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

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

- Estate planning – tax loophole

**CANNEX Usage Statistics – for Canada**

<table>
<thead>
<tr>
<th>Type of Annuity</th>
<th>Percent</th>
<th>Largest Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Registered, Prescribed</td>
<td>59%</td>
<td>Insured Annuity, Personal Funds</td>
</tr>
<tr>
<td>Non-Registered, Non-Prescribed</td>
<td>13%</td>
<td>Insured Annuity, Corporate Funds</td>
</tr>
<tr>
<td>Registered</td>
<td>28%</td>
<td>Retirement</td>
</tr>
</tbody>
</table>
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%
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](image)

- **US Product Innovations:**
  - Variable Payout Annuities
  - Long-deferred payout annuities (MetLife)
  - Combination accumulation + payout (GE)

  ![Easier to innovate in larger market](image)

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 2nd Canadian SPIA info service
  - 15 years later, CANNEX was the 1st 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

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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

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**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