The annuities manifesto

Here's a breakdown of some of the key trends that annuity experts say warrant an advisor's attention through 2010 and beyond.

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These are volatile times in the annuity market for distributors, producers and end users alike. Low interest rates and topsy-turvy equity markets are clouding the supply and demand picture. There's uncertainty on the government policy front and flux in the product lineup. So whether you're involved with traditional fixed products, indexed products, variable products or all the above, keeping abreast of developments in the fast-moving annuity arena is imperative if you're going to do right by your clients.

Here's a breakdown of some of the key trends that annuity experts say warrant an advisor's attention through 2010 and beyond.

Variable Annuities

Sales & marketing.

Variable annuity sales were largely flat throughout 2009, hitting $30.4 billion in the first quarter, $31.8 billion in the second quarter and $31 billion in the third quarter, according to figures from the Insured Retirement Institute in Washington, D.C. However, according to IRI, overall sales were down in the third quarter compared to the $37.8 billion recorded during the same period of 2008, an indication investors remain wary of committing to a product so closely linked to the volatile equities market.

The numbers don't necessarily say so, but according to Todd Erkis, a principal in the insurance consulting practice at New York City's Towers Watson, variable annuities just might be an easier sell today, because they afford clients access to features that address major concerns such as outliving their retirement savings and losing principal. Advisors can build a compelling case for a variable annuity by showing clients how their assets would have performed during the recent market plunge had they resided in a variable contract protected by some kind of principal guarantee, for example. "The variable annuity is a much harder sell when markets are chugging along at [average returns of] 10 percent," notes Erkis.

Advisors who dismiss variable annuities and their optional guarantee features as unjustifiably pricey for what they deliver might want to reconsider that stance, he adds, "because there might be more benefit there than you thought," at a cost that's justified for the protection such a guarantee provides.

Product development.
Variable annuity living benefits generally cost more and come with less rich benefits than they did 18 months ago, mainly because insurers have moved to de-risk those features to make them sustainable over the long term. Still, Joseph Montminy, research director at Windsor, Mass.-based LIMRA, an organization that tracks the annuity market, says those features aren't going away anytime soon, since they continue to resonate with variable annuity buyers, 90 percent of whom purchase some sort of living benefit rider with their contract.

But insurers are also taking variable annuities in intriguing new directions. Some are unveiling next-generation income guarantees investors can purchase with a variable annuity, points out Curtis V. Cloke, LUTCF, CLTC, an Iowa-based advisor who founded the Thrive Income Distribution System. These riders create a dedicated subaccount within the contract whose purpose is to generate an income stream that begins for the contract holder at a specified date in the future.

"Manufacturers are really starting to take a hard look at these types of features," he says. "Basically you're securing a portion of asset value for deferred income payments, without cannibalizing assets [within the contract] to create that income. What it enables clients to do is keep much more of their portfolio engaged for growth and to pass on to heirs."

The group retirement account market is another new area of focus for variable annuity manufacturers. In December, for example, Symetra Life Insurance launched the Retirement Passport group variable annuity for the 403(b)/457 market. According to Erkis, insurers are also likely to target retirement plan rollover candidates with low-fee, annuity-like withdrawal guarantees that afford downside protection and guaranteed income.

Regulatory and government policy developments.
An overhaul of the federal financial regulatory system is in the offing, which leaves uncertainty as to which regulatory body will be overseeing variable annuities. Advisors who sell and/or recommend variable annuities would be wise to keep tabs not just on financial regulatory reform, according to Erkis, but also on state and federal policies dictating capital and reserve requirements for manufacturers that provide variable annuities. Those actuarial guidelines are known as VA-CARVM. "Regulators want to make sure insurance companies are adequately capitalized to cover their [annuity] guarantees, and for the most part, I think they are."

Traditional Fixed Annuities

Sales & marketing.
After a banner year in 2008 and a strong start to 2009, sales of traditional fixed annuities, including those of the MVA (market value adjustment), book value and fixed income varieties, slumped as the year progressed, falling sharply from $19.6 billion in the second quarter to $14.6 billion in the third quarter, according to figures supplied by

Illinois-based Beacon Research. Still, sales were strong for the first three quarters of 2009 relative to the same period of 2008, with gains of 25 percent for fixed annuities with a market-value adjustment feature and 18 percent for book value products.

The flight to safety in which fixed annuity sales surged after the market plummeted in 2008 apparently has ended as investors shift assets back into vehicles with more upside potential. Their low rates of return "make fixed deferred annuities a tougher sell, no doubt," says Cloke.

"We don't expect to see growth in sales until rates begin rising and it becomes more profitable for companies to issue fixed annuities," probably sometime in 2010, adds Beacon Research CEO Jeremy Alexander.

Product development.
The investing public's growing appetite for products that guarantee income for a lifetime has begun to manifest in the fixed annuity space, where a growing number of manufacturers are rolling out deferred-income contracts designed to provide a guaranteed income stream beginning at a predetermined point in the future. Assets in these income annuities grow at a fixed rate for a period of time, after which the contract-holder can begin taking payments or opt to postpone them further.

Symetra positions its Freedom Income Annuity as a form of "longevity insurance," where "clients use a small portion of their savings, usually 10 to 15 percent, depending on age and deferral period, to buy a future income stream today, when the initial purchase payment will be quite small compared to the potential payout down the road." It touts its Freedom annuity, a single premium deferred-payout contract, as a retirement plan rollover option, whereby investors use qualified money to purchase the annuity contract, which in turns gives them the flexibility to defer their payment start date age 70½, as required for IRA distributions. Symetra's product allows investors to use qualified or non-qualified money and select a date up to age 94 to begin collecting income.

The next year or two could see a deluge of income annuity products, says Erkis, as insurers search for solutions to liquidity challenges and longevity risk. "What is going to be the longevity product? We don't know yet, but a lot of companies are looking to find a product that really hits that market well."

The fixed annuity product line-up figures to grow in the years ahead with the addition of more "linked" or "combination" products that allow contract holders to access account funds to cover long term care expenses. Federal tax breaks that provide favorable treatment to those types of products took hold in January, so Montminy says he expects more of them to hit the market as an appealing option for clients who otherwise would self-insure for long term care or who have a need for both permanent life insurance and some form of LTC insurance.

Regulatory and government policy developments.
Given how much the Obama Administration has talked recently about people taking steps to ensure they don't outlive their retirement savings, Cloke says this could be the year Uncle Sam enacts long-discussed legislation that provides tax incentives for people to invest in income annuities, and to annuitize contracts they already own. Several pieces of legislation pending on Capitol Hill would make annuity payouts tax-exempt, up to a certain annual amount, such as $10,000 or $20,000.

Index Annuities

Sales & marketing.
Fixed index annuity sales in 2009 were steady in an otherwise volatile year for fixed products. Estimated sales of index annuities hit $7.3 billion in the third quarter of 2009, 6 percent ahead of the year-ago quarter, according to Beacon Research. The indexed share of total fixed annuity sales rose to a seven-quarter high of 34 percent in the third quarter. On a year-to-date basis, index annuity sales totaled $22.6 billion through the third quarter, up 16 percent from the first nine months of 2008.

Product development.
A recent move by indexed annuity providers to simplify their products bodes well for advisors and consumers, for it makes them more straightforward to understand and to sell, says Montminy. "Companies have made a real effort to make products more suitable, with lower surrender charges, shorter surrender periods and other enhancements. It's one of the reasons sales were on a record pace for 2009, and why we expect sales to be strong in 2010 and 2011 as well."

Regulatory and government policy developments.
All eyes are on the SEC and how it will handle its controversial 151A policy, which would categorize fixed index annuities as securities. The agency in December opted to delay implementation of the rule by at least two years beyond the scheduled January 2011 implementation date so it can take a closer look at the potential economic effects of enacting it. The delay represents a reprieve for index annuity producers, who would have been required to have a securities license to sell the product if they didn't have such a license already. Meanwhile, legislative allies of the index annuity industry have offered bills that would render 151A moot by codifying that fixed index annuities are insurance products, not securities.

It's one of many intriguing storylines worth following if you're involved in the annuity business.