

A promotional banner for Mother's Day Deals. On the left is the FTD logo featuring a yellow figure holding a bouquet. In the center, the text reads "MOTHER'S DAY DEALS" in large black letters, with "STARTING AT \$19.99" below it. On the right, there is a "SHOP NOW" button with a right-pointing arrow, set against a background of pink and white roses.

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ANNUITIES

## Get Less, Pay More

*Variable-annuity issuers raise prices, reduce benefits in effort to restore profits*

By **LESLIE SCISM**

Life insurers are rapidly dialing back on the generosity of the performance guarantees they sell on variable annuities, but still-bigger change may lie ahead as companies grapple with sharply higher risk-management costs, industry consultants say.

In general, new buyers are getting less for their money than purchasers did a few months ago, in some instances a lot less. But the most recent round of changes—including higher prices and reductions in benefits that will take effect at many insurers this month—still leave total fees short of what the new annuities will cost the insurers to fully hedge their guarantees against market risk, says Ramy Tadros, who heads the North American insurance practice at consulting firm Oliver Wyman.

“The bottom line is that most of them have moved in the right direction, but they haven’t moved far enough,” he says.

It’s too early to say how the changes will affect sales. Many insurers have been reluctant to make major changes for fear of disrupting their sales networks, consultants say.

Variable annuities are a tax-advantaged form of investing in mutual funds. Most sold in recent years have included riders that guarantee an annual income check of some minimum amount, from the date the owner elects to start benefits until his or her death. If the underlying fund investments perform poorly, the owner collects the minimum amount; if the investments perform well, the amount can be much higher.

### *Rapid Revisions*

Mike Bartlow, co-founder of [www.AnnuityGrader.com](http://www.AnnuityGrader.com), which ranks the products on factors including benefits, annual fees and the issuer’s financial-strength ratings, says he and colleagues “revised all the data in January, then again in March and now again” in late April. Such change used to occur annually.

Of 17 contracts offering the most popular form of the guarantee, he says, two were yanked, in late March. Thirteen others reduce benefits this month. Assuming a 60-year-old couple was investing \$100,000 for 10 years before planning to withdraw money, the “worst-case scenario” for a minimum annual lifetime income stream has dropped to \$7,800 a year from \$11,000 under many contracts.

Many insurers are reacting to steep losses they suffered late last year and during this year’s first quarter, as stock markets slid and the gap widened between their promises and the value of customers’ fund accounts. All told, the roughly two dozen insurers who dominate the guarantee business boosted their reserves and capital last year by more than \$15 billion to show regulators they can make good on the promises, according to ratings firms and consultants.

### *Higher Costs*

Meanwhile, since late last year the insurers have faced sharply higher costs to buy financial hedges to offload the guarantees’ market risk. The costs soared as volatility spiked and interest rates fell—soaring to the point that “very few

companies” selling guarantees of minimum lifetime withdrawals “are actually pricing and designing products with sufficient [profit] margins to fully hedge the guarantees,” barring a strong long-term recovery of stocks, Mr. Tadros says.

Some companies “have moved quite aggressively, but the industry as a whole has more ground to cover,” says Kenneth Mungan, a practice leader at actuarial firm Milliman Inc. What’s needed is “more innovative” product design, he says. This might include guarantees with a withdrawal benefit whose amount floats between a floor and a ceiling based on interest-rate hedging costs.

The two insurers yanking guarantees are units of Fidelity Investments and German insurer [Allianz SE](#), which say they have replacements in the works.

AnnuityGrader.com’s Mr. Bartlow says growing numbers of insurers have reduced the amount that annuity owners can withdraw annually as a percentage of the guaranteed benefit base, or have cut back on guaranteed increases in the benefit base. Contracts sold in recent years generally allow 5%-a-year withdrawals for those in their 60s. Under the changes, many insurers allow those under 65 a maximum of 4% a year, he says.

Meanwhile, contracts whose annual fees previously totaled about 3.25% of account value now cost closer to 4%, says Mark Ragusa, a certified financial planner at AnnuityGrader.com.

Insurers also are tightening rules on asset allocation, requiring buyers to keep at least 30% of their money in bond funds. This reduces the insurers’ exposure to future stock-market declines, and therefore reduces their hedging costs.

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