# The Variable Annuity Market in Five Acts

By Editor Test *Wed, May 15, 2013*

*Actuary Timothy Paris, CEO of Ruark Insurance Advisors, Inc., charts the evolution of the variable annuity product and its market in this article, which first appeared as a blogpost on the Society of Actuaries' Riskpertise site.*

Let's consider the plot arc of the last decade of the variable annuity market in five acts.

First, the exposition: In the United States, variable annuities are tax-favored retirement savings products with a central investment component, often accompanied by additional guarantees in the form of a death benefit or lifetime income stream.

Fundamentally, the purpose of these products is to help individuals manage their retirement savings through tax-deferred investment earnings in the accumulation phase and a lifetime income stream in the retirement phase.

The action rose as these products evolved dramatically from their earliest forms decades ago: What was once a handful of simple mutual fund-like investments with the benefit of tax deferral was replaced by a dizzying array of investment options surrounded by dozens of types of guaranteed death benefits and lifetime income benefits.

In the years leading up to the financial crisis, product competition and growth were very strong, with sales increasing from $129 billion in 2003 to $184 billion in 2007, according to LIMRA. With these volumes, variable annuities transformed from a complementary product line to a position at center stage for the insurance companies offering them and for the insurance industry at large.

The financial crisis was the climax, and exposed the massive and complex risks embedded in these products. As global equity markets and interest rates declined precipitously, the value of the guarantees that were provided to variable annuity policyholders increased in value, but the value of insurers' investment assets failed to keep up.

The industry buckled, as several companies reported losses of hundreds of millions of dollars, and many that had been leaders in variable annuity sales significantly curtailed or closed to new sales. Sales dropped to $128 billion in 2009.

In the falling action since then, the industry seems to have gradually and reluctantly found a new normal, with "de-risked" products featuring more modest guarantee features around simpler investment options, with higher charges to policyholders. Sales have increased to $147 billion in 2012.

But this is hardly a resolution. As a result of the last decade of drama, shareholders, regulators, and rating agencies have become keenly aware of the risk dynamics for these products. In spite of a reasonable recovery in terms of sales and product re-design, the industry still has about $2 trillion (source: IRI) of in-force variable annuity assets of the old vintages that were so problematic during the last financial crisis.

What is to prevent the next financial crisis from triggering catastrophe for the variable annuity market?

That is the question for the variable annuity industry. And it is most pointedly the question for its actuaries. How will these actuaries, uniquely qualified through their powerful combination of quantitative risk management skills, business savvy, and insurance heritage, write a creative denouement that avoids a tragic ending? I'll share mine in a future column.