Industry Brief: Annuities 5-Part Series

Publication | June 2020

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 aggressively 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 5: The Future of the Industry

The Annuities industry in the United States provides an important set of solutions for retirees, primarily accounting for retirement income needs. Our five-part series has analyzed the industry from various perspectives and this final report focuses on the future of the annuities industry. We will look at developments in product design, industry sales, online presence, and our view of 4 emerging trends.

Author

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

Contents

New Product Innovation

Much has been written about the Annuity industry and product evolution appears to be moving in two tracks. The first track is ***simplicity***. Insurance companies are coming to realize that with the evolution of the digital age, products need to be simpler and easier to be understood by the general population. Those who can simplify language, fee structure, and product behaviors will be the winners, as annuities are projected to be a growth industry. The second track is on specific ***product innovation***, designing products to be fit for purpose, based on emerging consumer needs. Let us look at an example of a current trend in new product innovation.

The *registered indexed-linked annuity* (RILA) is a product design that has been conceived by insurance companies based on consumer demands.

According to Athene, RILAs can be explained as a cross between a fixed indexed annuity and a variable annuity. These products could be a benefit for the individual who wants to limit exposure to downturns but wants an opportunity to benefit from market growth. Similar to indexed annuities, RILAs offer the ability for growth based in part on the performance of a stock market index, and like other annuities will receive growth on a tax-deferred basis, annual free withdrawal amounts, and the option to convert the annuity into an income stream (annuitization). However, RILAs differ from fixed indexed annuities in that investors accept a level of risk of market loss in exchange for the potential for a higher upside.

As we have discussed in our previous reports, as an individual approaches retirement, protecting money saved for retirement from losses due to market downturns is of critical importance. However, some people who have a bit higher of a risk tolerance may find that the cost of protection that fixed annuities can provide does not outweigh the benefit of products offering greater returns. This is where a RILA may be an appropriate option.

Athene goes on to point out that the upside and downside limits of RILAs are connected. This means that a higher level of protection from downside risk means a lower cap on the upside potential, and this applies in the inverse as well. When the index performance is positive during a term, the annuity will earn interest credits. This is limited by a cap or participation rate. However, an index decline can result in negative interest credits, with a level of protection from investment loss. This is referred to as a **buffer** or a **floor**, which are two options that limit exposure to loss.

A **buffer** involves a percentage of downside protection between 10-30%. As an example, if an index declines 15% and you choose a 10% buffer, your loss would be limited to 5%. A **floor** is essentially the opposite of the **buffer** option. With this option you would be exposed to the percentage loss up to the floor amount, but are protected against any loss after this percentage. So an example of this would be choosing a product with a 10% **floor** and the market declines 15%, there would be a 10% loss due to the floor limiting the extent of downside exposure.

Overall, this product is typically for the person who is more focused on accumulating money for retirement. Athene notes that if you are looking for an option that provides lifetime income, other annuities may be a better fit.

Annuity Sales on the Rise

Looking forward, it is important to understand from the recent history that **total annuity sales** have hit the highest levels since 2008. According to the Secure Retirement Institute, in 2019 sales were $241.7 billion in total. This represents an increase of over 3% from 2018 sales. **Variable annuity** sales also grew overall in 2019 to $101.9 billion, representing a 2% increase above 2018 sales. This was the second consecutive year of annual growth for variable annuities. The top three manufacturers of these annuities were Jackson Life, AIG Companies, and Lincoln Financial. These companies made up 22% of all sales in 2019.

According to the Secure Retirement Institute, the variable annuity market benefited greatly from the registered index-linked annuities (RILAs) that was previously discussed in this article. RILA sales came in at $17.4 billion in 2019, which was a 55% increase from 2018. This made up 17% of the total Variable annuity market. There are many companies who are beginning to join the RILA market because of the value that they can provide retirees with downside protection for those nearing retirement.

Additionally, when we look at **fixed annuity** sales 2019, it was a record-breaking year. 2019 saw a total sales number of $139.8 billion, which is a 5% increase from the year prior. The top three companies offering these fixed annuities were AIG, New York Life, and Allianz Life of North America. These three companies make up 23% of the U.S. Fixed annuity market.

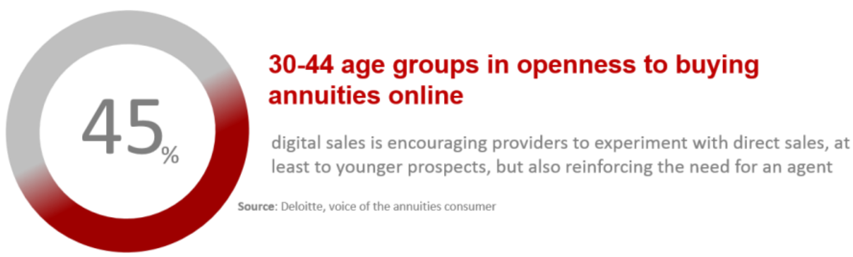
Fixed-indexed annuities also set annual sales records in 2019 with sales of $73.5 billion, 6% higher than 2018. The top three sellers in this category were Allianz Life of North America, Athene Annuity & Life, and AIG. They made up 28% of the overall market.

Online Sales

With the explosion of digital technologies, financial services and insurance companies are enabling online sales. The online purchase of mutual funds, stocks, and term life insurance are now commonplace. However, the purchase of an annuity online is still elusive. Certainly research and marketing material is commonplace, and the ability to illustrate a sale through financial calculators ("how long will my money last?") is equally common. However, insurance companies have resisted the ability to purchase an annuity online.

Many insurance companies believe that because an annuity product is complex, and also bundled with guarantees and fees, they therefore need to direct the buyer to an insurance agent or broker to educate them. Insurance companies are equally reluctant to disrupt or alienate their primary distribution source, the agent. Agents are quite protective of their legacy distribution model of face-to-face sales: agents and brokers are paid a commission when a client buys an annuity, they cross-sell products, build relationships, and educate clients.

This dynamic may be less than ideal to a consumer (to be bothered by having to speak to a person), however in such a highly regulated environment and complex products, insurance companies feel that annuities may not the right fit for everyone and the opportunity to understand the entire picture is paramount.



In an interesting shift, data indicates that buyers are reluctant to buy online – until now. A Deloitte survey revealed that only 17 percent of current annuity owners were either somewhat or very likely to consider buying another annuity directly over the Internet, without a professional financial intermediary shopping for them or advising them. However, this percentage increased to 45 percent in the case of buyers who were 30–44 years old.

When nonbuyers surveyed by Deloitte were asked what factors might make them more likely to consider buying an annuity over the Internet without involving their own agent or advisor, a strong percentage of the population said they wanted the ability to *compare products* offered by different companies, *expect a discount* after eliminating the intermediary, *wanted access* to a licensed advisor during the sales process to answer questions, and *want a single point of contact* at the company in case they need more information.

Industry trends seem to show that insurance companies are responding to this digital revolution but are not willing to completely bypass the agent or financial advisor. Not only for channel conflict concerns, but because they believe the agent provides substantial value in the decision to purchase an annuity product. This trend shows a move to a highly digital process in the research and comparative analysis phase, with a recommendation to speak with a financial advisor to ensure the purchase is the correct financial move. This advice or a service to connect interested prospects with a licensed agent will be that compromise.

The Future

As we contemplate the future of annuities, we see four developing trends.

1 One obvious trend is centered on the **consolidation** of providers as the industry repositions itself. Within the past few years, we have seen companies such as Voya, The Hartford, and Ohio National all exiting the industry, and spinoffs such as MetLife of Brighthouse Financial. We have also seen companies emerge, such as Athene, including their most recent partial purchase of Jackson National. This trend will certainly have an impact of the future and evolution in the industry.

2 Consolidation of industries tend to create more of a "one-stop shop" offering a wider variety and a richer set of products to meet the needs of the customer. With more concentration from fewer companies, consumers will likely be offered **advanced digital capabilities**, including the ability to shop for and research annuities on their own terms. They will be enabled to independently research available products and seek guidance of a financial professional.

3 In addition to the consolidation of providers, there is a trend in **decreasing the complexity of annuities offered.** Often, annuities that are difficult to understand and are complex in nature, perhaps falling under SEC regulation, are the ones with the highest fees and are what lead to the negative connotations associated with annuities. Continued growth in the fixed annuity space should be expected for this very reason, as they are much simpler and more transparent products. LIMRA data has shown that more than 50 percent of consumers will choose *guaranteed income* over *lump-sum payment* in retirement. This fact shows how fixed annuity products will likely continue to be valued and in demand by those approaching and entering retirement.

4 Finally, what may be the most important trend is a focus on **guaranteed income in retirement**. There are industry wide initiatives to shift the focus from retirement asset accumulation to retirement income. With the risks to Social Security and stagnant wage growth, often times this leaves retirees in a position where they don't have sufficient income to support their lifestyle. Annuities can be part of the solution in giving people more security knowing they have a guaranteed income stream for life, thus having more freedom to spend the money they receive.

What is certain about the annuities industry is that it will evolve and thrive. Legitimate criticisms related to high fees and transparency will continue to impact the industry, but the industry recognizes that fewer individuals will be able to depend on a defined benefit pension plan to support them in their retirement years. We believe that annuities will fill that void. Certainly, the perpetual low interest rate environment will influence future product design, and while not identified as a trend, it will be a huge factor in industry evolution.

The four trends identified here will be large factors for the industry in the coming decade.

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.