corporate bond yield curve was V-shaped, with rates lowest in the middle.

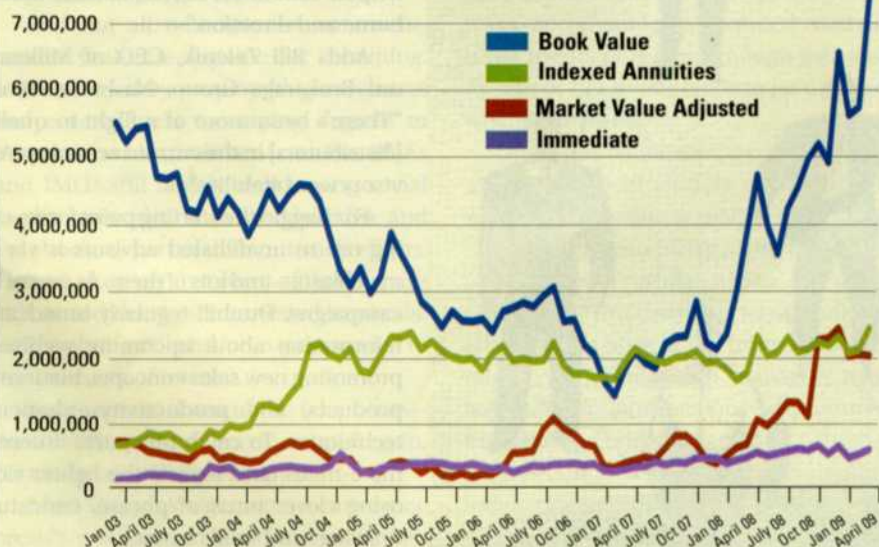
Longer term bond yields also declined, and this lowered income annuity payouts.

Some issuers also lowered rates to non-competitive levels in order to limit sales. Others raised minimum premiums or reduced commissions. A few carriers terminated agents and distributors, stopped contracting with new agents or shut down new business altogether. These companies lacked the reserves to support another big surge in new business due to investment losses (realized or not). Too much strain on capital could trigger serious ratings downgrades, jeopardizing their ability to do business.

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SALES HISTORY

Estimated Sales By Product Type 2003 – First Quarter, 2009



Source: Beacon Fixed Annuity Premium Study, Beacon Research, Evanston, IL



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FIXED ANNUITY SALES

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Given these constraints, the first quarter's record results were a real achievement.

In terms of sales by product type, book value (fixed rate, non-market value-adjusted) annuities were the big winners. They had their best quarter in six years, and were the only product type to grow quarter-to-quarter (12%), as well as period-to-period (98%). Most of these products are sold in banks, where they had a rate advantage over CDs.

Percentage-wise, sales of fixed rate annuities with market value adjustments grew the most compared to first quarter 2008 (180%), and fell the most from the previous quarter (-12%). Lower credited rates had a lot to do with the quarter-to-quarter decline. But first quarter 2009 was still the second-best period for MVAs since 2003.

Independent producers remained the most important MVA channel but as a group, broker-dealers outsold them.

Indexed annuities had their second-best quarter in four years despite the bear market, continued regulatory uncertainty and efforts by some issuers to keep sales in line with strained reserves. Results were up 24% from a year ago and down just 1% from fourth quarter.

With 88% of sales, independent producers remained by far the most important channel.

Estimated income annuity sales were 15% above a year ago. But after three consecutive quarterly increases, results declined from fourth quarter 2008. This was partly a function of lower payouts and postponed retirements.

But some of the income annuity drop-off was seasonal. The sales have fallen from fourth to first quarter in each of the last six years, due to a big fourth quarter sales push in the two most important channels—captive agents and independent producers.

Sales of participants in our study were higher in all distribution channels compared to first quarter 2008, and in all but



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two channels quarter-to-quarter.

Captive agents were first quarter's big success story, posting the biggest dollar gains relative to both periods. Their sales more than tripled over a year ago and grew 12% from fourth quarter. With 31% of first quarter sales, banks became the most productive channel for the first time since second quarter 2004. Results were 58% ahead of first quarter 2008 and 3% above the prior quarter. Book value sales drove the gains in both channels.

Independent producers' results improved 31% from a year ago, driven by indexed and MVA annuity increases. Their sales dropped 4% quarter-to-quarter, with decreases in all four product types.

We expect results for second quarter and 2009 to be well ahead on a period-to-period and year-to-year basis. There should be fewer restrictions on supply because many issuers have successfully raised capital via equity and debt offerings (and federal TARP assistance in two cases). The interest rate environment is improving in terms of higher rates and steeper yield curves. Although equities prices have risen since March 9, full economic recovery is not expected until year-end at the earliest.

Therefore, fixed annuities and conservative investments in general should continue to do well.

We believe that consumer demand will remain strong, even when the economy fully recovers. A significant segment will continue to prefer principal protection and income over capital appreciation—in other words, consumers are demanding return of their money. Taxes are likely to go up in 2011. This, plus implementation of the Pension Protection Act, will further increase demand.

There will be increased competition for conservative investors from simpler, less expensive variable annuities and newly designed mutual funds (some with guaranteed living benefits provided by insurance companies). Life insurance will compete as a source of retirement income, too, especially if indexed annuities are regulated as securities. But fixed annuities will certainly get their share. And if the industry finally makes a real, long-term commitment to educating advisors and the public on how to use fixed annuities as part of retirement income plans, the future is very bright indeed. ■

REFORM IDEAS

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According to government officials, the plan calls for the FDIC or SEC to act as a conservator with broad powers to take action. Treasury would borrow to finance the costs, which would be recouped by fees assessed on the firm once it is sound and resold to private investors.

Even putting aside the fact that consumer protection of insurance products could conceivably be given to a proposed Consumer Financial Protection Agency, another large department, just the fact that federal regulators would have oversight and resolution authority over "systemically risky" insurance companies constitutes a major change.

First, it would give federal regulators strong supervisory authority over these insurance companies and mandate a capital surcharge. And the federal resolution authority would have the power to take funds from the operating subsidiaries of institutions it takes over, presumably giving them a role in their regulation.

There is the strong potential here that being declared a systemically risky institution could become a financial plague, substantively affecting a company's profitability.

Moreover, the resolution authority could presumably have the power to sell the business or underlying affiliates to a non-insurance company as the least costly resolution alternative.

Moreover, insurance company executives are very worried that a surcharge would be imposed on them to pay for resolving these institutions—without the cost savings they believe will be generated by having a single federal regulator.

Thus, the obvious conclusion that should be drawn by all sides in the federal-vs.-state regulation dispute is that change is coming, and a tortuous, lengthy battle in the corridors of Congress will be waged before the ultimate future of insurance regulation is determined.

Moreover, the only thing to be decided is whether it will be full federal regulation or some sort of hybrid regulatory system.

"Prompt action" has a different meaning within the Beltway than it does outside. This administration and this Congress will get healthcare, budget issues and perhaps climate control out of the way before the fog lifts on financial regulatory reform. That implies perhaps as late as December 2010. ■