

4Q 2008 Flight To Safety Lands On Fixed Annuities

BY JEREMY ALEXANDER

THE FOURTH QUARTER'S results truly made 2008 a banner year for fixed annuities.

The quarter's estimated sales of \$34.1 billion set a third consecutive 6-year record and pushed the annual total to an estimated record \$107 billion, up 60% from 2007.

These results are not surprising because 4Q conditions converged to create a perfect storm of fixed annuity favorability.

A bear market prevailed in 4Q, and by December 31, the Dow stood at 8,776—down 2,055 points (19%) from October 1. Equity mutual funds had net outflows throughout the quarter as the flight to safety continued.

Although it fluctuated a lot, the yield curve not only remained positive but steepened slightly. Treasury rates generally fell, pulled down along with 3 Fed rate cuts and pushed lower by security-seeking demand.

But fixed annuity rates did not follow the same pattern. They rose in October and November, thanks to the yield curve and a widening spread between Treasury and corporate bond yields. Credited rates at the important 5% threshold level were available throughout 4Q—well above rates offered by bank certificates of deposit and other conservative alternatives.

Coupled with the ongoing flight to safety, this resulted in another big quarter for fixed rate annuities. Non-market value adjusted (non-MVA) annuity sales rose 23% from the prior quarter.

But 4Q really belonged to market value adjusted annuities, the sales of which were

up 76%. MVA sales grew so much that they actually surpassed indexed annuities for the first time since the first quarter of 2003.

Indexed annuity sales were up only 3%, but that gave them their best quarter in 4½ years despite the bear market and the Securities and Exchange Commission's mid-December decision to regulate them as securities in 2011.

Results for B-Ds as a group rose 316% over a year earlier, the largest percentage increase among the channels. Captive agents' sales climbed 154%.

Bank sales more than doubled. Independent producers were ahead 25%. Fixed rate annuities drove most of the gains in all cases.

Will all these trends extend through 2009? We think they will, for several reasons.

First, an economic recovery before late this year seems quite unlikely. Despite the stock market rally of mid-March, the bear market will likely persist. Conservative investments, like fixed annuities, will continue to do well as a result.

Second, consumers are saving more. This also will boost sales.

■ SALES BREAKDOWN

Estimated U.S. Fixed Annuity Sales By Product Type (in billions)

	04 '08	03 '08	% Change	04 '07	% Change
Total	\$34.1	\$27.7	23.2%	\$34.1	18.0%
Fixed Interest:					
Book Value (non-MVA)	\$17.1	\$14.2	20.6%	\$17.1	7.6%
MVA	\$7.4	\$4.2	75.7%	\$7.4	262.3%
Indexed	\$7.2	\$6.9	3.3%	\$7.2	6.4%
Immediate	\$2.4	\$2.3	2.7%	\$2.4	1.9%

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

Buyers apparently saw considerable upside potential in indexed annuities, given the quarter's low stock prices. Together with the products' downside protection, guaranteed lifetime withdrawal benefits and higher cap rates, this was an attractive value proposition.

Immediate annuities had their best quarter in 6 years on a 3% quarter-to-quarter increase. Dependable monthly income became more attractive relative to systematic withdrawals from shrunken retirement savings, especially since payouts were up and the inflation rate was minimal.

Sales of participants in our study increased in all distribution channels compared to 3rd quarter 2008 and also to a year ago (with one minor exception).

But 4Q will be remembered as the time that captive agents and broker-dealers truly became important for the distribution of fixed annuities, partly to compen-

Next, fixed rate annuities should have another excellent year. Even though credited rates are dropping, these annuities should have an ongoing competitive advantage due to a positive yield curve and a wide spread of corporate bond yields over Treasuries. Low inflation will help make these rates attractive.

Also, healthy growth in immediate annuity sales should be expected, even though payouts are down and many people

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are postponing retirement. Those reliable monthly checks will continue to look good relative to alternatives such as living on systematic withdrawals from depleted as-

sets or on interest in the current low rate environment.

Meanwhile, indexed annuity sales probably will not increase as much as the other product types. This is due to bear market conditions as well as lower cap and participation rates.



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At least as long as variable annuity sales remain depressed, captive agents and B-Ds will become increasingly important fixed annuity distribution channels. We also expect many indexed annuity issuers to cultivate B-D distribution to prepare for possible SEC regulation in 2011.

Overall, sales could hit \$120 billion this year. But 2009 won't be an excellent year for everyone. Just like the rest of us, life insurance companies are seeing many of their investments lose value. VA issuers are coping with the double-whammy of lower asset-based fees and higher costs to support guaranteed living benefits. There have been a slew of ratings downgrades, and the ratings agencies warn of more to come.

Given the current risk-averse mood, expect to see a flight to quality with sales flowing to the strongest carriers. Some of these companies will acquire or merge with weaker ones. Several major VA issuers will shift focus to become key players in the fixed annuity market. Other carriers that have long focused on fixed annuities will pull back to minimize demands on reserves (or to use reserves for more profitable product lines like life insurance).

Producers will remain the all-important engine of fixed annuity sales in 2009 and beyond, though the companies they represent may change. Unless the public loses confidence in the industry as a whole, those who understand how to take advantage of the public's demand for conservative investments are going to have a great year and a bright future as well. ■