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Session 5PD
Payout and Income Annuities

Track: Product Development

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Summary: Single premium immediate annuities (SPIAs) are positioned to be an increasingly important part of an insurance company's product portfolio due to the aging of the baby boomers and the wealth they've created. This session focuses on the value of SPIAs for individuals who do not want to outlive their assets, new features/enhancements to improve the attractiveness of SPIAs and mortality arbitrage and the SPIA market.

MR. MICHAEL J. LEBOEUF: I'm a consulting actuary with Aon Consulting in Avon, Conn. Our first speaker today is going to be Stephen Abels. Stephen is first vice president and an actuary with Mutual of Omaha. He has a background in individual product pricing and asset/liability management, and he most recently served as the annuity product officer at Mutual of Omaha. He's going to be providing the bulk of this topic and providing a lot of information for us this morning.

MR. STEPHEN J. ABELS: Payout and income annuities are an interesting market. Historically our industry has had trouble penetrating the potential market in this case because there has been a general lack of understanding and appreciation of the risks that potential consumers out there face. If you think about life insurance, there is a general appreciation that people need life insurance. They may have been involved personally or indirectly with what can happen if someone is underinsured with regard to life insurance. Not only that, but death is a tragic, one-time event. It

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Note: The chart(s) referred to in the text can be downloaded at:
http://handouts.soa.org/conted/cearchive/NewOrleans-May05/005_bk.pdf

sticks in people's minds, and they tend to appreciate their need for life insurance because they associate that tragedy with a need that they may also possess. But if you think of longevity risk, which is the risk that immediate annuities and payout annuities cover, it's not as much a tragic event. Nobody says that they lived to be 90, and that's a shame, do they? It's not a one-time event either. It doesn't stick as strongly in the consumer's mind. You are talking about a sale that requires more education.

I want to talk about the three players of the annuitization decision: the consumer, the producer and the manufacturer. Then we'll talk about some new designs that are showing up in the marketplace and some ideas that may help address the challenges that we face to the annuity sale. But first I want to take a look at the market in general.

I'll first discuss production trends. Abels Slide 3, page 1 shows production of new payout annuities in recent years. You can see that there's been quite a bit of growth in the market. The orange section is what we'll be concentrating on today. I've included structured settlement annuities in there. That's a different animal altogether, a different market and a different sale. I put it on here only for comparison purposes. It's not within the scope of what we're talking about. The lighter orange section represents the fixed immediate annuity sales, and the darker orange area represents variable immediate annuities (VIAs). You can see in 2000 that VIAs were almost 20 percent of the new sale SPIA market, and that's declined about 10 percent. That is not surprising knowing the Standard & Poor's (S&P) 500 hit its peak in early 2000 and has yet to recover to those levels. If there were a sustained rally in the equity markets, I would expect a greater share to be going to VIAs as opposed to the fixed SPIAs. In spite of that you can see the growth in fixed SPIAs and in a declining interest rate environment. I think there are a number of factors that are pushing this market toward growth, including demographics.

Abels Slide 1, page 2 takes a look at the realized income annuity market. The orange section from the previous graph is now light blue. I apologize for that. But $5.3 billion was the size of that market in 2003, and you can see the trends there. I've taken out the structured settlement annuities and added in annuitizations out of deferred contracts. In 2003 annuitizations of existing contracts were two-thirds of the payout annuity market, not new sales. Superimposed here we also see annuitization rates, and that is accrued annuitization rate that's figured on total annuitization dollars in the industry divided by roughly figured average deferred assets in force in each of those years. I did not put together a display for this, but in my preparation I pulled off the five-year constant maturity Treasury rate, and I plotted it against the annuitization rate on a dual axis. I normalized it, and it is amazing how strongly correlated the two are. As the five-year rate went up and down, so did the annuitization rate in the industry. The exception there would be 2003, and we're all aware of the interest-rate challenges of 2003.

The five-year rate dropped for the first time in many years below 3 percent, and that was a magic number because as far as annuitizations are concerned, you have many in-force deferred annuities sitting out there at a 3 percent guarantee. Not only that, but many of the guaranteed annuitization parameters in their contracts were based on 3 percent, and so we had a lot of consumers who were finding out that they were sitting on guaranteed annuitization parameters in their deferred annuity contracts that gave them higher payouts than they may have even been able to purchase as a new sale in the market during 2003, and so we saw a jump up in annuitizations. The other factor that may have contributed to this is that I'm aware of a number of companies that actively marketed the concept of annuitization to their in-force deferred annuity policyholders simply because those policyholders were sitting on guarantees that were becoming expensive for the companies to maintain. They could not drop credit rates below the guarantees, and yet their earned rates were continuing to fall.

Abels Slide 2, page 2 is a snapshot breaking SPIAs into fixed and variable. You can see that the fixed market is dominated by the nonqualified market. This is information that's through three-quarters of 2004, last year. Part of that may be due to some of the larger cases that Mike will be talking about in a little bit. Part of it also is, if you think about variable contracts, many of those are being rolled out of IRAs and 401(k)s. The consumers in this case may be more comfortable with a risk exposure to the equity markets and may want to maintain that. They may also be more familiar with the concept of their payouts going up and down with the equity markets and be more comfortable with that type of sale.

The average size for a VIA is a little bit larger, but not significantly larger, than a fixed annuity. My personal observation has been that you see a little more variance in average size in fixed SPIAs than in VIAs, but that's just my personal experience, which is unscientific, to be sure.

Who's selling these? Almost three-quarters of the new sales came through either career agents or independent agents. The next biggest players are small compared to those two—banks at 8 percent and stockbrokers at 8 percent. Even a combination of financial planners and independent broker-dealers is only 3 percent of the market. There's a smaller and growing section of the market that's being sold directly. These are self-educated consumers, or sometimes they may have gotten their advice elsewhere and decided to purchase an immediate annuity on their own. If there's no underwriting involved, it's a fairly easy purchase to make, and they can buy that directly. There are a number of companies offering this. "Other," which includes employer-issued, would be lumped in with the remainder.

Who are the players in this market? The top player in 2001 enjoyed over 25 percent of this market. This is looking at fixed SPIA sales, a $3.6 billion sector of the market in 2001. The Top 10 companies represent about 60 percent of the total market; it falls away fairly quickly. By comparison, if we look at 2003, there have been some movements. The top player, instead of being 25 percent of the market, is less than 12 percent, but in total the Top 10 still write almost 60 percent of the market. There's more parity running into this market in the two-year interim. Not only that, but there's been dramatic growth. This sector has grown from $3.6 billion in 2001 to $4.8 billion in 2003. In fact, $150 million would have gotten you almost in the Top 5 in 2001; it barely gets you in the Top 10 in 2003. Some of it is due to SPIA and life sales. Again, Michael will address the details of some of those later. I also think this is due to a greater appreciation by consumers of these products, but there's a long way to go.

Demographic trends are another factor that is pushing sales and I believe future growth in this market. According to the U.S. Census Bureau, Abels Slide 2, page 4 shows what the 2005 U.S. population looks like. I've drawn in some bars here that bracket what are traditionally considered the baby boomers. These people were born between 1946 and 1964 and this year will be between the ages of 41 and 59. This is significant because, as the oldest baby boomers are approaching age 60, remember that age 60+ was almost 70 percent of the annuitization market last year. We're on the cusp, I believe, of some greatly increased demand for payout annuities.

I'd also like to take a look at the pattern of annuitization by age, and this was interesting (Abels Slide 1, page 5). I can only ascribe the under-50 market as being basically your affluent market. You can also see a difference between the contracts and the annuitization amount at age 70. There we'll get into a little more detail, but you're talking about the 70-and–one-half rule on required qualified minimum distributions. If I split these data into nonqualified, qualified and other qualified (we split out IRAs here separately—other qualified would include all of their employer-sponsored markets, such as 403(b)s, 457s, single-employee pension plans (SEPs), Keoghs, simples, etc.), two different markets are emerging here. This is not the same kind of sale between qualified and nonqualified markets. As nonqualified contracts such as annuitizations are concerned, it's a barbell effect. You have your affluent market under age 50, whereas they're not a large percentage of the contracts and yet it's quite a bit of the dollars in the nonqualified market.

The other is the very elderly market. Almost half of the nonqualified market is either under age 50 or over age 80. In many cases at the older ages you're talking about period-certain (PC) annuitizations. It is difficult at above age 86 or so to find a company willing to underwrite a life-contingent payout, but a lot of PCs are used in financial planning cases, in estate management and to pass on inheritance to beneficiaries. Qualified markets are dominated by the middle ages, and, as I mentioned before, there is a spike, especially for IRAs, between ages 70 to 75 because of minimum disbursement requirements for qualified contracts. The median size for annuitizations does not vary a lot, but it is a little bit larger for nonqualified. This is a median, not an average, but it is influenced by that affluent market that we saw at younger ages.

More telling, though, is if we split this by variable and fixed (Abels Slide 2, page 6). I'll have to caveat it here: the data were taken from 2000 to 2001. People who are seeking variable annuitizations oftentimes are coming out of variable investments, and they were benefiting from a run-up in the stock market and possibly were simply cashing in. I don't know if this difference is as stark today, but it's amazing to see the difference in size.

There is one other thing that has happened that was not so much a factor in 2000 and 2001 as in recent years. If you are familiar with the variable annuity deferred market, there are a lot of contracts sitting out there that provided guaranteed minimum death benefits (GMDBs), and they were popular as far as an option for people who purchased those deferred and variable annuity contracts. In recent years, with the decline in the equity markets, there was, I believe, a majority of contracts where the charge for the GMDB was figured as a percent of account value. Not only that, but there was a dollar-for-dollar reduction in the GMDB benefit upon withdrawals. Allow me to illustrate the situation that creates. Let's suppose I have a $100,000 variable annuity deferred. I've suffered through a poor market cycle in the equity markets, and my account value is now $50,000. Considering a simple GMDB, I may have a death benefit of $100,000 that would guarantee me upon death the return of my original premium.

If I have a charge that's a percent of my account value, and I have a dollar-for-dollar reduction built into that contract upon withdrawal, I can now take out about $49,000 of my account value and have charges only figured on a $1,000 account value for $51,000 of term insurance. For the elderly or those in poor health, they may be even uninsurable. That can be pretty cheap term insurance, and we've seen that market dynamic as well. What do they do with the money that you get out of a variable annuity? Oftentimes they may annuitize it. I think that's a dynamic we've seen in the last few years. I think the industry has begun to address some of the wording in those contracts that was fairly common in the 1990s and early part of the 2000s, but there's a lot of in force that's still sitting out there with the wording.

Abels Slide 3, page 6 shows annuitization by income. This is for ages 65+ and compares the U.S. population household income versus annuitants' household income. The thing that I take away from this graph is we tend to think of the annuitization market as somewhat of an affluent market. That is not necessarily true. You can see the percentage of annuitizations that occur are what we would consider middle-market-type situations. People with household incomes between $15,000 and $75,000 are the majority of the annuitization market. It is not simply for the affluent.

Next I'll discuss the opportunity in the market. There are a number of factors that drive the opportunity ahead of us in this market. The first is the size of the potential market. The Life Insurance Marketing and Research Association (LIMRA) has pegged this at about $200 billion, and this is how it splits it out. Of those who are retired, it is a little over half that amount. There is another chunk here of those within five years and those a little further away. We saw the graph from the U.S. Census Bureau. There was a large baby boomer section of this population that is just beginning to enter into this opportunity phase, poising this for a growth. Sixty percent of annuitizations last year did occur at ages 65+, and that's another segment in our industry that has gotten less focus than it probably deserves. Over half of this potential market is already retired, and 60 percent of annuitizations last year were for people who were 65+, roughly the same market. Yet oftentimes we've tried to catch people prior to retirement when there's a wealth of potential of those who have already retired.

As recently as 1992 defined-benefit (DB) participation was greater than defined-contribution (DC) participation, but it has changed dramatically in just nine years, and these trends have continued. More people at retirement will find themselves with large, accumulated balances and a desire to convert those into guaranteed income. Fewer people at retirement will have other sources of guaranteed income, and even those who have them will not be as secure. You may have seen the articles that came out I believe around May 10 or 11 about United Airlines. A judge said that the company could walk away from $3.2 billion of its pension obligations. I'm sure you saw the articles. It was in most of the major papers. This is playing in consumers' minds. Even the income that they thought was guaranteed and were counting on for retirement may not be. Of the $3.2 billion that would be taken over by the Pension Benefit Guaranty Corporation (PBGC), understand that the payouts under PBGC guidelines cap the amount of payout it will give at $45,000 for a 65-year-old retiree. For many of the people who were working for United Airlines, that's about half of the benefits that they were expecting from their pension plan.

This is not an isolated incident. Many analysts are predicting a wave of bankruptcy filings by other airline carriers that have more expensive pension plans right now just so that they can keep pace and compete with the lower cost that United now has. There are also concerns that this could spill into other industries, such as the auto industry, which has similar high legacy costs. As these front-page articles begin to be seen by the consumers, they may begin to question what they thought was guaranteed, and it may drive them to try to seek their own sources of guaranteed income, which would be the payout annuities that we can write as an industry. That is a factor that is going to point to future growth.

Splitting the level of retirement planning by retirees and actively working, one out of six retirees has yet to start to plan their retirement, following the ready-shoot-aim theory of financial planning. I suppose there will always be nonplanners among us. Only half of retirees characterize their level of preparation as extensive. Remember, the size of the retiree potential was over $100 billion, and that age bracket is the majority of the annuitizations that we see—a huge potential market. A separate study that was conducted recently identified the formal written financial plan as both a differentiating factor and a growing trend in retirement planning. Abels Slide 2 page 8 looks at the number of people who had formal written financial plans in place by household assets. I was surprised. Even for those with over a half-million dollars of household assets, fewer than half of them had a formal written financial plan. This is important because I would assert that the more comprehensive and rational the thought behind consumer planning, the more likely it is that consumers will be open to the concept of a guaranteed income as part of their overall plan. We've already talked about how it is not as emotional a sale as perhaps life insurance, and yet I believe it is at least as important.

I split formal written financial plans by retired and not retired. We've talked a little bit about the retiree market. Of those who are actively working, over half either have a formal written financial plan or plan to have one, and, of these, four out of five don't have one yet. This is opportunity. But therein is the rub, and here is where our industry has missed the boat. We already saw the graphs seeing who writes payout annuities, who's telling the story and educating the consumer. Who are they going to for their financial planning? There is little overlap here, and this is a telling story. There are a couple of takeaways from this display (Abels Slide 1, page 9). Of those who have done planning, two-thirds utilized their employer. Almost as many utilized a financial planner. Other professionals are also brought in.

These percentages within categories do add to more than 100 percent, and that reflects the fact that people will seek more than one source of advice. Of those who have done extensive planning, they seek about two-and-a-half sources for their education. For those who have done some, it's about two. And for those who have done little or none, it's about one. You can also see by stepping through the levels of preparation here where people start when they start their own education on retirement planning. They start with their employer and then fill in the other professionals as needed.

It's also telling that the last category on this chart is the insurance agent. Even among those who have done extensive or some retirement planning, fewer than one in four have involved an insurance agent. Yet three-quarters of today's income annuities are written by agents. There is little overlap, and if we as an industry are going to address this need, this potential market, we have to find forays into what are in many cases nontraditional distribution channels for us—the financial planners and contacts with employers. The people who are influencing retirement planning are not the same people who are educating the consumer on the need for payout annuities. This is industry opportunity. The question is, How can we reach these new distributions?

For retirement activities, higher levels of preparation are associated with less severe spending reductions and additional product purchases. I'll get into more detail on that. That's one of the big concerns that we face from the producers, that a SPIA sale is the end of the client relationship. That's simply not true, and I'll share some more data on that in a second. Planning does matter. Lower levels of preparation are associated with lower retirement satisfaction. Those who have done little or no planning are over twice as likely to have health problems and are three times as likely to be bored with retirement.

What is the payout annuity story? What drives the annuitization decision? Why did you annuitize? When asked this question among annuitants, the overwhelming majority said it was to provide guaranteed income. This tells me that annuitants who have made this decision appreciate longevity risk and are seeking to cover it, and yet we'll find that the general public does not appreciate longevity risk. Delving into the consumer psyche here: Why is guaranteed income important to the consumer? There is retirement satisfaction. We know that perception sometimes is truth, and here the perception of retirement satisfaction increases by almost 25 percent by having what amounts to a nominal level of guaranteed income. Less than one-quarter of the total income being guaranteed creates more retirement satisfaction.

Also interesting here, and this is more general satisfaction, is there seem to be some diminishing returns. Other risks enter in, and they begin worrying about other risks as opposed to longevity risk. Although there is a positive correlation between guaranteed income and retirement satisfaction, there is positive correlation to the issue of longevity risk. When asked this question, the concern over longevity risk decreased dramatically with guaranteed income (Abels Slide 1, page 11). I'm a little amused at the tail on this graph, and you'll see it again later. I think these are chronic worriers. They already have three-quarters to 100 percent of their income guaranteed, and they're still concerned about it. Someone didn't do a good job of educating those consumers. Higher guarantees are associated with income above bare necessities, budget sufficiencies and perception of financial security in retirement.

Joint payouts are more popular with larger annuitizations. PC is more popular with smaller annuitizations. As I mentioned before, PCs can be used to hedge investment risk and also for tax efficiency and inheritance cases. But despite concern over longevity risk, consumers have displayed a reasonable appetite for PC guarantees. Among single-life contracts, the 10-year PC is a popular option. People are trying to provide income while protecting their assets, possibly for estate-planning purposes.

Among joint-and-survivor payouts, longer guarantees are more popular. With many options available to the prospective annuitant, employees can be a willing ally in the education process. When 401(k) sponsors were asked what level of education they provide and whether they wished to provide annuitization education to their employees, a little less than one-third currently provide it, but more than one-third do not provide it today but are interested in helping educate their employees about the benefits of annuitization. This is opportunity. Remember the graph. Two-thirds basically at almost all levels of preparation are seeking advice from their employers when it comes to retirement planning. The employer can be a valuable ally as we try to reach this market.

Next are considerations that people face when choosing the payout option from a retirement plan (Abels Slide 2, page 12). These are the categorizations of responses to this survey. I would lump together the first three on the left as those who are concerned about longevity risk. But comparing the responses of retirees to those who are actively working, there's an apparent shift in concern once a person retires. More important to a retiree is lifetime income and covering longevity risk. Less critical to retirees is emergency cash flow and inheritance, and I thought that was interesting because at the point of sale emergency cash flow is one of the big hurdles that we face. People don't want to let go of that nest egg because they associate current wealth with security. It's difficult to take away a chunk of that current wealth, even if it's being replaced with guaranteed income, to get over that psychological hurdle.

The differences between retirees and those who are actively working may be as much generational as they are related to attained age. Among workers the highest concern is for guaranteed income and higher interest in the annuity concept may be related to the current trends that we saw in DC versus DB retirement plans that are available to them. Active workers are more concerned that guaranteed income sources they currently have will not be enough for retirement and are more interested in discussing an annuity concept. We have a ready audience that just needs educating.

For those who are participating in a DC plan, one-third of DC plan participants are interested in using annuitization payments as a major source of retirement income. As I promised, we'll look at the three perspectives that are represented by the players in the annuitization decision. First is the consumer view: Guarantees equal peace of mind. We've seen some of that as it showed up in retirement satisfaction. Consistent income helps with planning. There's a psychological benefit there as well. How do you put a number on financial security? Yet that perception can be valuable in the consumer's mind. That almost means that for those who have purchased immediate annuities, we are in the service industry. There's tax efficiency. With graduated tax tables, generally a more volatile income pattern means less tax efficiency. It helps smooth out that pattern of taxable income and make it more tax-efficient for the consumer. Many consumers may be sitting on deferred contracts that have favorable annuitization features and not even realize it. This is part of the education that we need to see.

Guaranteed income helps address a number of risks that occupy the concerns of a potential annuitant. I won't read these all to you, but I've categorized them into two different categories. One is life events. Another is financial events. There are a number of things that occupy the mind of consumers, concerns that they bring with them as they head toward retirement. Pulling out a few of these significant risks, here are some of the details on the responses behind them. Of all the concerns expressed, financial and health-related, the risk of outliving assets received the lowest major concern responses and also had the highest percentage of not-a-concern responses among both polling bases. We saw with annuitants who had chosen annuitization that they were concerned with longevity risk, and this is the education gap. This is simply talking about people who have not chosen to annuitize. This is the target audience. They're not concerned about it because I don't believe they realize the risk. The risk of outliving assets is either a minor concern or not a concern at all for 80 percent of active workers, and retirees are even less concerned.

Many factors influence the need for postretirement income, including the availability and affordability of postretirement health care. The number of employers that are sponsoring postretirement health benefits has declined steadily over recent years. This is the number of employers offering it. It does not speak to the breadth and the scope of benefits, which have also been declining. The real dollars of coverage have been decreasing even more dramatically for retirees.

Here are some of the financial risks consumers will have: the risk of loss principle and exposure to market downturns. We saw this in responses from active workers. Interest-rate risk and a shrinking investment horizon as they reach retirement are also concerns. They have fewer years to recover if something bad happens to them and their investments. Also of concern are tax increases, inflation and public policy risk. The common theme among these concerns is the protection of capital, that nest egg that may represent a lifetime of work and accumulation. Although many may express a concern for their accumulated wealth, it may be based on an assumed cause-and-effect relationship, and this is a hurdle to the immediate annuity sale. Most people assume I have wealth, therefore I have income, and they can rationally assent to the fact that you can take that wealth and buy a guaranteed stream of income, and yet it's a psychological hurdle. It's difficult to pass that on; it's emotional.

Payout annuities offer guaranteed income that does not rely on the annuitant's currently held wealth. The safety associated with insurers' investments may be much greater than anything individuals are able to duplicate. In regard to interest-rate risk, which would be one of their concerns, people who are trying to invest and create their own stream of income could be suffering a double whammy. Consider the instance where inflation and interest rates head up. They're already getting hurt by inflation and a reduction in their real spendable income, but to the extent that they hold fixed-income securities as part of that income-producing asset base, their market values are declining and going the other way. They're getting double whammied. Even if they don't choose an annuitization option that includes a cost-of-living adjustment, they still are suffering only one-half of that equation if they go with a SPIA.

Here's some detail on some of the designs. Among retirees the No. 1 concern is increasing taxes, and a close No. 2 is inflation. This is one of the unsung benefits of a payout annuity in that the exclusion ratio at least locks in the taxable amount of each payment and helps smooth that income. Among preretirees the largest concern was a downturn in the equity markets, and this may be reflective of people's inability to refocus their investment portfolios as they near retirement. It's probably more indicative of their shrinking horizon as they see the time for recovery growing shorter. The concern underscores the potential for both fixed and variable payout annuities because of the polarized feelings about the risk.

What are the "avoid" components from a consumer? Why is this so difficult? It seems like this is a good idea. Much of it is psychological. Turning over that nest egg is difficult to do. There are concerns about liquidity. There are concerns about loss of control. What happens if I need that money? At least if I have it in an account, it's there in an emergency. There's the risk of losing it all at death; people are a little suspicious of something that would be a life-contingent-only payout. What happens if I get hit by a bus next week? Do I lose the whole thing? That's makes a difficult sale, but there are answers to those questions. We've seen concern over lower interest rates in recent years. In spite of the growth in the SPIA market, it's been in the face of some low interest rates, and people are not as inclined to lock in those low interest rates. They don't want to lock in the payouts that result from calculating them in low interest rates for the rest of their life. Many of these people remember well the late 1970s and the interest rates that were common at that time.

Consumers don't want to commit to that lifetime. I'll have to thank Kent Scheiwe for this illustration (Abels Slide 1, page 16). It appeared in a *National Underwriter* article that was published recently. Does the impact of interest rates have a marked impact on the payout? Absolutely. Using a consistent set of assumptions, I believe there was a 65-year-old, $100,000 of premium, a 5 percent load, and the Annuity 2000 Valuation Table, simply moving the interest rate from 5.5 percent to 8.5 percent made a 26 percent difference in the payout. If you think of that in terms of accumulated assets, as the consumer is likely to do, that means if interest rates were 3 percent higher, to make up for higher interest rates the consumer would have to have accumulated 26 percent more wealth during his working lifetime. Yes, it is a big factor.

There are some answers to help address these concerns, of course. This was for a 65-year-old. The impact of interest is greater for younger ages and lesser for older where mortality becomes a larger factor in the total payout calculation. Does the consumer appetite appreciate the role of mortality in the price of the payout stream? I don't think they do. Because I don't believe consumers appreciate the full cost of longevity risk, they do not fully appreciate the guarantees that are provided in these contracts. That's part of the education we face. As I was preparing for this, I found some life expectancy surveys where people should be able to pin down their expected lifetime fairly well. I took a couple of online surveys that were designed to give you your life expectancy. In case you're interested, I'll be here until I'm 89. That was a U.S.-based survey. I found a second survey from the U.K. that asked a different set of questions and pegged my expectation of life at 94. Provided I do make it to 89, I may be forced to relocate. That information is available at consumers' fingertips, and yet in spite of all the fairly scientific and fairly detailed information (one of the surveys was almost three pages of information you had to fill in), they are still way off-base in guessing how long they may live.

Abels Slide 3, page 16 shows perceptions of longevity risk, and this is a different presentation of data we saw before. You see the tail of chronic worriers there at the end. But a major concern, guaranteed income helps that.

I like this graph (Abels Slide 1, page 17). It looks at, in absolute differences, the difference between what respondents thought their expected lifetime should be and what the Annuity 2000 Table, which is a common basis for pricing, would say their expected lifetime is. Here are a few takeaways from this display. First, the male gender tends to be hopelessly optimistic. I'm sure that it has nothing to do with our higher auto premiums and higher rates of accidental death, but the other difference is between retirees and those actively working, especially among females. If you look at the differences between those actively working and retirees (these are in absolute years), you would expect that someone who is retired is estimating fewer total years. On a percentage basis they've really missed the mark.

This becomes important because in the consumers' thinking, as they're sitting down and contemplating the idea of an annuitization, the purchase of an immediate annuity, they are probably going to go through a calculation that goes something like this: "I expect to live to be age 85. I've just been told that x dollars buys y dollars of payout." They'll take that payout out to age 85, solve for the interest rate and say, "I don't like that." And then you get into discussions that everyone has to have his profit. There is commission on this. It centers around interest rates when the real difference may be a lack of appreciation for how long they may live, and that's without even considering the already complicating factor that when you're buying insurance, in this case longevity insurance, you're not talking about the mean or the median of the distribution. You're covering the tail of the risk, and that compounds the problem. It is a difficult sale.

The producer view is the second player in this sale. The appeal for the producer is that many times it's used as a funding vehicle. It also allows, in some cases, for the producer to make two sales instead of one. If someone has enough money for a prefunded life insurance policy or long-term care, why just put that into a long-term-care policy? He can sell them two products and prefund it with a SPIA. Buy a SPIA. Let the payouts pay for the premiums on the other product. It can be used as a financial planning or an estate planning tool. It continues the client relationship. There is some debate among producers about that, and I'll share some data here in just a second.

The avoid is that historically the commissions on this type of business have been fairly low. In my own competitive research I've noticed just in the past few years they have continued to decline, partially because of interest rates, narrower margins, and they're fairly low when you compare them to the commissions that are available on many deferred annuities. Not only that, but there's probably less education involved in a deferred annuity sale, and that's an easier sale for the producer. Why would producers go out of their way to earn lower commissions on a sale that requires more education? That's one of the challenges we face. Loss of asset control is another challenge, as well as no future commission stream. The producer, just like the consumer, may not appreciate fully the risk of outliving assets. There's certainly a greater fear of death than a fear of life. There's also the consumer education aspect.

These are some of the data that refute the idea that the client relationship is lost at point of sale. Even among those who have lower household asset brackets, almost half of those with household assets under $25,000 still bought additional insurance products after choosing to annuitize or to buy an immediate annuity. Those percentages are much higher for those with higher household assets. This is not the end of the client relationship. Another view of this is the last contact. When asked about their last contact with a sales representative, annuitants said that two out of five had contact within the last year, and almost three out of five had contact within the past two years. The client relationship is not lost. This is a perception that I do not believe is true and one that we have to overcome.

The third player in the SPIA sale is the manufacturer. Most of us are here representing that viewpoint. There is some appeal. It locks in a relationship with a client. There is a high consumer satisfaction rating. That's a mortality hedge. If my company is writing life insurance, I am already taking one-half of that bet. A couple years ago as part of the Nebraska Actuaries Club, I invited in a speaker from the Centers for Disease Control (CDC), who spoke on the issue of pandemics. The CDC is concerned about the possibility of another influenza outbreak. Whether it would be on the magnitude of the 1917 outbreak is another issue, but it could certainly alter the general mortality in population. If I'm a life insurer, I have already taken one-half of that bet. I think there's been general concern also about the possibility of an influenza outbreak simply with the shortages of vaccine, as we all saw last winter.

Abels Slide 3, page 19 shows the consumer satisfaction. This is unbelievable. In today's environment of consumer relationship management and relationships marketing, if you combine the extremely satisfied sector with the somewhat satisfied sector, you come up with a 95 percent approval rating. That's unheard of. I don't get this kind of approval rating from my kids. To put this in perspective, according to the Gallup organization the highest presidential approval rating ever measured was 90 percent. That was shortly after the 9/11 attacks, for George W. Bush. I assert to you that this is a more stable and less fickle constituency in light of last month's 45 percent presidential approval rating. This is a big win for insurance companies and, in light of those future product purchases, an opportunity to sell to a ready audience.

We asked a specific question of the annuitants: How can we better serve your needs? Better than two out of five couldn't come with anything. Try that question on your significant other sometime. I guarantee you if we as a group did, we would get more than a 60 percent response rating for suggestion, wouldn't we? This is a happy group. Only 4 percent expressed any buyer's remorse over the decision to annuitize. That is big. Most car companies would love that kind of buyer's remorse—for anyone selling anything, that is unbelievably low. In spite of all the hurdles at the sale point in the consumer's mind, those who have chosen to annuitize seem to be happy about it and show few regrets.

I would not be fair if I did not paint a picture of the risks that are involved for the manufacturer, as well. All is not sun and roses for payout annuities, and there are some significant risks for the manufacturer. There is the perception, real and perceived, of historically low profits, narrow margins, and it depends a lot on how you choose to measure profits, but there's also the interplay because you're talking about a single premium product. You set up a high reserve at the beginning as the interest rate that you must assume in your reserve calculation, and it plays heavily into the profit measurement. There are also the cost and risk of providing financial guarantees, longevity risk and concern over mortality improvement. There's the additional issue of cash-flow testing. If you think of deferred annuities, we are concerned with things like duration and convexity, and, if you think about it, we are talking about the timing of a one-time event, the surrender of that policy. With an immediate annuity you have a set pattern of payments, and cash-flow matching becomes a bigger deal. Some companies may not have the history or the expertise and may not be used to thinking in terms of cash-flow matching, but that's what's required.

There are two basic viewpoints about mortality improvement without a spouse in either one. I will probably share my personal opinion, but the first viewpoint would say the longevity is poised to increase. We might call this the mortality reduction paradigm. One of the most outspoken proponents of this viewpoint is Dr. Aubrey de Grey of Cambridge University. He is a geneticist and head of the Strategies for Engineered Negligible Senescence (SENS) product to prevent and cure aging. He also runs the Methuselah House for Rodents. They're looking at how they can extend the lives of mice and rats and then extrapolate that into humans. Dr. de Grey has told the BBC News that he believes the first people to live to be 1,000 could be 60 years old today. Usually those who are from this viewpoint point to genetic research. They say that if we had a breakthrough, we could repair DNA that is destroyed over time, and people could live to be thousands of years old.

The other viewpoint is that mortality improvements are likely to slow down. We might call this the limited lifespan paradigm. The most outspoken proponent of this view is Dr. Jay Olshansky of the University of Illinois at Chicago. He is a researcher in the new field of biodemography, which studies human longevity. He says the claims that humans will some day have a life expectancy of 120 or 150 years are ludicrous, and those who have this viewpoint would say that as different cures are found, as different causes of death are removed, they simply uncover the underlying cause of death, and that's aging.

There was an interesting study that was done in 2000 that looked at mortality in the Netherlands, and it was published in the *International Journal of Epidemiology*. I thought the results were interesting because the Netherlands, which is not a Third World country by any stretch of the imagination—they have access to modern medicine and similar lifestyles to what we have here—has seen a decline in the expected lifetime for males and a significant decrease in the improvements for females. As this research dug into the causes for this, what they found was that mortality was still improving for younger ages, but it was going backwards at older ages, and this is consistent with the second viewpoint that, as mortality improvements are made, they may be made at younger ages, but it may produce a more fragile aging population. You may have more people living to older ages, but the mortality expectations at those older ages may go backward.

Are you familiar with Jeanne Calment? She was the oldest documented living human being in France who died at the age of 122.45 in 1997. I think that plays into people's thinking, and is not a legitimate take on the facts. People will point to things like that and say, "Can't you see expected lifetimes are getting longer?" But you and I know from working with distributions of data you cannot point to the outliers and draw conclusions about the median or the average, can you? Life expectancy is exactly that. It is the median of the distribution. That's not a legitimate conclusion to draw.

What is the impact of the mortality improvement on payouts? Thanks again to Kent Scheiwe for Abels Slide 1, page 21. This is the second of two illustrations I borrowed from his article. There is not much of an impact. This is a concern that looms large in the minds of the consumer. This takes the same example that was used before. Instead of using the straight Annuity 2000 Valuation Table, the Scale G improvements have been applied. This is for a 65-year-old. The annual improvement that's implied here is between 1.2 percent and 1.4 percent annually. You can see that it makes little difference. It's less than a 4 percent difference in payout if you apply that scale in all years for a 65-year-old. There is a caveat again: The impact of mortality improvement is stronger for younger ages, making this a bigger risk factor at younger ages, less at older ages.

There are a few other concerns for insurers, including SPIA life combinations, especially those who may write products that would be purchased with an immediate annuity. Of particular concern is a universal life (UL) with secondary guarantees and long-term-care insurance, two insurance products that are greatly impacted by the realization of lapse rates. The use of SPIAs as a funding vehicle for a lapse in sensitive products is another concern. Antiselection is a concern. Much of the market for immediate annuities is buying immediate annuities off the shelf. Only in impaired risk cases is there any underwriting done. We open ourselves up as a result to antiselection. Underwriting inconsistency is an important point, because if you think about the underwriting of life insurance, we, as actuaries, think of higher mortality—well, it's a scaler—because the timing of death is uncertain, and so we think in those terms when we're underwriting for life insurance and are not underwriting for high mortality.

We're underwriting for early mortality. It's a single event that we are concerned with, just as longevity is also a single event, and I don't believe it is a legitimate assumption to say that the indicators of early mortality are necessarily the flip side of the indicators for longevity. If the underwriting expertise that we possess as companies does not understand that, we could be making some mistakes we'll pay for in the future. I've only heard rumors that there were a couple of companies pricing the impaired SPIAs using a life underwriting guide with slight modifications. I do not recommend that. If you are at a company that is writing impaired-risk SPIAs and are uncertain what your underwriters are using, I suggest you make a call during the next break because it is a crucial part of underwriting to understand what indicates longevity.

Next I'll discuss new designs in the market and go through these fairly quickly and not in a lot of detail. We've talked about the concerns that the producers have and talked about consumers. There are a number of features that are new to the market or even in the idea stage that are designed to address some of these concerns. One is accessibility to an account value. It may not be a true account value; it may be nothing more than a commitment to pay out the commuted value on certain circumstances. Those circumstances may be demonstration of good health, specific policy years for the exercise of that option, significant nonmedical financial emergencies, terminal illness or nursing home stays. Event-dependent payout features can be sold as riders where, for example, if you are admitted into a registered nursing home, there may be a rider that kicks in an additional payout amount for a certain period of time. Those can be used to address some of the emergency cash-flow concerns the consumer has and to help make the sale.

Features to increase payouts include a set percent per year and the CPI. Some of these apply more to VIAs than they do to fixed. Specifically for variable immediates, a number of the features that we were seeing in the deferred variable annuity market will begin to leak over into the immediate variable annuity. Ratchets, resets and guarantees are things that the market will demand, especially if we see a rally in the equity markets, and the share of the total SPIA market begins to lean a little more toward variable products.

One of the producers' concerns is compensation. It's hard to know what will happen in the future. Declining interest rates have forced reductions in commissions in some cases. However, what if interest rates rise? It will be interesting to see how the market responds. Payout-based commissions and trail commissions are unusual right now but may help address producers' concerns over losing that client relationship, a relationship that in many cases they worked years to cultivate. It is a legitimate concern on their part. Asset-based commissions would possibly be designed more for the distributions that are accustomed to asset or in wealth management. It could be based on the initial premium. It could be based on the initial premium less payouts received. It's an overwrite on the assets remaining, figured that way.

Dollar cost averaging (DCA) is a concept that most people are familiar with for getting in and out of the stock market. Rather than take a gamble on the timing of getting in and out, they can leak dollars in in a regimented fashion to invest over time and not be subject to the timing risk. This can be used for interest-rate risk as well. We have a potential consumer block that is probably concerned about low levels of interest rates right now. A sales methodology could be, instead of purchasing a large SPIA, why not purchase a series of smaller SPIAs and go into that market over time? That's a DCA idea. Insure the tail. We've heard some discussion recently on longevity insurance. There are some bills before Congress that may permit this to become more common, but I wouldn't expect anything immediately. The ACLI is doing a good job of watching these.

New designs may include built-in flexibility, liquidity and inflation. There are guaranteed minimum income and withdrawal benefits.

What are the takeaways? What are the conclusions as we look at this market and look at the players? The potential market is large, huge, in fact, but the risks are significant, and there are also large educational hurdles for the consumer and for the producer. We have to use creativity in addressing those concerns, and it is going to require some educational efforts from the insurers. SPIAs are currently underutilized in retirement planning, and our success in penetrating the potential market is highly dependent on penetrating those new distributions, the people whom the consumers are turning to to plan their retirement.

MR. MICHAEL J. LEBOEUF: That was a great presentation by Steve. He gave us a lot of great background, a lot of information on a potentially huge market. The focus of my comments is going be on areas where in our practice we've been observing nontraditional uses of immediate annuities and nonindividual purchasers.

The first area I want to talk about is funding for policies that have been purchased under life settlement arrangements, and then I want to look at funding on individual policies. Individual policies are newly issued life insurance policies. Some of these are single purchases by a trust or with a trustee. The other area I want to talk about is SPIA purchases being used for financing blocks of life policies owned for charitable organizations or charitable-owned life insurance (ChOLI), but it certainly has other names which you may or may not be familiar with.

Let's first talk about life settlements. My comments today will have nothing to do with whether or not life settlements are a good thing or whether or not they're harmful to life insurance companies. The fact is they do exist. What are their typical characteristics? They're looking for individuals who are 70 or older. They're looking for some level of health impairment, underwriting life expectancies that range anywhere from two to 15 years, and they're also wanting to target life insurance contracts that are underfunded. Most of the time you find those in UL and variable UL. If they have flexibility with secondary guarantees like shadow account products, they are aware of those and know how to take advantage of them. The last thing that was made clear to me at one point was that these better not be in lapse-pending status. Life settlement companies don't like to take over problem children.

Why would a life settlement company purchase a SPIA? When you're a life settlement company, you're using investor money and trying to capture a cash flow on or about life expectancy of seven years. You have a big concern about longevity risk. If this policy is going beyond seven years, you have to keep funding it. You have to keep finding funds to keep funding it. SPIA makes good sense for a life settlement company. Anecdotally, about two years ago there was a large block, $70 million of approximate total face amount, that was securitized, and Moody's rated this transaction. It was securitized in two blocks. There were Class A notes and Baa2 notes by Moody's. Moody's specifically noted in the transaction, in terms of its assigning the credit ratings, the credit quality of the annuity providers. Moody's felt it was important. Merrill Lynch, which had a large part in putting together this particular transaction, thought it was a huge part. It had longevity reinsurance coverage by one of the areas of Lloyds of London and felt that the SPIA purchases provided more protection than the Lloyds coverage.

The question I've gotten from a few life settlement providers is, If we buy SPIAs to back up the policies we're buying, is that going to cause an issue with the insurance companies that we're buying the SPIAs from? Talking with some of the insurance companies that have done this, they like the business they've been able to pick up in the life settlement because that's the reason why we have SPIAs. It's to hedge the longevity risk. They don't feel that anybody's taking advantage of them, although I do want to note that if you are underwriting your immediate annuities and trying to get into the substandard immediate annuity market, life settlement companies are looking for companies like that because you provide a better price for them, which gives them an opportunity to improve returns to investors or it frees up more funds to provide a more competitive quote in purchasing that insurance policy. If you want to get into this market, there are plenty of life settlement companies out there that will be looking for you.

Next I'll discuss SPIAs funding individual life policies. Individual trust purpose is something we stumbled on a couple of years ago. In our firm we were approached on a particular case, and we were asked to take a look at it because the trustees said, "We think we have some level of arbitrage going on here, and we'd like you to investigate it. We took a look at it. The parameters of this case, as well as other similar cases were the trustee is purchasing a life insurance policy and wants to find the most efficient way to fund it. It's definitely targeting secondary guarantee ULs. It wants to have a fixed cost to the life insurance policy and is always looking for the lowest possible cost. It likes the shadow account structures because they have a lot of flexibility in how they're funded, and generally these are being put in place for some final estate planning needs for some older individuals.

What do we have here? This is a little bit unlike the life settlement situations. The life contract does not have to be on an impaired individual, although in one case we looked at, there was some impairment on the individual. We found that there could have been some potential benefit here, but that was more so on the life side because we did have an underlying suspicion that the life policy being purchased was part of a table-shaving program. I think there's been a reduction on table-shaving programs, but this is from a couple of years ago. Those were still going pretty strong.

I wanted to take a look at the mortality arbitrage. LeBoeuf Slide 9 has a graph that depicts a 78-year-old male. It happened to be rated standard by the life company. Again this was possibly due to a table-shaving program. The annuity company issued the immediate annuity coverage and rated the individual as an 81 year old. This is a graph of the Annuity 2000 Table for the annuity pricing, and what we use for the life pricing is a function of the '75-'80 Table reflecting a standard risk for pricing on a 78 year old. It's roughly between 40 percent and 50 percent of the '75-'80 table, which at the time was in line with what companies were either pricing into their products or what they were getting in the open market for their reinsurance quotes. The graph there, which the client was able to look at, clearly showed there was a large difference in the mortality levels being priced in there.

One thing to take away from that is that's just the mortality. The life policy also has a lapse component that's not reflected on that graph, and that may be another source of the arbitrage going on in here. After we completed that, the client's first question was, Which company is correct on the mortality assumption? I guess it asked that because it assumed I had a crystal ball and could tell. It assumed I'm an actuary. I have a secret handshake and a password, and I know when everybody is going to die, which is true, but I couldn't let them know that for sure.

We concluded that if you place a high value on a life underwriting process, it would appear the life company is better-positioned, although the existence of any table-shaving programs obscures that view. We always thought the better question was, Which company will think better of this transaction and will profit? This is essentially a transaction that's not going to lapse, and, again, that was a bit muddy because it was a secondary guarantee UL product, and there is an element of lapse support in that. We don't know the actual pricing that was underlying that product, so we wouldn't know to what level the life company was being impacted.

The second area of what I want to get into is ChOLI. In some areas it is marketed as life insurance and life annuity-based certificates (LILACs) to investors, and the other thing it's known as is investor-owned life insurance. Those names all mean the same thing. We have a group of investors who are looking to make some good returns for themselves. How do they work? They're similar to the individual trust sales, but we're working on a much larger scale because the original goal is to raise money for a charity—that's the big purpose here—and we'll see a graph later that shows how well the charity does on this. What's happening is the investors are going put up money to purchase the policies. They're either going to borrow funds or have the charity borrow funds, and they're going to purchase life insurance contracts and immediate annuities. The SPIAs being purchased are typically being purchased to fund these policies, which are going be targeting secondary guarantee UL policies again. They're going to buy SPIAs that fund more than the premium.

The purpose of funding more than the premium is that if you have a loan, you're going to have to pay off your loan interest, and if you don't have a loan, you're paying a coupon to the investors. The investors are essentially looking at a LILAC opportunity as buying a bond with a yet-to-be-determined maturity date, which is determined by insured debt, but in the meantime they're going to get a coupon, and those coupon rates, at least on some of the transactions that were done in the past couple of years, range from 8 percent to 10 percent, which is a phenomenal return given the marketplace that they were being placed in. There weren't a lot of bonds you could buy at that level that you would rate highly because these were not being purchased. The life and annuity contracts weren't being purchased at the fly-by-night companies. They were targeting large, stable writers of coverage. The projected policy proceeds will be used to retire the loan or pay the investors, and the important thing is only a small residual amount tends to go to the charity.

LeBoeuf Slide 13 shows a graph that I found in a publication. It is supposed to represent something that was represented to Congress on a LILAC deal that was put together, and roughly on a little bit more than $2 billion of total face amount, the charity was going to get only $30 million. The donors, their beneficiaries in the arrangement, were getting about $50 million. About $2 billion was being targeted to go to the investors. This is something that Congress did see, and it's acting on it in a couple of different ways. Even in that $2 billion transaction with $30 million going to the charity, that looks like a good deal to the charity because it didn't have $30 million last week that it was planning on.

If you have a program that's funded via loans, all too often the charity may end up taking final responsibility for the repayment of the loan. That puts them at risk, because the loan is going be repaid in part by the cash flow from the death benefits. If the death benefits fall below the projections, the charity could have some trouble because the annuity payments that it's getting will not be sufficient to make the loan repayments as it's been planned, and there have been several cases where charities have been duped into projections with overly optimistic mortality projections. They were given the idea that people would die at a rate somewhat close to 1980 CSO mortality, and these are fully underwritten life insurance contracts. This was not a guaranteed issue program.

The other big problem that a charity has is if a program benefits private interest instead of charity, the IRS could easily take away the tax-exempt status of the charity. The charity, whether it knows it or not, could be at tremendous risk. Washington, D.C. has been made aware of it. Various coalitions, including the ACLI and Association of Advanced Life Underwriting (AALU), are against what's going on with ChOLI because it's primarily benefiting the investors. The initial response from Washington, D.C., and one of the big reasons for the response, was state-insurable interest laws are being liberalized in a number of states giving the ability to issue these contracts in different jurisdictions greater and greater potential. The original LILAC transactions were issued in the state of Tennessee, but since then there have been a few other states that jumped onboard and said, "This doesn't violate our insurable interest rules because investors are going to benefit, as long as there's a charity involved in some small way." Other states have responded the opposite way. I believe Nebraska went one way and flipped back the other way, didn't it?

FROM THE FLOOR: Yes.

MR. LEBOEUF: Yes, first it allowed it and then realized what it did and went back, thankfully. The original bill introduced in Congress was it would want to apply a 25 percent excise tax effective on any contracts entered after February 7, 2005, again because of the concern that the investors are the only ones making out in this arrangement. There are always exceptions to this excise tax, and it's more focused on legitimate reasons for ChOLI or legitimate reasons why someone other than the charity happens to be involved in this transaction.

More recently this bill came out of the House, I believe. Just a couple of weeks ago there was another bill that came out of the Senate that, instead of waiting for maturity to tax the investor, wants to tax the investors at the time of the investment. It's going tax them at a rate of 100 percent of the value of their investment, doubling the cost of the investment. Particularly for leverage types of transactions, that effectively kills the transactions. The margins are so thin that that would kill the transactions. Interestingly enough, I have talked to some people after the February 7 date, and they were going ahead with another similar type of LILAC transaction. I did make them aware that this law did have a provision saying any transaction entered into after February 7, 2005. Their response was that Congress does that all the time, and when they get to a final law they're just going to change the date, at which point I told them they better talk to a tax attorney because in my experience, particularly with respect to life insurance, don't count on that being the case. There was a reason why Congress put that date into the bill, and it was because it was unhappy with what was going on in this area of the industry. But I'm not an attorney, and I don't pretend to play one.

Are there any issues for annuity companies in ChOLI? They're generally the same issues that exist for the individual trust relying on any type of mortality arbitrage still exist. No one in terms of the action in Washington, D.C., that I'm aware of, is concerned that annuity companies are issuing immediate annuities on these transactions. There wasn't anything in the bills that was designed to penalize insurance companies for participating because Congress realized, and the ACLI is a large group behind this bill, that it wasn't one company that's putting together a life-end annuity. They're going out to separate organizations.

The other thing to worry about is billions of dollars of new sales is sexy to some marketing people, and these types of transactions could have the potential to create conflict between marketing and some financial concerns that the company has. Those always exist, and they exist here but perhaps to a larger scale because we are talking about some large dollar amounts.

FROM THE FLOOR: Where does the guarantee fund stand on all these payouts? My wife is getting near retirement, so I'm thinking about it for her. What's the risk there? You hear about a lot of insolvencies today. What's the risk of not getting your money because a company becomes insolvent? We do offer guarantees. What's the backup on those guarantees?

MR. ABELS: I'll try to summarize that question. Basically the question was what sort of guarantees are in place if a company does back away from its pension obligations and is allowed to do so through bankruptcy, for example. We talked about the United Airlines example. In that case the percentage of the payout that a retiree might receive has to do with age and the level that was guaranteed under United Airlines.

FROM THE FLOOR: But that's though the pension guarantee fund. I'm talking about the life guarantee funds.

MR. ABELS: Certainly they'd be at risk. If I'm reading the question correctly, United Airlines was not forgiven the entire amount. In fact the entire amount of its obligation was closer to $10 billion. It's forgiven only a portion of that debt. I think it may remain to be seen. I'm not aware of the details there, if there will be additional funds above the PBGC payouts. Is that what your question is?

FROM THE FLOOR: The question I'm asking is if a life company goes down, not a company ...

MR. ABELS: Someone buys an individual SPIA—what are the guarantees?

FROM THE FLOOR: Right.

MR. ABELS: Yes, there is risk there.

FROM THE FLOOR: But what do the guarantee funds provide in terms of benefit? They will pick up life insurance?

MR. ABELS: Yes.

FROM THE FLOOR: But I don't have any clue as to what they're doing with regard to SPIAs.

MR. ABELS: You want to know the bar so you can purchase just below the bar?

FROM THE FLOOR: Yes, I have to protect my wife somehow, but I have another observation. What I see lately is that the financial press (not the financial planners, but like Clements in the *Wall Street Journal*) is pushing annuities. The other interesting thing is a lot of politicians are pushing them because I assume they want to get the risk off of them. When all of these pension companies or companies providing pensions go down, and Social Security doesn't do it, if people are buying annuities, they'll be covered by insurance companies. It gets them off the hook for having to provide for all the people who are not planning for retirement. However, you still don't see any excitement at people buying this stuff for some of the reasons that you indicated, but everybody else wants them to buy it. That's an interesting consideration.

MR. ABELS: It's definitely a rational purchase and not an emotional one. I think that may be the difference.

MR. CHARLES E. RITZKE: I have a couple of questions, and if there's not enough time, you can pick the one that has the most interesting answer. The first question is on taxes. I remember reading a few months ago about some proposal to tax payout annuities at half the rate, and I was wondering if you've been following that, how likely that is and what kind of impact that might have on sales. The second area is about surplus strain. It seems that for every market you look into, at least on the life insurance side, a big concern always is whether there are surplus strain issues with the immediate annuity side. The third issue is on reinsurance, whether reinsurers are getting involved with this and what kind of reinsurance products and coverages might be available.

MR. LEBOEUF: In terms of the tax issue, I'm unaware what's currently going on in D.C. What's the industry group that would be pushing this?

FROM THE FLOOR: ACLI?

MR. LEBOEUF: Maybe ACLI, but I was thinking the National Association of Variable Annuities (NAVA) is probably pushing for that more than anybody.

MR. ABELS: Reinsurance has not been common in this market. With the growth in the market that I expect, I would expect supply and demand to start supplying that. We are seeing some securitization, more overseas, not in the United States so much. The life settlement issues that Mike was talking about are a securitized deal, so it's not a foreign concept. Whether it's privately securitized or reinsured outright by a reinsurer, I think that's probably something to come but not widely available today.

MR. RITZKE: My last question was about surplus strain and whether there are major surplus strain issues with payout annuities.

MR. ABELS: It's just one of the risks that a company has to manage. As with any line of business, you are talking about something that does have significant reserves at the beginning. If it's a profitable block, it allows you to invest a lot of capital into it, but it does put more pressure on how profitable that block is, and that gets to some of the profitability concerns I talked about.

FROM THE FLOOR: It looks like over the past 12 months several players have intensified their efforts to penetrate the market. Nationwide created a separate retirement segment, and Lincoln is focusing more on annuitization riders. Yet there is no evidence at all that the market is growing at any rate that was forecasted four or five years ago. Given that the interest rates are still around 4 percent a year, and that the commissions on these products are low, as you said, compared to the deferred annuities, is there any recent change at all that you can point to that could give us a hint that this market is going to accelerate the growth in 2005 or 2006? In other words, while this market will become more attractive now, why won't this opportunity be realized by the purchasers of the annuities now?

MR. LEBOEUF: I think you have to go back to your graphs.

MR. ABELS: Yes. I would point to demographic pressures and some of the baby boomers that are coming in. Even if you have the same penetration rate, I think that market is growing, and so you would see the net market. Also if you look at the sales, over the past few years, sales did tabletop. From 2002 to 2003 they were relatively flat in spite of some significant growth the previous years. Looking at the growth in the market in the future, it comes down to pointing to the factors that might produce that growth and waiting for them to kick in. You're right. Consumer education remains a good-sized hurdle.

FROM THE FLOOR: Do you think companies are changing commission structures?

MR. ABELS: It's probably in the cards. It goes back to jockeying for position in the market. We saw from the slides that there's more parity in the market, and I think companies will begin to try to distinguish themselves.

MR. DAVID BEARD: For funds from single premium deferred annuities that are annuitized within the company through settlement options, do you have idea what percentage of companies pay a commission on that event versus the companies that don't pay a commission?

MR. ABELS: No, I don't, and if I knew, obviously I couldn't share details anyway, but I think it's something that each company will have to address especially if it has sizable blocks in deferred annuities. As I pointed out, the annuitization rates in the industry for 2003 did jump in spite of interest rates going down, and I think that internal marketing was one of the reasons.