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FINANCE

There Were Runs on Banks, Not on Insurers. Here's Why.

Annuities are full of penalties for cashing out, deterring investors from seeking higher rates

By Jean Eaglesham Follow

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Marc Rowan, chief executive of Apollo Global Management, said that bank-run risk doesn't impact the annuities industry because people use these investments to save for retirement. PHOTO: LAUREN JUSTICE/BLOOMBERG NEWS

Investors who stashed billions of dollars in low-yielding annuities did a surprising thing last year: nothing. As interest rates shot up from near-zero, dramatically improving the returns on new annuities, investors mostly stayed in their existing policies, new data show.

By contrast, bank depositors cashed out of their accounts in search of higher yields or a safer home, helping to trigger a crisis that brought down three lenders. In both cases, the assets backing customers' investments fell in value as rates rose, but surrender penalties and other deterrents kept annuity holders in place.

Fixed-rate annuities offer a set return, akin to a bank certificate of deposit. Investors who bought these annuities before the Federal Reserve began its rate-rising campaign are getting a fraction of what is now on offer. Someone who invested $100,000 in a three-year fixed deferred annuity from New York Life in January 2022, for example, received a yield of 1.8% a year, less than half the 4% annual yield offered today.

Surrenders, or early cash-outs, from fixed-rate deferred annuities ticked up only modestly last year, rising to 8% of assets compared with 7% for 2021, according to industry-funded research firm Limra.

Across all types of annuities, surrenders actually fell as rates rose, tallying $180.5 billion last year compared with $189.5 billion in 2021, according to Limra.

"So far at least, surrender experience is running favorably [for the industry] compared to what you would expect in an environment where interest rates have increased this much," said Douglas Baker, director of North American life insurance at ratings firm Fitch Ratings.

This investor loyalty is one reason life-insurance companies are seen as less vulnerable than lenders to a Silicon Valley Bank-style collapse.

While shares in midsize banks have fallen some 27% in the past year, based on the KBW Nasdaq Regional Banking Index, life insurance stocks, as measured by the Dow Jones U.S. Life Insurance Index, are down only around 11% over the same period.

Insurers, like banks, are sitting on tens of billions of dollars in unrealized losses on bonds following the rate rises. Like banks, the insurers would face a cash-crunch if too many customers headed for the exits at once. But analysts believe there is little danger of that happening.

"The risk of a run on a leading life insurer is remote," said Josh Esterov of research-firm CreditSights.

The boost to insurers' balance sheets from relatively low surrender levels has been bolstered by a record-breaking flood of new money, as returns on fixed annuities outpace bank CDs. Annuity sales by all companies, including insurers, topped $94 billion in January through March, up 49% from the first quarter of last year, Limra said Tuesday.

"I see this a little bit as the golden age of annuities. Consumers simply prefer 5% to 2%. It's not more complicated than that," Marc Rowan, chief executive of Apollo Global Management, told investors this month. His private-equity firm owns Athene, one of the biggest annuity providers.

Annuity investors stuck around despite earning paltry yields in part because the industry makes it hard to cash out. Annuity holders typically don't closely follow financial markets, industry insiders say.

"I don't think people really are doing the math on the insurance side," said Greg Parady, a Florida-based financial adviser. "My consumers are typically retired folk [who] find something they like and stick with it."

Apollo's Rowan said on the earnings call the bank-run risk doesn't hurt the annuities industry because people use these investments to save for retirement. “This is not money they think is accessible,” he added.

Many investors simply don't have an option to cash out. Almost a fifth, or 18.5%, of money in annuities is held in contracts with no surrender option, data for last year from ratings firm AM Best data show.

Even if surrenders are allowed, there is often a price to pay. Annuities typically impose a charge of up to 7% for withdrawing more than a certain amount during the first years of the contract. There is often no penalty for withdrawing money from a bank account.

Investors may face another cost buried in the annuity small print: the so-called market value adjustment. When investors surrender an annuity with one of these adjustments, the return is adjusted to reflect changes in the value of the underlying bonds since the contract was bought.

The recent declines in bond values mean the market value adjustment is likely a “significant deterrent for clients to cancel,” said Todd Giesing, Limra's director of annuity research.

A quarter of the money in annuities last year was subject to some form of surrender penalty, including market value adjustments, the AM Best data show. About half the fixed-rate policies sold last year carried a market value adjustment, according to Limra.

Insurers say the barriers they put up to deter surrenders allow them to offer more competitive rates. Locking in investors for a certain number of years means the annuity provider can invest in longer-term assets that can boost returns.

Surrender costs are “the reason there isn't a run on annuity companies,” financial adviser Parady said. “It's the thing people hate the most about annuities, but also it protects the consumer the most.”

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