

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

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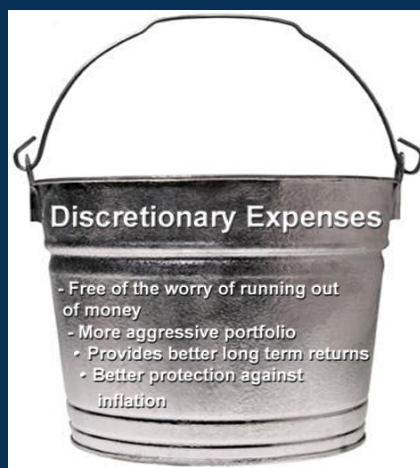
Retirement Income Planning

- **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

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How Should the Client Invest?



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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

<u>Type of Annuity</u>	<u>Percent</u>	<u>Largest Use</u>
Non-Registered, Prescribed	59%	Insured Annuity, Personal Funds
Non-Registered, Non-Prescribed	13%	Insured Annuity, Corporate Funds
Registered	28%	Retirement

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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

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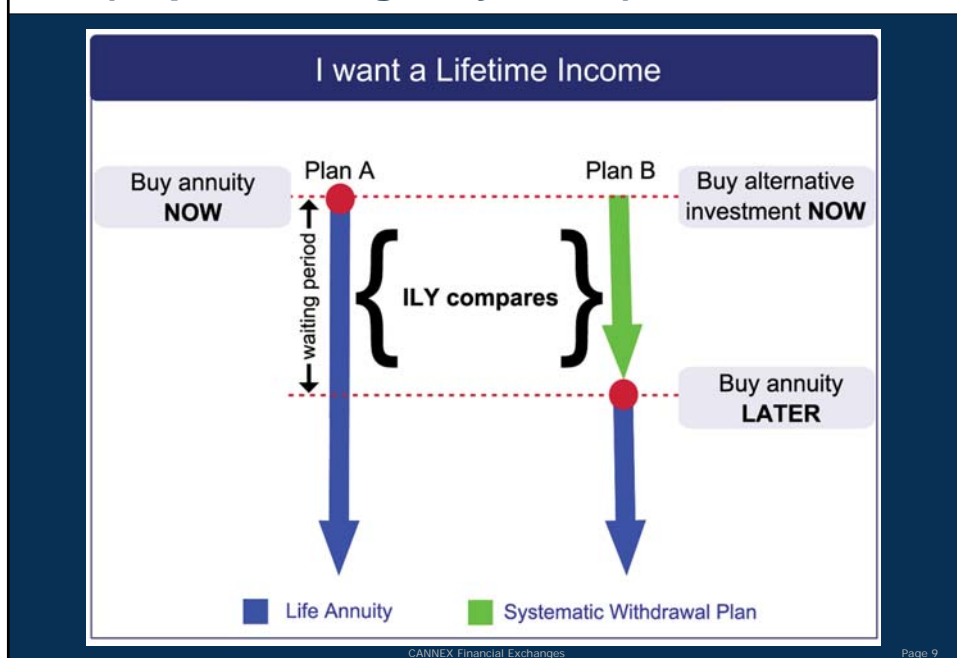
CANNEX' mandate will include education:

- **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%

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ILY (Implied Longevity Yield)



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**
- **US Product Innovations:**
 - Variable Payout Annuities
 - Long-deferred payout annuities (MetLife)
 - Combination accumulation + payout (GE)
 - ➔ **Easier to innovate in larger market**

But the Canadian SPIA market developed sooner

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#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

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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

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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

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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

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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

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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**

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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

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#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

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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**

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