



***There is good news!*** Fixed interest and fixed indexed annuities have been a relatively safe place to accumulate long-term savings. Although subject to surrender charge schedules, the principal is protected from direct market risk, unlike some other financial products. Regardless of past success, the current global economic and market distress is causing clients and agents to question whether a fixed annuity remains a safe place for long-term, principal-protected savings. You may ask, “Should my client be concerned about writing a substantial check to purchase this fixed annuity contract?”

# Fixed Annuities are **OKAY!**

Who can blame them (or us) for asking the question? I think we are better insurance professionals and financial advisors to address this question before it becomes an obstacle. Knowing our story of strength and safety allows you to help keep your clients’ long-term savings safe and growing. We want to inform and reassure clients on how the life insurance and annuity industry is operated and regulated, so they understand better the value of an annuity.

The individual State insurance departments enforce an elaborate system of supervision and regulation. Generally annuity carriers are required to reserve at least what policyholders could cash out at today.

They must also reserve funds for today’s value of any and all future benefits — if that would yield a larger reserve — benefits like lifetime income,



lifetime withdrawals, long-term care, death benefits, and even partial and full withdrawals. Under State investment laws, annuity carriers are required to hold these policyholder reserves mostly in high-quality fixed income securities.<sup>1</sup> “Risk-based capital” (RBC) provides the States with some measure of how well capitalized a carrier likely is. Where companies choose to assume additional investment or other risks, they must set aside additional capital to do so; otherwise, their RBC ratio falls and they are seen as “less well capitalized,” and carriers risk have their ratings reduced. This is why annuity carriers generally stick to investment-grade, fixed-income securities and investment-grade mortgage securities.

State law mandates a conservative statutory accounting system whose primary goal is to ensure company solvency. It conservatively measures present and anticipated carrier cash flows. Each insurance carrier is audited on-site by one or more State Insurance departments every three years. Life insurance companies file quarterly and annual statements that follow these conservative accounting requirements. The picture presented by this statutory accounting system is designed to ensure that annuity and life companies have the assets to meet policyholder obligations under almost any circumstance.

Insurance company statutory accounting requirements have played a significant role over many years in helping to minimize insurance company failures and prevent policyholder losses. Since insurance company assets must be liquid enough to generate cash to pay

benefits under most circumstances, carriers are required to perform an actuarial asset adequacy analysis that demonstrates their liquidity under a variety of future economic and policyholder behavior scenarios. For fixed indexed annuities, for example, a carrier is required to demonstrate that its promised indexed interest credits are sufficiently “hedged,” that is, backed by assets which mimic any promised interest credit in all index performance scenarios. If not, they must establish additional reserves. Furthermore, the various rating agencies use these statutory accounting results to conduct their own rating reviews, thus providing additional “eyes” on carrier solvency.

From time to time insurance companies do fail, despite State supervision and regulation. If that happens, the appropriate State insurance department generally places the carrier under supervision, in receivership, or brokers a sale in rehabilitation. This ensures the orderly satisfaction of in-force policyholder obligations. This system of loss prevention and damage control is one important reason State insurance departments approve major financial transactions such as company mergers, major transfers of capital and surplus, and the actuarial demonstrations required for the approval of insurance policy forms. The key mission of state insurance departments is to protect the interests of policyholders, including this regular proof of solvency.

All the individual states have life insurance and annuity guaranty funds that can provide yet another layer of insurance against policyholder loss. Where a carrier is in receivership

and there are not enough assets remaining to meet policyholder obligations, the state guaranty funds provide additional insurance. The guaranty funds usually provide \$100,000 or more of protection per citizen for annuity cash values (see [www.nolhga.com](http://www.nolhga.com) for each state’s coverage details). The guaranty fund is funded by assessments to all healthy insurance companies doing business in that state, and excessive insolvencies would generate additional assessments. Note that variable annuity separate accounts do NOT have guaranty fund coverage but their fixed interest general accounts do.

#### **IMPORTANT NOTE:**

The state guaranty fund cannot be used in a sales solicitation or as a sales inducement. Using the guaranty fund to help make an annuity sale is prohibited advertising and/or an unfair trade practice under State regulations. State guaranty funds are NOT the equivalent of FDIC insurance for bank deposits. The guarantees of any particular annuity are based only on the claims-paying ability of the issuing carrier.<sup>2</sup>

Our present economic situation has been caused in part by too much leverage by some financial institutions. When subprime mortgage-backed securities were downgraded, institutions had to recognize market losses.

Too many institutions had insufficient capital to meet these write-downs—thus the takeovers, mergers, and bankruptcies. The life insurance industry has historically

(Continued on Page 13)

(Continued from Page 11)

held large amounts of investment-grade, mortgage-backed securities pooling thousands of quality mortgages paid timely by credit-worthy homeowners. Though some carriers may have a relatively small amount invested in securitized subprime mortgages, the vast majority of carrier-owned, mortgage-backed securities should continue to pay interest and principal as expected.

Some annuity carriers will likely recognize investment losses from subprime mortgage securities, however, highly rated carriers will have enough capital or be able to raise the capital to go forward and meet all policyholder obligations. We will likely see further unsettling news about some carriers, insurance companies' stock prices will continue to fluctuate, and it is likely that the financial strength and investment quality ratings of some carriers will decline. That news is relatively minor compared to the distressing accounts we all have heard about from the commercial, mortgage, and investment banking industries.

When your clients purchase a fixed annuity, they transfer substantial risks to the insurance company. The annuity carrier bears the direct risks of stock and bond value declines; and bond and mortgage credit losses and defaults. Fixed annuity carriers have provided principal protection most impressively and will continue to do so. Should your clients stop buying fixed annuities? NO.

Should they surrender existing policies? NO. Can we separate life insurance company issues from those facing the banking and investment firms? YES.

*In the meantime, our carriers, especially those with higher ratings, should be regarded as very secure places for client long-term savings.* The safe-and-strong story of the life insurance industry is built upon strict state regulation, frequent state financial examination, required substantial reserves, high-quality investment portfolios, and state guaranty funds. Hopefully, this information assists you in understanding the state of

## ***The safe-and-strong story of the life insurance industry is built upon strict state regulation...***

our industry in these challenging times. You can have confidence that you are making good recommendations to your customers. The strength of both the carriers you represent and strict regulation by the states should help make your clients feel that their retirement savings are in good shape. Contact us at Creative Marketing to discuss your cases where there are concerns. Together we can help restore some confidence to our markets and our economy. The financial markets are on fire—and we sell buckets of water.

<sup>1</sup> "Annuities—Life and Health Continuing Education Course, 4th Edition," by David Shapiro and Thomas F. Streiff, Kaplan Financial, 2005.

<sup>2</sup> For example, Iowa insurance code section 508C.18 says "A(n) ... agent ... shall not make, publish, disseminate, circulate, or place before the public in a newspaper, magazine, or other publication, or in the form of a notice, circular, pamphlet, letter, or poster, or over a radio station or television station, or in any way, an advertisement, announcement, or statement which uses the existence of the insurance guaranty association of this state for the purpose of sales, solicitation, or inducement to purchase any form of insurance covered by this chapter.

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