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Puny Treasury yields could trigger more cuts to annuities – and agents' commissions

Key 10-year Treasury falls to an all-time low; brokers, customers and carriers could feel the pinch

By Darla Mercado
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Given the gyrations in the stock market — including another big sell-off today — annuities are suddenly a hot property. But low Treasury yields, sparked by investors' flight to safety, could be a deal breaker for insurers as their profitability from the products declines.

The yield of the benchmark 10-year Treasury dipped as low as 1.99% today, marking a new low and falling below depths it had reached in the 2008 recession. At the same time, returns on fixed income investments, such as corporate bonds, will likely take a hit as yields continue to slide, observed Noel Abkemeier, principal and consulting actuary at Milliman Inc.

Insurers use the spread between their fixed-income investments and the Treasury yield to cover upfront expenses related to new fixed and indexed-annuity business, such as broker commissions and advertising costs. The companies also skim profit margins off of the spread.

"When yields are this low on the Treasury and assuming the corporate bond spread hasn't expanded significantly, you end up with insufficient investment income to cover everything," Mr. Abkemeier said.

Thus, if Treasury yields continue to decline, carriers may choose to take a narrower profit margin or lower commissions for brokers, he added.

Life insurers can also make their products less appealing by reducing upfront bonuses, crediting rates, or in the case of an indexed annuity, lower the minimum guaranteed cap — the lowest guaranteed level of interest at which the annuity can grow, Mr. Abkemeier said.

The specter of even tougher times for indexed-annuity sellers arrives at a time when sales are still hot: According to AnnuitySpecs.com, indexed annuities generated $8.2 billion in sales during the second quarter, down only 1% from the year ago period but up 16% compared to the prior quarter.

Low interest rates tend to lift indexed-annuity sales as customers realize certificates of deposit aren't yielding much.

Going back to the beginning of the year, a number of carriers had switched gears for higher demand amid harder times and lower yields. As recently as Aug. 2, Allianz Life Insurance Co. of North America had pulled back the upfront bonus on sales of its top-selling Master Dex X indexed annuity to 7% from 8%. Meanwhile, others have prepared for rates to eventually rise by adjusting their products: ING USA Annuity and Life Insurance Co. yesterday introduced a crediting strategy based on the three-month London interbank offered rate.

Agents have also been feeling the pain of lower interest rates. Russell Smith, owner of Torimax Financial Group Inc., estimates that his commissions on one indexed annuity had fallen by 20% since the beginning of 2010, while the bonus to the client fell by 30%.

“This is belt tightening,” Mr. Smith said. “The products are still very competitive but if we stay in this low interest rate environment, they'll have to raise fees, reduce participation rates, lower bonuses or do a combination of all those things.”