5 Reasons to Not Worry About Your Clients' Annuities

In the era of COVID-19, economic uncertainty and market turmoil may be causing some of your clients to worry about their investments in annuity products. It can be helpful to note some of the mechanisms that exist to ensure that life and annuity companies are financially sound and able to pay claims throughout this crisis. Insurance companies have weathered the worst financial and economic storms in American history and will doubtless weather this one as well. Here are five important things to remember when your clients ask about the safety of their annuities.

1. Life Insurance Companies and Life & Annuity Products are Highly Regulated

Annuity and life products are insurance contracts and as such are regulated under state insurance laws. Variable annuities and variable life products are also securities, regulated by the Securities and Exchange Commission (SEC). The SEC and the Financial Industry Regulatory Authority (FINRA) both regulate firms that sell variable insurance products.

In order to offer annuity products within a state, an insurance company must be licensed in that state. To be licensed, an insurance company must be organized according to specific state laws and demonstrate compliance with capital, surplus and financial requirements. The state will issue a license only if it determines that the examiners regularly investigate the accounting methods, procedures, and financial statements of the insurance companies doing business in their state, and companies are required to submit quarterly and annual statements of financial condition to the states in which they conduct business.

NAIC National Association of Insurance Commissioners

FINRA

2. State Guaranty Funds Protect Your Clients

All states, the District of Columbia, and Puerto Rico have guaranty funds to protect contract owners against insurance company insolvency. Insurers conducting business in a state contribute to that state's guaranty fund. In the unlikely event of an insolvency, the state will first seek to transfer policies to a financially stable insurance company. Failing that, the guaranty fund provides coverage for annuity contracts that varies from state to state, with annuity payments and annuity assets held in the issuer's general account protected for between $100,000 and $500,000. Make sure you know how much coverage is provided by the state the annuity is purchased in and how the state protects death and living benefit guaranteed amounts in excess of policy assets. All NOLHGA member guaranty associations offer resident policyholders $250,000 or more in benefits for annuities, so consider placing business exceeding this level with multiple companies to both diversify issuer risk and keep individual contract values at or below the coverage limit. The National Organization of Life & Health Insurance Guaranty Associations (www.nolhga.com) is a good resource for more information.

It is exceedingly rare for a policyholder to have a need for state guaranty fund protection. Since the NOLHGA was formed in 1983, guaranty associations have provided more than $25.6 billion in coverage benefits to more than 2.6 million life, health and annuity policyholders.[1] By contrast, among annuities in 2018 alone there were more than 30 million policies in-force, holding almost $2.9 trillion in assets.[2]

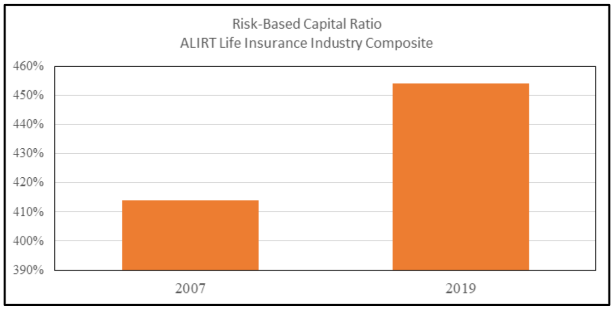
[1] "The Nation's Safety Net – 2019 Edition" (The Life & Health Insurance Guaranty Association System, 2019)
[2] "U.S. Individual Annuity Yearbook – 2018 Year in Review, Part 2" (Secure Retirement Institute, 2019)

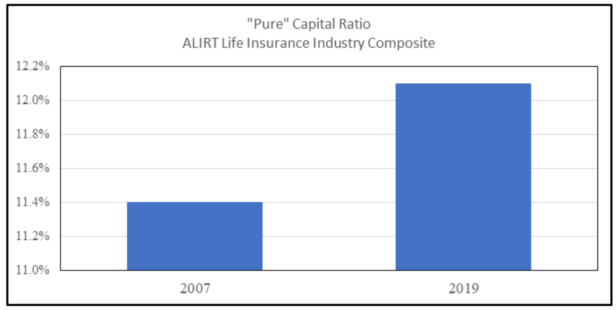
3. Variable Annuity Assets are Shielded

Dollars invested in variable annuity sub-accounts are held in the separate account of the insurance company and are therefore insulated against the claims of the insurer's general creditors. In some states, annuity assets are also shielded from a contract owner's creditors as the invested assets represent retirement funds. Guaranteed amounts in excess of invested assets (e.g. death benefits and guaranteed lifetime income benefits) are still subject to solvency risk, but the investment portfolio within a variable annuity is no more or less at risk of loss than an equivalent portfolio invested in mutual funds.

4. The Life and Annuity Industry is Financially Sound

Though subject to solvency risk, dollars invested in annuity products that are held in the insurance company's general account (fixed annuities, fixed accounts of variable annuities, structured variable annuities, and reserves covering the insurer's potential exposure related to guarantees associated with variable products) are also well protected by a financially strong industry. Annuity and life insurance issuers are well capitalized, with risk-based capital ratios for the life industry exceeding levels in 2007 (prior to the onset of the financial crisis). In the event investment losses that result from the economic disruption of the coronavirus prove less than or equal to losses incurred in 2008-2009, and the need to bolster reserves for variable product guarantees is similar to or less than what was the case in the financial crisis, the life and annuity industry should be able to absorb these losses without a significant deterioration in financial strength or solvency. The insurance companies that issue policy contracts may retain a high level of financial strength in this scenario, in spite of declines in the stock prices of publicly traded insurance organizations and/or rating agency downgrades. The ALIRT Insurance Research charts below show that life and annuity issuers are better capitalized today than they were prior to the 2008 financial crisis.





Notes:

> ALIRT Research is a privately held company that has specialized in analysis of the financial strength of insurance companies since 1999. ALIRT focuses its efforts and analytical model on the financial profile of the individual life insruance companies that issue life insurance and annuity products, and places less emphasis on the parent companies of the insurers.
> ALIRT Life Industry Composite = a weighted composite of the 100 largest U.S. life insurance companies.
> Risk-Based Capital (RBC) is a method of measuring the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size, investment and policy risks profile. The RBC Ratio is the amount of capital held by an insurer, as a percent of the required risk-based capital.
> Pure capital ratio = Total capital and surplus, plus required investment reserves, as a percent of general account invested assets.

Bear in mind that individual company ratings and financial strength can vary so make sure you also check ratings from Moody's, S&P, FITCH, and/or other rating entities before placing business with the company, and that you understand the process your broker-dealer (as applicable) employs to evaluate the financial soundness of the companies whose life and annuity products you sell.

5. Alliances Among Insurers

Most life and annuity insurance companies form alliances with other insurance companies to share certain risks, such as those of optional lifetime income benefits in variable annuities. Known as "reinsurers," these global companies enter into reinsurance contracts based on scrutiny of products (design and price), risk-management practices, administrative processes, and their experience in the variable annuity and variable life businesses. Reinsurance helps support the overall risk-management framework. In 2017 approximately $70 billion in reinsurance premium was written globally, with the United States, Canada and the United Kingdom accounting for 65 percent of the total. While the payment liability still rests with the policy issuer, the arrangements further protect policy owners by diversifying risks with more than one insurance company.