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Consulting Actuaries

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Plan B – Indexed Annuities

As the Securities and Exchange Commission ("SEC") moves to take jurisdiction over indexed annuities through Rule 151A, companies in this market are faced with difficult choices. Although these companies are likely to work to preserve the current state regulation environment, the potential for losing this argument is great. If the SEC moves to adopt the rule later this year, it would become effective in late 2009. One result of this rule is that agents selling indexed annuities would be required to have a securities license. This means a significantly smaller potential distribution channel, likely resulting in significantly reduced sales.

For some of the companies in the indexed annuity market, this is virtually all their new business production. How can these companies move to replace this potential loss of business? The annuity divisions of these companies have much in common

- Primarily marketed through non-securities licensed brokerage channels. These brokers typically specialize in the marketing of annuities to senior citizens
- Most do not have life underwriting capabilities. If necessary, this is typically out-sourced
- Most have electronic application capabilities

The challenge for these companies will be to deliver products which are attractive to the current distribution channels while capitalizing on the company's strengths. To properly evaluate what options are available, a company must first consider the needs that are being met by the current products. The following are a few

- Growth potential for retirement funds, without the risk of losing your entire principal
- Ability to annuitize funds for periodic income, including options for life or joint life
- Liquidity benefits, including long-term care options and preferred partial surrenders
- Estate transfer benefits, effectively transferring funds to the next generation
- Producer needs for compensation

A company's first option would be to make relatively few changes to the products and register the annuities as securities. Agents would be required to have a securities license to market the products. Depending on a company's current distribution, this may result in significantly reduced sales. Also, the company will now find it competing with different life insurance companies, those that have been operating in the variable annuity market for many years. While this may be a viable solution for some companies, it is not likely to be the solution for many.

The second option would be to look at other annuity products currently in the market which meet these needs. Perhaps enhancements of these products could achieve similar results to those of indexed annuities. For example, market-value adjusted annuities ("MVA") deserve another look. Care must be taken, however, to make sure that these designs do not violate the new rule when adopted.

Parse the words of the regulation. This is a strategy full of risk. There are specific clauses in the rule which a company could use to design a product. If this design isn't within the spirit of regulation intended by the SEC, there may be future problems. This time, the SEC chose to exempt policies sold prior to the effective date of the rule. Next time, they may not feel as generous.

Develop other lines of business. For example, the estate transfer need expressed above could be better met by a life insurance product. With an electronic application process, the process of issuing a life insurance product could be as easy as issuing an annuity. With electronic underwriting support, immediate decisions could be made. Also, with appropriate pricing, companies could design products that can be issued to anyone, just like annuities. An added bonus is that these life insurance products can be designed to pay similar or higher commissions than indexed annuities. Bear in mind that the death benefit would be the highlighted variable, not the account value. These death benefits might even be indexed, although be very wary of the above caution about parsing the regulation.

Even if the SEC's proposed Rule 151A does not become effective, it is likely that there are changes coming to indexed annuity regulation. Whether these are changes in state regulations motivated by the SEC's actions or the SEC itself, companies must consider alternatives to their current product offerings. It would be best if these products could be introduced to the market well before such changes become eminent.

ABOUT THE AUTHOR

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