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## Heat from the Street

By Kerry Pechter    Tue, Apr 3, 2012

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*At a vulnerable juncture in the evolution of their products, publicly-held VA issuers are feeling unprecedented pressure from Wall Street. That was made clear by speakers at the IRI Marketing Conference in New York this week.*

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The Hartford's recent announcement that it would get out of the individual annuity business brooded over the Insured Retirement Institute's marketing conference this week like the wall-mounted head of a taxidermized, heavily-antlered, glass-eyed stag.

The insurer's decision, which apparently came at the insistence of hedge fund manager John Paulson, was an unsettling reminder that Wall Street will help determine the future of the annuity business, for better or worse. Paulson controls a reported 8.4% of Hartford shares (NYSE: HIG).

Indeed, the influence of Wall Street seemed evident in the mere fact that so many IRI attendees stuck around for Monday's final pre-cocktail general session, listening closely to a pair of sobering presentations on why investors continue to undervalue most life insurer stocks.

The ballroom of the New York Hilton remained quiet as Ramy Tadros of Oliver Wyman explained that, according to his data, every dollar of new VA business—hypothetical, fully hedged living benefit business with conservative assumptions about the economy—stands to lose about six cents, depending on client behavior. Yet some insurance executives continue to use rosy assumptions that project margins of 10% to 20%, he said.

Following Tadros at the podium was well-known UBS analyst Andrew Kligerman, who said the market wants more transparency from life insurers. Unless variable annuity pricing techniques become less of a "black box," he said, investors would undervalue the companies that issue them—even though "the life industry is healthier than it's ever been."

"If insurance companies want valuations to go up, they'll need to declare more," Kligerman noted. "I'm not seeing the disclosures. That's the big issue right now."

And that's also the big rub. In a business where product developers guard the recipes of their "secret sauces" like four-star chefs, where accounting fudge-factors are not uncommon, and when many investors may not even want to spend time studying the VA funds and riders—how much more transparent can a publicly-held VA issuer be, and how much impact would it have?

(At one point, the irony that life insurance guarantees inspire less confidence than the Street's demonstrable inability to anticipate the future course of the markets seemed to hang in the air of the ballroom like the tobacco smoke that would have hung there if this meeting were held a few decades ago.)

The other elephant-in-the-room—bigger than the transparency elephant but perhaps more futile to debate—was the low interest rate environment, a form of financial repression that gives life to equities but

murders the annuity business. “We need a good move in interest rates,” said Kligerman. “We need 10-year Treasury rates of 3.0 to 3.5%.”

### **Not hula-hoops**

To evaluate the viability of the VA business, however, requires that an investor know much more than how the hedges in the products work. The panelists at the IRI breakout sessions on Monday made it clear that each annuity manufacturer positions its products differently and each advisor uses the products a bit differently. These are not hula-hoops.

At the session on “Trends in Retirement Income,” for instance, Michael Harris of Lincoln Financial, Kevin Kennedy of AXA Distributors, and Bob Densmore of Allianz Financial Services made it clear that their strategies are as different as their ownership (Lincoln Financial is a publicly-held U.S. company; Allianz and AXA have European parents).

Lincoln focuses on consistently pushing its patented deferred variable income annuity, i4Life, which has given Lincoln a perennial fourth-place ranking in VA sales. “Our niche is income,” Harris said. “Twenty percent of the business that comes in the door gets annuitized.” For Allianz Financial, indexed annuities continue to be the sweet spot.

AXA Financial, by contrast, appears most excited about its Structured Capital Strategies ADV variable annuity, an accumulation vehicle that uses a collar strategy to mitigate risk while offering exposure to equities and commodities indices. The product just posted its first \$100 million month, Kennedy said, and 58% of sales are going to advisors who’ve never sold a variable annuity before.

The same impression—that there is no monolithic VA industry—was left by a panel on “Retirement Income Methodologies of Advisors,” where statements by Gregory Blank of Blank Financial Group, Ben Kronish of Kronish Associates, Inc., and Gregory Olsen of Lenox Advisors demonstrated the heterogeneity of advisor approaches to the use of annuities.

For Blank, an income benefit is just a safety net that enables his clients to take more risk. For Kronish, who sells only by commission, guaranteed income is the goal, not the safety net. For Olsen, the VA living benefits allow his nervous clients to stay invested through dicey markets instead of cashing out.

### **1% to 2% growth forecast**

Unprecedented sales consolidation was also on the minds of several IRI attendees. Manufacturers and distributors alike were asked if they were concerned that the “big three”—MetLife, Prudential Financial and Jackson National Life—account for more than half of all VA sales. At least one executive said yes.

“I worry that I’ll wake up one day and find that 40% of our business is going to one insurance company,” said Scott Stolz of LPL Financial. “The domination by three firms is unprecedented,” said Bob Densmore of Allianz Financial Services. “We’re seeing a separation into the haves and have-nots. Each company is trying to decide where they want to be in the marketplace.”

Few expect VA sales to be strong in 2012. If anything, the pace of exchanges, which normally account for most new sales, should slow because new products are generally less generous than older products. LPL's Stolz expressed concern that VA products might "get worse for awhile"—with higher costs and leaner benefits—and lead to a period of lower sales.

MetLife intends to reduce VA sales from \$28 billion in 2011 to "\$17.5 to \$18.5 billion" in 2012, said Kligerman, who predicted sales growth of just one to two percent in 2012 and 2013. Wall Street might even like that; as Kligerman said, "Growth in this category is not seen by investors as a good thing."

Despite recent upward movement in 10-year Treasury rates, the low rate environment, which escalates the cost of hedging, is expected to linger until at least 2014. If an attractive new product appears in 2012, said one attendee, it will probably come from a smaller life insurer that doesn't have what one IRI speaker called the "albatross" of a questionable book of old VA business around its neck.

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