A Sobering VA Outlook, Via Cerulli

By Editor Test *Wed, May 19, 2010*

"The industry is still feeling the fallout from the Great Recession," Cerulli's Lisa Plotnick tells RIJ. "But the bad news is not unaddressable."

A new update from Cerulli Associates offers both good and bad news about the state of the variable annuity industry ("Cerulli Quantitative Update: Annuities and Insurance 2010").

The bad news, says Cerulli analyst Lisa Plotnick, is reflected in the feeble amounts of new cash flowing into the VA space. Net inflows were only 14%, or $17 billion, in 2009. That's about half what they were in 2007. "The VA industry is having a very difficult time attracting money right now," she told RIJ.

"When we see such a concentration of sales among the top sellers, that's indicative of an industry that's not growing," she added. "That doesn't imply a lot of exchange activity; it implies that the others aren't pulling in any money.

"The entire annuity industry is still feeling some of the fallout from the Great Recession. There remains a lot of distrust among advisors and consumers. Financial strength rating is the most hyped attribute of an insurance company, which is something we've never seen before."

But the "bad news is not unaddressable," she noted. If the industry comes through its current period of "stabilization and rationalization" with more willingness to listen to advisors rather than pitch products to them, they'll be in a better position to recover lost ground.

"They need to clean up their image and be more transparent," Plotnick told RIJ. "We are not in the same environment as 10 years ago. Jumping onto [product] bandwagons and chasing after RIAs (registered investment advisors)—none of that will work unless serious consideration is given to what advisors are looking for and how the annuity products can fit alongside other products in a clients portfolio."

Cerulli suggests that variable annuity marketers should prospect for sales in the following areas:

Qualified money. More qualified than unqualified money is flowing into VAs. As of 2009, 70% of total VA premiums consisted of qualified money, up from just 52% in 2000.

Mass-affluent investors. This is part of the qualified money story. Among the mass-affluent, qualified assets represent the majority of their retirement savings.

Rollover IRAs. The great majority of DC plan assets are rolled over into IRAs, and more advisors are said to be considering annuities as investments for rollover dollars. Plotnick writes: "Fifty-seven percent of advisors surveyed in 3Q 2009 would consider both immediate and deferred annuities for rollover dollars, up from 41% in 2005." Cerulli expects $1.8 trillion in rollovers between 2009 and 2014.

Financial planners. It's an enduring fact that while advisors on the whole don't love VAs, advisors intermediate 98% of VA sales. Financial planners "are considerably more likely than their counterparts in other practice types to recommend annuities for rollovers," Plotnick wrote in the update.

Simpler product designs. Although several VA issuers are still committed to contracts that are loaded with options and potential expenses, Cerulli seems to agree with the side of the industry that's banking on cheaper, no frills contracts for the advisor market.

On the other hand, "the market isn't quite ready for simplified variable annuities," Plotnick said. Advisors still want lots of investment choices, she said. John Hancock's simple Annuity Note contract got a chilly reception last summer when it offered just one investment option.

Long-term care insurance/annuity hybrids and living benefits on mutual funds. Insurance companies see these two product/distribution areas as offering the most opportunity in the future, Cerulli says. The addition of living benefits to UMAs and the idea of distributing VAs in the workplace are "viewed with less fervor."

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Advisors continue to say at conferences and in panel discussions that VA wholesalers approach them the wrong way. The wholesalers focus on insurance features, but the advisors want to know about the investments. Wholesalers pitch VAs as an all-inclusive product, but advisors want to hear about blending annuities with other products.

"VA wholesaling must evolve to incorporate product positioning—not product pitching—as a central element, in order for wholesalers to successfully capture advisors who infrequently use variable annuities," Plotnick wrote.

Although annuity marketers are hoping that the financial crisis will awaken a larger appetite for guaranteed products, that hasn't happened, Cerulli has found. Although 30% of advisors have "increased their use of guaranteed income streams," most advisors still have accumulation-focused practices and "remain reluctant to embrace holistic retirement planning" that includes guaranteed income streams and budget analysis."

On the question of product design, Cerulli thinks less is more. Based on research in the first quarter of 2010, the firm "determined that the most comprehensive features are not necessarily the most effective in generating assets." Providers should "optimize, not maximize" their offerings, and position them "within a holistic retirement income plan."

Within the next year or two, it should become clear whether the variable annuity with the GLWB will play a larger role in serving the Boomer retirement market, or if life insurance companies will call off the chase, and return to their core competency of mortality pooling.