

# **An Exchange for the Canadian and US Payout Annuity Markets**

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# Agenda

## SPIA markets and the evolution of an exchange in the US and Canada

### Defining differences:

- Market size
- History
- Government

### Perspectives:

- Technology
- Small Business
- Exchange



# Retirement Income Planning

- **Analyze income needs into:**
  - Essential expenses: food, shelter, ...
  - Discretionary expenses: travel, estate, ...
- **Why?**
  - Avoid running out of money
    - By buying appropriate product
  - Avoid under spending
    - By knowing you will not run out of money
  - Get a better return
    - Guarantee essential expenses are covered
    - More aggressive in discretionary expenses




# How Should the Client Invest?



## Essential Expenses

- For the annuitant – not for the estate / kids
- No need for money after death
- Fixed or Variable life annuity



## Discretionary Expenses

- Free of the worry of running out of money
- More aggressive portfolio
  - Provides better long term returns
  - Better protection against inflation



# Is Retirement Income Planning successful?

## US Statistics:

- #1 concern of retirees is outliving income
  - 55% interested in concept
  - But only 1% or 2% annuitize
- Most Planning is done to life expectancy
  - 50% live beyond that
- Key concerns are longevity and inflation
  - Variable Payout Annuity sales: terrible, declining
- 70% of retirees plan to fund retirement by working
  - Only 30% do, many can't because of health or demand
- Most people feel they will live longer than average
  - Most greatly under-estimate average life expectancy

Sources: LIMRA, DSG

**... Not yet**



# After years of pushing retirement income, most Canadian payout annuities are sold for ...

- Estate planning – tax loophole

## **CANNEX Usage Statistics – for Canada**

<u>Type of Annuity</u>	<u>Percent</u>	<u>Largest Use</u>
Non-Registered, Prescribed	59%	Insured Annuity, Personal Funds
Non-Registered, Non-Prescribed	13%	Insured Annuity, Corporate Funds
Registered	28%	Retirement



# Who is CANNEX?

## How does the system work?

- Provides an Exchange for the SPIA market
  - Carriers provide code
  - CANNEX analyzes code into components
  - Reproduces algorithm with pre-written subroutines
  - Tests and proves accuracy to carrier
- One system (shared architecture) provides:
  - Canadian SPIA exchange
  - US SPIA exchange
  - ASP solutions for individual carrier illustrations
  - Differences are market driven – not technology driven



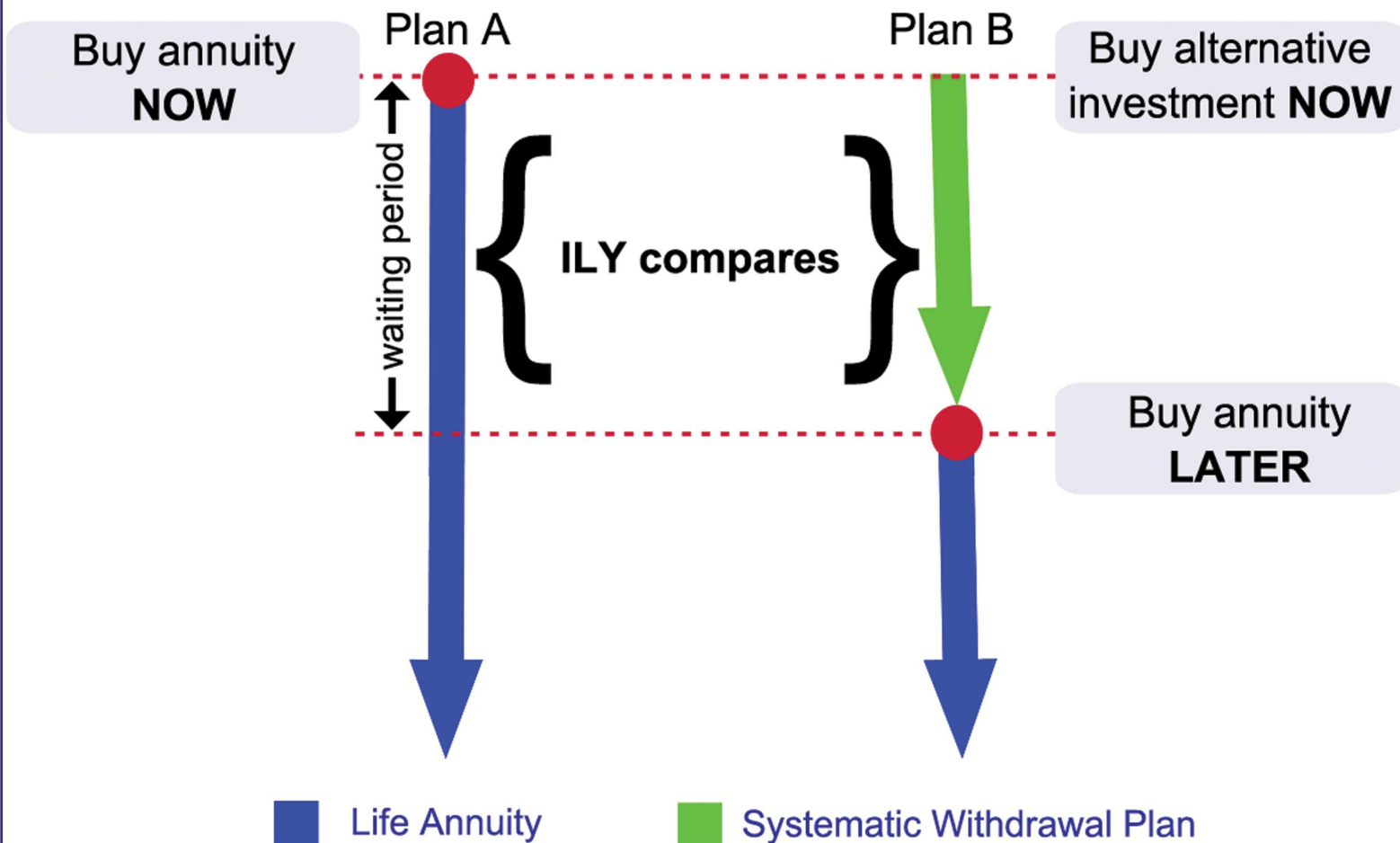
# **CANNEX' mandate will include education:**

- **Presentation Material (from advisor):**
  - Explanation of the suggested product
  - Yield: Graph of IRR vs. age at death
  - ILY: Combines yield with individual mortality credits
  - A custom Monte Carlo simulation study indicating that the SPIA contemplated would reduce the probability of ruin by x%



# ILY (Implied Longevity Yield)

I want a Lifetime Income





# **The US & Canada – 3 Defining Differences**

- **#1 - Market Size Differences**
  - Channels
- **#2 - History of Retirement legislation**
  - Technology evolved differently
- **#3 - Government Planning**
  - CPP versus Social Security
  - Planned Estate tax legislation



# **#1 - Market Size generates innovation**

- **Channels:**
  - Canada – Producers buy from everyone
  - US – Shelf space is a key business driver **Carriers innovate to be on seller's shelf**
- **US Product Innovations:**
  - Variable Payout Annuities
  - Long-deferred payout annuities (MetLife)
  - Combination accumulation + payout (GE) **Easier to innovate in larger market**

**But the Canadian SPIA market developed sooner**



## **#2 - Retirement Legislation History**

- **RRSP legislation – late 1950's**
  - Add 25 years to establish a market
  - Early 80's: high interest rates, stagflation
    - 18% for 15 years and 9% thereafter
  - Excellent conditions to establish an exchange
- **IRA legislation – early 1970's**
  - Add 25 years:
  - Mid 90's: low interest rates, booming market
  - Poor conditions to establish an exchange
- **Result:**
  - CANNEX was the 2<sup>nd</sup> Canadian SPIA info service
  - 15 years later, CANNEX was the 1<sup>st</sup> US service



# **To establish a new technology ...**

- **Need significant improvement over current methods – result: leap frog effect**
  - In Canada distributed SPIA software never really got established
    - Web-based SPIA software is more established in Canada
  - In the US, a central exchange took longer
- **Prisoner of history:**
  - All CANNEX SPIA quotes are guaranteed in the US
  - All US carriers provide custom illustrations



# 1981 – The state of the art in Canada ...

- Modems were gee-wiz technology
  - Thermal printers could “type” faster than most people
  - Largest start-up costs: Computers, Phone, then Salaries
- Phone-book sized rate tables
  - Agent called for table page number
    - Central control of updates
    - Simple calculation of rate/1000 plus policy fee
  - Biggest issue was weight
- Hot product: Income Averaging Annuities
  - Spread balloon income over a number of years
  - Banks dominated sales
  - Insurance carriers had better product
    - Excellent initial cooperation with prototype
    - CANNEX developed understanding of variations of annuities



# 1982 – Tax law amended ...

- No more Income Averaging Annuities
- Insurance Carrier concern - commoditization
  - CompQuote dominated annuity surveys
    - Based on rate-table look up
    - No joint life annuities
  - CANNEX had better technology at its 1983 launch
    - Reproduced cooperating carrier's formula (first principles)
    - Fit published rates to a common annuity curve
  - Both companies fully supported by brokers
- High Interest Rates
  - 18% for 15 years and 9% thereafter



# Why did we succeed in Canada ...

- Rate books were too heavy
  - Thermal printer was easier to carry
  - Sale was generally at client's home
- Insurance Carrier phone-in service - unresponsive
  - Three-day turn around
  - Quotes good for 24 hours
  - Volatile interest / annuity rates
  - Competitive market required agents to shop
- Patience
  - Generally a 5 – 10 year sales cycle
  - Insurance carriers embarrassed by CANNEX inaccuracy
- Self-improving architecture
  - As insurance carriers cooperated, accuracy improved
  - Barriers to entry



# Why are we succeeding in the US ...

- Distributors require Carrier participation
  - Information is no longer hidden
  - Speed is essential
  - Guarantees are required
- CANNEX is an independent third party
  - Does not compete with clients
  - Seen as part of the solution
- Patience
  - Generally a 5 – 10 year sales cycle
  - Same, persistent message
- Self-improving network
  - As insurance carriers participate, distributors are more interested
  - As distributors participate an exchange develops



# Impact of an Exchange

- **Centralize information gathering**
  - Reduces expenses to carriers
    - Proprietary illustrations become less important
    - Reduced need to advertise competitiveness
  - Increases transparency
    - More competition between carriers
    - Third party comparisons given to consumers
  - Shifts costs to distributors
    - Distributors pay for some of illustration costs
    - Reduces distributors' costs
  - Reduces need for PC-based illustrations
    - Central control of rates
      - Reduces investment mismatch risk
    - Canadian carriers change rates at 3x frequency
      - 56 times/year versus 18 times/year
- **Being studied by IFID**



# **Market Direction – in the US & Canada:**

## **Driven by US needs**

- **Retirement Income Planning**
  - Ibbotson
  - Ernst and Young
  - Financial Planning software vendors
- **Education:**
  - Courses: InFRE, NAVA
  - Conferences: LIMRA, NAVA, IIR
- **CANNEX Analytical tools:**
  - ILY
  - IRR vs. Age at Death
  - Impact of SPIA on financial plan



# **#3 - Government Planning**

- **Canada:**
  - Balanced Budgets
  - CPP is fully funded
- **US:**
  - Spending is out of control
  - Social Security is under funded
- **Impact of under funded Gov't Pensions:**
  - General strikes in Italy, France
  - Excessive costs in Germany, Japan
  - US need for individual responsibility
    - Introducing strong tax incentives for SPIAs



# **Estate Tax Legislation**

- **US – Plans to eliminate in 2010**
- **Canada – No plans**
- **Result – Insured Annuities**
  - Moot issue in US
  - Concern in Canada



# **Summary**

- **US and Canadian SPIA markets evolved differently**
- **Underlying technology to service each market will be the same**
- **The US has a higher perceived need for SPIAs**
- **Canadians can not be complacent**
  - Need to promote individual responsibility
- **US market will be more dynamic**
- **Canadians should study the US retirement market directions and trends**