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An Actuary's View of the VA Market

By Editor Test *Wed, Jul 6, 2011*

Consulting actuary Tim Pfeifer, a self-professed fan of the guaranteed lifetime withdrawal benefit, spoke with RIJ about the evolving variable annuity market.

Tim Pfeifer, president of Pfeifer Advisory LLC in Libertyville, Illinois, works with annuity issuers on the design of variable annuity contracts. He is a former Milliman actuary who, since 1986, has been a consultant to life insurance companies, regulators, marketing organizations, banks and mutual fund companies. He formed his own consulting firm in 2008.

Last week, Pfeifer shared his views about the current state of the VA industry in an interview with *Retirement Income Journal* editor Kerry Pechter.

RIJ: Tim, what's driving the variable annuity market today? Downside protection? Upside potential? Liquidity? Tax-deferral?

Pfeifer: We're basically on a one-way street as far as guaranteed lifetime withdrawal benefits being the VA story. Today's customers want control and guarantees. Other factors—cheap pricing and tax efficiency, for example—are secondary, within reason of course. That's the direction the industry is moving in. The agencies, reps and customers want those two things.

RIJ: But haven't companies hurt the value proposition by diluting those guarantees?

Pfeifer: After the crisis, we went through a period of de-risking that saw some companies leave the business entirely. The more common [method of de-risking] was to increase prices and to restrict which assets could be wrapped in the guarantee. The market has responded pretty favorably to both of those things.

RIJ: The pendulum might even be swinging the other way. You've mentioned the word "re-risking."

Pfeifer: When I use the term re-risking, I don't mean that carriers are backing away from the required asset allocations, or the passive accounts, or limiting activity on the underlying investments or notching their pricing up a bit. I mean that I see companies making certain components of their lifetime withdrawal guarantee more attractive. Investors aren't throwing caution to the wind, but the direction is away from total avoidance of risk.

The attitude is, 'Let's find designs that are clever.' Prudential's success with asset transfer is getting play at other carriers. In their labs, a lot of companies are looking at something similar that gives them the ability to move money around on pre-programmed basis. The client may get a little more latitude to allocate assets than in some of the existing designs, but certainly not full latitude, and the carrier has the contractual right to re-allocate assets under certain circumstances.

RIJ: What’s your view of the concentration of the business among a handful of issuers?

Pfeifer: I see a continued movement toward the ‘rich getting richer.’ The VA business has always been a business of scale. The bigger players have a variety of advantages, up and down the line. They have the scale to negotiate better agreements with asset managers and administrative partners. In addition, the larger players have been innovative products on the product design side, and have advantages on the expense and risk management fronts.

The top six to eight VA players will continue to gather more market share. With the possible exception of mid-tier players who sell through captive distribution, it will be difficult for a carrier selling $700-800 million or less of VAs each year to find the economics attractive. It is simply getting harder and harder to compete against the large participants. Other competitive advantages must be sought.

RIJ: Are some companies growing too fast for their own good?

Pfeifer: As long as you’ve been writing a steady amount of business, that helps on the risk management side. A company that writes $10 billion worth of business in one year and writes a lot less than that the year before and after has a different risk profile than the company that writes $2 billion a year. The more you spread your sales over different economic cycles and market conditions, the better off you are likely to be from a risk perspective.

RIJ: Consumers are buying this product for guaranteed income. What part do the roll-up percentages play in making the income component attractive?

Pfeifer: The roll-up percentage, in my opinion, is a bigger sales story than the ultimate payout percentage. It’s also a source of potential risk if not sold properly. For instance, a friend of mine bought three variable annuities from three different carriers, all with GLWBs. He’s no dummy, but he thought he was getting a five to seven percentage roll-up on money that he thought he could take out as a lump sum. That element of the design—the roll-up percentage—is the product’s strong point, but it has to be sold accurately.

RIJ: That sort of confusion could come back to haunt the issuers.

Pfeifer: I love the GLWB. I was involved in the early days of the feature. It speaks to a need out there and the industry will be able to take advantage of its combination of control and guarantees. But it’s incumbent upon everybody to sell these the right way.

RIJ: Thanks, Tim.