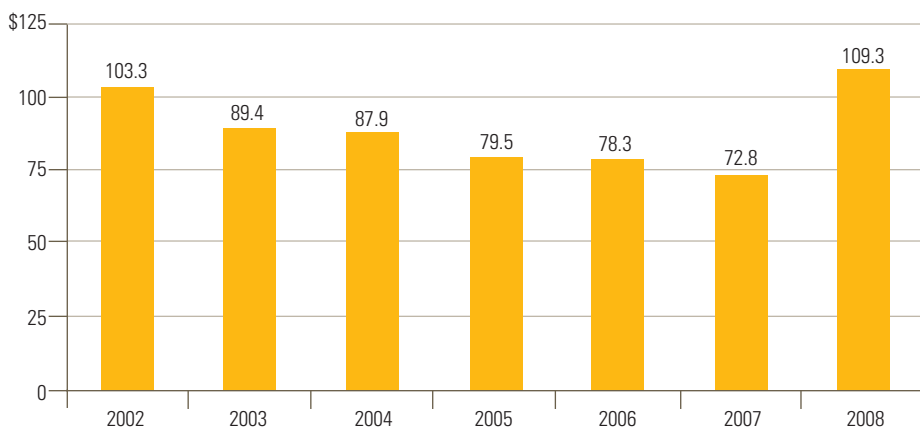


Fixed Annuities—2008 Update

7

Individual fixed annuity sales¹ in the U.S. increased 50% in 2008, reaching a record \$109.3 billion. The competitive interest rates offered by fixed annuities, in addition to the equity market losses and volatility experienced in 2008, made fixed annuity products an attractive alternative for those consumers looking for retirement products that offer safety and guarantees.

Figure 7-1 Fixed Annuity Sales: 2002-2008
(dollars in billions)



Source: LIMRA International

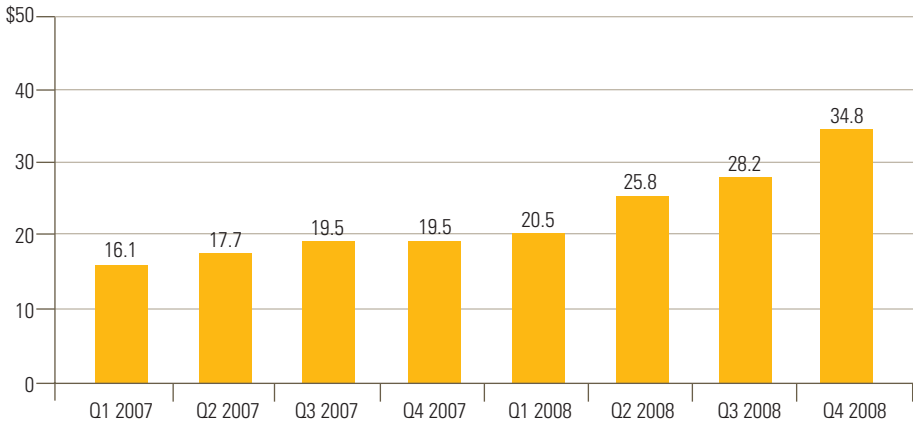
Since peaking in 2002 in a down market similar to what was experienced in 2008, sales of individual fixed annuities decreased from 2003 to 2007. While the dramatic events starting in the latter part of 2008 weigh heavily on the economy, the market conditions affecting annuity sales actually began to unfold in the second half of 2007. Beginning in the summer of 2007, short-term interest rates began to drop while long-term interest rates remained steady, creating an increasingly favorable yield curve for fixed annuities by the fourth quarter of 2007. In October 2007, the equity markets peaked and then began their long, downward decline.

¹ Fixed annuity sales are comprised of the following product types: deferred book value, deferred market value adjusted (MVA), indexed annuities, fixed immediate annuity products and structured settlements sales.

By mid-year 2008, the sales results confirmed what the improving yield curve and equities market environment foreshadowed: skyrocketing fixed annuity sales with dropping variable annuity sales. On a quarterly basis, fixed annuity sales kept rising quarter over quarter during 2008, before reaching a staggering \$34.8 billion in the fourth quarter of 2008.

Fixed annuities' share of the total annuity market rose to 51% in the fourth quarter of 2008, up from 28% in the first quarter of 2007, as variable annuity sales slid. Fixed annuity sales in the fourth quarter of 2008 exceeded variable annuity sales for the first time since the second quarter of 1995.

Figure 7-2 Fixed Annuity Sales by Quarter 2007-2008
(dollars in billions)

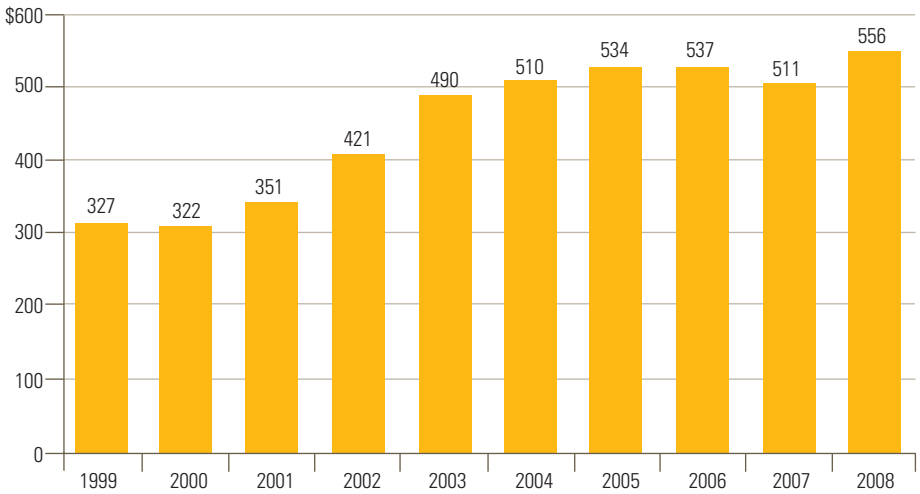


* Based on quarterly data

Source: LIMRA International

Fixed deferred annuity assets increased 9% from \$511 billion at year-end 2007 to \$556 billion at year-end 2008. Prior to 2006, fixed deferred annuity assets had increased each year since 2000. During 2006-2007, assets for book value and market value adjusted products declined as outflows (mainly due to increased surrender of contracts coming out of contingent deferred sales charge (CDSC)) exceeded inflows and in-force earnings growth. However, in 2008, fixed-rate (book value and MVA) annuity assets grew mostly due to positive earnings as well as positive net inflows. Indexed annuity assets grew as inflows exceeded outflows by a 2-1 margin. At the end of 2008, fixed-rate deferred annuity assets reached \$419 billion (a 9% increase over 2007) and indexed annuity assets hit \$137 billion (a 10% increase over 2007).

Figure 7-3 *Fixed Deferred Annuity Net Assets*
(dollars in billions)



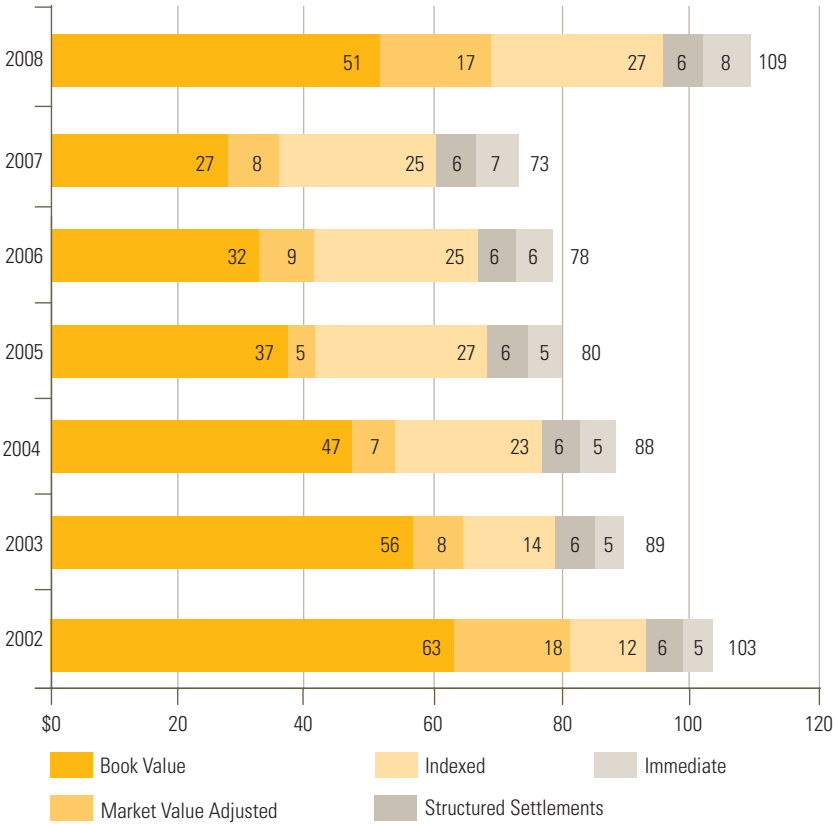
Source: LIMRA International

Sales Trends

Product Type

Fixed annuity sales increased for all product types in 2008. The largest fixed annuity product type is book value products, followed by indexed annuities, market value adjusted annuities, fixed immediate annuities and structured settlements. However, the major sales growth in 2008 came from book value and market value adjusted annuity sales which increased 86% and 123% respectively. In 2008, book value sales reversed the trend of declining sales from 2003 to 2007. Indexed annuity sales peaked in 2005 at \$27.2 billion after growing each year since the first product was introduced in 1995. Particularly strong growth occurred in 2002 and 2004. However, in 2008 indexed annuity sales grew slightly to \$26.9 billion from \$25 billion – an 8% increase.

Figure 7-4 Fixed Annuity Sales by Product Types
(dollars in billions)



Source: LIMRA International

Market value adjusted (MVA) fixed annuities are similar to book value annuities in that both earn a fixed rate of return. However, MVAs mitigate some of the intermediation risk, allowing for a more competitive multi-year guaranteed interest rate. The market value adjustment affects the surrender value on withdrawal activity occurring during

the interest rate guarantee period, based on a comparison of the guaranteed rate to current interest rates. MVA sales peaked in 2002 at \$18 billion, before tumbling each year to a low \$4.5 billion in 2005. However, in 2008, the market value adjusted annuity sales rose 123% to \$17.4 billion from \$7.8 billion in 2007.

Figure 7-5 *Indexed Annuities*
(dollars in billions)

Year	Total IA Assets*	Total IA Sales	Sales as a % of Total FA Sales
1999	14.0	5.0	12%
2000	19.0	5.5	10%
2001	25.0	6.8	9%
2002	35.0	11.8	11%
2003	47.0	14.4	16%
2004	71.0	23.1	26%
2005	93.0	27.2	34%
2006	103.0	25.4	32%
2007	125.0	25.0	34%
2008	138.2	26.9	25%

*Total assets are estimated

Source: LIMRA International

Immediate fixed income annuity sales rose a moderate 22% in 2008. Historically, sales of fixed immediate annuities have increased slightly or remained level every year since 1998. The slow climb in sales continued in 2008 as sales increased to \$7.9 billion (including \$200 million of indexed immediate annuity sales). Structured settlement premium grew 3% in 2008 with sales of \$6.4 billion. Structured settlement sales have been at or near \$6 billion each year since 2001.

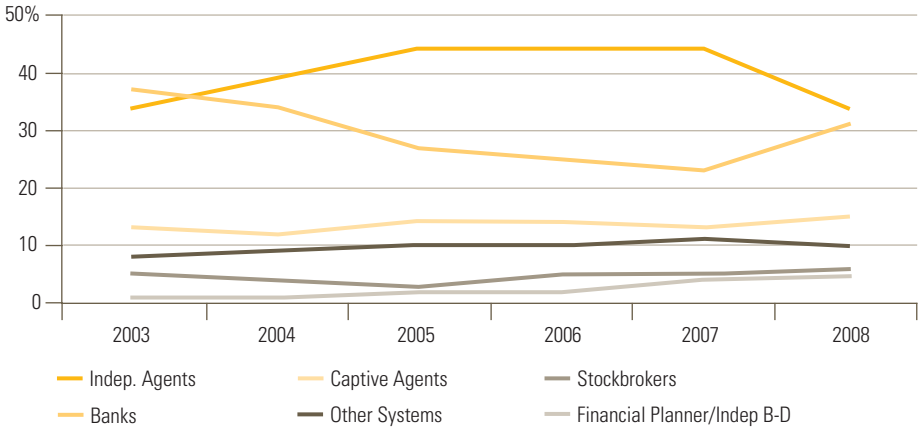
Distribution Channel

The distribution of fixed annuities continues to be dominated by independent agents and banks. In 2008, these two channels accounted for almost two-thirds of all fixed annuity sales, \$70.3 billion out of total fixed annuity sales of \$109.3 billion. In 2008, banks sold \$33.4 billion (31% of sales); almost as much as independent agents. Banks had only 23% of the market share in 2007. Independent agents have long been a leading sales channel for fixed annuities. Banks had increased their market share from 1998 through 2003, surpassing independent agent sales in 2003 (with 37% of the market) before falling back in recent years.

Robust growth in fixed annuity sales enabled all channels to increase their fixed annuity sales. The independent agent channel, in recent years the most dominant channel in fixed annuity sales, increased fixed annuity sales by 16% to \$37.0 billion in 2008 and accounted for 34% of total fixed annuity sales. Banks increased fixed annuity sales by 97% while career agents increased sales by 71%. The financial planner/independent broker-dealer channel, the largest distribution channel for variable annuities, increased fixed annuity sales by 77%, from \$3.0 billion in 2007 to

\$5.2 billion in 2008. The direct response channel increased its fixed annuity sales by 180% to \$2.9 billion in 2008 from \$1.0 billion in 2007. Fixed annuity sales through “other systems” are mostly structured settlement sales.

Figure 7-6 Fixed Annuity Market Share by Distribution Channel



Source: LIMRA International

Factors Impacting the Fixed Annuity Industry

Economic Factors

Much of the variance in fixed annuity sales can be explained by certain key drivers, primarily interest rates, market volatility and yield spread. The positive yield spread and equity market volatility played an important role in the growth of fixed annuity sales in 2008 because of investors’ demand for ‘safety of principal’ and ‘guaranteed returns’.

The yield curve —the difference between short-term and long-term interest rates — also impacts fixed annuity sales as insurance companies can invest long term, taking advantage of the spread when long-term rates exceed short-term rates. When the yield curve is flat or inverted, or when short-term rates are higher than the longer-term rates, it is difficult for carriers to offer interest rates that are higher than the rates offered on other short-term investments, such as certificates of deposit (CDs).

In contrast to the last few years, the yield curve remained positive throughout 2008. Short term yields declined due to the Federal Reserve Bank’s numerous rate cuts in 2008 and the increasing demand for principal security. During this time, fixed annuity rates offered by insurance companies remained quite attractive, becoming more lucrative in October and November due to a widening spread between treasury notes and corporate bond yields. As a result, fixed annuities rates remained well above

rates offered by bank certificates of deposit (CD) and other conservative investment alternatives, thus creating a very high demand for fixed deferred annuities in the last quarter of 2008.

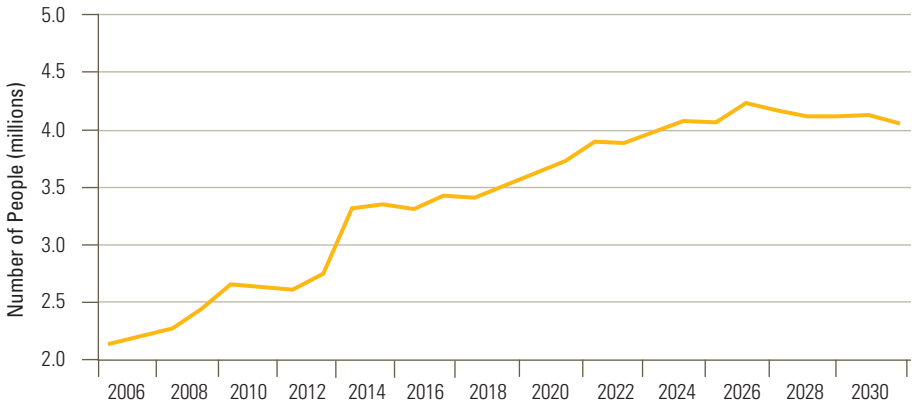
Demographic Factors

Perhaps more intriguing than the interest rate environment, the implications of the demographics of the United States has the potential to generate additional fixed annuity sales. In the past, older customers tended to be more conservative and were more likely to buy fixed products than younger individuals. The number of people turning age 65, the average age at which people buy fixed annuities, will continue to increase for the next 20 years as baby boomers grow older.

However, the rise in population reaching age 65 in recent years has not led to organic increase of fixed annuity sales. It is likely that fixed deferred annuity sales will enjoy increased attention in the future as individuals must now contemplate market risk and principal protection along with other considerations in retirement, such as longer life spans, less bountiful Social Security and defined benefit plan benefits.

Figure 7-7 Population Projections — Fixed Annuity Buyers

Turning Age 65 - Average Age of Fixed Annuity Buyer



Source: U.S. Census Bureau and LIMRA

Nonforfeiture Interest Rates

Fixed annuity products, by definition, have a guaranteed minimum interest rate. While the standard non-forfeiture laws which establish the required minimum interest rate can vary by state, most states allow the minimum rate to fluctuate between 1% and 3%. Fixed deferred annuity products typically credit an amount in excess of the minimum guaranteed rate. At the time of the sale, traditional fixed deferred annuity products will establish the initial interest rate to be credited. Subsequently, renewal

interest rates are determined by the insurance company. The return on an indexed annuity is tied to an index (typically equities based), yet the minimum guaranteed interest rate still applies.

Product Trends and Innovations

Fixed deferred annuity product trends and developments include the continued use of bonuses, offering guaranteed lifetime withdrawal benefit (GLWB) riders, as well as offering combination annuity and long term care (LTC) products. Indexed annuity product development has included more liquidity options, shorter deferred sales charge (surrender charge) schedules, offering GLWB riders, and provisions that provide income when it is used to pay for health care expenses. Fixed immediate annuity products continue to add features that offer greater flexibility, liquidity, and options by which payments increase over time, in addition to longevity annuities that provide protection against outliving your assets later in life.

Bonuses

A bonus can be added to a fixed annuity in multiple ways. The most common bonus for traditional fixed products is an interest rate bonus which typically will provide a higher first year interest rate. Also available is a premium bonus, which credits an additional dollar amount (typically a specific percentage of the initial sale) to the customer. Another type of bonus is a persistency bonus, in which a client can earn a bonus for retaining their annuity for a specified period.

GLWBs

Guaranteed lifetime withdrawal benefit riders began to appear in indexed annuities in 2006 and to a lesser extent in traditional fixed deferred products. Since loss of principal is not a concern for a fixed annuity buyer, the value of the GLWB is income that cannot be outlived, while retaining ownership control of the assets.

Combination Annuity/LTC Products

An area that has potential is the developing market for combination annuity/long term care products. Under the Pension Protection Act of 2006, starting in year 2010:

- Qualified long term care riders can be added to any non-qualified annuity contract issued after December 31, 1996.
- Charges to the cash value of an annuity or life insurance policy to pay for the qualified long term care rider will reduce the investment in the contract and will not be included in gross income. Furthermore, long term care expenses paid pursuant to the annuity/LTC benefit are tax-free.
- Section 1035 of the Internal Revenue Code (IRC) will allow for exchanges with long term care combination products. An existing annuity can be exchanged for qualified stand-alone long term care insurance (LTCI) or a combination product with a qualified LTCI rider.

Very few companies offered annuity/LTC products prior to the legislation. Today, more annuity companies are developing products to take advantage of the favorable tax treatment opportunity.

Current designs employ a traditional fixed or indexed annuity chassis with an LTCI feature built into the product or with the purchase of an LTCI rider. If the annuitant requires long term care, expenses are often paid first from the existing account value. After the account value has been depleted, the rider kicks in and will provide up to three times the account value in additional benefits. The period of time over which funds will be paid can vary (24, 36, 48, 60 months or lifetime payouts) and will impact the cost of the insurance benefit.

Outlook

For 2009, we expect to see continued success with fixed annuities, particularly if the yield curve remains positive, which provides a favorable interest rate environment for fixed deferred book value and MVA sales. The concern about protecting principal and fixed return will remain an important consideration in investors' minds. However, the concern about the financial strength as well as better use of capital elsewhere may force many insurance companies to participate cautiously in the fixed annuity market. Sales of equity indexed annuities should continue to improve since proposed Rule 151A, approved by the SEC in December 2008, does not go into effect until January, 2011. Continued focus on the retirement income market will help to improve fixed immediate income annuity sales.

