

## Variable annuity deferral bonuses are working: Ruark

By Editorial Staff      Thu, May 31, 2018

*GLWB withdrawal frequencies have increased consistently at normal retirement age and above, with over half of withdrawals now at or near the maximum benefit amount, according to a study by the actuarial firm Ruark Consulting.*

Owners of variable annuities with living benefits are using their riders more efficiently than ever, “with over half of all withdrawals now at or near the maximum benefit amount,” according to the results of Ruark Consulting’s Spring 2018 studies of variable annuity (VA) policyholder behavior.

The studies, which examine the factors driving surrender behavior, partial withdrawals, and annuitization, were based on the actions of 13.9 million policyholders from January 2008 through December 2017. Twenty-five variable annuity (VA) writers participated in the study, comprising \$948 billion in account value as of December 2017.



Timothy Paris

“A variable annuity writer’s cost to provide guarantees depends on policyholder behavior, including surrender and income utilization,” said Ruark CEO Timothy Paris in a release this week. “Each company should ask itself the basic question: Is my own data enough?”

Study highlights include:

- As the market for guaranteed lifetime withdrawal benefit (GLWB) riders matures, it is possible to see the effects of long-dated insurer incentives to delay benefit commencement. Commencement rates are low overall, 12% in the first policy year and falling to 6-7% annually thereafter. However, usage jumps over 5 points in year 11,

with the expiration of ten-year bonuses for deferring withdrawals common on many riders. In this study, we see for the first time that commencement frequency thereafter falls to an ultimate rate of about 9%. The deferral bonuses appear to have the intended effect of delaying benefit utilization. Among contracts that take a withdrawal, nearly 90% continue withdrawals in subsequent years.

- Overall living benefit annual withdrawal frequency rates have continued to increase, primarily as a result of increasing utilization efficiency. Withdrawal frequency for guaranteed lifetime withdrawal benefit riders is now 25%, up nearly two points over the rate reported in Ruark Consulting's Spring 2017 study and three points over the Spring 2016 value. GLWB withdrawal frequencies have increased consistently at normal retirement age and above. Most of the increase is attributable to more efficient utilization of the rider benefit, with over half of withdrawals now at or near the maximum benefit amount.
- The effects of moneyness (account value relative to the guarantee base) on partial withdrawal behavior differ depending on circumstances. When contracts with lifetime withdrawal benefits are at or in the money, policyholders increase the frequency of standard benefit withdrawals. This is consistent with greater benefit exercise when the benefit is more valuable. The effect is more pronounced after the expiration of deferral incentives. In contrast, when contracts move out of the money, withdrawals in excess of the maximum amount are more common. This is suggestive of policyholders taking investment gains out of the contract.
- Overall variable annuity surrender rates in 2017 have returned upward to post-crisis levels, following a secular dip in 2016. We see three regimes in the study window: Surrenders at the shock duration (the year following the end of the surrender charge period) were nearly 30% at the onset of the 2008 economic crisis; shock rates below 10% were observed during 2016; and otherwise a post-crisis regime has prevailed, with shock rates in a range of 12-16% from 2009 through mid-2015 and 13% in 2017. The 2016 dip, first observed in Ruark's fall 2017 study, is only partially attributable to benefits moving more in-the-money during the year; it is likely that uncertainty surrounding the Department of Labor's proposed Fiduciary Rule and political factors encouraged a "wait-and-see" attitude among many policyholders and advisors.
- The presence of a living benefit rider has a notable effect on surrender rates; contracts with a lifetime benefit rider have much higher persistency than those with other types of guarantees. Also, a contract's prior partial withdrawal history influences its persistency. Contracts with a lifetime benefit rider that have taken withdrawals in excess of the rider's annual maximum have surrender rates three points higher overall than other contracts with those riders. In contrast, those who have taken withdrawals no more than the rider's maximum have the lowest surrender rates (three points lower at the shock, for example, compared to contracts who have taken no withdrawals).
- When calculating relative value (moneyness) for lifetime withdrawal guarantees, use of a nominal measure can be deceiving. A nominal measure fails to reflect important aspects of living benefit design, and can be inflated over time as the benefit base

remains unchanged even as the account value is reduced through regular withdrawals. It may be preferable in many cases to use an actuarial measure of moneyness that incorporates interest and mortality rates. Actuarial moneyness exhibits a similar dynamic effect on lapse though with notable differences in shape. As an actuarial basis pushes a contract toward out-of-the-money by discounting the guarantee, very little exposure exists for heavily ITM contracts: nominally, 77% of GLWB exposure is in-the-money, while only 10% is in-of-the-money when measured on an actuarial scale.

- Annuitization rates on policies with guaranteed minimum income benefit (GMIB) riders continue to decline. The overall exercise rate for the riders with a 10-year waiting period is 2.1% by account value. Rates have been falling steadily since 2010, and quarterly observed rates have stayed at or below 2% since 2014. “Hybrid” rider forms that allow partial dollar-for-dollar withdrawals have much lower exercise rates than tradition forms, which reduce the benefit in a pro-rata fashion – less than 1% for hybrid, vs. 5% for pro-rata; the increasing share of exposure in the study from the hybrid type is a partial explanation for the decrease in annuitization rates over time.

Detailed study results, including company-level analytics, are available for purchase by participating companies.

Ruark Consulting, LLC, based in Simsbury, CT, is an actuarial consulting firm specializing in principles-based insurance data analytics and risk management. It has produced industry- and company-level experience studies of the VA and fixed indexed annuity markets since 2007. As a reinsurance broker, Ruark has placed and administers dozens of bespoke treaties totaling over \$1.5 billion of reinsurance premium and \$30 billion of account value.

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