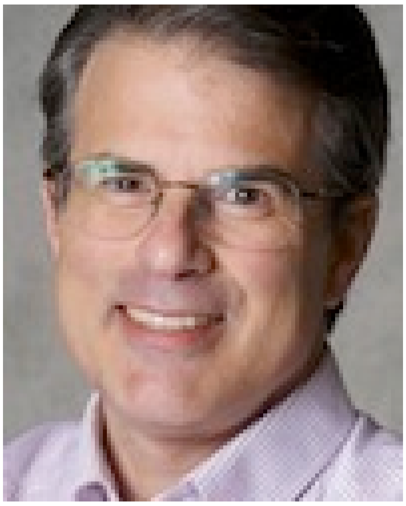
Why Living Benefits Are Dying

By Kerry Pechter *Thu, Apr 11, 2019*

Instead of buying variable and indexed annuities for lifetime income and protection against outliving their savings, Americans are buying annuities for accumulation. We pose six theories for the weakness of sales of annuities with lifetime income riders.



One of my takeaways from last week's LIMRA-Society of Actuaries Retirement Industry Conference in Baltimore was that sales of income-generating variable annuities (VAs) and fixed indexed annuities (FIAs) have shrunk during a period when they should have been rising.

In a **presentation** of data on past, present and projected annuity sales, LIMRA Secure Retirement Institute director Todd Giesing and research analyst Teddy Panaitisor showed a reversal in the percentage of sales annuities with income benefits in recent years, from 56% with a rider in 2011 to 56% *without* a rider (such as guaranteed lifetime withdrawal benefit, or GLWB) in 2018.

Sales of annuities rose smartly in 2018 vs. 2017, but mainly on the strength of contracts without income benefits. FIAs as a category grew 26.5%, but sales of FIAs with income-generating riders rose only 11.7%. Between 2011 and 2018, sales for the FIA category grew by 190%, but sales of FIAs with living benefits rose only 64%.

In the VA category, sales of contracts with income-generating riders grew more (7.6%) than VAs overall (2%) last year, but the long-term trend for VAs is negative: VA/GLWB sales are down 62% since 2011. (Indeed, according to the Insured Retirement Institute, there was a net outflow from all VA contracts in 2018 of $79.2 billion.)

The point is this: Instead of buying annuities for lifetime income and protection against outliving their savings, Americans are buying annuities for accumulation. They're using annuities (or their advisors are recommending annuities) for tax deferral, or for higher returns than they can get from conventional bonds, or for safer returns than they can get from equity mutual funds.

Sales of true annuities—single premium immediate income annuities, or SPIAs—were up 16% in 2018, to $9.7 billion, thanks in part to an increase of about 10% in the level of monthly income they pay out to the owners. But SPIAs are a small discrete market dominated by mutual insurers (vs. publicly held) and sold mainly by captive agents (vs. independent agents and advisors). SPIA sales have not risen above their historic range; sales also reached $9.7 billion in 2014.

The aging of the baby boomers seems to be driving annuity sales only to the extent that boomers use them to reduce their market risk as they (and the bull market) get another year older. But neither advisors nor boomers seem to be gravitating toward the purchase of "longevity insurance," which involves mortality pooling and is the advantage that only annuities (and annuity-like tontines) can deliver.

Boomers want to de-risk, but they don't want to miss out on gains. Today's deferred annuities allow them to have it both ways, more or less. "At the moment we still have strong returns from equity markets and most individuals are still in the stage of accumulation," Panaitisor told *RIJ* this week. "They see the equity market rising and defer on locking in those guarantees." When they do buy annuity living benefit riders, they're buying them later in life and "taking advantage of equity growth and higher interest rates to grow their underlying assets," he said.

Why are living benefit sales weak, aside from the fact that the bull market has lulled older Americans into a false sense of security?

Theory One. An annuity distribution executive said recently that the living benefit, which puts limits on the amounts that the annuity owners can spend each year without penalty, doesn't entice his wealthy clients. They don't want limits on their spending, and they're not especially afraid of running low on cash. Their biggest concerns are long-term care expenses and capital gains taxes.

Theory Two. The VA/GLWB was most attractive when it offered the prospect of generous payout rates and gave advisors ample freedom to choose the underlying investments. Now, the income riders for VAs and FIAs usually offer either attractive income *or* broad freedom to invest, not both. But some advisors wonder why, if their clients are paying a 1% insurance fee to the insurer, there should be any limits on investment freedom. (Perhaps because without limits the insurance fee would be twice as high.)

Theory Three. Thanks to "governors" (volatility management strategies) that often limit the growth of the VA investments, advisors are no longer confident that their clients' VA or FIA account balances will grow enough to earn "step-ups" in payouts. These step-ups that will help maintain the purchasing power of their income in the face of inflation. Advisors used to tell clients to add a GLWB to their VA "just in case" the market crashes. They're not doing that as much.

Theory Four. Even if advisors are not inclined to churn annuities and earn new sales commissions, advisors generally want the freedom to move in and out of products. Income-generating annuities, which make sense mainly as buy-and-hold propositions, don't fit into that worldview.

Theory Five. GLWBs are high maintenance products, and advisors don't feel like they're getting much help from the issuers in managing them. The contract owners don't monitor their contracts, and don't necessarily know when they to lock in a step-up or take income, especially if they don't need the distribution to pay for current expenses.

Theory Six. Life insurance companies may not be pushing the sale of living benefit riders because of the hard-to-measure liabilities they can create. The sudden departure of Ohio National from the variable annuity business was a reminder that it's still possible, even with the use of volatility-management strategies, for a life insurance company to overdose on GLWBs.

As the 21st century began, the typical VA/GLWB (with an annual enhancement to the benefit base during a 10-year interval before the first withdrawal) seemed poised to be the financial workhorse of the Age Wave, providing insurers with both insurance and investment fees and boomers with protection from outliving their savings.

But sales of VA/GLWBs fell to $41.1 billion in 2018 from $107.2 billion in 2011. Sales of FIA/GLWBs haven't picked up the slack; they peaked at $31.6 billion in 2016. Combined sales of all income-generating annuities (including deferred income annuities, or DIAs) were $133.5 billion in 2011 but only $81.8 billion in 2018. Even as the oldest boomers have reached their "slow-go" decade, sales of income-generating annuities are *falling* as a percentage of annuity sales overall.