Industry Brief: Annuities 5-Part Series

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Summary

The origins of the Annuities industry date back to the eighteenth century in the United States, but it was not until 1912 that the concept of retail, or "individual" annuities were made available to the general public. Annuity growth from that point on was steady, but annuities really accelerated in earnest in the 1930s. Concerns about the overall health of the financial markets prompted many individuals to purchase products from insurance companies. During the Great Depression, insurance companies were considered stable institutions that could make the payouts that annuities promised.

Since then, a lot has been written about the industry, both good and not so good.   Certainly, with the almost complete eradication of the defined benefit pension plan, annuities have been designed to fill that void whereby financial professionals are using this tool to provide guaranteed income for life as a piece of the overall portfolio construct. However, the industry has been under attack by those who consider the cost of the protections too high (e.g. fees) and aggressive criticize the industry.

This report is a 5-part series looking across the industry from different perspectives. They include the Industry, the Consumer Perspective, the Agent Perspective, Criticisms, the Future.

Part 2: The Consumer Perspective

This report looks at the Annuities industry from the consumer perspective. The report will build on the first report "Annuities Defined" and focuses on the value proposition from the point of view of the consumer. The report addresses the consumer need for annuities, why consumers buy (or do not buy) annuities and addressing annuities in the context of "the retirement puzzle".

Author

Don Desiderato
Founder and CEO Mantissa Group
d.desiderato@mantissagroup.com

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Purchasing Annuities

Consumers considering an annuity often constrain their thinking and will paint too "black and white" of a picture. They often believe that a person buys an income annuity with a lump sum and immediately starts receiving an income stream where their money is forever locked into the annuity contract. While those annuities certainly have a profound benefit, many have the added benefit of *accumulation phases* and *living benefit riders*. As alluded to in the part 1 of this series, the accumulation phase can provide favorable tax treatment on growth during the deferral period, and many times offering access to the assets at the discretion of the consumer during this period.

Under normal circumstances, annuities do not pay income until the person either elects annuitization or reaches an older age (70s or 80s, for example), allowing for substantial asset growth. Then at retirement, the annuity will pay a fixed amount on a monthly, quarterly, or annual basis. This means that those just entering their retirement years can put a plan in place to ensure that if they continue to live a long life, they will they have a source of guaranteed income, in addition to social security and/or other defined benefit retirement plans. This, of course, is the primary value proposition of annuities.

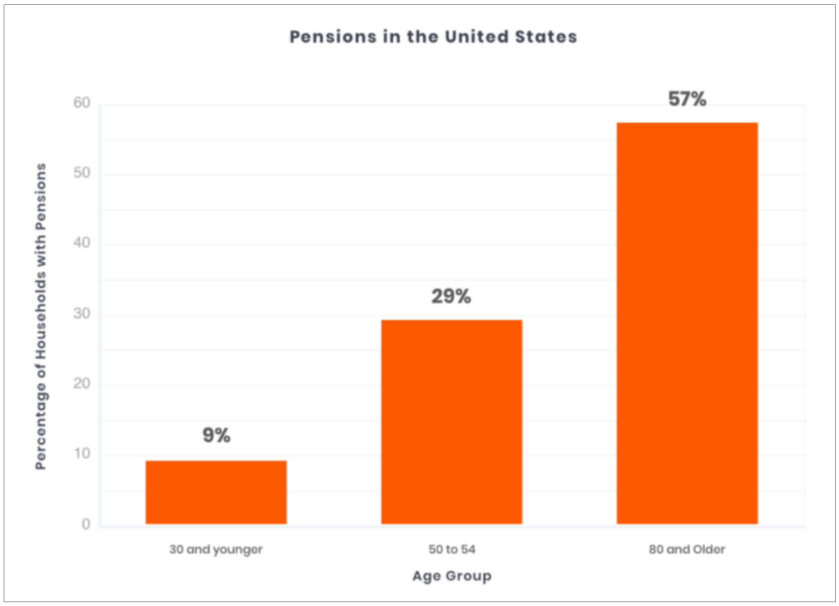
Why Consumers Choose Not to Buy Annuities

There are challenges that many people face when making the decision of whether to purchase an annuity. As an example, a consumer will purchase homeowners insurance as they see it as a requirement for homeownership. However, these same people view the money that they saved in their retirement accounts (401k, IRA, 403b, etc.) to be their money, and the idea of relinquishing that money to an insurance company for a guaranteed retirement income stream for life and largely losing control over the assets is difficult to imagine. The industry concern is that people who do not apportion some assets to annuities may overestimate their ability to manage their own money to fund retirement for the rest of their lives (which is an unknown timespan).

Consumers often worry about income annuities only paying for only a certain period (e.g. 10 years), leaving an unprotected period, or wanting flexibility to redirect assets to cover emergencies such as long-term care needs. Consumers go on to express concerns that a deferred income annuity, for example, may not pay a benefit at all due to pre-mature death and is not "worth the investment". To offset these concerns, insurance companies offer return of premium riders, spousal benefits, and living benefit riders to ensure that the original investment is never forfeited, or the money can also be used for living benefits.

We believe that a person is better off viewing an annuity purchase as a form of *longevity insurance* as opposed to a pure *investment* vehicle. The higher fees paid to insurance companies for annuities are often compared to standard investment vehicles and deter consumers. However, if looking at an annuity as an *insurance product providing longevity insurance*, it is easier to understand the rationale for higher fees when compared to investment products.

Solving the Retirement Puzzle



According to demographic data, there are 76 million *baby boomer* retirees that will be approaching 65 years old by the end of this decade. With the average life expectancy of 80 years, up from 68 years old in the 1950s, a 20-year retirement can be expected.

These retirees are clamoring annuity products with attractive accumulation features, coupled with lifetime income security.

This demographic reality impacts product design, and according to LIMRA, virtually all annuity product categories will be in demand in the coming years. Index-based products are particularly in great demand given the favorable accumulation benefits.

As is illustrated in the chart, pensions are considerably less common among late baby boomers and younger individuals, so annuities will fill the void in serving as a major piece of the retirement puzzle. With defined contribution plans continuing to become the norm from employers, retirees are now responsible for managing their savings to last for the rest of their lives without knowing just how long they will live.

What adds to the retirement anxiety is the fact that there is little guidance from retirement plan administrators on how to convert this lump sum of money in their retirement account into a stream of income that is guaranteed to last for the rest of their life. This leaves people without a long-term strategy, and often times a larger sum of money to manage than they have ever had to manage before. Financial advisors, therefore play a substantial role in educating consumers and providing financial guidance.

The concept of *annuitization* is often overlooked when people consider purchasing an annuity. As discussed in previous sections, many individuals look at annuities as an *investment*, which we believe is likely the single largest deterrent. Thinking of an annuity as an *insurance* purchase that will be either immediately annuitized (turned into a regular and consistent stream of income) or annuitized when the income is needed at a later date will help to frame annuities in the proper light, and will help to solve a large piece of the retirement planning puzzle.

Technology Expectations

The most indicative sign of a growing industry is the emergence of the start-up community. We continue to see activity in retirement planning tools and direct to consumer approaches to educating retirees. Consumers, particularly in this digital age, have high expectations of technology. This technology comes into play in three areas: *pre-purchase*, the *purchase process*, and when the annuity insurance contract is *in-force*.

During the **pre-purchase** process, online calculators to help consumers understand "what-if" scenarios. Meaning, what happens to the income stream if they increase the premium amount, assume longer or shorter longevity, factoring in living benefits, or adding spousal benefits. Insurance carriers will use an Illustrations provider such as *Insurance Technologies* to perform an illustration to help the consumer make their decision. Platforms such as Insurance Technologies are often integrated in an insurance company technology ecosystem and connected to agent technology.

During the **purchase process**, insurance carriers will use technologies to create a fully digital experience. The backbone for many insurance companies is a CRM platform such as *Salesforce* for agents to use in guiding the consumer and typically vendors such as *iPipeline* or *Ebix* for the electronic application process. Documents will normally be electronically signed via technologies such as *DocuSign* and the use of platforms such as *Firelight* for e-delivery of insurance documents. All of this creates a digital experience that consumers come to expect.

Finally, once an annuity policy is purchased and is **in-force**, an online web portal and mobility app is enabled. This will allow for normal transactions, (e.g. address changes), financial transactions (e.g. adding money), or rebalancing funds in the case of variable annuities. Statements will be available online, and virtually anything needed to administer the insurance policy is made available to the consumer.

All of this creates a digitally enabled experience for the consumer.

Concluding Thoughts

As we expand the scope with which we view annuities, understanding the impacts and benefits that they provide, gives insight into why consumers so seriously consider them as a significant piece in solving the retirement puzzle. Annuities do not serve just one single purpose, and therefore having a more holistic view and framing them in the proper context as an insurance product (as opposed to a pure investment) will allow for proper consideration. Aiding in consideration are the available technologies, such as retirement calculators, that assist in understanding the "what-if" scenarios and allows a consumer to evaluate all of the benefits and alternatives of an annuity – both accumulation and income phases. There are certainly criticisms of annuities in the market, which is addressed in *Part 4: Criticisms*, and consumers need to contemplate all aspects in their decision making.

Finally, some economists tend to look favorably on annuities because they serve as one of the few ways a retiree can address the uncertainty of making their retirement savings last. Spending too much increases the risk of outliving their savings, but spending too little may not allow an individual to enjoy the time and money they have worked their whole life to enjoy. The steady and dependable income stream that ultimately results from annuitization can help to solve this complex issue.

About the Author

Don Desiderato is a former Fortune 100 Executive and Founder of Mantissa Group LLC, a strategy consulting firm serving the CIO executive and their extended leadership teams. Don is a recognized industry expert, and a deeply experienced senior technology executive helping leaders with their **technology strategic plans,** as well as simultaneously focusing on **leadership development and culture**.

About Mantissa

Mantissa Group provides business and technology strategic consulting services. Mantissa supports the Chief Information Officer executive and their leadership teams, with a focus on CIO engagement as a business leader. Mantissa has practical experiences supporting leaders with **technology strategy, executive coaching, leadership development**, and relevant **research** for technology organizations.