

## Selling annuities in a low interest market

# SEIZE THE OPPORTUNITY

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In today's market, the annuity industry faces perhaps its greatest opportunity ever to serve American consumers.

As advisors, we have before us an unprecedented annuity sales opportunity, one that I would dare to call historic. But because every opportunity needs a context, let's begin by reviewing some of the more significant challenges brokers face as 2003 begins to unfold.

First, interest rates, a critical component of all financial products, are at a 50 year low. As for the stock markets, three consecutive years of negative performance have left Americans reeling with \$7 trillion in losses. While still early, 2003 thus far has given us only more losses, the Dow was down another six percent by mid-February. And yet, consumers show hope for better results.

Amazingly, the risk for investors is getting even worse. Millions of Americans have shifted billions out of stocks and mutual funds into bond and bond funds. So it's no coincidence that the largest mutual fund in the U.S. doesn't invest in stocks. America's top mutual fund is a bond fund (PIMCO Total Return).

Financial professionals have a key role to play in stopping clients from making serial bad decisions. The very worst time to invest in bonds is when interest rates are low, and we've already established that rates are at their lowest levels in 50 years. Yet ignorance of a different sort of investing risk—principal devaluation risk—is causing millions of Americans to jump out of the frying pan and right into the fire.

It shouldn't be this way but I sometimes fear it always will be. As long as greed and fear are prominent aspects of human psychology, Americans will tend to over-do. Extremism leads to emotional heartache and bad investing results. Fear will force those people who over buy stocks or mutual funds to inevitably over sell those same investments at the worst possible time.

This syndrome of performance chasing and panic selling

deprives people of satisfactory investing results. When results for 2002 are calculated, Fortune Magazine reports that the annualized investment return for the typical American investor over the period from 1984 to 2002 will be about three percent. That's over an 18 year period that included the greatest bull market in U.S. history.

Shocked? Don't be. Because this is even scarier: during the 109 year period from 1871 to 1980, 80 percent of the return from stocks was attributable to dividends. Have you checked out the dividends paid by stocks lately? All those historical statistics we've been fed about long-term stock market performance seem to create a different impression when viewed in this context. The sad truth is investing in equities just doesn't work for the average American.

It's ironic that the typical American investor, over the course of our best bull market ever, would have been better off keeping his or her money in a fixed annuity. Which brings us to sales opportunity.

We often search for the sales "angle", the positioning for the product we seek to market. Rarely do we find a time like today, when there are so many "angles" that we run the risk of losing our focus.

Let's look at some of the best angles, all bona fide sales makers geared to representing our clients' best interests:

### THE BOND ALTERNATIVE "ANGLE"

"Save me from principal risk! Please!" Such would be the refrain from clients if they really understood the relationship between interest rate movements and bond values. Simply stated, bond prices and interest have an inverse relationship. When interest rates drop, bond prices rise.

The more pressing concern, of course, is the rising interest rate scenario. For when interest rates rise, bond values become depressed. Pricing theory becomes real-world pain when it's your money that's being devalued. And this is precisely the pain that will be felt by your clients and prospects when interest rates increase.

The angle: Use bond strategy annuities to access the best aspects of bonds without the risk of investing in bonds.

These annuities are still few in number but they represent a whopping sales opportunity for enlightened professionals who see the value of a vehicle that allows purchasers to select the types of bonds their premiums are invested in. As vehicles designed for savers seeking protection from investment risk, bond strategy annuities are offered by insurance companies that create “portfolios” of bonds that may feature convertibles bonds, high yield bonds, high grade corporate bonds, government bonds, even real estate securities. These portfolios create interest earnings which are passed-thru to the annuity owner. Importantly, the interest margin, the portion of the interest return that the insurance company keeps, is fixed and guaranteed. Depending upon the carrier, interest margins can range from about 1.5 percent to three percent.

This approach assures competitive interest rate crediting every month of every year. If five years from today the insurance company can earn 12 percent, the annuity contract owner is guaranteed to receive in the range of nine percent to 10.5 percent. Unlike investing in bonds, bond strategy annuities protect against investment losses and also provide an ironclad mechanism to protect owners when interest rates increase.

#### **THE BETTER WAY TO ENJOY STOCK MARKET EXPOSURE ANGLE**

The idea is to provide interest growth linked to stock market performance without the risk of direct investing in stocks or mutual funds. A very attractive idea but exercise caution. Equity indexed annuities, or EIAs, vary widely in quality and contractual provisions. Agents need to view these contracts with a jaundiced eye because too many are gimmicky in nature and penalize purchasers through up front loads which can range as high as 25 percent of the initial premium. Caution: seek out the best and avoid the rest. The worst possible outcome will be one where client expectations fail to match up with client results.

Sifting through this product minefield is easier said than done. Misleading marketing can trick agents into believing these products will deliver the same result as investing in stocks. For instance, EIAs link interest growth to one or more well-known stock indices, such as the S&P 500. Some EIAs feature participation rates of as much as 100 percent. The tendency is to believe that an EIA with a 100 percent participation rate based upon, say, the S&P 500, will deliver 100 percent of any potential S&P gain. Many agents would be surprised to learn that a host of other contractual provisions, including “averaging”, water down potential returns dramatically. Don’t be duped.

I would even go so far as making a hard and fast rule: never sell an EIA that has a front end load of more than 10 percent. The reason is that if you are starting at a deficit (premium minus initial load) it’s difficult to generate even

modest potential gains regardless of stock market performance. This is why EIAs that feature minimum interest crediting based upon 100 percent of the original premium are now coming to market. In the long run these contracts will rule.

The angle: remind clients and prospects of what the typical American really gets out of investing in equities (three to four percent) and use that as a starting point to manage expectations. One of the greatest benefits of EIAs is that they can serve to re-establish necessary exposure to the stock market but in a manner that people can really live with over the long term. Therefore, if these contracts can return six percent over seven to 10 years they will have out-paced equity investing by 50 percent.

#### **THE GUARANTEED MONTHLY INCOME ANGLE**

Retirees who have seen their investment portfolios sink are much in need of reassurance and guidance. One of the best strategies to enhance retirement security is through the guaranteed monthly income provided by a single premium immediate annuity (SPIA). The most underutilized of worthwhile financial vehicles, an SPIA provides a paycheck that never stops. Similar to Social Security, an SPIA’s income payments create peace-of-mind and enhanced financial security for seniors reeling from stock market volatility and losses.

SPIAs are exceptionally flexible tools to build financial confidence. Use them with your senior clients to provide guaranteed income for a specified period of time or for a lifetime. Moreover, SPIA purchasers receive a wonderful income tax benefit. The “exclusion ratio” makes part of each monthly payment income tax free.

There’s never been a better time to market fixed annuities because there’s never been a time when the benefits of these products have been in such wide demand. But you must look beyond the marketing hype and misleading product features to provide your clients the best possible results.

All annuities are not created equally. Regrettably, the gap between the best of them and the worst of them is far too wide. Selling an inferior product can have the chilling effect of spoiling a client relationship you’ve worked hard to build. Looking five, seven or 10 years ahead, you’ll want your clients to feel that the products they purchased delivered results that were in keeping with realistic expectations. Otherwise, the annuity industry’s greatest opportunity to serve the American consumer will be tarnished and lost.▲

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