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## Net VA flow ebbs to \$1.5 billion in 3Q 2013: Morningstar

By Kerry Pechter     Thu, Nov 21, 2013

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If the variable annuity market were a large dance hall, you might see a dynamic confusion of sweaty couples streaming on and off the crowded floor, some spinning to the music under the glitter ball and others flopping into folding chairs along the wall.

Some are changing partners. A few have slipped out the fire exit for a change of scenery, or headed home. The dancers number almost the same as always—but a subtle ennui in the air suggests that this venue is no longer the hippest in town.

Or, to dispense with obsolete metaphors, you could say that the variable annuity sales statistics for the first three-quarters of 2013 are contradictory and difficult to interpret. Assets under management reached an all-time high. But net flows have reached what may be a 10-year low. Publicly held companies still dominate this market, but they’ve played musical chairs with the top-ten list.

“Shifts in market share this year have been massive,” wrote Morningstar VA analyst Frank O’Connor in his third quarter and year-to-date sales report, issued yesterday. “Former market leaders Prudential and MetLife were down a whopping 44.3% and 37.1%, respectively,” while Lincoln National sales were up 47%, SunAmerica/VALIC (now American General) was up 34.8%, AEGON/Transamerica was up 59%.

Jackson National, which has diversified its VA offerings with the no-living-benefit Elite Access product, was the top seller by a large margin, with \$5.2 billion for the quarter and \$15.5 billion for the year. Relative to 2012, Elite Access sales have risen more than four-fold so far this year, to \$2.77 billion.

Despite the ongoing turmoil in the industry—evidenced by the departures, the de-risking, the dropouts, the buy-backs and the launch of complex structured or buffered products—consumers and advisers are still evidently looking for an all-weather retirement income tool. By no means have they abandoned variable annuities.

In the third quarter of 2013, gross new sales were \$34.7 billion, down 5.9% from the previous quarter (\$37 billion) and down 3.2% from the year-ago quarter (\$35.9 billion). Through the first nine months of this year, sales totaled \$106 billion, a 3.1% drop from the same period in 2012. “Absent a significant bump in sales activity in the fourth quarter, full year 2013 sales are expected to be down 2-3% from 2012 sales of \$143.4 billion,” O’Connor wrote.

Although sales were slightly down on an industry basis, the shifts in market share this year have been massive. Former market leaders Prudential and MetLife were down a whopping 44.3% and 37.1%, respectively, as those carriers put the brakes on VA sales. The net flows figure was extremely low, at about \$1.5 billion in the third quarter and \$4 billion for the year so far. But Morningstar characterized the net

flow as surprisingly good, given the cash drain from older and/or run-off blocks (like Hartford's) and from group annuities like TIAA-CREF.

"Though low, net flow remains in positive territory despite the heavy bleeding, which is no mean trick and in some respects perhaps a blessing in disguise to the extent the cash outflow represents a reduction in risk assets," Morningstar noted.

Sales of variable annuities without income benefits, which are sold for the long-term benefits of tax deferral and tax-deferred trading, were strong in the third quarter. With or without living benefits, variable annuities are still the only product where an investor can put virtually any amount of after-tax money for tax-deferred growth.

"Jefferson National's Monument Advisor, a flat fee product aimed at the RIA market, has seen quarterly sales almost double in the past year. Jackson National's Elite Access VA, focusing on alternative based investment strategies and offering no benefit guarantees, has nearly tripled quarterly sales in the past year. Another example is Midland National's LiveWell VA, where sales, while small in the context of the product sales of major players, increased almost 500% in the third quarter relative to the 3rd quarter of 2012," Morningstar said.

Most of the traditional variable annuity sales leaders or their parents have been stock companies: AXA, AIG (American General, SunAmerica/VALIC), AEGON/Transamerica, Jackson National (Prudential plc), Lincoln National, ManuLife (John Hancock), MetLife and Prudential Financial. ING, AEGON/Transamerica. Nationwide, ranked 13<sup>th</sup> in VA AUM, was a stock company but went private.

That makes sense, because their shareholders expect equity-like gains and the only way to get those is by taking risks—which in the 2000s meant equity-linked insurance products. Now that they've been whipsawed by equity volatility and an interest-rate drought, it's not yet clear where they will look next for strong profits.

Not every stock company jumped on the VA bandwagon. Principal (which has less than \$8 billion in VA assets under management), Protective, Genworth Financial, and Allianz Life of North America, either purposely chose to stay out of the business of writing puts on the equity markets or just decided to focus on other businesses. Nationwide has

The big mutual companies make up most of the second-ten leading VA issuers. Members of this group include Pacific Life, Thrivent Financial, New York Life, Ohio National, Northwestern Mutual, Minnesota Life, Massachusetts Mutual and Guardian. Together, they sold roughly as much VA product in the third quarter as Jackson National, the distant leader, sold alone.

More than two-thirds of variable annuities sold are of the B-share type, which carries an up-front of commission of 5% or more for the intermediary. Many sales were driven by both rich customer benefits and rich advisor incentives, and the risks as well as the direct cost of sales was high.

The issuer earns back the commission through the mortality-and-expense risk fees paid by the contract

owner at least through the surrender period. Those fees may be tied to the account value, which is tied to the stock market, which makes the issuer dependent on steady or rising equity values both to fund the income guarantee (especially if deferral bonuses are promised) and to recoup the deferred acquisition costs (DAC). When equity values dropped in 2008, companies had to set aside higher reserves for potential losses on DAC.

Variable annuity issuers now face the challenge of trying to offer new equity-linked insurance products with lifetime income benefits to Boomers without exposing themselves again to high levels of market and longevity risk. They're doing that by requiring the investor to share the market risk, often by requiring investors who want living benefits to allocate their premiums to low-volatility mutual funds.

These new risk-shared variable annuity products may in fact sell in significant quantities to Boomers, who will remain amenable to combo-products that offer downside protection and upside potential. But a return to the VA sales boom of the mid-2000s would probably require a return to the peculiar naïveté of the mid-2000s—which doesn't seem likely anytime soon.

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