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Fixed Annuities and the Small Company

by Eric Sondergeld

Rapid Sales Growth

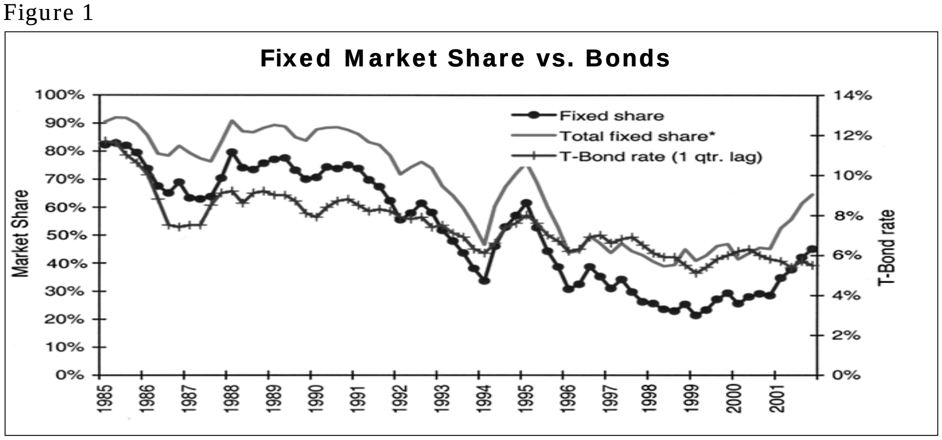
After a decade of relatively flat sales results, fixed annuity sales have grown rapidly in recent years. Bottoming out in 1998 at $32 billion—the lowest level since 1987—sales of fixed annuities grew 40 percent reaching a third consecutive annual record of $103.8 billion last year. While variable annuities have received the lion's share of sales in recent years, sales of fixed annuities actually caught variable annuity sales in the second quarter of 2002. The last time fixed annuity sales surpassed variable annuity sales for a single quarter was five years ago. The last time fixed annuity sales surpassed variable annuity sales for a full year was ten years ago (and before that, fixed annuities were always the dominant product).

During the 1990s, interest rates continued their long-term decline while the stock market posted record gains. As a result, the appetite for equities-based investment products also rose. Many of the leading writers of fixed annuities shifted their attention to variable products, emphasizing existing products or entering the variable annuity marketplace for the first time. Their ability to shift back to fixed annuities in economies like the current one coupled with many large insurers merging has helped the market share of each year's top 20 fixed writers (based on sales) grow from 55 percent in 1998 to 73 percent in 2001.

What's driving sales?

Historically, it was relatively easy to explain fixed and variable market share by looking at interest rates and stock prices (See Figure 1). As interest rates rose (fell), fixed annuity market share generally increased (decreased). Well, interest rates have been falling or remaining about the same. Yet, fixed annuity market share has increased rapidly. Another general rule that has been broken lately is the tendency for interest rates and stock prices to move inversely with one another. But stock prices have also been falling. So, instead of determining what is more attractive, investors are trying to figure out what's the least unattractive option. In the current environment a guaranteed, albeit relatively low, positive rate of return may hold more appeal than a negative return (e.g., in the stock market). In such times of uncertainty, more and more investors are seeking guarantees.

Figure 1



The guarantees that seem most popular today are longer guarantees. Here, longer means more than one year. Most new fixed annuity product development today involves some type of longer interest guarantee. One indicator of the popularity of longer guarantees is the rapid growth of market value adjusted annuities (MVAs) which grew at a 72 percent annual rate from their 1998 level of $2.4 billion to $21.2 billion last year.

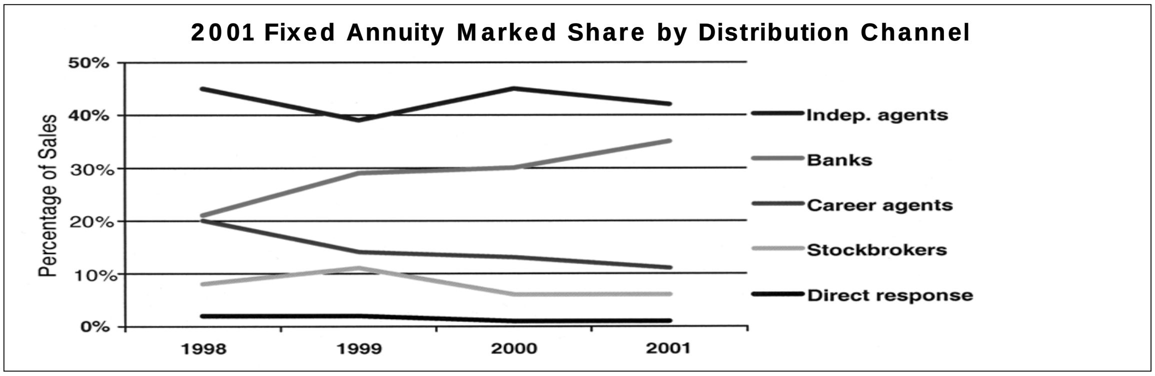
The small-company experience

The fact that the market share of the top 20 fixed writers has increased lately does not signal a decline for the small company. Quite the contrary. Lacking a true definition of "small," I examined the sales results for 51 companies with fixed annuity sales under $100 million in 1998. In the three years that followed, these companies' sales grew at an annual rate of 34 percent, two points ahead of the industry. Eight of them sold more than $100 million in 2001, including one whose 2001 fixed sales topped $1.4 billion.

Illinois Mutual is one of those eight. Their average annual growth rate over the three years ending 2001 was 130 percent—four times that of the industry. They attribute their success to two factors. First, they created an annuity group in 1996. Prior to that, the annuity line was more of a side product than one the company emphasized. Then, in the spring of 2000, they introduced a competitive CD-type MVA product.

As with variable annuities, many fixed annuity writers have made great strides in expanding their distribution outlets. Chief among these is the bank channel. Historically, independent agents have been the dominant channel for fixed annuities. Bank fixed annuity sales have increased

Figure 2



especially fast lately, and their market share is beginning to rival that of independent agents. Recently, fixed annuity interest rates have been very competitive vis-à-vis bank CDs.

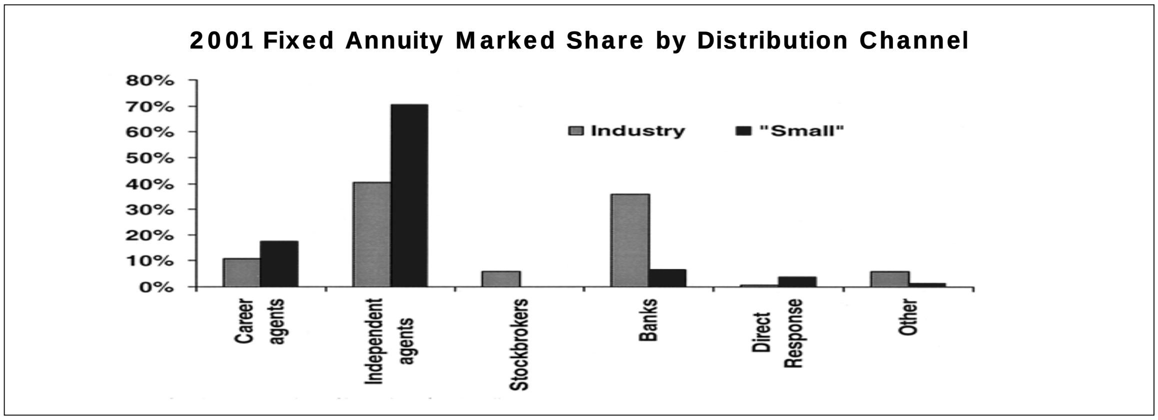
Most "small" companies have not benefited from banks' success since the majority of their sales are through independent agents. While industry-wide, banks represented over one-third of 2001 fixed annuity sales, they represented just seven percent for companies with less than $100 million in sales. However, one "small" company, Savings Bank Life of Connecticut (now VantisLife) has made the bank channel their forte. Their annualized sales growth during the three years ending with 2001 was 71 percent—more than double that of the industry. They are in a unique position, having relationships with banks in Connecticut for 60 years, giving them the luxury of geographic closeness to their customers. As a result, they have become a proven entity and the banks they work with have a comfort level with their wholesaling and administrative operations. They attribute their recent growth to being in the right place at the right time (e.g., the stock market turning sour) with a simple, yet competitive product.

What does today's success mean going forward? The following are questions fixed annuity writers should consider in developing future strategy. Will fixed annuity sales continue their rapid growth? Would today's fixed annuity buyers be investing in variable annuities if the stock market wasn't declining? Will they when the stock market rebounds? What if interest rates increase? What might surrender activity look like if either of these occurs when surrender charges wear off? It helps to make sure people are buying the right product for the right reason. Sitting out a turbulent stock market yet planning to reinvest when things improve is not necessarily a prudent strategy.

Many people assume that if rates are low now they will undoubtedly go (back) up at some point. What would happen if interest rates stay low or continue their decline? Many companies are already concerned about bumping up against minimum guarantees.

The stock market has been a great educator regarding risk. Many people, including many of us industry people, may have gotten a bit complacent regarding equity risk. But as we end a third straight year of negative stock market returns, it is unlikely that even when the market rebounds the industry won't forget about fixed annuities so quickly this time. ●

Figure 3



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