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WEB EXCLUSIVES

Top story: Competing for fixed annuities based on fame, commission or rate

One broker's viewpoint

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Insurers compete for annuity sales from agents based on fame, commission, or rate. Which approach is best? Let's see.

When the stock market goes up, up, up, greed drives people to move their money to riskier and riskier investments. When the bubble bursts, fear drives people to move their money to safe havens.

In today's turbulent economic environment, money is moving back to guaranteed safe accounts, such as bank certificates of deposit and traditional fixed annuities.

In the past few years, many insurers have been heavily promoting indexed and variable annuities, allowing their fixed annuities to fall out of competition. The SEC's 151A decision and increased cost of guarantees on VAs will change their attitude and prompt them to reenter the FA market more aggressively.

However, the number of agents in America is shrinking drastically every year. Membership in agent trade associations is down about 50% from 10 years ago. Insurance companies are trying to recruit sales from a smaller and smaller group of people.

As noted above, insurers compete for annuity sales from agents based primarily on fame, commission, or rate. For instance, the big, old, highly rated companies usually compete based on fame. The only problem is that most well known companies normally pay low interest rates to policyowners.

Why do the big, old companies pay such low rates? Over the years, the answer from many home executives has always been the same: "We don't have to pay high rates because everybody in America knows who we are. Our sales are based on who we are, not what rate we pay." In view of their large sales volume, it's safe to say they have a point.

Based on the sales figures I've seen, the next biggest factor for agents to use when deciding which annuity to sell is commission. Simply put, the higher the commission, the more a company sells. My understanding is that the biggest selling annuity in Texas is the one that pays the highest commission.

That does not speak well for the life insurance business.

The good news for companies offering exorbitantly high commissions is they sell a lot of annuities. The bad news is, those companies are more prone to lawsuits.

In economics, there's no such thing as a free lunch. Those high commissions are funded by low renewal rates on annuities. This is very short sighted. After clients receive low renewal rates for a while, they surrender their contracts and never do business with that company or the selling agent again.

High commission companies must continually solicit new business from new agents and new policy owners. Recruiting new agents in today's world is very difficult and expensive.

If smaller, less well-known insurance companies want to sell large volumes of annuities and don't want to endanger themselves with lawsuits caused by selling "junk" annuities, they must compete based on paying higher interest rates.

Some company chief executive officers try to get agents to sell their lower-rate annuities by touting some worthless contract gimmick and/or fringe benefits for agents—e.g., travel incentives, free gifts of steaks, computer toys, etc. Of course, each company claims to have the best service in the business.

While all those things are important, they are insignificant when compared to the issue of whether the company offers high interest rates or not.

The five primary factors in FA sales are rate, rate, rate, and the other two factors don't matter.

If a company pays high rates, the fame, size, rating, or other gimmicks don't matter. Recruiting agents and making sales is a snap when the product offers high interest rates. Agents and clients will put up with lousy service for higher rates.

CEOs periodically brag that their FAs are in the 90th percentile in terms of rates. Well, try telling that to an Olympian. The top three in an event win medals; everyone else is a loser. Have you ever heard an Olympian bragging about being in the 90th percentile? College and professional coaches are fired if they are only in the 90th percentile.

The bottom line: If a company wants to sell a lot of annuities and it is not big and famous and does not want to get sued, then it has to compete on rate. That means being in the top three.

Being in the 90th percentile on rate just doesn't cut it for smaller, less well-known FA companies.

On a side note, the biggest competitor for FA money is a CD. FAs have many advantages over CDs, including higher rates, but CDs now have protection up to $250,000. People are more willing to put their money in an FA if they know their money is safe.

Following the well publicized problems at AIG, however, many consumers have become less trusting of the big insurers.

Yes, the state guaranty funds do offer protection. But only 10 states offer $250,000 of guaranty fund protection on non-qualified, deferred FAs.

The other states need to increase protection as soon as possible. Also, the insurance business should be able to promote the fact that annuities have guaranty fund protection. A "gag" order on safety is absolutely ridiculous.

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