What’s Up Down Under? SPIA Sales.

By Editor Test *Wed, May 11, 2011*

An ad campaign featuring the 1967 Buffalo Springfield classic, "For What It's Worth," and other factors are helping drive higher income annuity sales in Australia for Challenger Ltd. Their latest product offers liquidity in the first 15 years.

Americans may be slow to recognize to the importance of income annuities, but near-retirement Australians seem to catching on.

Investor shock from the financial crisis, an anticipated nationwide ban on sales commissions for retail financial products, and a folksy ad campaign whose theme song is the Buffalo Springfield classic, “For What It’s Worth,” are all adding up to a sharp uptick in sales for Challenger Life, Australia’s largest issuer of annuities.

The insurance unit of A$27 billion Challenger Ltd. saw a 49% increase in period-certain immediate income annuity sales in the first quarter of 2011—albeit from a low base—and the company now projects full-year sales of A$1.8 billion ($1.91 billion), Challenger spokesman Stuart Barton told RIJ this week.

Until about two years ago, Sydney-based Challenger was primarily an asset management firm, catering to investors in Australia’s compulsory defined contribution retirement or “superannuation” funds. And from 1992 to 2008, Australians themselves had a large appetite for investment risk—with little aversion to paying loads and commissions to financial intermediaries.

Then came the financial crisis of 2008-2009. Australia saw its version of Lehman-and-Bear Stearns debacles with the collapse of the firms Storm Financial and Opes Prime. Investors, especially older investors, became more conservative.

Meanwhile, the government embarked on its own version of Dodd-Frank reforms, known as the Future of Financial Advice. If enacted, it will ban sales commissions on financial products, effective July 1, 2012, and require most financial intermediaries to act as fiduciaries.

Watching these events, Challenger started switching its focus about two years ago from mutual funds to annuities. It tripled its distribution of Challenger Guaranteed Income Plan, a strictly period-certain (one to 50 years) income annuity and released a life version of the product called Liquid Lifetime. It hopes the sales trajectory will eventually match that of its period certain annuities.

“The crisis has changed attitudes overall,” Barton said. “After 1992, when compulsory super [the mandatory 9% employer contribution to retirement accounts], people weren’t interested in annuities at any age. The share [stock] market was so strong. The whole system was dedicated to shares. But it has changed. How long will that last? It could change with a major market event.”

Australia’s interest rates are significantly higher than in the U.S., and that can’t hurt annuity sales. According to Barton, an investment in a three-year deferred fixed annuity currently yields about 6.7% a year. Australia's current "Fed funds" rate is 4.25%, compared to zero in the U.S., and the yield curve isn't as steep.

Regarding the ban on commissions and the new fiduciary standard, the company expected these changes to create a better climate for selling a prudent, low-margin product like an annuity. "That absolutely factored into corporate strategy," Barton said. Low commissions, relative to other financial products, is one of the reasons—perhaps not the largest—why brokers in the U.S. don't promote income annuities more.

The Liquid Lifetime product differs in some respects from single premium immediate annuities issued by U.S. life insurance companies. Payments are indexed to the Consumer Price Index, contract owners have the option of getting a cash refund (or death benefit for a beneficiary) during the first 15 years of the contract, and the income from contracts purchased with savings from taxable accounts is tax-free.

At the end of 15 years, contract owners have the option of withdrawing a guaranteed lump sum, depending on their age when they purchased the contract. For instance, someone who pays A$100,000 ($106,000) for a contract at age 66 receives inflation-protected income for up to 15 years. For a woman of 66, income would start at about A$404 a month. The payments during the first 15 years do not contain any mortality credits or return of principal.

At any time before the 15th contract anniversary, the owner can commute the contract to cash. The refund size depends on changes in interest rates, but remains close to $100,000. After 15 years, at age 81, a woman (or couple, in a joint life policy) would be guaranteed 100% return of premium. A man would be guaranteed at least $85,000. Alternately, the owner can waive the refund and opt for continued income for life.

The older the owner is when he or she buys the contract, the lower the commutation value. For instance, if the owner is age 76 at purchase, the guaranteed refund at age 91 would be only 20% of premium for a man, 30% for a woman, or 50% for a couple. The commutation value reflects the value of the payments over the remaining life expectancy.

Prior to the financial crisis, changes in financial legislation in Australia had a steadily adverse impact on domestic demand for life annuities. According to research by Amandha Ganegoda at Australia's Centre for pensions and superannuation, "Prior to the Age Pension reforms in 2004, immediate annuity sales averaged around A$736 million per quarter and maintained a market share of averaging 31% of total retirement income streams."

But after changes to the rules that reduced a person's state pension if they had annuity income, "immediate annuities became less attractive for buyers. Sales dropped down to an average of A$389 million per quarter and the market share dropped to an average of 20%. This drop was significant in both life and term annuity markets. The average quarterly sales of life annuities dropped by 78% while sales of term annuities dropped by 45%."

Life annuity sales sank further after 2007, when Australia allowed all distributions from the national Superannuation fund to be tax-free, like distributions from a Roth IRA, and life annuities lost their exclusive right to tax-free distributions.

Retirement works differently in Australia than in the U.S. Australian employers are required to contribute 9% of wages per year for each employee to the “Super.” Employees can make substantial additional contributions. Opposite to the U.S. policy, these contributions are taxed when they go in, not when they come out.

“The life annuity market is almost nonexistent here,” said Hazel Bateman, a pensions expert at the University of New South Wales in Sydney. “Challenger over the last few months has done a lot of advertising. It’s the first time we’ve seen life annuities advertised in the popular press.

“Before Challenger, the number of providers had fallen from a dozen a decade ago to one or two. Before 2007, life annuities were taxed at a lower rate than products that didn’t provide longevity insurance. Other products were taxed on entry and on exit, and then we changed it so that all benefits come out tax free.”

As for the impact of the ban on commissions on annuity sales, Bateman added that the ban “isn’t a done-deal and I wouldn’t have thought that would be an important factor. The bigger factor would be that they’re doing a lot of advertising.”