VAs suffer record outflows, but enjoy record assets

By Editorial Staff *Wed, Mar 31, 2021*

As Morningstar's quarterly VA sales report for 4Q2020 shows, the VA business is complicated, with record-high sales of index-linked VAs, record-high VA assets on the books, but record outflows from VAs overall. Go figure.

The registered index-linked annuity, or RILA, has perhaps the least self-descriptive name in the entire annuity industry, and that’s saying something. A few distributors flat-out hate the acronym for this hybrid product—which combines features of a variable annuity, a fixed indexed annuity, and a structured note.

But no one can argues with the sales numbers that RILAs are putting up. As Morningstar’s VA quarterly sales **analysis** for 4Q2020 shows, sales of these cap-and-buffer contracts were up 70% in the fourth quarter of 2020, versus 4Q2019, and LIMRA had them growing almost 40% in 2020, to $24 billion.

The RILA market is still much smaller than either the traditional VA market ($74.9 billion sales in 2020), where Jackson National dominates ($16.6 billion), or fixed indexed annuities ($55.7 billion) in 2020, where the private equity firms have muscled in. But both of those categories saw overall falling sales in 2020.

That makes sense. RILAs don’t seem to carry the annuity stigma, and they give nervous investors a Goldilocks alternative to high-priced stocks or bonds. Not that the average investor would understand how RILAs work. To structure them, insurers buy upside calls and sell downside puts on domestic or international equity indexes. The call options buy gains up to a cap, and the puts buy buffers against the first five to 35 percentage points of loss over a given term. The S&P 500, Russell 2000 and MSCI are among the indexes commonly used.

With their fixed income assets yielding so little in today’s low interest rate environment, life insurers have for a decade had to tap into the robust equity market, either by wrapping guarantees around mutual funds (in a traditional VA) or buying options on an equity index. Equitable (then owned by AXA) brought the first RILA to market in 2011; others have followed.

Five of the 10 best-selling VA contracts in 4Q2020 were RILAs: Prudential Flexguard B (2), Equitable’s Structured Capital Strategies (3), Lincoln’s Level Advantage (4), Allianz Life Index Advantage Income (6) and Allianz Life Index Advantage (10). The top seller, with a whopping 14.3% market share, was Jackson's Perspective II.

Flexguard was the top-selling rider in the fourth quarter of last year, but, as a newcomer to the market, was only fifth in sales for the year. Lincoln's Level Advantage B-share was the top seller for 2020, with $4.18 billion in sales. Allianz's Index Advantage Income moved into the list of top 10 best-selling VAs jumping 14 places compared to Q4 2019. RILAs accounted for almost 24% of all VA sales in the fourth quarter, up from 14% a year ago.

VA assets top $2 trillion

Sales of traditional variable annuities, with and without lifetime income guarantees, have taken a huge hit from the low interest rate environment of the past decade. While a rising stock market would be expected to favor VAs—which consist of tax-deferred mutual funds—low interest rates makes it expensive to hedge them. Costs have gone up and benefits have gotten less generous.

Sales of VAs have stabilized at between $87 billion to $91 billion a year for the last three or four years, after peaking at $125 billion in 2011. But the real damage shows up in the net flow statistics. The category has suffered increasingly large negative net flows. In 2020, for the first time, net outflows of money from VAs (-$94.9 billion) surpassed new sales ($87.1 billion).

Don't cry for VA issuers, however. They are still huge fee generators for the companies that issue them. The market value of assets held in VAs surpassed $2 trillion for the first time in 2020. Since VAs generate both insurance and investment fees (as high as 4%, in contracts with income benefits), those assets could easily produce more than $50 billion in fees for annuity issuers and asset managers. Of that $2 trillion, more than 25% is at TIAA, where it is held mainly in group annuities at the firm's network of 403(b) plans. The top 10 VA issuers account for about 80% of VA assets.

VAs with GLWBs

The sale of non-RILA VAs offering guaranteed lifetime withdrawal benefits (GLWBs) fell 12% y/y but grew 12% over the previous quarter—signaling a slow recovery for the segment. Jackson's Perspective II, AIG's Polaris Platinum III B, and Ameriprise's RVS RAVA5 Advantage all showed significant sales movement, according to Morningstar.

The Perspective II retained its top position and saw sales jump by 7% to $3.4 billion in the fourth quarter. Its living benefit offers an average fixed percentage increase (FPI) of 6% and its withdrawal rates lie near the 75th percentile of the industry. AIG’s Polaris Platinum grew 8% y/y in sales; its GLWBs offer better-than-average benefit fees and withdrawal rates.

Sales of Ameriprise’s RVS RAVA5 Advantage dropped 34% y/y and the contract fell out of the top 10 sellers. While its living benefits offer a relatively high FPI of 6%, the withdrawal rates of its GLWBs dropped by 20 to 50 basis points year-on-year. Benefit fees increased by 15 to 55 basis points in the same period.

Though Perspective II and RVS RAVA5 have comparable FPIs, withdrawal rates and benefit fees, The discrepancy in quarterly sales between Perspective II and RVS RAVA5 may reflect the role of distribution channels and surrender schedules. The Perspective II is distributed primarily through independent agents; that channel rebounded after restrictions on businesses were lifted in the third quarter.

RVS RAVA5 is distributed through captive agencies, which continue to record negative quarter-on-quarter sales growth. Moreover, interest rates increased in the fourth quarter, which may have led investors to favor more liquid products. RVS RAVA5 has a 10-year surrender schedule, whereas Perspective II has a relatively short 7-year schedule.

Four new VA contracts were introduced and five closed down in 4Q2020, as new product activity remained sluggish. Seven new living benefits appeared while twelve closed, perhaps because high market volatility drove up the cost of hedging.