Fixed Annuity Interest Rates Need Fixing

BY DANNY FISHER

Money moves like a river. Although it may "pool" for a while in a savings or investment account, at maturity, the money will move towards higher rates.

Sales of deferred fixed annuities (FAs) come from "new" money applications and exchanges of existing contracts. In 2006, the ratio of "new" money sales to exchange sales was down dramatically from 2001 levels.

In 2001, the average 5-year "CD" type FA rates were higher than the average 5-year certificates of deposit at banks or 5-year Treasury bonds. This is based on data tracked by the *Fisher Annuity Index*.

As shown in the chart, new money FA sales were about 70% of a company's business, and 30% were internal or external exchanges. But new money FA sales fell when banks and Treasury bonds paid higher rates than FAs.

With most insurance companies, then, the trend has been that the mix of new money sales and exchanges starts to invert when interest rates change.

Currently, the ratio of exchanges is much higher than new money sales.

Although total FA sales remain brisk with many insurers, with some posting increased sales, there is more cannibalization going on now than in the past.

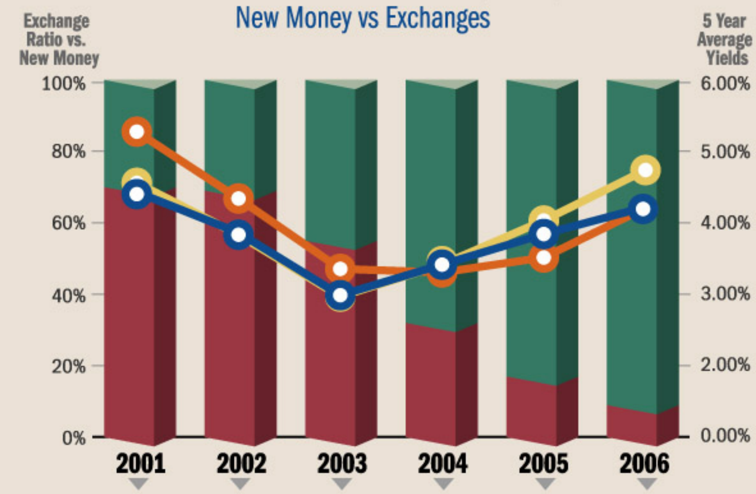
New money sales are down for a number of reasons. Historically, FAs have paid higher rates than banks or Treasury bonds; however, for the past couple of years, it has been the banks and Treasurys that have paid higher rates. And, because "moving" money seeks higher rates, it has naturally flowed to banks and Treasury bonds.

This should clear up any questions about what is the key factor in new FA sales. The key drawing factor is rate.

LISTEN UP

DEFERRED FIXED ANNUITIES

New Money vs Exchanges



	2001	2002	2003	2004	2005	2006
Exchange Ratio	30%	31%	45%	68%	83%	91%
New Money Ratio	70%	69%	55%	32%	17%	9%
5 Yr T Bonds	4.56%	3.83%	2.96%	3.41%	4.03%	4.74%
5 Yr CDs	4.43%	3.86%	2.98%	3.41%	3.84%	4.22%
5 Yr Annuities	5.28%	4.34%	3.35%	3.30%	3.51%	4.21%

Source: Sales data gleaned from several insurance companies by Fisher Annuity Index, Dallas. The data has a general variance of about 5%.

Other factors repel new money sales away from FAs. One is that insurance companies are making it harder for clients to buy FAs and for agents to sell them.

For example, one top rated company requires all these forms: 4-page application, 3-page disclosure form, suitability form, verification of identity form, beneficiary form, and another form if the FA is owned by a trust. And that's just on a new money sale. If the sale involves a transfer from another company, more forms are needed: replacement form, transfer form and any other forms required by the surrendering company.

That's way too many forms. Banks, mutual funds, and the federal government don't require that many forms or that much disclosure.

Another factor is that the insurance industry has not spent enough resources to educate the public about the advantages of annuities. The result is that although industry professionals know that annuities are a great way to accumulate or distribute wealth, the general public knows very little about them.

Additionally, the FA image is being defined by non-industry people. Think about it—when was the last time you read a positive article in the general media about FAs?

Another factor has to do with how the companies handle renewal rates. There were more FAs "on the books" in 2006 than there were in 2001. As those products matured, many insurers dropped the renewal rates to contract minimums. Because money seeks the highest rate, a very high percentage of the matured contracts were exchanged for new contracts with higher rates. This was done through internal and external exchanges.

What's more, in 2006, many people cashed in their FAs, paid the tax and put their money in certificates of deposits at banks and savings and loans. That is something I have never seen before in my 30+ years in the insurance business.

Typically, this money flowed into 1-year CDs that were paying 6% interest. When I asked clients what they were going to do at the end of the year, many took a page from Scarlett O'Hara in Gone With The Wind: "I'll worry about that tomorrow."

The insurance industry had better worry about falling new money FA sales today. The industry has to figure out a way to pay higher rates in its FAs if its wants to recapture market share. Otherwise, it will just keep picking the bones of each other's companies through FA exchanges. NU

Danny Fisher, CLU, ChFC, is founder and principal of The Fisher Agency, Dallas, and publisher of Fisher Annuity Index. His e-mail address is Danny@MrAnnuity.com.