# Lounging by the (Mortality) Pool

By Kerry Pechter  *Tue, May 1, 2012*

*The climate was ideal, but annuities upstaged sunbathing at the 2012 Retirement Industry Conference at Walt Disney World Resort in Orlando last week.*

"Life is really quite stochastic in nature," said Bob O'Donnell, the new president of Prudential Annuities, at the start of the LIMRA-LOMA-SoA 2012 Retirement Industry Conference at the Hilton Buena Vista in Disney World last Thursday morning.

Insurance people can be masters of understatement.

O'Donnell's keynote, "The Complexities and Opportunities of Modern Retirement," flew mainly at the 20,000-ft level but eventually touched down on a topic that Prudential executives have mentioned a lot lately: Contingent Deferred Annuities, or CDAs (aka Stand-alone Living Benefits, or SALBs).

"Using CDAs to offer longevity risk protection on currently unprotected pools of assets" represents the next phase of Prudential's annuity business and, O'Donnell (at right) suggested, the VA industry's future—especially now that the regulatory status of CDAs as life insurance products is being clarified.

"Our belief is that the CDA solves a fundamental challenge," said the bearded O'Donnell, who came to Prudential when it acquired American Skandia in 2003 and who brought the basic chassis of what became Prudential's "Highest Daily" VA lifetime income rider with him.

In response to a question from the audience about CDAs, he said: "We struggle with why our value proposition doesn't reach a larger crowd… It's not the complexity of the [VA] product or the fees. It's a conflict introduced by the variable annuity industry.

"At a financial advisory firm or a broker-dealer, they offer investments and asset allocation, all wrapped in branded solutions. That's how they live every day. Enter the annuities industry. We force advisors to make choices between their processes and our value proposition. That's our fundamental constraining element in reaching the broader market," he said.

But CDAs can resolve that constraint, he said, and can invigorate the annuity business. "Substantial participants have left the VA business or dialed back their effort, but we will see firms that are not as prominent and firms that not currently participating in VAs enter this space. This is an enormous opportunity. There is high demand and low supply. That's French for profit."

(Prudential, the top VA seller in 2010, has been open about its intention to issue a CDA, which attaches a living benefit rider to mutual fund portfolios and managed accounts. In an interview with RIJ this week, Bruce Ferris, senior vice president, sales and distribution, at Prudential Annuities, said his firm's CDA will employ the same dynamic asset transfer risk management method used in Prudential's variable annuities. Prudential hasn't said when it will introduce a CDA product.)

**The framing guy and the statistics guy**

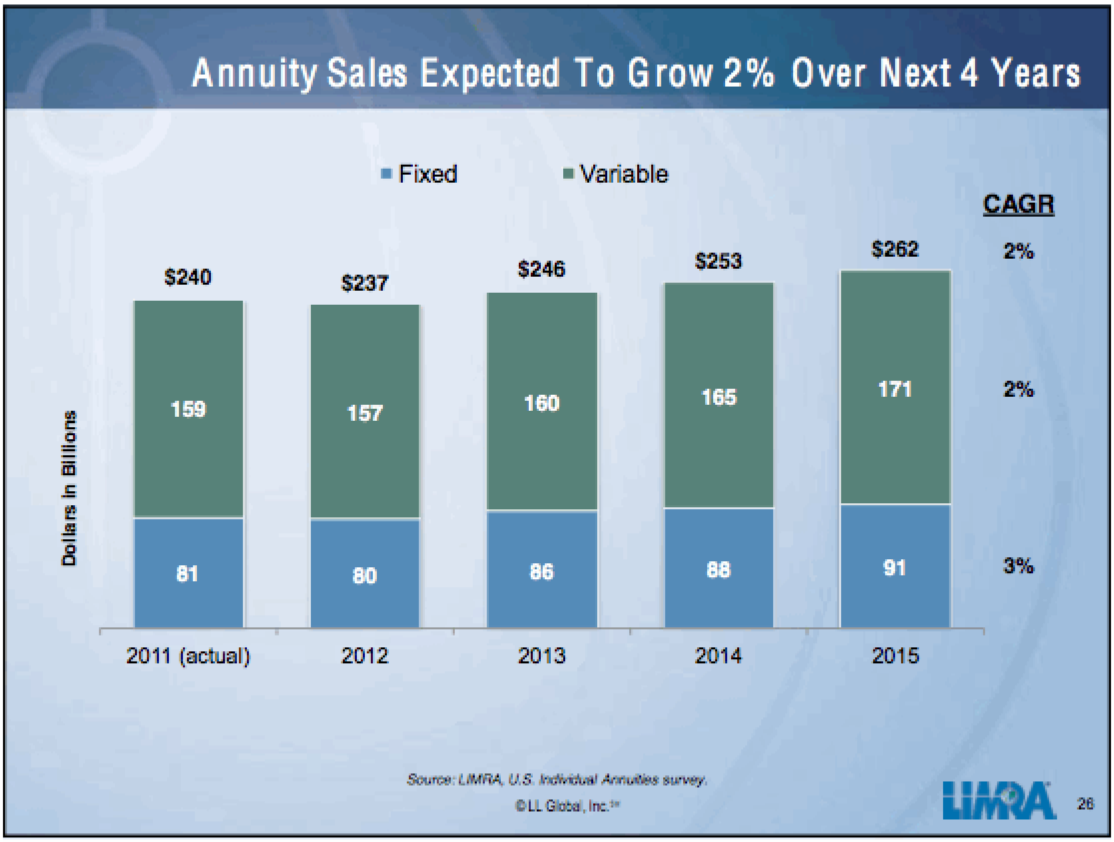
O'Donnell was followed by Jeffrey Brown of the University of Illinois, who identified himself as "The Framing Guy." Brown is a leading authority on annuity framing effects, a branch of behavioral finance that studies how and why people make annuity purchase decisions.

Brown has established, for instance, that people tend not to favor annuities when they are "framed" in a disadvantageous way—as a poor source of return relative to investments, for example, or as all-or-nothing bets against getting hit by a bus tomorrow.

Even worse for annuity sellers, he pointed out, is the fact that most financial planning tools ignore the dangers of longevity risk and most employer-sponsored retirement plans don't even mention annuities as a strategy for funding retirement.

"If an annuity isn't listed as an option, people will assume that it isn't a good idea. This needs to change. We have to get annuity options into the plans," Brown said. The RMD rules also have to change, he added: "You will run out of money if you follow [the current] recommendations."

LIMRA's Retirement Research vice president, Joe Montminy, who presents annuity sales statistics at the Retirement Industry conference each year, presented a slide show of his latest data. While 2011 VA sales rebounded to 2008 levels last year, he said, sales softened toward the end of the year as some VA sellers retreated from the market.




Indexed annuity sales, meanwhile, matched their 2010 record in 2011, with about $32 billion in sales. Some FIA manufacturers benefited in 2011 from the sales strategy of limiting distribution to a small number of highly-regarded independent marketing organizations, Montminy said. The FIA market is dominated by Allianz Life, Aviva USA and American Equity.

Despite the low interest rate environment, sales of fixed immediate annuities continued to climb from their low base, to a record $8.1 billion in 2011, according to LIMRA data. The average age of a SPIA purchaser is 71, 60% of SPIAs are funded with non-qualified money, all SPIA owners take income virtually right away, and the average premium is about $107,000, Montminy said. In comparison, the average purchase age for VAs with GLWBs is 61, 75% of VA/GLWB purchasers under age 70 use IRA rollovers to fund their contracts, only one in five GLWB owners is taking income, and the average premium is about $104,000.

Montminy co-presented with Chris Raham, senior consulting actuary at Ernst & Young, which operates the Retirement Income Knowledge Bank. In response to a question about VA issuers who may be looking at potential ways to buy back in-the-money GLWB benefits in order to reduce the long-term risk of certain books of business, Raham said they should “be careful” about doing so because of the potential “liability” issues involved.

On a promising note, Raham seconded O’Donnell’s bullishness on CDAs, suggesting that E&Y clients in the investment distribution world are ready—though not necessarily pining—for lifetime income solutions: “They’re saying, ‘We want the best way to provide outcomes. We understand that we will have to bring in products that we’re not comfortable with, but we want to do it in a systematic way.’”