

Ten 'emerging developments' in FIAs: Oliver Wyman

By Editorial Staff Thu, Jun 5, 2014

Several charts in Oliver Wyman's brief but informative new report on fixed indexed annuities provide useful overviews and snapshots of the evolving FIA market and the companies that populate it.

"Fixed Annuities: Recap and... What's Next?" is the title of a new [white paper](#) from the consulting firm Oliver Wyman. The report offers a list of "emerging developments to watch for in 2014 and beyond":

- **M&A activity should continue.** There exists a wide range of views on the valuation and attractiveness of the business. This and other factors, such as limited capital available to certain carriers, will likely fuel additional M&A activity.
- **The FIA market is well positioned for rising rates relative to the traditional fixed annuity market.** Most FIA carriers' inforce blocks are composed of recent sales and thus have surrender charge protection that reduces disintermediation risk. About half of inforce FIAs feature a market value adjustment ("MVA"). Although many MVA features had mixed effectiveness when corporate yields spiked in late 2008-early 2009, MVA formulas were subsequently improved for new business. In addition, most carriers with growing GLWB blocks generally stand to benefit from higher reinvestment yields. Finally, rising rates would be expected to positively impact sales and reduce pressure on new business profitability.
- **As long as the yield curve remains steep, significant growth in banks and broker dealer distribution will likely continue.** This is being accomplished with low commission and short surrender charge "no frills" designs with competitive indexing features. In the long run, sales in this channel will benefit from inforce bank channel contracts rolling into new contracts, much like in the VA market.
- **AXA (2010), MetLife (2013) and Allianz Life (2013) have launched VA/FIA hybrids that do not have living benefits.** The rationale for introducing these designs varies. For VA manufacturers, they could be a way to attract VA assets without offering rich guaranteed living benefits. Hybrids could also fill the "spectrum" of products available, or as a way to expand in new distribution channels. Finally, hybrids can be designed to balance the risk profile of existing VA blocks, which can motivate VA carriers to enter the space for risk mitigation purposes.
- **Several carriers have recently announced their intention to redomicile.** Carriers relocating to Iowa include Fidelity and Guaranty Life (announced November 2013) and Symetra (announced January 2014). Athene also decided to locate its headquarters in Des Moines following the Aviva transaction. Going against this trend is EquiTrust, who is moving to Illinois from Iowa (announced January 2014). Regulatory environment, operating costs and human resources are the key motivators.
- **Thanks to a sharp decline in interest rates and statutory valuation rates, the conservative AG 33 framework is causing reserve strain for many carriers offering GLWBs.** A number of companies obtained permissions from their regulator to apply less conservative reserve approaches on their inforce block such as AG 43 or modifications to AG 33. Meanwhile, the American Academy of Actuaries Reserve Working Group ("ARWG") is working on the VM-22 reserving framework for fixed annuities. The industry is generally eager to adopt principle-based approaches on new business.
- **Third party providers have accelerated the product release cycle and helped many carriers reduce costs.** One such third-party provider issued \$9 billion of FIAs in 2013. As the FIA market

matures, operating costs and service to consumers and distributors will become more important differentiators.

- **Significant inforce blocks are starting to exit the surrender charge period, which will give FIA carriers a wealth of data on surrender behavior.** GLWB utilization experience is still emerging, and several more years of experience are needed to observe behavior outside the surrender charge when a GLWB is present. Due to relatively limited industry data, there exists a wide range of GLWB surrender and utilization assumptions. Going forward, a growing number of FIA carriers will apply advanced analytical techniques such as predictive modeling to gain further insight into policyholder behavior for application in assumption setting and customer retention.
- **With stronger corporate balance sheets and lower interest rates, certain FIA carriers compensated declining yields by seeking additional liquidity and credit risk premium.** Growing sales volumes from PE carriers and the rebalancing of asset portfolios from acquired blocks have created significant investment activity.
- **In contrast to their VA counterparts, FIA GLWB riders benefit from stable statutory and US GAAP accounting.** Because of this and the “fixed income/book value lenses” of many FIA carriers, many companies primarily view GLWBs as a source of insurance risk that is consequently left mostly unhedged. But GLWB riders impact both the duration and convexity of the insurance liability, and its sensitivity to index returns. Many FIA carriers will become more deliberate about how they embed GLWBs in their ALM, how they approach hedging decisions and how they manage statutory accounting volatility.