A Time to Laugh, or Cry

By Kerry Pechter *Wed, Aug 29, 2012*

Just in time for the Insured Retirement Institute annual meeting in San Diego September 9-11, LIMRA and Morningstar have released their first-half variable annuity sales reports.

As of the halfway mark of 2012, the news on variable annuities, like news about the world at large, is mixed. The good news: net new money is flowing into the business. The bad news: net flows are at their lowest level since the beginning of the living benefit era.

LIMRA released mid-2012 sales figures for the top 20 annuity issuers in the U.S. last week. This week, Morningstar followed up with its quarterly VA sales report. The numbers provide specific detail to the anecdotal reports that annuity sales have softened this year.

Sales are off 6% year-over-year for three main reasons. Supply is down as a result of the retreat or withdrawal of several once-major players. Products are also less generous than they use to be, thanks in part to the fact that low interest rates raise the cost of hedging the guarantees. In addition, the industry relies heavily on its biggest members for growth. The five largest issuers (including TIAA-CREF) account for about 58% of sales; the top 10 issuers account for 80%.

At this point, most people know about MetLife's intended pullback from the market, evidenced by its lower (but still high) sales this year. In 2011, MetLife sold $12.65 billion worth of variable annuities in the first half of the year. In 2012, the firm's mid-year VA sales were $9.54 billion, a decline of just over 25%. MetLife was in third place in VA sales rankings in mid-2012, after having been first in mid-2011.

In his first-quarter 2012 earnings call, MetLife CEO Steve Kandarian told analysts that the firm was targeting total annual 2012 VA sales of "$17.5 to $18.5 billion," following its record sales of $28.44 billion in 2011. To the chagrin of investors and brokers, MetLife has reduced the generosity of its living benefit riders to help reduce risk exposure and temper its sales.

MetLife's chief competitors, Jackson National Life (known for giving advisors maximum investment freedom) and Prudential Financial (known for its "highest daily" benefit and asset-transfer risk management mechanism), have also moderated the generosity of their riders, but without as much impact on sales. Jackson's VA sales are actually up slightly.

Jackson's mid-year 2012 sales were $9.64 billion, compared with $9.53 billion for the first half of 2011, putting it in second place, up from the third spot a year ago. Prudential VA sales were down about 9%, to $10.29 billion this year from $11.35 billion in the first half of 2011.

Among the rest of the top 10, sales are down moderately at Nationwide and RiverSource, up moderately at AXA Equitable and AIG, and roughly even at Lincoln Financial, AEGON/Transamerica and Allianz Life of North America. Meanwhile, there's been some action among smaller companies. Ohio National and Guardian, for instance, have quietly slipped into Morningstar's top 20 list after beefing up their products earlier in the year.

Guardian Life, a mutual company, saw the industry's biggest percentage increase in sales, going from $487.5 million in the first half of 2011 to $843.4 million in the first half of 2012, an increase of more than 70%. Ohio National sales data didn't appear on LIMRA's Q2 2012 sales list because it doesn't participate in the LIMRA survey, but it did appear on Morningstar's. The Cincinnati mutual insurer, which introduced a new living benefit rider last winter that offers a 7% annual rollup for those who agree to invest in volatility-managed funds, had first-half 2012 sales of $1.377 billion, up 65% from $837 million in the first half of 2011.

In a single year, Ohio National rose from 21st place to 13th place on Morningstar's VA sales ranking, which was the greatest positive change in ranking of any company during that time. Ohio National was also the fourth-highest selling VA issuer in the wirehouse channel, with $367.2 million in the first half of this year. Its two most popular contracts are the ONCore Premier and ONCore Lite II.

John Hancock may have seen the biggest decrease in VA sales, with a decline from $1.05 billion in the first half of 2011 to $514.8 million in the first half of 2012.

Sun Life Financial, the Canadian-owned company that has gotten out of the VA business in the U.S., is the only firm not on LIMRA's top 20 list of domestic VA sellers in mid-2012 that was on it in mid-2011 (with $1.65 billion in sales). Hartford Life, which was not on the list a year ago, is back on the top 20 list this summer, with about $480 million in VA sales. The Hartford will continue to sell VA contracts until the sale of its VA business to Forethought is completed, a company spokesman said. (Hartford and John Hancock were not on Morningstar's top 20 in the latest report; ING Group and Ohio National were there instead.)

Everything but net

Less fresh money is flowing into VAs this year. According to an analysis by product manager Frank O'Connor of Morningstar's Annuity Research Center, only about $7.8 billion of the $73.5 billion in VA sales in the first half of 2012 was net cash flow; exchanges from one contract to another made up most of the sales volume.

"The positive flow has gotten so concentrated in the two or three biggest companies that when they hit the brakes the industry number nose dives," O'Connor told RIJ yesterday. He rattled off the annual mid-year net flow totals (in billions) for years 2005 through 2011: $10.0, $15.2, $15.1, $14.7, $11.2, $9.8, and $11.6.

If net flow stays at the current low pace, the variable annuity industry will end 2012 with the least total net flow than it has seen in over a decade. It will be even lower than the $17 billion recorded in 2009, during the aftermath of the global financial crisis, and far below the $46 billion recorded in 2003.

Morningstar's VA numbers were slightly different from LIMRA's. Second quarter 2012 variable annuity new sales were up 5.5% over first quarter 2012, to $37.7 billion from $35.8 billion, but were down 4.6% from the second quarter of 2011, O'Connor's report said. "At the midpoint of the year new sales of $73.5 billion are approximately 48% of 2011 full year new sales, indicating a strong possibility of a flat to slightly down year for VA sales absent a significant uptick in the second half. Assets were down 3.3% due to stagnant market performance," he wrote.

The two most significant trends in VAs this year are what O'Connor called a "back to basics" movement that emphasizes the tax-deferred growth advantage of VAs (which put no limit on contributions of after-tax money) and a trend toward simplified lifetime income guarantees.

On the "back to basics" side is Jackson National's Elite Access product, launched last March 5. The B-share has a 1.00% combined M&E and Administrative charge. It offers no death or living benefit guarantees; rather, its focus is on tax deferral and a broad array of investment options, including alternative asset classes.

Two other "back to basics" contracts are the Midland National LiveWell and Symetra Tru variable annuities. Both offer no loads and an extensive range of investment options, but the LiveWell VA offers a guaranteed death benefit and costs more (2.65% vs. 1.32%, all in). Neither product offers an income benefit.

Both Schwab and TDAmeritrade are adding low-M&E, simplified VAs with living benefits to their platforms. Schwab Retirement Income, launched on August 1 and underwritten by Pacific Life, has an optional single or joint lifetime withdrawal benefit and three fund options: Schwab Balanced, Balanced with Growth, and Growth funds. All three options are funds of exchange-traded funds (ETFs) and each costs 0.80% a year. The contract has no guaranteed death benefit. The total cost of 2.20% (2.40% for joint) also includes a 0.60% M&E/Administrative fee and 0.80% for the single lifetime withdrawal benefit (1.00% for the joint life version).

Great West launched the Smart Track contract last February 27 for TD Ameritrade's platform. Smart Track offers an extensive fund lineup, a tiny 0.25% combined M&E and administrative charges, average total fund expenses of 1.01%, and optional single or joint lifetime income benefits for an additional 1.00% (the joint version has a lower withdrawal percentage). Only amounts allocated to the Maxim SecureFoundation Balanced L fund, with a total expense ratio of 0.94%, are covered by the guarantee, so the all-in cost for the income guarantee in Smart Track is just 2.19%, in the same territory as the new Pacific Life product on the Schwab platform.

The most popular VA share classes remain the B-share (61.4% of sales) and the L-share (21.3% of sales), but sales of the client-friendly O share, whose M&E fee drops from B-share to A-share levels at the end of the surrender period, are growing. From virtually zero sales a year ago, the O share had a 3.9% share of sales as of June 30, 2012, according to Morningstar.