Retirement Income
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VA Net Flows ‘Grim’ in 4Q 2012: Morningstar

By Kerry Pechter *Thu, Mar 28, 2013*

“A spike in outflows from group contracts and continued large outflows from companies that have exited the business were the major components of the precipitous drop," wrote Morningstar's Frank O'Connor in his quarterly sales report.

Net cash flows into variable annuities dipped into negative territory for the first time in over a decade in the fourth quarter of 2012, but finished the year in the black, according to Morningstar Inc.’s latest *Variable Annuity Sales and Asset Survey*.

“The industry net cash flow number for fourth quarter was grim at $(598.5) million, the first quarter of net redemption reported since VARDS began the net flow survey in 2001,” wrote Project Manager Frank O’Connor of Morningstar’s Annuity Research Center in his quarterly report.

“A spike in outflows from group contracts and continued large outflows from companies that have exited the business were the major components of the precipitous drop, while continued strength was observed in the net cash flows of the active retail market providers,” he noted. “Net cash flow for the year remained in positive territory at $14.0 billion.”

Babyboomers in 403(b) plans are reaching retirement age, and older blocks of group annuity business are maturing and calving off, like icebergs from a glacier. At the same time, advisors are moving clients’ money out of variable annuities that were issued by companies that have left the individual VA business, such as The Hartford and ING, and not moving it to another variable annuity.

More money went into VAs than came out, however. The exodus was offset by the demographically-driven demand for lifetime income products—evidenced by the fourth-quarter 2012 gross sales of $34.4 billion (down 5.4% from the third quarter) and $143.4 billion for the year, down 6.5% from $153.7 billion in 2011.

A large chunk of the decline could be attributed to MetLife’s intentional curtailment of VA sales. In 2011, MetLife sold $28.44 billion worth of VAs. In 2012, the company collected $17.7 billion in new VA premium.

The top five issuers alone accounted for more than half of gross VA sales last year; the top ten sellers captured 77.7%. In 2012, Jackson National led all sellers in the fourth quarter with a 13% market share ($4.43 billion), followed by Prudential (11%; $3.78 billion), MetLife (10.5%; $3.56 billion), TIAA-CREF (9.9%; $3.36 billion) and Lincoln Financial (9.3%; $3.16 billion).

Although rising stock prices in 2012 pushed the outstanding asset value of variable annuity subaccounts to a record $1.64 trillion (up slightly from $1.62 trillion in the third quarter of 2012 and up 9.1% from $1.5 trillion in the fourth quarter of 2011), VA sales didn’t seem to climb in tandem with equities, as they have in the past.

“That might be exuberance—people thinking they don’t need protection. They might be saying, ‘I don’t need it because look how well the market is doing,’” O’Connor told *RIJ*. But he added that last year’s bull market might have been different from previous one.

“It doesn’t look like the individual investors are back in the market,” he said. “You’ve got a lot of institutional money and buybacks—there are other things going on that have helped to drive equity prices higher.”

Protection from cat food

O’Connor, who has analyzed variable annuity sales data for more than a decade, said that the pendulum may have swung back too far in the past five years—from an era of under-pricing and generous benefits to one of high prices and stingy benefits. In the first era, carriers hurt their own balance sheets; they may now be hurting their own value proposition.

Fees may have reached an intolerable point, relative to benefits. Fees shouldn’t matter much to people who are buying VAs for lifetime income, O’Connor believes, because the potential insurance value dwarfs the cost. But if people are buying living benefit riders as investment risk protection rather than as longevity risk protection, then high fees are clearly counter-productive.

“If you sell the product that way”—as a hedge for market risk—“then of course fees will make a big difference,” O’Connor said. “But there has been widespread misunderstanding of what the product is supposed to do.”

Articles in the media about variable annuities tend to stress the investment aspect, he said. “Especially in articles when the product is panned, the author will explain in detail how fees will eat away at the nest egg. I’ve yet to see an article that mentions that when you’re 95, these products can protect you from a diet of cat food. That part gets completely ignored or glossed over.”

VAs were misunderstood in another way, he said. Anecdotally, many people seemed to believe that a VA with an annual benefit base increase of 6% (a “rollup”) offered a 6% guaranteed return. “I’ve heard that from relatives and from friends, and from friends who would relay what their relatives had been told. I’ve heard it more than once,” O’Connor said.

Asked to assess the VA business from a historical perspective, O’Connor said: “I see an industry that innovates, and that tries to capitalize on innovation. At the same time, I wonder if the me-too activity that got the industry into trouble has come home to roost. There was a mad drive for sales, then a throttling back.

“The really solid players—Prudential, MetLife, Jackson—seem to have gotten a better handle on risk than the others. But is it really a handle? Before the financial crisis, the life insurers all said they had the risk challenge knocked. Who knows what will happen in the next downturn. Will it blow up the models they’re using today?”

Other Morningstar data

Sales rankings stayed much the same in 2012 as in 2011, with a few notable position changes. MetLife moved down two notches to third place, Nationwide slipped from 6th to 11th and Allianz Life moved down to 16th place from 11th place. Going in the opposite direction, Protective moved up to 13th place from 16th, Ohio National moved up to 15th place from 18th, and Fidelity Investment Life jumped to 17th place from 22nd.

In terms of product rankings, there were several fast-growing contracts: Lincoln Financial’s Choice Plus Fusion (to 22nd from 134th), Protective’s Dimensions (to 25th from 140th), AXA Equitable’s Structured Capital Strategies B (to 17th from 42nd), Fidelity’s Personal Retirement Annuity I (to 14th from 27th), Ohio National’s OnCore Premier (37th from 62nd) and OnCore Lite II (to 43rd from 75th).