Eight VA trends worth noting

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Sales flat-out flat

Sales of variable annuities rose in 2007 to $179.5 billion, then took a dive along with stock markets in 2008, falling to $151.9 billion, according to data from Morningstar Inc. There's been some recovery in those numbers, particularly as advisers and clients began to appreciate how variable annuities with living benefits could act as a buffer against market volatility. Still, last year ended with $153.7 billion in sales and with assets under management hitting $1.5 trillion — which is flat compared to 2010.

Big Three getting bigger

The last couple of years have been busy for variable annuity providers. Following the 2008 crisis, more customers and advisers began to gravitate toward the top three issuers of variable annuities. Last year, the top three purveyors of variable annuities, MetLife Inc., Prudential Financial Inc. and Jackson National Life Insurance Co., accounted for around 43% of VA sales. In comparison, the top three companies of 2006 only accounted for a quarter of all variable annuity sales. Kevin Loffredi, vice president, insurance solutions and advisor software at Morningstar, attributes the recent sales concentration to attractive features and a strong sales force among the top players.

Living benefits not dying off

Living benefits, which provide guaranteed income and withdrawal benefits, typically accompany a variable annuity when it's sold. About 87% of all variable annuities come with a living benefit, according to Morningstar. Clients and advisers have largely chosen the guaranteed lifetime withdrawal benefit in the single life version; this feature has been elected in 58% of variable annuity sales. Guaranteed minimum income benefits, which guarantee a minimum level of annuity payments, are chosen in 16% of variable annuity sales. Mr. Loffredi noted that GMIBs eventually became too expensive for life insurers, resulting in 12 companies ending sales of the feature.

Singles going steady

Among those who take the guaranteed lifetime withdrawal benefit, nearly all (95.5%) will buy the single life version. Only 4.5% selected the joint life version. The single-life living benefit doesn't continue for both spouses in the event one of them dies. Mr. Loffredi noted that single life versions of living benefits provide slightly larger payouts and that these features are cheaper than the joint version. Still, "if joint life is too expensive, then the single life is too expensive," he added.

Not out of the woods on in-the-money accounts

The insurance industry's exposure to variable annuities that are in-the-money, where the account value is smaller than the guaranteed living benefit base, continues to shrink. In 2011, life insurers had $721.3 billion in assets under management tied to variable annuities with these features, while benefit bases were worth $823.4 billion. That leaves the industry underwater on these benefits by $102.1 billion, according to Morningstar. During the crisis in 2008, insurers were underwater on these benefits by $253.7 billion. In 2006, the halcyon days prior to the downturn and the living benefits arms race, carriers were only underwater by $3 million.

Wax on, risk off

The popular theme in variable annuity product development has been to de-risk, mostly by using investment models that minimize volatility risk to the insurer or by reducing income and withdrawal benefit features – which are sensitive to low interest rates. During the first quarter of this year, companies filed 59 annuity product changes with the Securities and Exchange Commission, which is moderate compared to the 130 filings that posted in the fourth quarter of 2011.

Brakes being applied

Recent changes to variable annuities include lowering guaranteed withdrawal percentages or tying them to U.S. Treasury rates. "They're not offering an attractive 7% [withdrawal] for life, but instead they're giving you a rate that's not out of their realm," said Mr. Loffredi. Carriers that tie their income features to the Treasury rate include Allianz Life Insurance Co. of North America and Axa Equitable Life Insurance Co.

Others have found ways to dampen equity market movements by adding volatility management strategies, including Axa, MetLife, Ohio National Financial Services Inc. and Transamerica Life Insurance Co. Some bake market hedging into the underlying funds, which is what Lincoln National Life Insurance Co. has done with its LVIP Protected Asset Allocation Funds.

Alternate routes

(Alternative strategies have also been showing up in carriers' variable annuity fund lineups. So far this year, 17 unique alternative subaccounts have been added to insurers' investment options, compared to 32 in all of 2011, according to Morningstar. "We're on track for a good year, but by far, it's not the largest year we've ever seen," said Mr. Loffredi. For instance, in 2007, 47 unique alternative subaccounts were added to variable annuities. Fee-based and fee-only advisers are the target of these product changes, with a special emphasis on tax-deferral rather than living benefits. Recent additions include Jackson National's Elite Access and Symetra Life Insurance Co.'s True Variable Annuity.