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A.M. Best report defines VA issuers’ dilemma

By Editorial Staff *Thu, Sep 15, 2016*

Qualified VA’s will be affected by the DOL fiduciary rule, which includes more fee disclosures and level compensation structures, said a new report from the ratings agency. About 58% of VA separate account direct premium in 2014 was qualified.

Although marketplace demand for variable annuities continues as near-retirees look for lifetime income products, many VA issuers may not necessarily able to take advantage of that demand, according to the ratings agency A.M. Best.

According to “Variable Annuity Sales Decrease Amid Regulatory Changes,” a new Best’s Special Report, “The continued low interest rate environment and recent equity market volatility have pressured policyholders’ VA returns. This has also pressured insurers’ ability to manage large blocks of in-force VA business, many of which have richer guarantees than are currently underwritten.

“Risk management strategies, including the use of hedges, have helped mitigate these concerns, yet A.M. Best continues to see some market-driven volatility in earnings stemming from Statutory VA reserving requirements, including Actuarial Guideline 43, as well as some recent GAAP charges related to policyholder behavior.”

VA sales were down 18% in the first quarter of 2016 compared with the same prior-year period and down 16% from the fourth quarter of 2015. Decreases in VA sales have not been uncommon in recent years, as companies have looked to de-emphasize market-sensitive products and reduce the generous guarantees seen in prior years, Best said.

However, the decrease in the first quarter of 2016 also relates to equity market volatility and the looming U.S. Department of Labor (DOL) fiduciary rules changes. While equity markets are up in the second quarter of 2016, it is possible the industry will continue to see VA sales wane as policyholders look toward more stable returns from fixed and indexed products.

A.M. Best said it has already seen more money going toward equity-indexed products, including fixed-indexed annuities. Overall, there continues to be a strong and increasing need in the market for retirement and wealth management products as the U.S. population ages. Prudent investment returns have also been harder to come by.

Going forward, qualified VA’s will be affected by the DOL fiduciary rule changes, which will include additional fee disclosures and more level compensation structures. Approximately 58% of separate account direct premium written in 2014 was related to qualified business. A.M. Best does not expect this allocation to change significantly as there is a great need in the marketplace for tax-advantaged products.

A.M. Best also expects that companies could apply the new DOL fiduciary rule changes to both their qualified and non-qualified businesses. The rule changes will also greatly impact companies that utilize the Independent Marketing Organization for sales as they look to update systems and products for these changes.

Overall sales and separate account value growth have slowed for the industry. While there was strong growth in separate account individual annuity reserves from 2011 to 2013, this growth slowed from 2014 to 2015 as companies scaled back their VA sales and the equity market volatility for the period negatively affected account values.

Separate account individual annuity premiums and deposits also decreased 5% from 2014 to 2015, and withdrawals remained relatively high compared to historical amounts after increasing for five straight years from 2010-2014. Furthermore, surrenders and withdrawals outpaced premiums and deposits in each year from 2011 to 2014. Given the current environment for 2016, A.M. Best expects the trend would continue.