Safety of Annuities

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Wealth Advisory

IS MY MONEY SAFE?

This is a very common question, and you really must dig in to find out how safe your money is. With us, we typically work with LARGE insurance companies that have been around for a long time. There are exceptions, but for the most part, companies that get into trouble are typically small companies that we have never even heard of. Now let's discuss the mechanics of insurance companies and how safe they really are…

01 LEGAL RESERVE

This means that for every $100 million in premiums from clients, the carrier must have $100 million in assets in reserves. The money in reserves is invested, but in highly conservative investments. For example, most of the carriers have 50%-70% of their money in Treasuries or investment-grade bonds. Most of these bonds are held by Fortune 500 companies. They are also not all with one carrier; they are highly diversified, and usually one carrier is less than 1% of the total portfolio.

So, if that one company had a problem, the insurance company would first try to cut its losses and sell off the bond on the secondary market. If they do see a loss, it's very small on their portfolio, and often that one bond makes very little impact because the rest of the bonds perform as expected. If a lot of bad things happened all at once, the company must have a "SURPLUS OF CAPITAL."

02 SURPLUS OF CAPITAL

This is how much money the company has above its liabilities, or what's owed to its consumers. For example, if $100 million in assets is owed to its consumers, the company typically has $104-108 million in total assets; so, 4%-8% in surplus. If the carrier gets into trouble and all this bad stuff happens at the same time, they will then use their own surplus to put into the reserves and maintain the dollar-for-dollar ratio.

03 PARENT COMPANY

Next, if they exceed their surplus, they then go on and talk to their investors or parent company and let them know they need help. For insurance companies, it's very important that you know WHO is backing them. This is an extra layer of protection. You want the parent company to have a vested interest and substantial capital on hand. For example, Guggenheim Partners owns many insurance companies, such as Security Benefit, and they have over $4 billion in their general account alone. It's very highly probable that they would put more money into Security Benefit if they needed it.

04 SELL OFF OR INSOLVENCY

If the company does not have a parent company or if it cannot get capital from its group of investors, they are now starting to get into trouble. The first step here is for the carrier to go out and try to sell off to a much larger insurance company that's not in any trouble. Other insurance companies tend to look at this as an investment opportunity.

It's important for annuity consumers to understand that if this happens, the new carrier MUST buy the new policies as is and maintain the same terms on the policy. So, if the client is getting $5K per month in income, the new carrier must honor that as well.

05 REINSUREMENT & RECEIVERSHIP

Next, if the insurance company cannot be sold to another carrier, then the State comes in. When the State comes in, the insurance company is placed under state control, and the State will try to put them with another stronger insurance company. This is referred to as "receivership." Now the State has a legal responsibility to be sure the funds (the consumer's money) are safely transferred to the next carrier.

06 STATE FUND & LIQUIDATION

Lastly, if this doesn't work and the State can't find anyone to help, then the carrier ends up being backed by the State Guarantee Association.

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