Annuity issuers need to innovate: A.M. Best

By Editorial Staff *Thu, Aug 17, 2017*

Many post-election signs in the U.S. appear favorable for life insurers, but it may be 'a little too early to lock in this enthusiasm,' said the ratings agency in a special report on the life/annuity industry.

Boomer retirement, now well under way, was supposed to bring boom times to the life insurance industry, which alone can write life annuities. It hasn't been working out that way, and a new **report** from A.M. Best explains why.

Individual annuity direct premiums written (DPW) declined by 4.9% in 2016 to $202.7 billion after tepid increases each year from 2012 to 2014, according to "Regulatory Uncertainty, Equity Market Volatility Lead to Shifting Trends in Individual Annuity Products," the new report from the ratings agency.

That muted annual growth rate, averaging only 0.7% over the last four years, reflects the pressures that annuity writers face: increased life expectancies, persistently low interest rates, volatility in the financial markets and the uncertainty surrounding the DOL fiduciary rule.

Interestingly, the report adds "the imminent retirement of baby boomers" to list of annuity issuer headwinds.

A.M. Best has revised its outlook for the life/annuity industry to negative from stable. The industry doesn't look vulnerable to any single shock, but it is susceptible to a multitude of pressures, the report said.

Although many post-election signs in the U.S. appear favorable for life insurers, A.M. Best believes it "may be a little too early to lock in this enthusiasm," given the risk of global economic volatility, changing regulation, evolving capital requirements, and increased investment risk.

Product innovation will be essential to success, A.M. Best said in a release: "The annuity industry has a growing need for products that deliver guaranteed income and new market segments to engage an aging population… As insurers continue to adapt to the landscape, product innovation and strategic decisions on product focus remain imperative."

Annuities comprise a sizeable portion of the life insurance industry's business production. Individual annuities have fluctuated at around 30% of the industry's net premium written (NPW) and 45% of reserves over the last 10 years (2007-2016). Individual annuities also have consistently contributed favorable pre-tax operating gains, accounting for 30%-45% of operating gains in each of the last eight years except for 2011.

Group annuities have contributed an additional 19% in NPW and 11% in reserves, thanks to the emerging pension risk transfer market.

Variable annuities (VA), which are registered securities and might be considered a subset of the mutual fund industry, remain the largest contributor to DPW, at 36.2%. But their contribution to DPW has declined since 2012. The VA market is concentrated, with the top 10 individual VA writers accounting for 77% of the market in 2016. The indexed annuity market is similarly concentrated.

The traditional fixed deferred annuity space remains tiny but competitive. It accounts for only about one quarter of individual annuity premium, but almost twice as many insurers wrote $50 million or more of DPW in 2016 than wrote VA and indexed annuities.

Companies with greater investments in technology and more technical expertise in product development likely can conduct better cluster analysis to help identify commonalities in customer characteristics and behavior, which would help to minimize lapse ratios and better predict policyholder behavior, the report said.