It’s July, So We Must Be in VA-VA-Land

By Editor Test *Tue, Jul 5, 2011*

Welcome to Retirement Income Journal’s Variable Annuity Month. We’re devoting all four of our weekly issues in July to the promise and the problems of variable annuities.

It’s tough to describe the variable annuity market because it is many different markets in one. Among VA makers, for instance, you have the leaders, the niche-nursers and the opt-out-ers. (Or, to borrow a description of retirees: the go-gos, slow-gos and no-gos.)

The distribution world is just as fragmented. Among independent advisors, there’s a small core of heavy users who want insurance for their equity plays or simply love the commission. There are a few who use VAs primarily for tax deferral. Many of the rest skeptics.

At the same time, end-users vary widely in their wants and needs. You have individuals who warm to the combination of guarantees and control. You have people who like the 10%-of-principal-for-life-after-a-10-year-deferral proposition. Potentially, you have the 50-to-65-year-old DC participants with big balances. And you always have your 1035-exchange prospects.

What you don’t have, even after five years of innovation and marketing and pep-rally conferences (and a financial crisis and three years of zero interest rates and the arrival of the first Boomer at age 65), is much growth in the relative size of the annuity market.

For years, the amount of assets in individual annuities of any kind has remained at less than 10% of the retirement market. According to the Investment Company Institute’s recent Retirement Industry Report, the annuity share was 8% in 1996 and 9% in 2010.

The value of all total U.S. retirement savings, including public and private plans and individual assets, is $18.1 trillion, as of March 31, 2011, according to the ICI. The value in annuities of all kinds was $1.64 trillion (most of it in variable annuities). In 2000, $951 billion of the 11.7 trillion in retirement assets was in annuities.

This is not to say that VA issuers been complacent. On the contrary, their product developers and actuaries and financial engineers have been working as fast as they can just to stay in the same place. Unfortunately, they face at least three big problems.

Problem one: the low interest rate environment. Low interest rates have been a two-edged sword. Had they not fallen to historic lows after 2008, the equity market (along with insurance company stocks) would not have reinflated. Consequently, those living benefit guarantees would still be under water. So there’s a positive side to low interest rates when most of your underlying assets are in equities.

But low interest rates means high hedging costs, which have to be passed along to the customer in terms of weaker benefits or higher prices. Luckily, the customer has tolerated price hikes fairly well. And the fees, to the extent that they reduce account value growth, will ultimately be felt by the beneficiary, not the contract owner.

Problem two: If you’re not one of the top five or six manufacturers, your problem is that the top five or six issuers are grabbing more than half of all sales. According to Cerulli’s survey of insurers (see accompanying article in today’s issue of RIJ), the “concentration of sales with a few carriers” is among the top three industry problems cited by life insurers.

That’s not just sour grapes on the part of those who are losing market share. Bing Waldert, Cerulli’s director of research, says that industry concentration hinders the development of broader consumer acceptance of VAs. Even executives at the market leaders have said they’d rather have a smaller piece of a bigger pie than vice-versa. see more balanced growth.

Problem three: the small number of advisors who are selling VAs. Even after the financial crisis showcased the value of the living benefit guarantee, and even after VA issuers developed low-cost shares for the fee-based advisor community, only a small segment of advisors sell more than a handful of VAs each year. (For much more on this, see Cerulli article.)

Over the next several weeks, we’ll be examining these problems, as well as their potential resolutions.