The Retirement Industry Conference

By Kerry Pechter *Fri, Apr 25, 2014*

Want lots of 2013 data on annuity sales and VA rider use? You'll find it—plus Richard Thaler's crowd-stumping riddle—in this roundup of news from the recent LIMRA/LOMA/SoA conference in Chicago.

At the Retirement Industry conference in Chicago two weeks ago, researchers from LIMRA's Secure Retirement Institute presented annuity sales data for 2013. They also predicted 6% average annual growth for fixed annuities, 2% growth for variable annuities and 4% for annuities overall between now and the end of 2018.

Slides from the presentation by Joseph Montminy and Jafor Iqbal of LIMRA can be found here.

With sales of $145.3 billion in 2013, variable annuities remained the top selling type of annuity in the U.S. But despite the bull market in equities last year—higher equity prices don't coincide with higher VA sales the way they did a few years ago—gross sales fell slightly from 2012 levels.

The reasons: reduced life insurer appetite for selling VAs, less generous living benefit riders and a greater emphasis by manufacturers on less capital-intensive VAs that are designed for tax-deferred accumulation rather than guaranteed retirement income.

Difference companies are using different product strategies. Jackson National (with its popular Elite Access VA,) Guardian, AXA, and Protective are among the leaders in promoting accumulation-focused VAs, according to LIMRA. AXA, Allianz Life, MetLife and CUNA are promoting structured VAs that give investors upside potential with a cap and a buffer against downside losses.

According to the presentation, all of the major VA issuers, including Prudential, MetLife, Jackson National, Lincoln Financial, AXA and others, have cut their risk exposure either by reducing their distribution, requiring contract owners to use managed-volatility funds, offering to buy back in-the-money contracts, or blocking additional contributions to existing contracts.

(On the upside, last year's bull market helped drive up VA account values, on which part of VA fee revenue is based.)

VA contract owner behavior

Because VA policyholder behavior has a big impact on profitability, LIMRA has tracked it on behalf of its life insurance members. As the data show, withdrawal and surrender behavior is largely determined by the kind of money the annuity was purchased with (qualified or non-qualified), the age of the owner and whether the owner is systematically withdrawing the assets for retirement income.

The guaranteed lifetime withdrawal benefit (GLWB) rider has been a mixed blessing for VA issuers. It brought in lots of premium, but it attracted qualified money (seeking retirement income), mainly from IRAs, instead of the after-tax money (seeking tax deferral on large sums) historically associated with VA purchases.

Qualified contracts with GLWBs are less likely to lapse, and to the extent that those riders were underpriced (as many were during the VA “arms race” of the mid-2000s), the cost of maintaining them and managing their market risks and longevity risks can make them long-term liabilities.

According to LIMRA, contract owners who elected guaranteed lifetime withdrawal benefits (as opposed to guaranteed minimum income benefits, withdrawal benefits or account balances) who purchased their contracts with qualified money, who set up systematic withdrawal plans, and who keep their annual withdrawals close to the percentages dictated by the rider, were the least likely to surrender their contracts in 2012.

Assessing the 2.36 million existing VA contracts with living benefits in 2012, LIMRA found that 71% were owned by Boomers ages 48 to 66 and two-thirds were purchased with qualified money. The average contract was “in the money” by $16,300 in 2012. (Thanks to the bull market, the amount of in-the-moneyness has probably shrunk since then, a LIMRA spokesman said.)

Owners of qualified contracts with living benefits had an average surrender rate of only 4.2% in 2012, and those with a GLWB had an average surrender rate of just 2.9%. Surrenders by GLWB owners with systematic withdrawal plans were rare (2-3% at any age).

FIA sales soar

The abrupt rise in sales of fixed indexed annuities (FIAs) during the last three quarters was the big annuity sales story of 2013. Sales rose to $11.9 billion in the fourth quarter from $7.9 billion in the first quarter.

Fixed indexed annuities are selling better for several reasons. The five-year Treasury rate more than doubled after May 3, to 1.72% from 0.68%, offering fixed annuity issuers about 100 basis points of breathing room. Aggressive private equity-owned insurers, particularly Security Benefit, made their presence felt. FIAs with GLWBs probably absorbed some of the demand for lifetime income that VA issuers lacked the appetite or the capacity for.

The Boomer retirement wave continued to drive demand for guaranteed income. In 2013, $105 billion of the $230 billion in annuity sales involved income guarantees, according to LIMRA. VAs with GLWBs accounted for $61.7 billion, VAs with GMIBs for $11.9 billion, and FIAs with GLWBs for $20.7 billion. Single premium immediate annuities ($8.3 billion) and deferred income annuities ($2.2 billion) both posted record annual sales.

Resignation in retirement

Mathew Greenwald of Greenwald & Associates, the research survey firm, and Carol Bogosian of the

American Society of Actuaries presented the findings of a recent survey and focus groups involving 1,000 near-retirees, 1,000 retirees, and 200 retired widows ages 45 to 80.

The research, part of the Society of Actuaries' ongoing analysis of the cluster of risks associated with aging and retirement, found that most people drift into retirement without much planning or preparation, nor do they worry much about their ability to adapt to the challenges of retirement if and when they arise.

Middle-aged and older Americans tend to be either confident, optimistic or resigned about retirement. They appear to underestimate their need to tap savings in retirement (as a supplement to pensions, Social Security, dividends, capital gains and interest), tend not to recognize the risk of cognitive decline in old age, and don't appreciate the potential impact of inflation on their future purchasing power, the data showed.

As earlier research has shown, many pre-retirees seem to overestimate their ability or willingness to extend their working years. In focus groups, retirees confessed that retirement is often thrust upon people rather than chosen.

"When the company reorganized and showed that they weren't interested in people my age and opportunities came and went. Opportunities came to younger people and to me it was a sign that you'd better start thinking about it," said one focus group participant. Another said, "I was on the road constantly. I found that I was getting less and less enjoyment out of it… It was just too much."

Keynote by Thaler

The celebrity speaker at the Retirement Industry conference was Richard Thaler, the well-known behavioral economics expert at the University of Chicago and the co-author of "Nudge," a book that promoted the use of default options such as auto-enrollment and auto-escalation in 401(k) plans to raise participation rates in employer-sponsored retirement plans.

To break the rhetorical ice, Thaler posed this riddle to the presumably math-adept LIMRA crowd:

Consider two one-mile lengths of iron rail meeting at a single junction. If a heat wave caused the length of each rail to expand by an inch, how high would the junction have to rise off the ground to accommodate the expansion (assuming that both lengths of rail stayed rigid and straight and didn't buckle)?

Vastly underestimating the leverage effect created by the length of the rails, the vast majority of the audience thought the junction would have to rise by less than one foot. The answer was almost 30 feet.

That's the number you get by applying the Pythagorean theorem, which says the square of the hypotenuse of a right triangle (in this case, 5,280 feet plus an inch, or 5280.0833 feet) minus the square of the base (5,280) will equal the square of the triangle's height, which is what you're trying to solve for.

At the end of his speech, which described the successes and limitations of auto-enrollment and auto-escalation, Thaler made two parting suggestions. He recommended that people maximize their Social

Security benefits by claiming at age 70, even if it means spending their tax-deferred savings in the meantime. He also suggested that Uncle Sam allow people to buy higher Social Security benefits before or at retirement.