

Retirement Income Solutions: Impaired Payout Annuities

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**Society of Actuaries
San Antonio 2004 Spring Meeting**

The Under-tapped Under-tapped Market

- **A “healthy” percent of the growing mature market are either unhealthy or feel they are**
- **Only a relatively few companies seek to tap this reality in the income in retirement market**
- **“Impairs” Wholesaler services**
- **No companies offer an impaired IVA**

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Progression in Time

- **Supreme Court Decision**
- **Actuarial Guideline IX-C**
- **Shift to DC, Longevity, Boomers, & the Future**

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Why Offer Impaired Annuities

- **Market**
- **Distribution**
- **Strategic**

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Why NOT Offer Impaired Annuities

- **Underwriting**
- **Risk**
- **Competition**
- **Market**

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Positioning is Key

- **What do you want to achieve in offering the product?**

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Market Sectors

	<u>Impairment Level</u>	<u>Typical Age</u>	<u>Market Size</u>	<u>Enhancement</u>
Easy Does It	+25-50%	60-70	Large	+10%
Broad Market	+150%	60-80	Medium	+50%
Seriously Impaired	+250%	75-90	Smaller	+125%

Seriously Impaired Annuities

- For people already incurring long term care costs
- Leverages shortened life expectancy with high ongoing cost of long term care
- Niche market given Medicaid and the sense that life span is short –
- Positioning the sale & distribution
- Opportunities for variations, LTCL, and retirement planning

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Areas to Consider

- **Underwriting**

- **Ex**

- **Pri**

- **Pro**

- **Re**

- **Re**



"So after my second heart attack, they put a pig valve in me and I've been feeling great ever since."

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Impaired Annuity Survey

- **Participatory**
- **Practices**
- **Markets**
- **Sales**

Interested?

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Retirement Income Solutions

Wachovia Insurance
Joel Jessen
Annuity Product Manager



I'm Convinced!

- ◆ Baby Boomers retiring
- ◆ 401(k) Rollovers
- ◆ **Immediate Annuities!!**
- ◆ Longer life expectancy
- ◆ Pension Plan extinction
- ◆ Systematic Withdrawal risks
- ◆ Social Security uncertainties



Agenda

- ◆ Wachovia Insurance Strategy
- ◆ Bank Retirement Initiative
- ◆ Sales Positioning

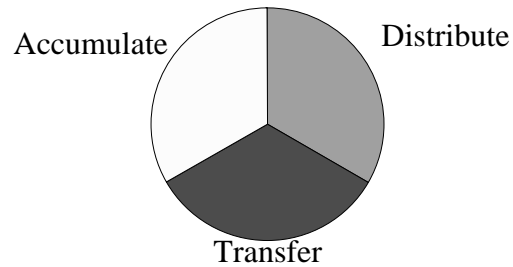


Wachovia Insurance Strategy

- ◆ Objective Wholesaling
- ◆ Market Growing Products
- ◆ Stay Ahead
- ◆ Successes
 - \$4.2 Billion in Annuity Sales in 2003
 - \$29 Million in Immediate Sales in 2003

Bank Retirement Initiative

- ◆ Wachovia's Focus on Retirement



- ◆ Training of Platform Reps

Sales Positioning

- ◆ Accumulation Strategies vs. Distribution Strategies
- ◆ The “Wealth Distribution Specialist”
- ◆ Overcome Traditional Objections
- ◆ Compare to what they know
- ◆ Use Combinations

Sales Idea

- ◆ Retired Customer, 65, using laddered bond approach to generating income:
 - \$1,000,000 Portfolio earning 5%
 - \$50,000 per year in income
 - Income fully taxable
 - Risks

Sales Idea – Alternative #1

- ◆ Using the Immediate Alternative
 - Control taxes, reduce risk, guarantee lifetime income!
- ◆ Option 1 – Lifetime annuity
 - Invest \$600,000
 - Receive \$50,000
 - After tax income increase by 26%!
 - Invest the other \$400,000



Sales Idea – Alternative #2

- ◆ Option 2 – Split Annuity

- Annuitize \$428,000 for 10 year certain
- Receive \$50,000
- After tax income increase by 36%!
- Invest remainder in VA with GMIB (6-7%)

Options 3-100 – Use IVAs, Combo with bonds and other investments, etc, etc..

Retirement Income Solutions: Payout Annuities

Society of Actuaries Spring Meeting

June 14, 2004

Susan J. Sell, FSA, MAAA

A MILLIMAN GLOBAL FIRM

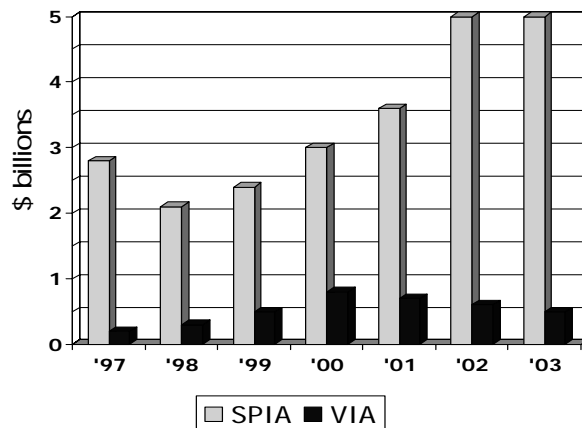


Milliman USA

Consultants and Actuaries

Total Immediate Annuity Sales (excluding Structured Settlements)

SPIA Sales Grew Consistently Until 2003



Source: LIMRA International, Inc.

Distribution of SPIA Sales

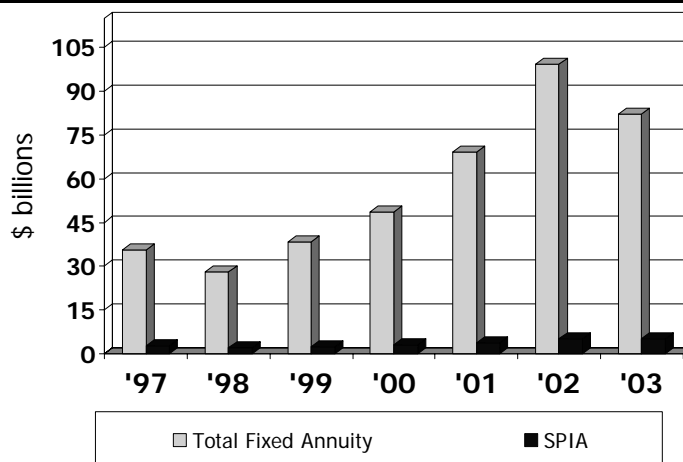
Independent Producers Have Led Sales

Distribution Channel	Percentage of Sales
Independent Producers	41.6%
Career Agents	34.7%
Large/Regional Broker-Dealers	9.5%
Banks	5.0%
Independent Broker-Dealers	3.8%
Wirehouses	3.5%
Other	0.8%

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SPIA Sales vs. Total Fixed Annuity Sales

Still a Relatively Small Part of the Annuity Market

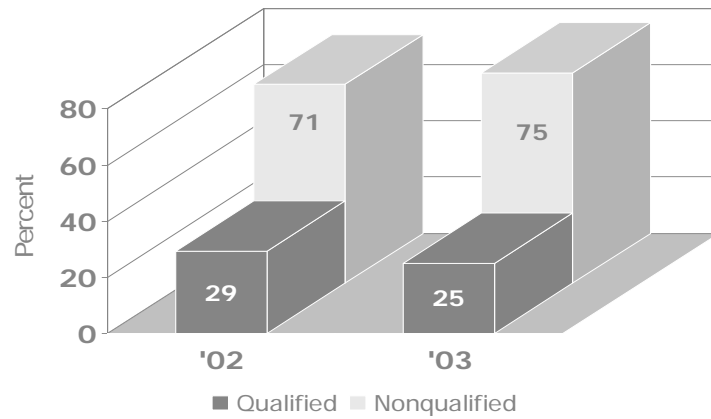


Source: LIMRA International, Inc.

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Qualified vs. Nonqualified Sales

Nonqualified Sales Outpace Qualified Sales



Source: LIMRA International, Inc.

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Average Premiums

Recent Growth Seen in Size of Nonqualified Premiums

	2000	2001	2002	2003
Qualified	\$75,349	\$84,199	\$73,845	\$78,824
Nonqualified	\$73,161	\$88,095	\$86,661	\$110,710
Total	\$73,731	\$87,107	\$83,526	\$102,672

Source: LIMRA International, Inc.

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Successful Companies

Familiar Companies Continue to Dominate the Market

- Sales in the last few years jumped dramatically for a number of carriers
- Increase in the use of SPIAs to fund life insurance
- Product Packaging

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Competitive Assessment

Core Qualities are Necessary to be a Successful Immediate Annuity Competitor

- Superior Commissions
- Competitive Pricing
- Competitive Product Design
- Strong Service/Support for Reps and Policyholders
- Excellent Training/Sales Tools for Reps
- High Financial Ratings

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SPIA Variations

Little Change in Standard Payout Options

- Period Certain
 - 5 to 30 years, Typically Commutable
- Single Life
 - Life Only
 - 10, 15, and 20 Year Periods Certain
- Joint and Survivor
 - Life Only
 - 10, 15, and 20 Year Periods Certain
 - 100% and 50% Survivor
- Refund
 - Cash
 - Installment
- Customized Options
 - If Premium is Large Enough

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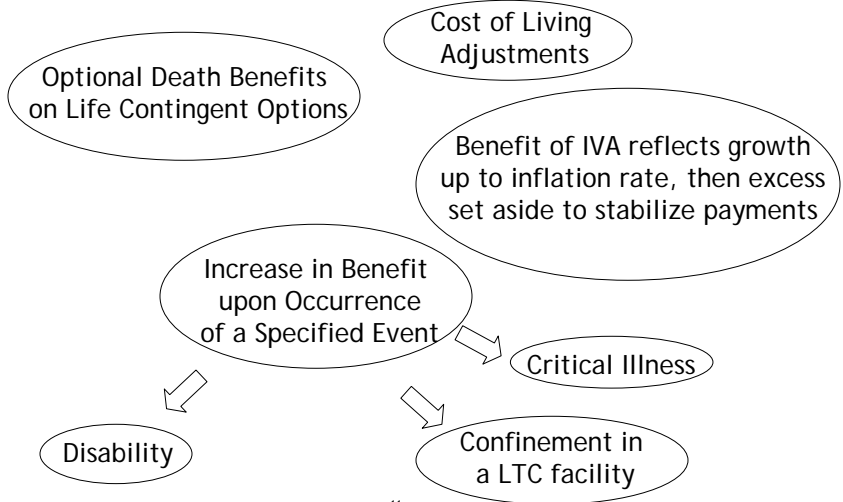
Recent SPIA Trends

Increased Level of Interest in Payout Annuities

- SPIA product development has picked up considerably in the last year
- Good current market conditions for selling SPIA's (little reserve strain)
- Heavy usage of SPIA's to fund life insurance
- Substandard SPIA's have been used to fund substandard life insurance
- Companies are considering impaired risk products
- Pricing for the large case market has gotten more competitive

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Emerging Product Features



Emerging Product Features

Liquidity

- Full and Partial Withdrawals
- Including Life Contingent Payouts (may involve underwriting)

Flexibility

- Changes to payment mode, certain period, payout option
 - Additional premiums allowed
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Sales Compensation

*Reductions Occurring in the Fixed Deferred Market
have not been Witnessed to the Same Degree in the
Immediate Annuity Market*

- **Recent Trends**

- Upfront

- Average top level gross commissions equal 3.00 - 5.00% for life contingent or long period certain payouts
- 1.50 - 3.00% for short period certain options
- Many companies reduce compensation to 50% at age 80

- Trail Compensation

- Few products offer

- Chargebacks

- Typically not assessed unless partial or full surrenders are allowed in the early years

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Sales Compensation

*Little Variation is Seen in Compensation by
Distribution Channel*

Distribution Channel	Average Commission
Independent Producers	4.30%
Career Agents	3.80%
Large/Regional Broker-Dealers	3.90%
Banks	3.80%
Independent Broker-Dealers	3.70%
Wirehouses	3.30%
Other	3.75%

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Pricing/Profitability

Common Mortality Assumptions

- Experience Mortality: Annuity 2000 and Annuity 2000 Basic Mortality Table
 - Many carriers do not reflect mortality improvement
 - If mortality improvement is reflected Scale G is used
 - 100% for males
 - 50 – 80% for females
- Valuation: Annuity 2000 Mortality Table with no improvement

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Pricing/Profitability

Common Expense Assumptions

- Allocated on many different bases
- Average issue expense levels have been:
 - 0.80% of premium
 - \$235 per contract
- Average maintenance expense levels have been:
 - 0.12% of assets
 - \$55 per contract

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Pricing/Profitability

Common Target Surplus Assumptions

- Average level for majority of SPIA carriers has been about 4.30% of statutory reserves
- Some have held 3.80% of statutory reserves (average), plus an average of 4.84% of premium
- These levels represent, on average, 250% RBC level

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SPIA Pricing/Profitability

Typical Pricing Targets

Statutory IRR	GAAP ROE	ROA	Profit Margin
Low 9 - 11%	11-15%	20 - 40 bps	1.00 - 2.50%
Average 12%			
High 13 - 15%			

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Investment Strategies

Asset Types Similar to Deferred Annuities

- Average Mix of assets for SPIA's

<u>Asset Type</u>	<u>Allocation</u>
Investment Grade Corporates	54.3%
Non Investment Grade Corporates	5.0%
Commercial Mortgages	15.6%
Private Placements	9.8%
Asset-backed Securities	4.5%
Common Stocks	< 1%
CMO's	5.1%
Other	5.6%

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Investment Strategies

Longer, Less Liquid Investments

- Similar proxy to deferred annuities regarding types of assets
 - More illiquid and longer durations for IA's
- Assets backing life contingent options tend to be less liquid than those backing period certain options
- Duration matching strategy is typical

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Investment Strategies

Longer, Less Liquid Investments

- Some IA insurers have assumed that the earned rates assumed in pricing decline in future years since reinvestment rates are uncertain
 - Adds a degree of conservatism to pricing
 - Today, most assume level reinvestment rates
 - Some carriers assume an increasing reinvestment rate

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Pricing/Profitability

SPIA Spreads are Quite Varied

- Typical SPIA required interest spreads range from 50 to 320 bps
 - Some carriers assume a level target spread across all payout options
 - More common to see target spreads vary by payout option
 - Average 5 year period certain spread has been 118 bps
 - Average Single Life spread has been 89 bps

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Pricing/Profitability

Common SPIA Pricing Methodology

- Many insurers also include policy loads within the benefit calculation mechanics to cover commissions and other expenses
 - Not uncommon to see a policy fee either implicitly or explicitly
 - Fairly common to see implicit percent of premium load at a level close to the commission rate
 - Some SPIA's are priced with annual per policy load that is near the level of the annual maintenance expense on the policy

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The Future

More Focus from More Carriers

- Greater flexibility, including liquidity
- Relative positioning of income annuity FIT treatment likely to increase
- Lower benefits may result from more robust mortality experience data
- Increasingly competitive pricing, with company ratings rising in importance
- Equity indexed immediate annuities are being discussed

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