Will Fed Rate Cuts Make Fixed Annuities Less Desirable?

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Even though a cut in the Fed's benchmark interest rate hasn't happened yet, the anticipation is already having an affect on some annuities, advisors say. Fixed annuities, rather than variable annuities, will feel the most direct impact, they predict.

“When the Federal Reserve lowers interest rates, the effective rates on fixed annuities will also decrease,” said **Janet Fox, president of ACH Investment Group in Raleigh, N.C., and an LPL financial advisor**. “As a matter of fact, we have seen some fixed annuity rates start to decrease with the anticipation of a decrease by the Federal Reserve.”

The Federal Reserve is widely expected to begin easing rates at its meeting later this month, with most of the speculation centering on whether the decrease will be a quarter or half a percentage point.

Unlike other types of annuities, Fox said, fixed annuities offer a payout rate that’s closely tied to predominant interest rates. They are contractually guaranteed to provide a certain preset rate for a specific period of time. Many fixed annuities only hold the rate for three, five or seven years, however. Clients with one of these products may not feel any change immediately, she said. When the contract term is up, though, renewals will likely offer lower payouts, as will brand new issues.

Moreover, she noted, Fed rate cuts may extend into next year. “If the Federal Reserve continues to decrease rates, the rates of newly issued annuities will be lower than the current rates,” she said.

The pain of interest-rate cuts won’t be felt equally by all annuity holders. “The impact will vary,” said Teodor Panaitisor, assistant research director at Windsor, Conn.-based industry-data tracker LIMRA. Lifetime annuities—whether single-premium immediate annuities (SPIAs) or deferred-income annuities (DIAs)—lock in a rate when the contract is signed, he said. That won’t change.

Still, new fixed annuities might not offer the attractiveness of those that were contracted when rates were higher, which will be reflected in a sales slump. “As interest rates decline, it is likely sales will pull back,” Panaitisor said.

A possible exception is the fixed index annuity (FIA), advisors said. FIAs provide income linked to the performance of an underlying index, such as the S&P 500. They offer complete protection from market declines in exchange for a cap on upside potential. Interest rate cuts might cause annuity providers to lower the cap rates on these products, or adjust the spread (the percentage subtracted from index gains before the interest is credited to the account), analysts say, but FIAs could remain popular with clients who want market exposure without the risk of losing their investment.

"FIAs have a strong value proposition for investors looking for principal protection and growth opportunities, and we don't expect that to be impacted by interest rate cuts," said David Wood, a vice president at Lincoln Financial in Greensboro, N.C. If anything, he said, lower payouts for regular fixed annuities might cause more clients to pivot to FIAs. "We expect the FIA market to continue to grow," he said.

Overall, many industry watchers say they aren't particularly worried. "Although decreases in interest rates can lead to lower fixed annuity rates, changes in industry sales are also dependent on the current market environment and the relative value of these products in comparison to other available solutions," said Scott Gaul, head of individual retirement strategies at Prudential Financial in Shelton, Conn. "For example, if a period of lower interest rates coincides with heightened equity market volatility and uncertainty, some risk-averse clients may still value the protected growth that fixed annuities can provide relative to other solutions, like CDs."

Indeed, lower interest rates will depress the yields on most other "safe" investments, such as Treasury bonds and cash accounts, noted David Blanchett, Lexington, Ky.-based head of retirement research at PGIM, the investment management group of Prudential.

Blanchett pointed to a potential rise in annuity demand from new sources. For example, many fee-based advisors have started recommending annuities to their clients now that there are more low-cost, zero-commission products available, he said.

Another possible source of growth, he said, is 401(k)s. The SECURE Act made it easier for employer-sponsored retirement accounts to offer annuities to members by essentially extending legal protections against annuity providers that go bankrupt. For all these reasons, said Blanchett, annuity demand might keep rising "even if payouts and rates do decline."