RESEARCH BRIEFINGS

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Present and Future Prospects for Impaired Risk Annuities

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Impaired Risk Annuities

As an increasing number of Americans enter retirement without defined benefit pension coverage, the annuity industry can offer the equivalent benefit to individuals — the payout annuity. To broaden the appeal of these products, some insurers have issued impaired risk annuities, which match payout amounts to an individual's life expectancy through medical underwriting. This Research Briefings investigates the scope of impaired risk annuities and industry sentiment regarding their future prospects. Sixty-three companies participated in the survey.

Key Findings

- Of the 55 responding companies that currently sell immediate annuities, seven companies — representing 41 percent of 2003 fixed immediate annuity sales — now offer impaired risk annuities.
- Ten companies (representing 9 percent of 2003 sales) are either planning to offer impaired risk annuities within the next six months or are considering offering them.
- Fifty-seven percent of companies believe that impaired risk annuities will comprise a greater proportion of industrywide sales within two years, and no companies believe that the proportion will decrease within that time.

A critical component of any life insurance operation is its underwriting function. Although most individual insurance products are commonly underwritten the same cannot be said for annuities. Like some direct-marketed life insurance policies, annuities are almost always "guaranteed issue."

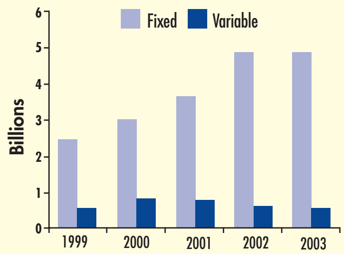
By definition, impaired risk annuities are medically underwritten, such that payouts are greater for those applicants whose life expectancies are determined to be significantly shorter than is average for people of the same age and gender, the two factors most often used in determining annuity rates. These products are sometimes also known as "age-rated," because the age on which payouts are determined is adjusted upward. For example, following the underwriting process, a 65-year-old buyer with a substantial health impairment may receive a payout benefit equivalent to that of a 70-year-old buyer.

Underwriting annuities is hardly a novel concept for the industry — for many years, companies have routinely performed underwriting within the structured settlement marketplace. For example, in a MarketScan survey, LIMRA found that nearly all structured settlement writers responding made use of medical underwriting, representing one third of their entire structured settlement premium in 2002. Medically underwritten individual annuities, on the other hand, are relatively new developments. One reason for their establishment reflects a key change to actuarial guidelines that permits lower reserves for substandard risks. This guideline, promulgated by the National Association of Insurance Commissioners in 2001, could lead to more profitable impaired risk annuity production.

Perhaps the overriding reason for the rising interest in immediate annuity underwriting is the burgeoning population of retirees, many of whom have no defined benefit pension plan. With no protection from longevity risk other than Social Security payments, these people must manage their income needs on their own. The only product available that can guarantee lifetime income and be purchased individually is an immediate annuity. One would expect that the income annuity market would expand in light of the increased need for longevity insurance among consumers. Payout annuities have represented a small proportion of total annuity sales, but have expanded during the past several years (Figure 1). However, it is not known whether recent growth in immediate annuities is due to increased consumer demand for lifetime income or the use of immediate annuities in premium financing arrangements. As the demand for payout annuities grows, innovative ways to manufacture and distribute them — including under-writing to make these products more "actuarially fair" for a larger number of people — may multiply as well.

FIGURE 1

Immediate Annuity Sales



Source: LIMRA International

Survey Results

Of the 63 companies that responded to the Research Briefings survey, 55 currently sell immediate annuities. Collectively, these 55 companies accounted for 76 percent of all fixed immediate annuity sales in 2003, and included eight of the top-selling 10 companies.

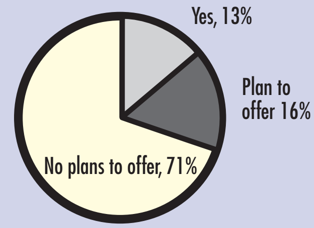
Only seven of these 55 companies presently issue impaired risk annuities. Although they make up only 13 percent of the immediate annuity companies in the survey, these seven companies wrote 41 percent of all 2003 fixed immediate sales.

On average, sales of impaired risk annuities represent a modest portion (29 percent) of each company's 2004 immediate annuity sales, and an even smaller proportion (13 percent) of all immediate annuity contracts issued by each company in 2004. Each company was weighted equally in computing these averages. The percent of premium ranged from 8.1 percent to 70 percent of all 2004 immediate annuity sales, and the percent of contracts issued ranged from 1.2 percent to 30 percent. All companies reported a larger percent of impaired risk premium than contracts, which indicates that the underwriting function tends to be applied to large cases.

Ten surveyed companies are considering offering impaired risk annuities; one company intends to offer them within the next six months. One company that does not currently sell any immediate annuities indicated that they are considering offering impaired risk annuities. This company is not included in Figure 2. Several of these companies have comparatively large market shares, so their entry into the impaired risk arena could measurably boost the overall proportion of immediate annuity sales that are medically underwritten. However, the majority of companies have no plans to offer annuities on an impaired risk basis (Figure 2). One respondent explained that his company would look into the possibility if the underwriting process could be made easier, and if baby boomers showed interest in the concept.

FIGURE 2

Offer Impaired Risk Annuities?

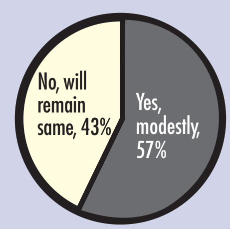


Note: Results based on companies that sell immediate annuities.

Companies were also asked to estimate how the share of the immediate annuity market that would be comprised of impaired risk sales might change over the next two years. While no companies feel that the share would increase "substantially," 57 percent of companies feel the proportion would increase "modestly." Interestingly, all of the companies planning to introduce impaired risk annuities in the future believe that the proportion of industrywide sales will increase modestly. This belief is logical in light of the fact that even a single company's venture into impaired-risk annuities will modestly raise the industry proportion of sales. However, they probably also assume that other companies, in their respective assessment of environmental factors, will also recognize the need for underwriting their immediate annuity products and hence begin to market this capability.

FIGURE 3

Will Impaired Risk Proportion of Immediate Sales Grow?



Note: Seven companies provided no response for this question. No company indicated that the proportion of sales would "increase substantially" or "decline."

The remaining companies believe that the current share of immediate annuity sales that are impaired risk will remain constant over the next two years (Figure 3). Notably, not a single responding company forecasted a decline in the proportion of sales from impaired risk annuities.

In general, these results support the contention that impaired risk annuities will comprise a small but growing portion of the immediate annuity market. For this to occur, companies must design strategies to address key issues, such as underwriting costs and resources, coordination with sales forces, and communication with current and potential customers.

For more information:

LIMRA International, *2003 Individual Annuity Market: Sales and Assets*
http://www.limra.com/abstracts/4601.asp

LIMRA International, *Annuitization Study: Profiles and Attitudes*
http://www.limra.com/abstracts/4401.asp

LIMRA International, *Medically Underwritten Structured Settlement Annuities*
http://www.limra.com/abstracts/4322.asp

Sources:

National Association of Insurance Commissioners (NAIC), 2001. "Actuarial Guideline IX-C: Use of Substandard Annuity Mortality Tables in Valuing Impaired Lives Under Individual Single Premium Immediate Annuities." Kansas City, Missouri.

Gary Underwood and Michael Silver, "Using Impaired Risk SPIAs: Strategies For Unhealthy Clients," *National Underwriter*, November 15, 2004.
http://www.nationalunderwriter.com/lifeandhealth

Gary S. Mettler, "Can Defined Contribution and Defined Benefit Plans Offer Actuarial Fairness?" *Benefits Quarterly*, Third Quarter 2002.
http://www.insurance-portal.com/072402gmettle.pdf

Thomas J. Granata, "Understanding Rated Annuities Today," *Canada Life of New York.*
http://www.fensterine.com/articles/june2002CL.pdf

LIMRA thanks the following companies for participating in the survey:

AAA Life Insurance Company
AIG American General
AIG VALIC
Allianz Life
Allstate Life
American Express
American Fidelity Assurance Co.
Americo
AmerUs Group
Amica Life Insurance Company
Assurity Life Insurance Company
Aviva Life
AXA Equitable
Baltimore Life
Chase Insurance
CUNA Mutual Life Insurance Company
Erie Family Life
Farm Bureau Life of Michigan
Federated Life Insurance
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Genworth Financial
Guaranty Income Life Insurance Company
Harleysville Life Insurance Company
Illinois Mutual
ING
Investors Insurance Corporation
Jackson National Life
Jefferson Pilot
Kansas City Life
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Mennonite Mutual Aid Association
MetLife
Midland National Life
Minnesota Life
Modern Woodmen of America
Motorists Life Insurance Company
Mutual of America
Mutual of Omaha
Nationwide Financial
New York Life Insurance Company
North American Company for Life and Health
One America Financial Partners (AUL)
Pekin Life Insurance Co.
Penn Mutual Life Insurance Company
Physicians Mutual
Presidential Life
Principal Financial Group
Protective Life Insurance Co.
RBC Insurance - Business Men's Assurance
Reliance Standard Life
Shenandoah Life Insurance Company
State Farm Life
Sun Life Financial
The Lafayette Life Insurance Co.
Thrivent Financial for Lutherans
Transamerica Capital, Inc. (AEGON)
Union Central Life
United Farm Family Life Insurance Company
United Life Insurance Company
Woodmen of the World Life

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