

# In the Press

Webb Financial Group, LLC

**Michael Bischoff**  
CFP® & COO



**FINANCIAL  
ADVISOR**

## Rates Sour Fixed Annuity Market

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An unforgiving interest-rate environment is making fixed annuities a hard sell to investors.

Fixed annuities, structured to thrive amid high long-term interest rates, have lost their competitive edge as yields on short-dated securities rise comparatively higher. The phenomenon has caused a slight inversion of the Treasury yield curve and is pushing investors to alternative products such as certificates of deposit, which are currently offering more attractive rates.

Fixed annuities—which have returns tied to interest rates—are insurance products regulated by states that provide investors with a specific return over a certain period of time. While the return can change over time, it can't fall below a guaranteed floor.

**“The fixed annuity has totally lost its appeal in the market,” said Michael Bischoff, a financial planner at Webb financial Group in Bloomington, Minn. “Long-term interest rates are so low and short-term interest rates are so high.**

Indeed, after the Federal Reserve's 20-month spree of raising short-term interest rates, the Treasury note is yielding about two one-hundredths of a percentage point more than the benchmark 10-year bond. While the Fed is expected to end its tightening campaign sometime this year, it is expected to have as many as two more rate hikes up its sleeve. That will keep upward pressure on the near-term end of the curve.

**Bischoff said he had a client recently that wanted to place**

**\$100,000 in a conservative investment. He proposed putting the money in a one-year certificate of deposit until interest rates reversed course.**

**“As an investment representative, I have a hard time locking it up in a five-year (annuity),” he said. “That is why the CDs are more appealing than these fixed annuities.”**

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Fixed annuities have faced stiff competition from CDs, as banks increased rates to court consumers as short-term interest rates climbed. One-year CDs are yielding about 5%, up from 1.04% in 2003. By comparison, the S&P 500 last year returned 4.9%, and taxable bond returns were 2.06%, according to Lipper Inc.

“This is a very attractive environment for CDs,” said Greg McBride, a senior financial analyst at Bankrate.com. He noted that CDs are currently yielding between 4.5% and 5% on maturities ranging from six months to five years.

Such yields are attainable with modest minimum deposits and are protected by FDIC insurance and come without fees.

“Those returns...stand pretty tall relative to other asset classes,” Mr. McBride said. Investors are “getting additional return without having any

additional risk. That is unheard of in investment markets.”

In an environment where long-term interest rates are higher, insurance companies can go out and invest proceeds in longer-term instruments and offer higher rates. They aren't able to use this strategy when rates are relatively flat.

Michael Mortensen, president and chief executive of PNC Investments, said investors are more drawn to liquid, short-term investments such as CDs and Treasury Bonds with interest rates at or above what fixed annuities are currently offering. The tax-deferral benefit of annuities doesn't even offer much compensation.

“People tend to buy as much for the yield advantage as they do for the tax deferral,” Mortensen said, also noting that annuities which, typically have surrender fees out to five to seven years, yield around 4.5%.

“Customers don't feel comfortable tying their money up for that long and not receiving a premium over bank CDs and other short-term investments,” Mortensen said.

**Webb Financial's Bischoff said rising short-term interest rates have been particularly hard on fixed annuity producers.**

**“We can't sell the fixed annuity because the rates are so low. If we don't sell them then there's no commissions. If the client puts the money into a CD, then it's hard to charge a management fee,” he said.**