The Future of Annuities

By David Port | Published October 1, 2009 From the October 2009 Issue of Senior Market Advisor Magazine

Garth Bernard has been around the annuity business long enough to have developed a keen eye for trend-spotting. And these days, when Bernard, founder and president of Sharper Financial, a Boston-based consulting firm specializing in retirement income strategies, surveys the annuity landscape, he sees strong indications of a shift from a product-centric to a solutions-oriented mindset, especially among suppliers.

No longer are insurers preoccupied with developing new bells and whistles within the annuity contract itself, observes Bernard, an actuary and former senior executive at MetLife, where he helped guide the carrier's annuity department. Instead, he says, insurers are bent on simplifying their annuity offerings, particularly on the variable side, so they are sustainable from a risk standpoint, and so they can be more readily packaged in an integrated retirement solution that addresses clients' multifaceted needs entering, and during, retirement.

"From a product standpoint, it's not so much about new products and features but about new methods and processes for bringing multiple products together to create very flexible, very customizable solutions for the client," explains Bernard, who is also a partner in a new, proprietary income distribution system called Thrive (developed by advisor Curtis Cloke) that relies heavily on deferred-income annuities.

To that end, Bernard predicts more alliances between insurance companies and entities such as mutual fund companies and banks to develop multifaceted solutions with an annuity component.

The rise of income annuities
In that context, Bernard isn't alone in envisioning a growing role for income annuities — contracts that provide investors with guaranteed income, either immediately (via a single-premium contract) or (as with the aforementioned deferred-income annuity), at some point in the future. With the latter, the value of the contract grows at a fixed rate for a period of time, during which withdrawals aren't permitted. Once that period ends, the contract-holder has the right to begin taking payments, or to postpone those payments further. Some deferred annuities are designed to provide income for a specified period of years and others for a lifetime.

New annuity alternatives that provide guaranteed fixed income for life are gaining resonance with consumers and insurance companies alike, according to Joe Montminy, research director at LIMRA, a Connecticut-based organization that tracks the life insurance and annuity markets. "Once interest rates start increasing, I think you'll see more interest in these pay-out annuities, including deferred pay-out products, where there's a deferral period before a person starts receiving payments. I don't think demand for them will be huge in the next few years, but 10 or 15 years from now, I can see them being used more in the retirement planning process."

The consumer craving for annuity guarantees continues to grow, largely as a result of the investment community being "traumatized" by recent equity market turbulence, according to

Bernard. “People want insured solutions.”
Recent sales figures from LIMRA support that contention. According to Montminy, close to 90 percent of new variable annuity contracts are purchased with some form of accumulation, withdrawal or income benefit. Of these so-called living benefits, guaranteed lifetime withdrawal benefits are most popular, with a 60 percent election rate on new VA contracts, he notes.

Montminy says he expects demand for living benefits riders to remain strong in the near term, despite moves by many carriers to increase the cost and scale back the benefits associated with those riders. “Our data shows [consumers] are willing to pay extra for these kinds of guarantees.”

Back to basics for living benefits
On the supply side, meanwhile, there’s been an abrupt halt to the so-called living benefits arms race. “In terms of product features, I don’t think any stone was left unturned, and the result was that products became extremely complex. You almost needed a degree in mathematics to figure out how they worked,” says Bernard.

Now it’s “back to basics” for insurers, says Montminy. “I see guarantees getting more expensive, but much simpler and easier to understand.”

Insurers also appear to be emphasizing simplicity in variable annuity subaccounts. “I think what we’re going to see over time are contracts with fewer subaccounts and subaccounts that are more streamlined,” he says. In particular, he sees indexed products gaining prominence in the subaccount mix because their fees and hedging costs tend to be lower.

There’s also room for innovation on the fixed annuity side of the business. While fresh LIMRA figures show a 21 percent drop in fixed annuity sales in the second quarter of 2009 on the heels of a record-breaking first quarter (largely the result of low rates of return) both Bernard and Montminy say they expect insurers will find new ways to package the traditional fixed annuity so it can stand on more than just rate of return alone.

Besides developments on the income annuity front, Montminy suggests more insurers are poised to make long term care insurance features available with their fixed annuities, giving contract holders the ability to tap into annuity value to pay for long term care. Such features figure to become more appealing with the onset in January 2010 of federal tax breaks whereby the cost of qualified long term care can be covered using the cash value of life insurance and annuity contracts on a before-tax basis.

These kinds of advances are a clear sign that in the annuities space, the living benefits arms race has yielded to a renewed drive to innovate.

Sidebar: Time to tear down traditional compensation structure?

A move to make annuities simpler and more consumer-friendly could prompt a revamping of compensation structure. Doing so could cut costs and curb a producer’s urge to put their own

best interests above those of their clients, observers say. “With an immediate annuity, for example, historically producers have been paid based on premium,” explains annuity market veteran Garth Bernard of Sharper Financial. “To more closely align [compensation] with clients’ needs and priorities, you might move to a compensation structure based on the income produced by the annuity.”

Overhauling traditional front-loaded annuity compensation structures makes sense in light of the advisory community’s broadening embrace of fee-based compensation, says LIMRA’s Joe Montminy. “I think there’s potential with more of a trail-based compensation system. That could help reduce the capital requirements on the insurance company, and from the consumer perspective, it could help cut fees, which can increase the spread in their favor a little bit.”

The big unknown with such an overhaul is what it would mean to the producer bottom line. Stay tuned…