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## VA issuers dodged a bullet in 2008-2009, study shows

By Editor Test    Tue, May 10, 2011

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*Had owners of deep-in-the-money variable annuity living benefits acted more "rationally" at the depth of the financial crisis, the issuers of those contracts might have suffered much more serious losses.*

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If owners of variable annuity contracts with deep-in-the-money living benefits had acted in a strictly economically rational manner in the winter of 2008-2009 and begun exercising the benefit (and perhaps shoveling their withdrawals into depressed stocks), it would have been bad news for the insurance companies who issued those contracts.

The insurers would have lost assets under management, lost the fee revenue on those assets, and possibly (depending on their previous actuarial assumptions) had to set aside a higher level of reserves.

Fortunately for the insurance companies, most VA owners didn't jump on that opportunity—not, perhaps, because they weren't financially astute but simply because they chose to stay-the-course with their existing retirement plans. It remains to be seen exactly how insurance company actuaries will use that experience in making assumptions about benefit utilization and reserve requirements in the future.

Those insights come from a recent study by Ruark Consulting LLC on behalf of eight insurance companies: AXA Equitable, ING, MassMutual, Ohio National, Pacific Life, Prudential, Sun Life of Canada, and Commonwealth Annuity and Life.

Ruark's "2010 Variable Annuity Surrender Study and 2010 Variable Annuity Benefit Utilization Study" examined the variable annuity surrender and benefit utilization data at those companies before, during and after the 2009 financial crisis and recession. The data included over 10 million policy years of experience from January 2007 through March 2010.

Among those owners who took partial withdrawals, the study found that only about one-third of owners of in-the-money living benefits withdrew the most efficient amount—the maximum they could take without reducing their guaranteed benefit base from their contracts during the financial crisis. The rest took either more or less than that amount, which mitigated the risk to the insurance company.

"Insurance companies and actuaries would typically have expected that the benefits would be used with a high level of economic efficiency—that people would use them when they were in-the-money—but the data is not showing that," said Rich Tucker, a vice president at Ruark Consulting.

Key findings of the 2010 Variable Annuity Surrender Study, which was follow-up to a similar study published by Ruark Consulting in 2008, included:

- Full surrender rates have declined significantly since the 2008 recession. The prevailing opinion is that owners greatly curtailed all financial activities in favor of watchfulness during this period. A combination of low interest rates and a pull back by VA writers on the aggressiveness of new living benefits also meant that fewer better alternatives to current VA contracts were available.

- Policies with guaranteed living benefits experience lower surrender rates than those without. The type of living benefit also has an effect. Policies with Guaranteed Lifetime Withdrawal Benefits (GLWB) have the lowest surrender rates, followed by Guaranteed Minimum Income Benefits (GMIB), Guaranteed Minimum Withdrawal Benefits (GMWB), Guaranteed Minimum Accumulation Benefits (GMAB), and then policies containing no guaranteed living benefit.
- Surrender rates decline significantly as the current value of guaranteed benefits increases. This is commonly referred to within the industry as “In-the-Money” level. The In-the-Money effect is exhibited for all types of guaranteed living benefits (GLWB, GMIB, GMWB, GMAB). Policies with a guaranteed minimum death benefit (GMDB) only also exhibit this effect, albeit to a lesser degree than found with guaranteed living benefits.
- When the equity markets dropped in 2008 and 2009, there was a temporary spike in surrender rates for contracts without valuable In-the-Money living benefits.
- Surrender rates will also vary noticeably by attained age, policy duration, distribution channel, commission structure, and policy size.

Ruark’s 2010 Variable Annuity Benefit Utilization Study, which was a follow-up to the similar study published by Ruark Consulting in 2009, covered partial withdrawals under variable annuity contracts containing Guaranteed Lifetime Withdrawal Benefits (GLWB), Guaranteed Minimum Withdrawal Benefits (GMWB) and Guaranteed Minimum Income Benefits (GMIB), as well as partial withdrawals on policies that did not contain any guaranteed living benefit.

Partial withdrawals were measured by annual frequency. The amount taken, given that a withdrawal had occurred, was also measured. The amount taken was expressed as a percentage of the guaranteed base amount of each policy, the current account value, and, for GLWB and hybrid GMIB designs, the maximum allowed to be withdrawn under the terms of the benefit.

The partial withdrawal activity among owners with any of the guaranteed living benefits (GLWB, GMWB, and GMIB) was strikingly similar to those without such benefits. We’ve noted that full surrender rates have declined since the 2008 recession. At the same time, utilization of partial withdrawals under Guaranteed Living Benefits has not shown a significant increase. Owners appear to be preserving the future value of their guaranteed benefits for when they are needed in retirement.

Key findings common to partial withdrawal activity include:

- Partial withdrawal frequency increases with attained age
- Older age tax qualified policies exhibit higher partial withdrawal frequency than non-tax qualified policies. This is due to required minimum distributions at age 70 under tax qualified policies.
- Among owners taking partial withdrawals, substantial proportions take amounts larger than the maximum allowed under their benefit (thereby causing a reduction in benefit amount). A substantial portion also take an amount below the maximum allowed. These proportions vary noticeably by the attained age of the owner.
- Withdrawal frequency and amounts withdrawn have not noticeably increased on policies with greater In-the-Money