CANNEX RESEARCH

How Competitive Are Income Annuity Providers Over Time?

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AUTHORS

DAVID BLANCHETT
MANAGING DIRECTOR, HEAD OF RETIREMENT RESEARCH,
DEFINED CONTRIBUTION SOLUTIONS
QMA

MICHAEL FINKE
PROFESSOR AND FRANK M. ENGLE CHAIR OF ECONOMIC SECURITY RESEARCH
THE AMERICAN COLLEGE OF FINANCIAL SERVICES

BRANISLAV NIKOLIĆ
VICE PRESIDENT OF RESEARCH
CANNEX FINANCIAL EXCHANGES LIMITED

ADDITIONAL AUTHOR OF BRIEF

TAMIKO TOLAND
DIRECTOR, RETIREMENT MARKETS
CANNEX FINANCIAL EXCHANGES LIMITED

CONTACT AUTHORS FOR BRIEF

For more information about interpretation and industry trends, contact Tamiko Toland, Director, Retirement Markets: tamiko.toland@cannex.com, 203-826-8977

EXECUTIVE SUMMARY

Can annuity buyers rely on an insurance company with competitive rates to stay competitive? Or even be competitive across different ages? This brief highlights key findings of a study we performed to examine how income annuity (single premium immediate annuity, or SPIA) rates have changed for a collection of insurance companies over time. The full study with additional figures and analysis is available here.

In fact, the data show:

- No insurer offered consistently high annuity rates;
- Competitiveness can change abruptly and dramatically;
- An insurer's competitiveness also varies depending on the client scenario (age, gender, one or two people);
- Insurers with higher financial ratings tend to offer a lower payout than lower-rated competitors, but this sometimes flip-flops.

Every way we looked at it, the real-world rates for income annuities moved—often dramatically and abruptly. For a buyer, these fluctuations mean that relying on a quote from a single insurer, even one with a history of favorable rates, may result in lower income or a higher cost for an income target.

There are other factors that can signal pricing practices that benefit the buyer. Outside of the trends mentioned above, we find that insurers that sell income annuities as a high proportion of total sales tend to offer more favorable rates that also remain more persistent over time, based on correlation with sales from LIMRA[1] over the same period. It is also possible for an insurer to commit to staying competitive within a given business line. Even so, history demonstrates that payouts vary even for insurers offering the most consistently high payouts.

These findings can play a role in guiding the following considerations:

- Product shelf management for any distributors that offer retail income annuities;
- Practices of individual financial professionals who may falsely believe that known insurers will provide their clients with the most favorable rates;
- Retirement plan design for plan sponsors looking to provide income options for their workers, especially those considering whether to offer a single or multiple group contracts;
- Annuity group contract periodic monitoring and review.

[1] Data provided by the Secure Retirement Institute® (SRI™)

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BACKGROUND

People seek competitive rates for income annuities in order to safely maximize retirement income and increase the efficiency of their portfolios. In practice, we are aware that the insurer with the best rate is not static and changes over time.

The management and pricing of annuities do not function in isolation from the insurer's other lines of business. Furthermore, the motivation to sell contracts and take on risk of that nature is not constant. Anecdotally, we know that there are factors that drive pricing decisions for each individual insurance company that would change how its rates compare against peers. For example, life insurance counterbalances annuities because these policies cover opposite risks. This lowers the cost for the insurer to sell annuities to clients who share demographic characteristics with a group of life insurance policy holders.

The management and pricing of annuities do not function in isolation from the insurer's other lines of business.

Annuity Data

Annuity Characteristics

- Life-only (no death benefit)
- Annual payment based on $100,000 premium
- Five ages: 60, 65, 70, 75, 80
- Three buyer types: single female, single male, and a couple of the same age

Historical Data

CANNEX provided weekly rate information for income annuity payout rates for 30 U.S. insurers for the period November 3, 2013 to August 12, 2020. Among those 30 companies, rate information is available for 14 over the entire period and for the remaining 16 either stop or start at some point during that span.

Financial Strength Ratings

We aggregated financial strength ratings from AM Best, Fitch, Moody's and S&P, when available, and are relatively constant over the period. While financial strength ratings are not available from all insurers over the entire time period, we included all available information.

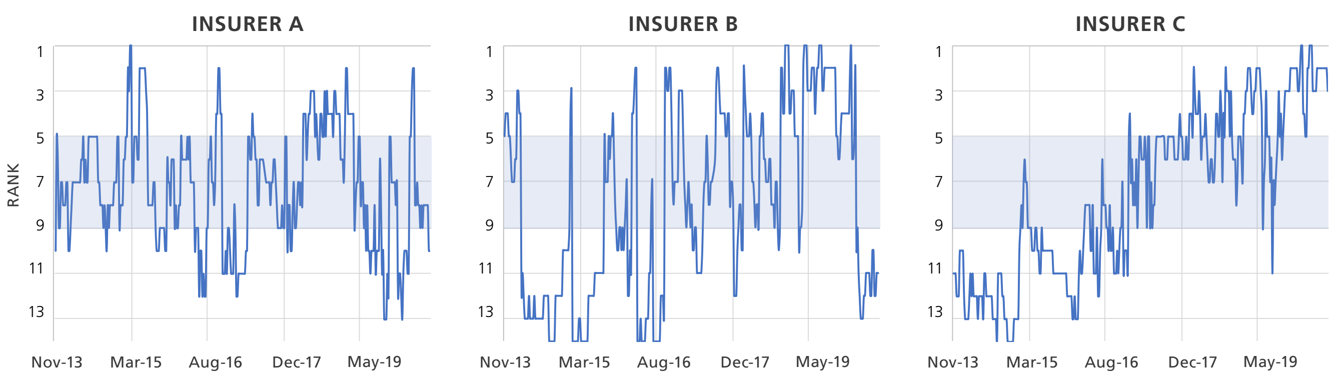
HIGHLIGHTS

Individual Company Competitiveness

To better understand the dynamics at individual insurance companies, we focus on how the payout rates vary for the same scenario (65-year-old single man). To ensure consistent ranking order (1 is best and 14 is worst), we restrict analysis to the 14 insurers for which data are available for the entire period of analysis.

In this analysis, we are most interested in rank persistency and rank volatility. **Exhibit 1** provides information about three companies that demonstrate how these two measures can vary over time.

Exhibit 1: Payout Ranking of Three Insurers



We can see that the individual rankings shift over time and to varying degrees. The 14 companies can generally be categorized as those whose rank changes little over time (Insurer A), whose rank is extremely volatile (Insurer B), and whose rank is gradually declining or, as in this case, improving (Insurer C).

This analysis demonstrates there are significant deviations in the relative ranking of companies over time.

Competitiveness of Individual Insurer

- No company maintains a highly competitive position consistently;
- An individual company may shift in rankings wildly and abruptly;
- Even an insurer that became more competitive over the period demonstrated volatility in annuity payouts.

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The Cost of Using a Single Insurer

To understand the cost of sticking with a single insurer over the period, we calculated the average difference in each insurer's payout rate compared to the highest rate at the time. This allows us to consider how much lower the payout is from the top rate either by insurer or by quote type. The complete table is available in the Appendix (Page 7).

Single Insurer Competitiveness Across Clients

- All insurers vary in competitiveness according to client demographics;
- Even an insurer that tends to provide close to the highest rate on average for one type of client is unlikely to do the same in all categories.

We found that any given insurer would have better rates on average for certain demographics over others. In other words, an insurer offering a generally strong rate for one type of client does not necessarily do the same for other types. Also, the insurer with the best overall average across all client types did not have the best overall average for each category.

These are important considerations when relying on a single insurer or even a very small group of insurers to provide income for a variety of clients. Also, bear in mind that this analysis used averages over time and that the pricing volatility that we observed for individual insurers still holds.

When a primary goal is to secure competitive income for a range of clients, it makes sense to include multiple insurers and to review rate trends periodically and potentially update that list.

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Financial Strength and Payout Rates

An important consideration when selecting an insurance company is financial strength rating. While annuity payouts are backed by state insurance guaranty funds, there is still some risk to the buyer. Insurer default would result in delayed repayment and may involve a loss of principal if premiums exceed the guaranty limits.

We expect financial strength ratings to correlate negatively with payout rates to compensate for insolvency costs, meaning that a more highly rated company would offer a lower rate because it is less risky to the consumer. When an insurer with a higher financial strength rating offers a higher payout we interpret this as a "free lunch" to the buyer since they would receive more income with more safety. While financial strength ratings are imperfect, they have predicted the cumulative probability of impairment and liquidation, especially for individual companies (per a 2019 AM Best report).

The Relationship of Payout Rates and Financial Strength

- Overall, higher the financial strength of a company equates to lower rates;
- However, there are periods when the opposite is true;
- On average, companies with higher financial strength offered higher rates.

The correlation varies over the period. While it is generally negative, it is sometimes even slightly positive. Most importantly, we see that there is no constant association between financial strength rating and the payout rate, so buyers do not have to expect that a company offering a high payout will necessarily be riskier or vice versa.

Predicting Future Payout Rate Ranking

Is it possible to predict future payout ratings and determine whether companies that have higher payout ratings today will have higher payouts in the future? We correlated future payout ranking for all 15 client types against the rankings on November 13, 2013. Over time, we see this correlation approaches 0, which means that there is no association, on average, between initial rank and later rank.

Does Today's Rank Predict Future Rank?

- The longer the evaluation period, the less likely that a highly-ranked insurer will maintain a high ranking;
- It is unlikely that ranking at a given point in time will predict future ranking well.

The data demonstrate that an insurer that offered a competitive rate did not continue to do so over time. Given enough time, we expect that today's most competitive annuity providers become relatively less competitive

CONCLUSIONS

Income annuities can be an important supplement to other sources of guaranteed income streams. Although pensions have been historically important to retirement security, they are shrinking in prevalence and many American workers will have to rely on their savings to support their income in retirement.

Income annuities have represented a small but steady portion of the overall retail annuity market. In addition to the potential increase in that market under the pressure of this demand, workplace savings is another area of anticipated growth. The The Setting Every Community Up for Retirement Enhancement (SECURE) Act, passed in late 2019, eases the implementation of annuities within plans with a safe harbor for the selection of the insurer. Nevertheless, there is no standard for the fiduciary practice of the initial selection or ongoing monitoring of contracts themselves, both of which are outside of the safe harbor.

The potential costs of going with a single provider can be significant and are not predictable from the outset.

As the inclusion of annuities becomes more common, we expect plan sponsors to focus more on this evaluation process. Assuming that pricing practices translate from the retail to the institutional space, results from these analyses suggest that variation in price competitiveness over time complicates the selection of an annuity provider.

Our findings also suggest that there are periods where insurers with higher financial strength ratings have higher payouts on average, indicating significant value to evaluating both relative pricing and financial strength to identify more competitive providers.

The potential costs of going with a single provider can be significant and are not predictable from the outset. Looking back, we know that the cost of picking the “wrong” insurer can be high, resulting in income that is lower or more expensive for the buyer. While the average cost was only 4%, it exceeded 9% for certain providers and 12% for certain age and household type combinations.

Thus, any company with a goal of offering annuities, whether in the retail or institutional setting, must evaluate competing annuity providers over time rather than simply selecting the then-current lowest cost provider. Other metrics can support the selection of insurers that will provide more consistently competitive quotes, though we see no evidence that any metric is likely to hold over any length of time.

APPENDIX

Average Percentage Difference in Payout Rate versus Highest Payout Rate

		Company#															
Type	**Age**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**Avg**	**Std Dev**
Male	60	4.45%	1.76%	2.77%	3.02%	8.83%	3.65%	5.26%	2.87%	2.42%	2.71%	4.34%	3.03%	3.22%	3.52%	**3.70%**	1.66%
Male	65	3.34%	1.13%	3.48%	2.96%	7.53%	4.14%	5.62%	3.18%	1.60%	4.07%	3.80%	5.26%	3.44%	3.10%	**3.76%**	1.55%
Male	70	3.95%	1.83%	4.12%	2.37%	8.70%	4.32%	5.82%	3.08%	0.63%	4.30%	3.77%	6.89%	3.42%	2.85%	**4.00%**	1.99%
Male	75	6.75%	3.09%	5.46%	2.15%	9.50%	4.61%	4.85%	2.77%	0.26%	6.57%	4.36%	6.93%	2.57%	3.97%	**4.56%**	2.29%
Male	80	6.13%	6.17%	6.56%	2.96%	8.95%	4.01%	3.65%	1.01%	1.02%	6.53%	4.23%	5.96%	n/a	5.36%	**4.81%**	2.20%
Female	60	4.63%	2.01%	2.91%	3.79%	10.67%	3.82%	5.42%	2.08%	4.77%	3.18%	4.51%	2.64%	4.01%	5.04%	**4.25%**	2.06%
Female	65	2.83%	1.12%	3.25%	3.59%	9.29%	3.74%	5.29%	2.12%	3.78%	4.17%	4.15%	3.80%	4.01%	4.32%	**3.96%**	1.77%
Female	70	2.21%	1.10%	3.02%	2.21%	9.63%	3.66%	4.53%	1.34%	2.02%	4.11%	3.55%	4.97%	3.79%	3.26%	**3.53%**	2.03%
Female	75	5.07%	1.81%	4.31%	1.62%	10.29%	4.32%	3.61%	1.03%	1.19%	6.39%	4.34%	4.56%	3.49%	3.25%	**3.95%**	2.32%
Female	80	7.36%	6.40%	6.91%	3.71%	10.70%	4.83%	4.00%	0.46%	2.62%	8.97%	6.27%	5.16%	n/a	4.60%	**5.54%**	2.58%
Joint	60	5.91%	2.11%	3.65%	2.70%	12.10%	4.21%	5.81%	2.52%	5.39%	2.73%	4.86%	3.97%	3.83%	5.55%	**4.67%**	2.40%
Joint	65	5.20%	1.20%	3.95%	2.58%	10.43%	3.93%	5.48%	2.40%	4.31%	3.19%	3.97%	4.87%	3.70%	4.85%	**4.29%**	2.05%
Joint	70	4.36%	1.22%	4.03%	1.82%	8.37%	3.75%	4.85%	2.01%	2.82%	2.72%	3.18%	6.22%	3.24%	3.90%	**3.75%**	1.79%
Joint	75	4.33%	1.57%	5.05%	0.99%	6.67%	3.71%	3.24%	1.48%	1.78%	5.72%	2.94%	5.36%	2.55%	3.82%	**3.52%**	1.69%
Joint	80	4.96%	6.72%	7.56%	2.67%	5.77%	4.24%	3.11%	0.33%	3.41%	6.82%	3.69%	5.56%	n/a	5.39%	**4.63%**	1.92%
Average		**4.77%**	**2.62%**	**4.47%**	**2.61%**	**9.16%**	**4.06%**	**4.70%**	**1.91%**	**2.54%**	**4.81%**	**4.13%**	**5.01%**	**3.44%**	**4.19%**	**4.18%**	1.69%
Std Dev		1.36%	1.97%	1.47%	0.76%	1.59%	0.35%	0.92%	0.90%	1.49%	1.84%	0.75%	1.22%	0.47%	0.87%	0.48%	

Ranking Period: Nov. 2013 - May 2019

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ABOUT CANNEX

CANNEX supports the exchange of **pricing information** for annuity and bank products across North America. We provide financial institutions with the ability to evaluate and compare various guarantees associated with retirement savings and retirement income products.

Our **quantitative research** team provides methodologies that help optimize the selection and allocation of annuity and insurance guarantees in support of retirement programs and practices.

Our pricing and analytic services can be deployed to support a variety of processes, including:

- Research & Market Intelligence
- Financial Planning & Education
- Sales & Compliance
- Transaction Processing
- Product Service & Administration

Contact Information

CANNEX Financial Exchanges Limited
1200 Bay Street, Suite 1001
Toronto, Ontario
Canada
M5R 2A5

Phone: (416) 926-0882
Toll Free: (800) 387-1269
Fax: (416) 926-0706

Email: cannex@cannex.com
Web: cannex.com

