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It's Still True – No FIA Has Lost Money Because A Carrier Failed

On 8 May 2012 *Shenandoah Life Insurance* exited Virginia state receivership becoming a subsidiary of the Prosperity Life Insurance Group LLC. Shenandoah Life Insurance Company entered receivership on 12 February 2009. What this means is Shenandoah will return to normal operations and fulfill all of its commitments to policyholders. *What this also means is it is still true that no index annuity owner has ever lost a dime because their carrier failed.* The news release for Shenandoah Life says it is a rare thing for an insurance company to successfully exit receivership, but in the index annuity world a successful rebirth is not an unusual outcome.

Standard Life Insurance Company of Indiana entered state control on 18 December 2008. On 22 December 2010 the Indiana Insurance Commissioner announced that agreements had been reached for the $1.7 billion in policies and financial obligations of Standard Life to be assumed by Guggenheim Life and Annuity Company. This was accomplished in 2011 and Standard Life index annuity owners received the full value of their annuities.

On 2 March 2004 Western United Life Assurance entered Washington state receivership after being brought down by problems related to their parent, Metropolitan Mortgage & Securities and Summit Securities Inc. Western United was acquired by a joint venture formed by Global Secured Capital and DLB Capital in June 2008 and continues to operate as before.

Finally (or first) a small index annuity player named General American Life entered Missouri rehab on 10 August 1999 due to a liquidity crisis. General American Life was sold to MetLife on 6 January 2000 and the existing account values for all index annuity owners were not diminished.

Since inception of the index annuity industry in 1995 four index annuity carriers have entered receivership and the annuity customers of these four carriers have reemerged on the other side without loss. A four-peat clearly shows that the current state regulatory system works and it allows the bragging rights mentioned earlier which is no index annuity owner has lost principal because the carrier failed.* It also points out two big differences between banks and carriers.

Liquidity – When FDIC takes over a failed bank another healthy bank is usually found that will handle the deposits, and account balances covered by FDIC insurance are available at the new bank the next business day. If a bank isn't found to take over the account, checks are immediately mailed out to bank customers payable up to the limits of FDIC coverage. By contrast, when an annuity carrier enters receivership withdrawals are usually banned, except in cases of extreme hardship. Yes, all of the index annuity customers of these four carriers were eventually able to access their cash value, but they might have had to wait up to three years to do so.

* Of the seven *fixed rate* annuity carriers that have entered receivership since 1995 ultimately two of them did not fully protect account balances that exceeded guaranty fund limits (London Pacific and American Protectors Life Insurance).

Coverage – Although FDIC covered accounts are immediately available, balances over the limits that are uninsured mean the customer is treated as a creditor. These additional amounts are paid out as assets of the failed bank are sold and there is no guarantee that the customer will ever be made whole. Indeed, in one case only 65% of the uninsured deposits were ever repaid, but a more typical result was recovering 90% to 100% of these uninsured deposits. By contrast, all index annuity owners eventually were made 100% whole whether they had one dollar or one million dollars in their policy.

Once again the state insurance regulatory system has shown that it works well in protecting policyholders in the even the carrier fails. Once again annuity agents can show why fixed annuities are a safe money place.

Consumers Still Buy

The always punctual *Beacon Research* study disclosed that the top selling annuity for the first quarter of the year was not a MYGA, not an FIA, but a SPIA. However, in spite of lower rates and illiquidity more consumers chose to buy this single premium immediate annuity over any other fixed annuity because consumers liked the guaranteed income.

Index annuity sales also held up well in the first quarter. A lot of this is due to consumers hearing the index annuity or guaranteed lifetime withdrawal story for the first time and deciding that a 3% cap or a 6% roll-up is much more attractive than a 0.3% CD yield or the unknown growth (or loss) of a Wall Street managed portfolio.

As an annuity seller one may tend to look backwards, comparing today's rates and caps with past ones, and deciding today's annuities aren't attractive enough. However, the consumer's fresh eye sees annuity rates and guarantees as ones that they can't get anywhere else. Talk to a consumer. They'll sell you on why annuities are such a great product to buy during today's uncertain times.

Status Quo Bias

Status Quo bias means sticking with what we have done in the past and simply repeating the same decision, even if we know it is not the best decision (better the devil you know). It also means we try to avoid finding out how well the alternatives we did not choose perform because they would indicate we made a bad decision. Avoiding conflicting facts is known as *Confirmation Bias* and means people search for information that supports their current beliefs and decisions, while neglecting information that might say they are wrong.

A consumer may select the certificate of deposit over the annuity simply because they have owned CDs in the past and the annuity is a new thing. The consumer may even believe the annuity could offer a higher yield, but the consumer minimizes potential regret by telling themselves that even if the annuity beats the CD they will never know and ignorance is bliss.

What does this mean for a representative? Take away their bliss. Research indicates that if the consumer is told they will know the outcome of the alternative not chosen that it will cause them to rethink their decision. What this means is if the consumer is leaning towards the CD and the representative basically says, "If you choose the CD I'll call you in a year and let you know how you would have done in the annuity" that the consumer will be less likely to simply repeat the past decision of buying the CD and will give the index annuity a fair chance.

Endowment Effect

The Endowment Effect is always at work when you are trying to get a consumer to swap what they have – money or an existing annuity – for another annuity. The endowment effect makes us overvalue what we already have over something new. It is the old "a bird in the hand is worth two in the bush" story and it makes us place an unrealistic value on something simply because we own it.

The only real counter for it is to make the consumer believe what you offer is more valuable than what they have, and you do that by directly comparing what the consumer has with what they could own. The Endowment Effect can be defeated by the Ben Franklin close where you list the benefits of each choice and go with the list that is longer.

CD	**Annuity**
Compound Interest	Compound Interest
Free from Market Risk	Free from Market Risk
Ability to Bypass Probate	Ability to Bypass Probate
	Tax Control
	Minimum Interest Rate
	Guaranteed Lifetime Income
	Tax Deferral

A variation on this is to make the consumer feel they have last year's model. It would be along the lines of the representative saying "Yes, you have a very nice CD; it is what people used to put their money into before they discovered the benefits of annuities" or "your current annuity was state of the art back at the turn of the century, but now annuities come with living benefits". You defeat the effect by rationally demonstrating that your solution has a higher value, so the consumer can "trade up."

Availability Bias

Which is more likely – dying from being struck by lightning or dying in a flood? If you are reading this in the spring of the year you probably said dying in a flood, because when floods occur they tend to get quite a bit of press coverage, but if I asked you during a summer electrical storm you would probably say lightning will kill you. *Availability Bias* means we give more credibility to things we remember first. However, the first thing to come to mind is not always the best answer. In this instance the National Safety Council reports that the odds of dying in any given year by being struck by lightning is 1 in 6 million while the odds of drowning in a flood are 1 in 13 million (www.nsc.org).

If you are presenting an annuity and mention safety a typical client may immediately think of CDs, if you mention growth the consumer may think of mutual fund, and their feelings about the first thing they think of will influence how they react to the annuity presented.

<u>Show The Consumer Why They Should Change</u>

Obvious reasons are the potential for a better yield or greater safety or better features, and any of these reasons provide the extra value needed to justify why the consumer should not stick with the status quo. The representative needs to be aware of what the consumer may first recall. If the news headlines for the last month have been talking about loss and financial risk the representative will need to begin the talk emphasizing the safety of the annuity they are presenting. If the headlines are screaming stock market gains, talking about either the potential upside of the annuity or how the annuity acts as a balance to the gains and accompanying risk of the market will enable the representative to counter the bias.

2011 Total Annuity Sales By State

This map shows total annuity sales (variable, fixed, indexed, immediate) for 2011 on a state-by-state basis. It is based on an analysis by Advantage Compendium of Annual Statements filed by fixed and variable annuity carriers with regulators and then pulling out the individual state annuity sales. The selected carriers represented 80% of annuity production; these actual state sales numbers were then extrapolated to determine total estimated annuity sales by state. Sales are broken-down into 5 divisions.