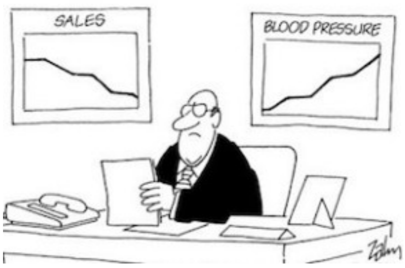
Expect Sharp Drop in VA Sales: LIMRA

By Kerry Pechter *Thu, May 26, 2016*

'We are seeing a significant shift in the annuity market," said Todd Giesing, assistant research director at LIMRA's Secure Retirement Institute. 'We have to go back 20 years—to 1995—to find when the VA market share was 45% or lower.'



Variable annuity sales in the U.S. are likely to drop 15-20% in 2016 and an additional 25% to 30% in 2017 as broker-dealers adjust to the requirements of the Department of Labor's conflict-of-interest rule, and in particular to the rule's "BIC" Exemption, which applies to variable and indexed annuities.

That prediction came this week from the LIMRA Secure Retirement Institute, which conducts market research for life insurers. "We foresee sales coming down in 2017, but we expect sales to rebound in the future. Growth levels should come up as companies get used to the new normal," SRI director Todd Giesing told *RIJ* this week.

The prediction followed the variable annuity industry's worst sales quarter in almost 15 years. In the first quarter, total annuity sales were $58.9 billion, or 9% higher than in 1Q2015, but VA sales experienced their lowest level since 2001, at $26.6 billion, or 18% lower than in 1Q2015 and only 45% of the annuity market.

January 2016 sales were 28% lower than in December 2015, according to Morningstar's quarterly Variable Annuity Sales and Asset Survey, which was released this week. "Looking at the top-ten issuers, they were all in negative territory for sales versus the previous quarter. Seven of the top ten had double-digit negative sales growth from the previous quarter. More broadly, nearly every issuer had negative growth for the quarter," wrote Kevin Lofreddi, Senior Product Manager for variable annuities at Morningstar Inc.

"The equity markets had huge 10% drop in January, from which they've slowed rebounded," Giesing (below right) said. "This was the second spike in volatility and drop in equities since August of 2015. We've seen variable sales drop when equities go down, but not this much.

Even during the financial crisis, sales didn’t fall below $30 billion.”

Lofreddi believes that DOL conflict-of-interest rule, which was issued April 6, 2016, did not affect first quarter variable annuity sales. “But the rule will have an impact in the future as firms ramp up for the changes that need to take place,” his report said.

“In the first quarter, we were still pre-final DOL ruling,” Geising said. “Expectations were that variable annuities would be under the BICE, and indexed annuities under PTE 84-24. Some of the variable annuity players were already putting more focus on their indexed businesses, especially AIG and Nationwide. We don’t expect a huge drop-off in indexed sales over the next quarter or two, but we expect more impact in 2017.”

“The DOL will have its biggest impact on the rollover market,” Giesing told *RIJ*. “Out of the $236 billion in individual annuity sales in 2015, $120 billion was in IRAs. Of that, $67 billion was in variable and $34 billion indexed. Of $120 billion, $67 billion in variable and $34 billion in indexed. That’s roughly $100 billion in VA and indexed, which is 84% of IRA annuity sales.”

Variable annuities are largely vehicles for equity investments and tax-deferred trading, and VA watchers put the blame for weak first-quarter sales on the 10% drop in equity indexes in January, which created a flight to the safety of other annuity products, like indexed annuities and fixed-rate annuities, which can’t lose value.

In the first quarter, sales of fixed annuities jumped 48%, to $32.3 billion. \All retail fixed products experienced double-digit growth, compared with the prior year. Indexed annuity sales jumped 35%, to $15.7 billion, with all of the top 10 writers reporting increases.

“Indexed annuity sales have experienced eight consecutive years of positive growth and we are forecasting that indexed annuities will continue to see strong growth throughout 2016,” the LIMRA release said. Sales of book value and market-value-adjusted fixed-rate deferred annuities, which often spikes when equity market volatility spikes, were up 90% in the first quarter.

First quarter fixed immediate annuity sales were $2.5 billion, up 25% y-o-y, LIMRA's SRI said, even as higher demand pushed prices up and yields down to a 2016 low of 1.63% on February 11. Deferred income annuity (DIA) sales jumped 29% in the first quarter, to $729 million.

Eleven companies are now offering qualified longevity annuity contracts (QLAC) products, and 12% of first quarter 2016 DIA sales were in QLAC compliant products. The Institute predicts QLAC sales will see an uptick in 2016. The growth of these products (SPIA and DIA) demonstrates the strong demand for guaranteed income, LIMRA said.

There's a stark difference between the top-line and bottom-line numbers for the VA industry. While total assets under contract, at $1.83 trillion, are close to their all time high ($1.88 in 2014), the industry overall is shrinking in terms of net new sales. Net flows in the first quarter of 2016 were negative 1.9%. Net flows were negative 3.3% in 2014 and negative 5.2% in 2015.

Overall sales have been falling since 2011, and have never returned to the peak year of 2007, when gross sales were $179.2 billion and net flows were $34 billion. But variable annuities are still the biggest-selling annuity product in the U.S. They remain the only retail product where an investor can put a virtually unlimited amount of after-tax (non-qualified) savings for tax-deferred growth. They are also the only annuity product that is sold through the securities-licensed broker-dealer channel. More than 70% of VAs in the first quarter were sold either by captive agents (38.7%) or by independent advisors affiliated with broker-dealers (33.2%).

But the VA share of the market has been shrinking, relative to sales of fixed indexed annuities, which continue to climb. "We are seeing a significant shift in the annuity market," said Giesing. "In the first quarter, VA sales had a 45% market share, compared with a 60% market share just a year ago. We have to go back 20 years—to 1995—to find when the VA market share was 45% or lower."

All sectors of the VA market are soft, Giesing said. "When we talked to manufacturers, we found that three-quarters expected variable annuity sales to decline irrespective of whether the product has a guaranteed lifetime withdrawal benefit or if it's investment-only," he said in an interview. "And if you look at qualified versus the non-qualified markets, we still had over half of manufacturers expecting moderate to significant declines in non-qualified annuities."

"When you look at why people turn to annuities, as the only source of guaranteed income, that need won't go away. Half of annuity sales in 2015 had an income component. By 2021 there will be 11,000 people a day turning 65. Today there are 50 million retirees. We expect that number to reach 66 million by 2025. And as fewer people have the backstop of a defined benefit pension, and if Social Security still faces unknown questions, people will look to annuities. In the short-term, through the end of 2017, you'll see the manufacturers taking a very conservative approach."