

Fixed Annuity Sales Off 20% In 3Q

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Compared to the very strong fixed annuity market of the preceding 12 months, third quarter 2009 was a disappointment. Estimated sales of \$22.1 billion were 20% behind a year ago as well as the prior quarter, according to data in the Beacon Research Fixed Annuity Premium Study. But from a longer term perspective, results were ahead of any quarter from October 2004 through March 2008.

Sales didn't fall in third quarter due to a general drop-off in demand for fixed annuities. Retail investors largely ignored the stock market rally in favor of assured returns. Some 85% of third quarter's net mutual fund purchases went into bond funds, and survey after survey indicated continued strong desire for guarantees.

If underlying demand was strong, why were fixed annuity sales lower? For one thing, the interest rate environment was unfavorable.

The demand for bonds pulled yields down and narrowed the spread over Treasury rates, which also declined over the quarter. With credit spreads so narrow, fixed rate annuities did not have much of a competitive advantage.

The average rate on a five-year CD-type annuity (rate-for-term or multi-year guarantee) was 2.99% in July, 2.83% in August, and 2.71% in September, and the spread over five-year Treasuries shrank from 0.53% in July to 0.34% in September. Guaranteed minimum interest rates fell as low as 1%.

Many fixed rate annuity issuers probably could have credited somewhat higher if they wanted to write the business. Those that priced competitively saw strong sales.

Why would insurers choose to limit business? Sales were so strong in the first half of 2009 that they may already have issued most of what they planned to sell by the time July arrived. And though the capital situation of most insurers improved in third quarter, the companies may have preferred not to commit still-pressured reserves to fixed annuities at a time of spread compression and reduced profitability.

Also, the very demand for fixed rate investments held down sales. The reason: a limited supply of investment-grade cor-

and broker-dealer channels, but fell in the dominant independent producer channel relative to both periods.

Upside potential with downside protection finally started to be promoted again. This should have been quite appealing, given the quarter's rally coupled with the fragility of the young recovery and the low yields offered on fixed rate investments. It seems that many prospective buyers wanted an assured return.

Indexed annuity fixed accounts were promoted to an extent not seen before. Two of the quarter's bestselling indexed annuities offered very competitive fixed rates, and it seems likely that a significant percentage of sales were allocated to these accounts. Guaranteed lifetime income, premium bonuses and liquidity also continued to be stressed much more frequently than upside potential.

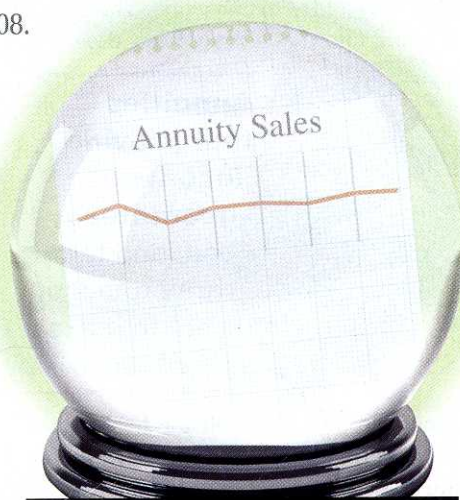
Looking at deferred annuity results as a group, indexed and declared rate annuity trends overlapped in third quarter. Fixed rates played a more important role in indexed annuities; guaranteed lifetime withdrawal benefits were more heavily promoted for fixed rate products, and liquidity was an important selling point for both.

The interest rate environment affected income annuities too. Yields on 20-year AA corporate bonds declined from the prior quarter and credit spreads narrowed, reducing profitability. Because yields were so low, several insurers stopped issuing term-certain annuities with durations of less than five or 10 years.

Surveys indicated that the desire for guaranteed lifetime income continued to be very strong, but some prospective buyers may have postponed purchases, expecting higher rates and larger payouts in the future. Estimated income annuity sales dropped 16% (off \$356 million) from third quarter 2008 and 10% (off \$225 million) sequentially. Five channels were behind year-ago results; six were down quarter-to-quarter.

As of December, conditions hadn't changed much. So the expectation is that fourth quarter sales, once tallied, will be down quarter-to-quarter and period-to-period.

Going forward, results probably won't



Future annuity results probably won't improve much as long as the interest rate environment remains the same and insurers' capital continues to be constrained

porate bonds to back them.

All these factors probably restricted new business for FAs in general.

Needless to say, it wasn't the best quarter for fixed rate deferred annuities. Estimated book value (non-market value adjusted) sales fell 30% from a year ago, and dropped 28% from the prior quarter. Results declined in all non-broker-dealer channels relative to both periods. MVAs were down 31% period-to-period and 18%, sequentially. With two exceptions, sales shrank in all channels compared to either period.

Indexed annuities did considerably better, despite continued regulatory uncertainty. Estimated sales were up 6% from third quarter 2008, though down 11% from the previous record quarter. Interestingly, results for participating carriers in the Beacon study improved in the bank

