Trends RIJ Will Track in 2021

By Kerry Pechter *Thu, Jan 7, 2021*

When will annuities be loved? After all the creative destruction of the past 10 years, what's next for the annuity industry? Which trends will persist? Which products will flourish? We discuss the trends that Retirement Income Journal expects to cover in 2021 and beyond.

Most boomers will easily remember Linda Ronstadt's 1974 country-rock hit, "When Will I Be Loved?" A few may even recall the original 1960 version by Don and Phil Everly, who.wrote the lyrics: "I've been put down. I've been pushed 'round. When will I be loved?"

The life/annuity industry has been asking that question for years. By now, the industry expected to be counting far more profits from the sale of annuity contracts to retiring Boomers. No one imagined that ZIRP (zero interest rate policy) would spoil the party.

Healthy yields on AAA-rated corporate are the oxygen of life/annuity companies, and those companies are still gasping for air. After 2008, the Fed's emergency easy-money efforts propelled the industry into a decade of furious adaptation. A stream of changes in ownership, products, technology, and distribution channels marked the 2010s.

After all that creative destruction, what's next? Which trends will persist or peter out? Which products will flourish or flop? In this article, we'll talk about the trends that *Retirement Income Journal* expects to cover in 2021 and beyond.

RILAs are still the shiniest, newest annuity. Since the stock market climbs a wall of worry, a certain segment of investors is going to want safety-net products that let them hold equities without sleepless nights. That should mean investor-demand for fixed indexed annuities (FIAs) and structured annuities (aka registered index-linked annuities, or RILAs).

Of all annuities, RILAs might offer the best "fit" for today's markets. These contracts use a bracket of options—the sale of downside puts and purchase of upside calls—to deliver more upside potential than an FIA and more downside protection than a variable annuity.

RILAs are the only type of annuity contract that saw healthy sales growth in 2020 (up 25%, to $15.7 billion through September 30). RILAs beguile investors with their offers of “up to” 140% asset appreciation over six years, but it’s not clear how likely that outcome might be.

Low rates have been brutal on the payout rates and sales of what you might call “true” annuities: Single-premium immediate annuities (SPIAs), deferred income annuities (DIAs), and qualified longevity annuity contracts (QLACs). Their yields depend on the contract owner’s longevity as much as on current interest rates, but their source of strength—illiquidity—is what turns potential customers off. DIAs may find new life 401(k) plans, however (See below.)

The “insurance solutions” gold rush continues. In 2020, *RIJ* finally started giving this trend the attention it deserves, with our “Bermuda Triangle” series of articles on a new business model that’s relieving the low-yield woes of certain life insurers. We’ll give it more coverage in 2021.

“Triangle” refers to a three-part business model involving a life insurer with blocks of long-dated fixed indexed annuity liabilities, a sophisticated asset manager with expertise in private debt origination, and a reinsurer—especially a captive one domiciled in a jurisdiction with relatively reduced reserve requirements.

Insurance solutions providers—as we’re still learning—are companies that have all the pieces in the model or can bring all these pieces together quickly and efficiently for a life insurer that has slow-moving annuity blocks to sell, refinance or reinsure, and would welcome a huge infusion of new cash so it can reconfigure itself for long-range survival. Tens of billions of dollars in in-force annuity contracts—the savings of millions of risk-averse Americans—have been set in motion since Apollo pioneered this strategy after the Great Financial Crisis.

This trend is both a gold rush and a source of worry. If you’re an asset manager like Apollo, Blackstone, or KKR, or a life insurer who wants help turbo-charging its investment department, it’s a gold rush. If you’re a traditional fixed indexed annuity issuer who can’t match the higher yields of Bermuda Triangle players, or a regulator who’s nervous about the risks of private debt and the opacity of reinsurers, it’s a source a worry.

Merger fever should reappear post-COVID. That Bermuda Triangle phenomenon has been driving M&A in the life/annuity space for about 10 years, and the trend will probably continue in 2021. According to a recent report from Moody’s:

Private capital and companies with private credit, structuring or asset origination capabilities, continue to invest in the life insurance sector. In particular, private or alternative capital continues to participate in the sector's consolidation by bringing resources to consolidate cash flows.

These firms leverage size and breadth to establish a platform for additional transactions, and allocate capital toward established companies with known brands to increase the insurance business' return on investment or profitability, often through enhanced investment income.

Moody's is talking about asset managers pursuing "Bermuda Triangle" strategies. Life insurers are the targets, but they're also buyers, Moody's said. They're shopping for "companies which provide additional technologies to expand their operations and digital capabilities. As a means to enhance its digital capacity, M&A is likely to be motivated through the accelerated role of technology as insurers acquire via insurance buying, underwriting and servicing processes."

There could be a temporary lull in this trend. "The pandemic-driven economic disruption in the first half of 2020 caused many life insurers to hit the pause button on M&A and divestiture activity to focus on sustaining operations and building liquidity and capitalization," Moody's Vice President Bob Garofalo said in a release.

"As the recovery unfolds, life insurers are updating forecasts and assessing the implications of the economic landscape with even lower interest rates and increased asset volatility, and are assessing how to position their products and businesses while considering interest rate sensitivity and the outlook for their capital positions."

The revolution in distribution. The distribution tree of financial products, including annuities, has grown some new branches over the past ten years. We're watching the pooled employer plan (PEP) market, which was activated on January 1. Thanks to the SECURE Act of 2019, retirement plan providers can create a single, customizable 401(k) plan that dozens or even hundreds of companies could join.

PEPs would allow providers of mutual funds to reach millions of prospects with a single sale to a PEP sponsor. They could also do the same for the distribution of annuities through 401(k) plans. We'll be watching to see which types of contracts, if any, get traction in this market. Contenders include optional multi-premium deferred income annuities, as well as lifetime income riders embedded in target date funds or managed accounts.

The sale of FIAs and other annuity contracts to fee-based registered investment advisers

(RIAs) through online platforms is growing; few people would have predicted that 10 years ago, when commission-paid agents sold almost all of them. Annuities have been added to cloud-based RIA platforms, like Envestnet.

Advisers can also buy fee-based annuities on independent platforms like DPL Financial and RetireOne. Direct-to-the-public annuity platforms have also appeared (e.g., Blueprint Income), but a licensed agent still has to mediate the purchase of the annuity.

'SECURE 2.0' and Social Security reform. Along with much of the retirement plan industry, we expect to see the Secure a Strong Retirement Act passed in 2021. Known informally as SECURE 2.0, it will include some of the industry wish-list items left out of the SECURE Act of 2019, like requiring auto-enrollment for all qualified plans and raising to 75 the age for initial minimum required distributions from qualified plans.

We'd like to see the Biden administration begin to tackle the Social Security question before mid-term elections in 2022. Last year was the first year in which the program's payouts exceeded revenue plus interest on the remaining surplus in the trust fund. In other words, some of the benefits are already getting paid out of the US general account.

We don't think Social Security faces an existential "crisis," but there remains a technical barrier—comparable to the "debt ceiling"—to the continued payment of Social Security benefits when the surplus built up in the trust fund since 1983 is finally consumed. Starting in 2034, the payroll tax alone is expected to cover just 75% of expenses. President Biden is expected to spend a chunk of his energy on reinstating the Affordable Care Act, but we hope he takes steps toward legislating Social Security out of limbo.