Creating Guaranteed Lifetime Income

INCOME ANNUITY BUYER STUDY

CANNEX

LIMRA Secure Retirement INSTITUTE®

INCOME ANNUITY BUYER STUDY:

Creating Guaranteed Lifetime Income

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Introduction

Fueled by demographic, regulatory, technological, and economic trends, the demand for guaranteed lifetime income is growing. In particular, there is an increasing market appeal for Single Premium Immediate Annuities (SPIA) and its more recent manifestation, the Deferred Income Annuity (DIA). While headwinds persist, market dynamics are converging to bolster the category.

Against this backdrop, in partnership with CANNEX, the LIMRA Secure Retirement Institute conducted a comprehensive Income Annuity Industry Experience Study. The study compiled contract-level sales data from 22 manufacturers, covering sales from 2012 through third quarter 2015 and representing 83 percent of the industry.

Key Findings

Income annuities are increasingly purchased with tax-qualified money. While DIA funding is predominantly tax-qualified retirement savings (74 percent), SPIAs are still slightly less often funded with tax-qualified retirement savings (48 percent).

Income annuities are more often sold to women. Almost 62 percent of single life SPIAs and 57 percent of single life DIAs are sold to women.

Joint-life sales are most commonly owned by males, at 74 percent for SPIA and 73 percent for DIA, yet most commonly cover mixed-gender spouses.

At 72 years, the average SPIA purchase age has dropped slightly to meet head-on with the age of Leading Edge Boomers.

At just 59 years, the average DIA purchase age has brought the income annuity market opportunity down to include much younger aged consumers.

A Case for Growth

DEMOGRAPHIC FACTORS

While there are more people alive today over age 70 than ever before, that number will triple over the next 18 years as the last Boomers turn 70 in 2034.

There has been dramatic growth – and it will continue to increase each year – in the number of retirees personally responsible for managing their own conversion of retirement savings into a predictable source of income over an uncertain time horizon.

While the incidence of attaining extreme advanced age is increasing, it remains a low-probability, high-consequence event — creating the perfect scenario for risk-pooled solutions.

MARKET DYNAMICS

An increase in market demand can also be attributed to changing supply dynamics as some insurers retreat from the guaranteed lifetime withdrawal benefit (GLWB) affixed to accumulation annuities. This has been a slow, but noticeable, trend — especially among career and national broker/dealer distribution channels.

REGULATORY FACTORS

While the U.S. tax code has not fully kept up with the pace of product innovations, introduction of the Qualified Longevity Annuity Contract (QLAC) represents government endorsement of the product construct.

The United States Department of Labor (DOL) Fiduciary Rule has put pressure on competing guaranteed lifetime income options such as Guaranteed Lifetime Benefits (GLBs), favoring the simple fixed income product.

TECHNOLOGY FACTORS

Technology-enabled product allocation platforms and decision support tools have displaced all-or-nothing thinking of either full annuitization or no annuitization with a more relevant context of 'how-much-to annuitize' decision instead.

Documenting the need and best interest of the client may force consideration of guaranteed lifetime income.

However, there are also considerable headwinds:

- Real, dramatic growth continues to be hindered by historically low interest rates or, more specifically, the longstanding ***expectations that rates will rise.*** As long as people think rates will be higher next year (which will bring the future cost of income down), they will be inclined to delay the purchase. This is especially true for the "income-later" DIA, where the purchase trigger is more discretionary.
- Traditional advisor practice models either compensate advisors at point-of-sale via commission or by an assets-under-management (AUM) fee. Neither model works well with SPIAs and DIAs which essentially replace the asset with an income stream. This leaves the advisor with no further sales opportunities.

OUR TAKE

With increasing demand has come product innovation, including liquidity and flexibility options.

As retiree income becomes increasingly dependent on the successful management of individually-controlled retirement savings the use of retail income annuities funded with tax-qualified savings will grow too.

The introduction of a market-popular DIA has decreased the average age of income purchase and expanded the market.

Aging Baby Boomers are now reaching the average purchase age for SPIAs, and further expanding the guaranteed lifetime income market.

For all of these converging reasons, we continue to view the long-term (if not near-term) growth of the income annuity market positively.

Detailed Findings: SPIAs

Comparing SPIA sales in the most recent study to the 2010 study reveals some trends:

- SPIA sales are increasingly tax-qualified. Each year the percentage of sales contracts and premium that are sourced from retirement savings has grown.
- Increasing premium deposits reflect a movement up market (see Appendix A).
- The proportion of SPIA sales being used to guarantee lifetime income rather than for a fixed period only is on the rise.
- Purchase ages are slowly trending younger.
- Gender distinctions are minimal and mostly unchanged.

Even as the population ages, the average purchase age for SPIAs has been trending slightly downward, dropping in half-year increments every year since 2012 and settling just shy of 72 in 2015. Tax-qualified sales have an average purchase age of 69 while the average age of a non-tax-qualified buyer is currently 75.

The amount of income generated by SPIA is on the rise. The increase in average premium size is more than can be attributed to inflation. From 2008 to 2015, average premium increased three times the rate of inflation.

FIGURE 1

CHANGES IN SPIA BUYER CHARACTERISTICS 2012 – 2015 VERSUS 2008 – 2009

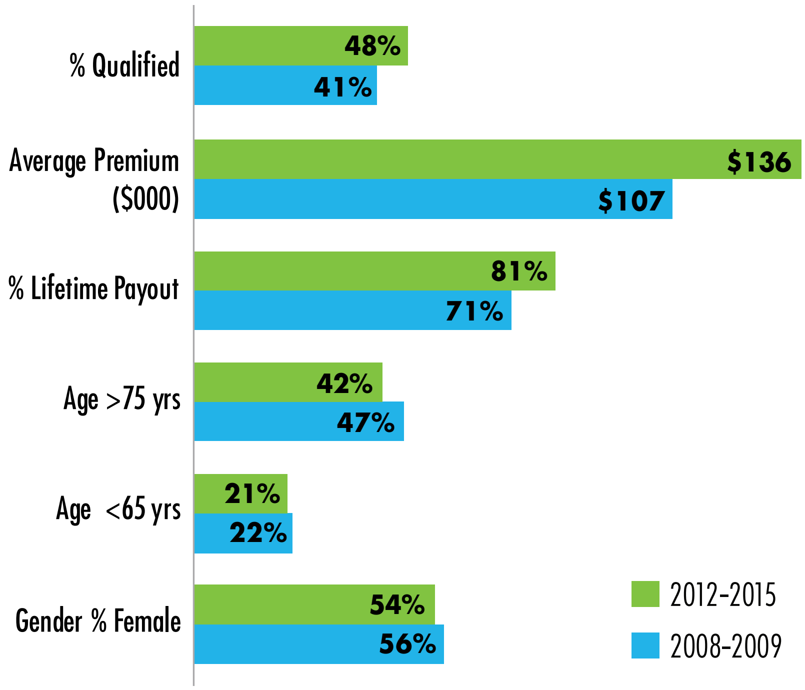
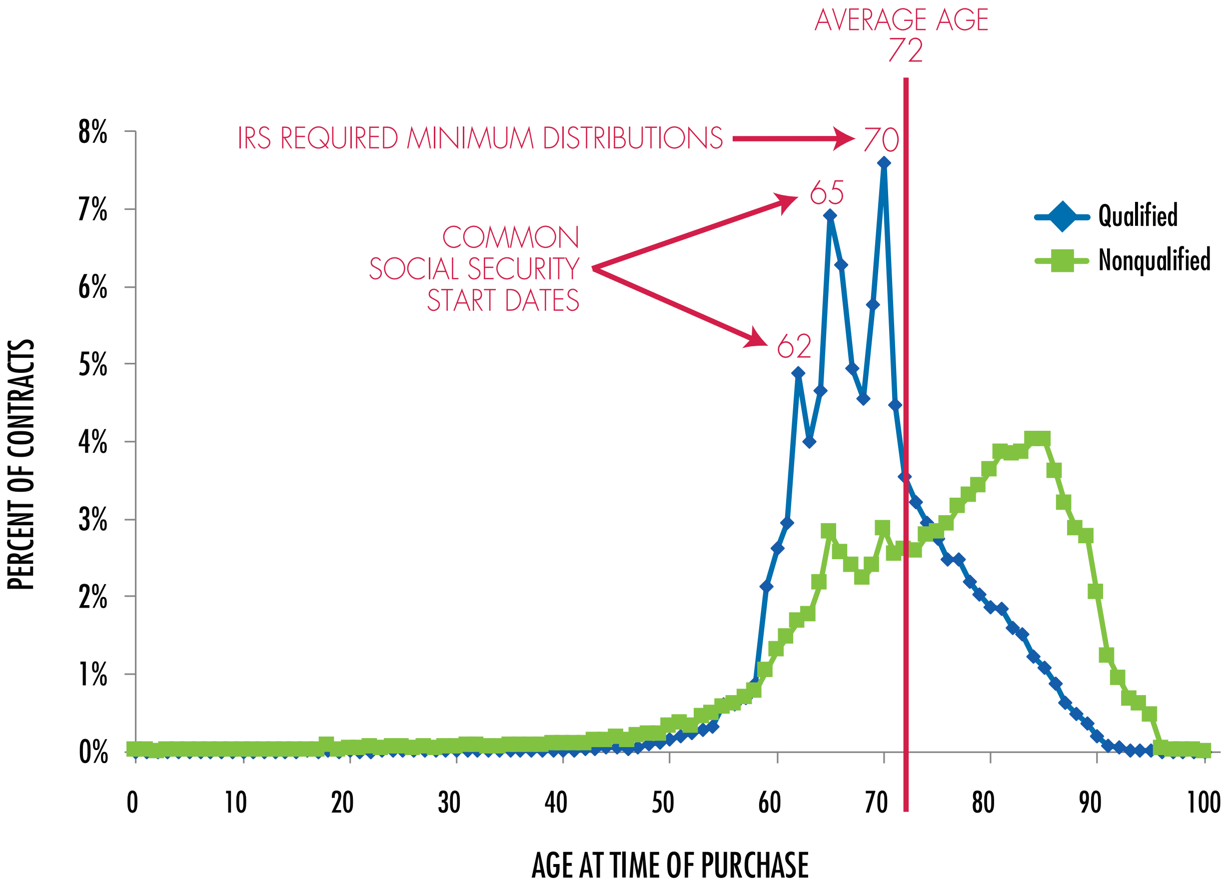


FIGURE 2

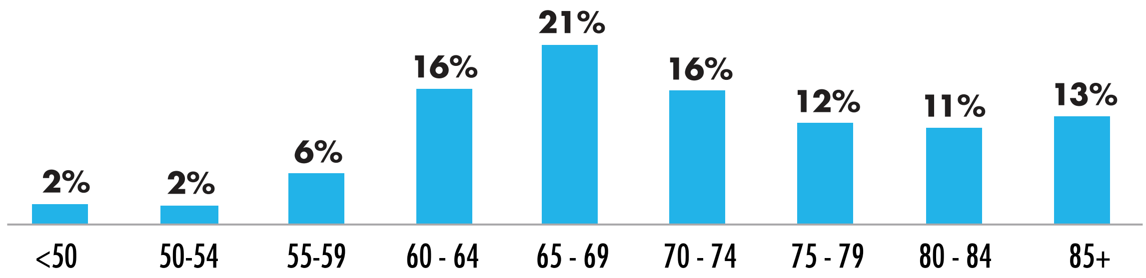
WHEN ARE PEOPLE BUYING SPIAs?



Qualified SPIA purchases are noticeably triggered by key milestone dates (Figure 2). Sales spike at age 62, 65, and again at 70. The first two ages represent popular Social Security start dates and therefore, common retirement dates; age 70 triggers required minimum distributions. In turn, these events commonly align with retirement income planning, where an income annuity sale is most likely to occur. On the other hand, when purchased with non-qualified assets, SPIAs are more likely to be sold at older ages. In these cases, the trigger goes beyond retirement income planning and is more often associated with estate planning activities.

FIGURE 3

SPIA: DISTRIBUTION OF PREMIUM BY AGE AT TIME OF PURCHASE



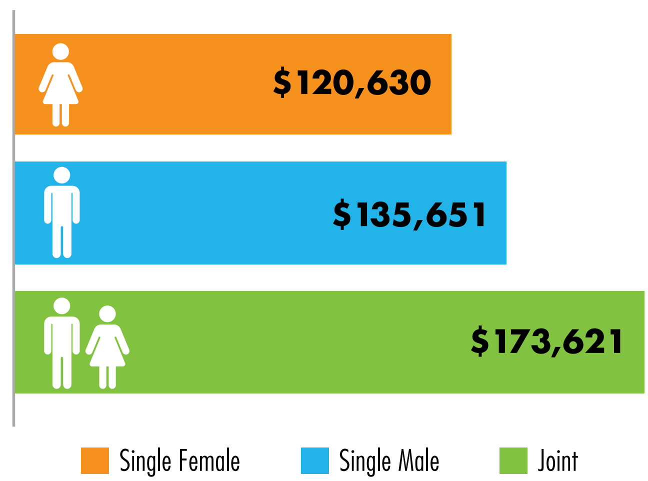
SPIA buyer ages reflect an in-retirement sale (Figure 3). Few SPIAs are purchased at ages younger than 55. While the amount of premium is greatest among buyers in their sixties, purchases continue into advanced ages.

Premium amounts are highest when two lives are covered (Figure 4). See Appendix A for premium splits by calendar year. In 97 percent of these cases, there is less than a 20-year difference in age between the joint annuitants. It appears that most are mixed-gender couples and few joint annuitants are children or grandchildren.

Among single-life contracts, males have higher average premium amounts than females — consistent with lower savings balances of women as compared with men. Owing to their longer longevity expectations, women also are offered lower payout rates per thousand creating an even larger distinction between genders in amount of retirement income generated.

FIGURE 4

SPIA: AVERAGE PREMIUM AMOUNT BY LIVES COVERED



SPIA CHANNEL MIX

SPIA sales are fairly concentrated in the full service national broker dealer and career channels of the major mutual insurance carriers (Figure 5). Because higher premium amounts typically correlate with formal holistic planning, it is not surprising that direct response sales are the lowest. We attribute the high concentration of sales in the career channel to familiarity with the value of mortality risk-pooled products (e.g., life insurance).

The average premium across all channels is $136,000 — with half of all contracts at more than $97,000, making a SPIA one of the largest purchases people make in their lifetimes (see Appendix A).

While average premium sizes are modest in the career channel, the volume of cases sold is the highest (Figure 6). Though the average premium size is 25 percent lower in the career channel versus the full service national broker dealer channel, the higher number of sales generated in the career channel more than offsets the difference resulting in minimal distinction in amount of total sales premium coming from each channel.

Although none of the SPIA contracts in this study offered a long-term care feature, SPIA contracts did have the following features:

- One third had a liquidity or commutation option
- Four percent elected an automatic increasing income feature
- One percent had any type of underwriting

FIGURE 5

SPIA: PERCENT OF PREMIUM BY CHANNEL

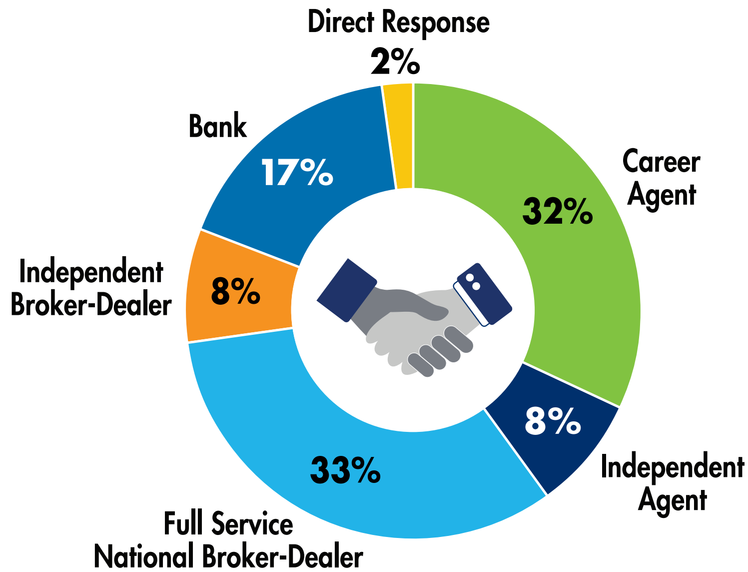
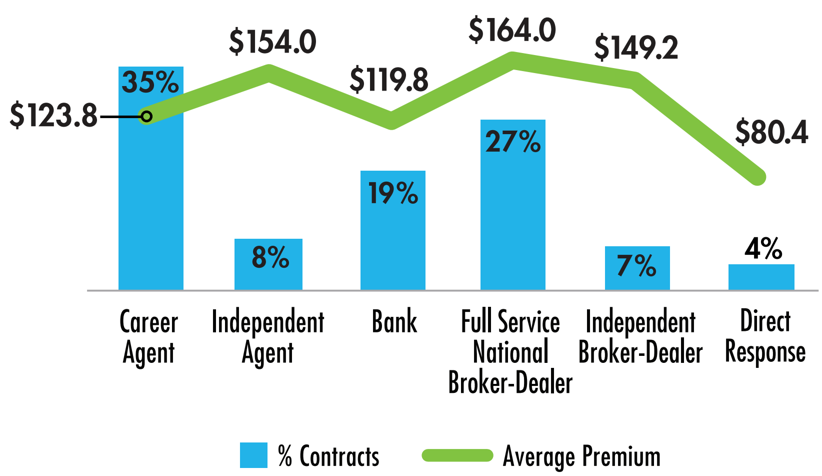


FIGURE 6

SPIA: PERCENT OF CONTRACTS AND AVERAGE PREMIUM AMOUNTS BY CHANNEL ($000)



Detailed Findings: DIAs

Taking a closer look at DIAs, it is clear sales of these products is highly concentrated between ages 55 and 69 (Figure 7). This is a function of the almost singular market framing of *"build your own pension"* aimed squarely at pre-retirees. The average DIA buyer is a 59-year-old pre-retiree forfeiting the liquidity of existing assets to guarantee a greater future income stream as part of retirement planning (Figure 8).

DIA income start dates are almost always before age 70 (Figure 9). We can attribute this to the fact that $3 of every $4 invested in a DIA comes from tax-qualified retirement savings. Few carriers are willing to allow income to start after age 71 due to required minimum distribution ages (RMDs). While not an IRS-dictated limitation, manufacturers' concern is that the holder of the illiquid DIA contract may not have other assets available to take the RMD, leading to hefty penalty taxes and resulting in a very negative customer experience. Currently, we are aware of two carriers who do allow income to start beyond RMD age:

- One offers liquidity in the case of a missed RMD whereby liquidity comes at a cost to income.
- One will allow investors to assume the risk with ample disclosure.
- The average deferral period for both qualified (7.7 years) and nonqualified DIA contracts (7.6 years) is nearly identical.

FIGURE 7

DIAS: DISTRIBUTION OF PREMIUM BY AGE AT TIME OF PURCHASE

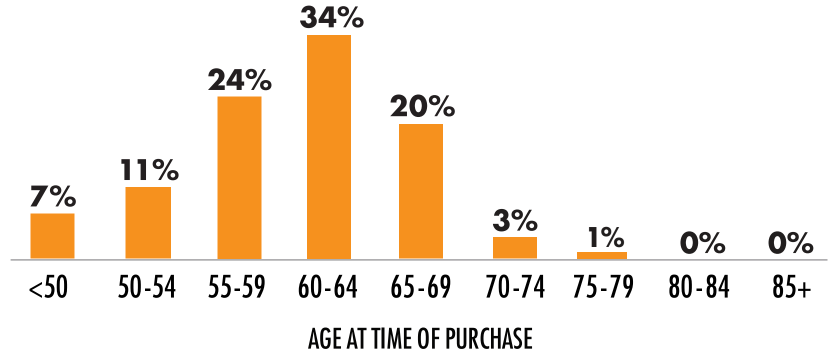


FIGURE 8

WHEN ARE PEOPLE BUYING DIAS?

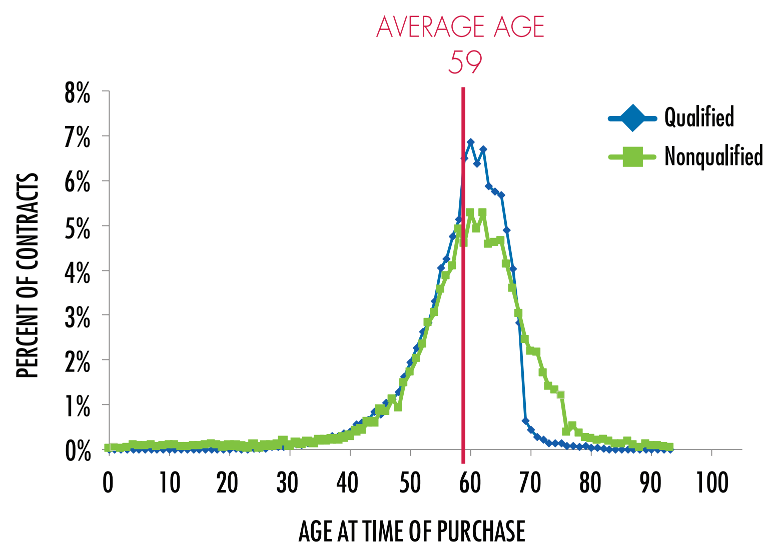
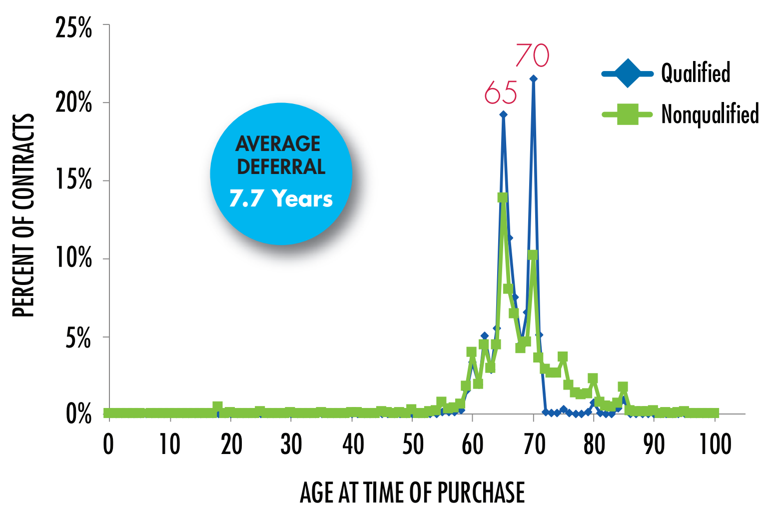


FIGURE 9

WHEN ARE PEOPLE STARTING INCOME?



LIVES COVERED

Similar to SPIAs, single life DIA contracts sold to women are, on average, smaller than those sold to men (Figure 10). See Appendix A for premium splits by calendar year. DIAs are more often sold to women. However, given the increased premium size of DIAs sold to men, the actual difference in total premium between genders is narrow (Figure 11).

As seen with SPIAs, average DIA premium amounts are highest when two lives are covered. In almost all of these cases, joint annuitants are fewer than 20 years apart in age. It appears that most are mixed-gender couples with minimal incidence of children or grandchildren as joint annuitants. Among single-life contracts (similar to SPIAs), males have higher premium amounts than females on average, which is consistent with lower savings balances of women as compared with men. Here too, owing to greater longevity expectations, payout rates per thousand are lower for women. This suggests even greater distinction between the genders in the amount of retirement income generated.

FIGURE 10

DIA: AVERAGE PREMIUM SIZE BY LIVES COVERED

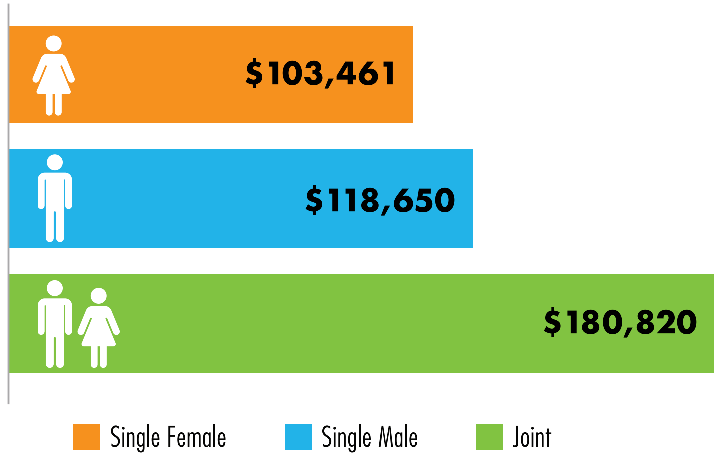
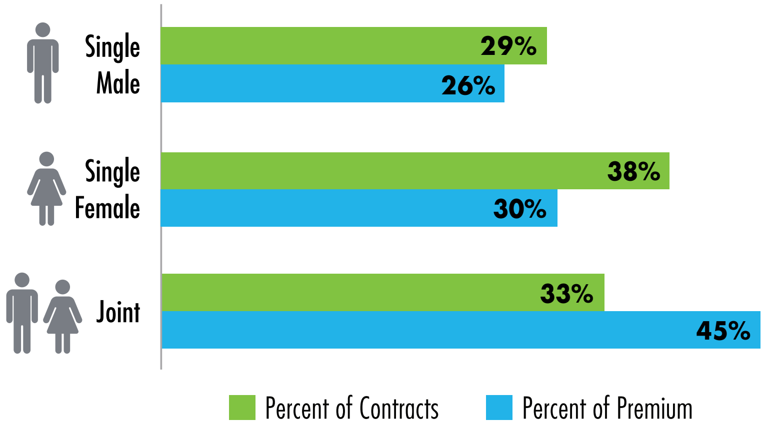


FIGURE 11

DIA: PERCENT OF CONTRACTS AND PREMIUM AMOUNTS BY LIVES COVERED



QLACs: The U.S. Treasury Makes an Exception

The Required Minimum Distribution (RMD) limitation gave way to the creation of QLACs – Qualified Longevity Annuity Contracts. Announced in July 2014, the U.S. Treasury provided for an exemption from RMDs when purchasing a QLAC for the minimum of 25 percent of prior yearend IRA balance or $125,000. While there are minimal QLACs represented in this study, we know from our annual sales data that they have seen considerable traction. We expect this to continue to be a growth segment among buyers who can delay income.

Channel Mix

Since DIAs are a newer product, first made popular in the career channel, sales are more highly concentrated in that channel (Figure 12). Like SPIAs, this may change with time.

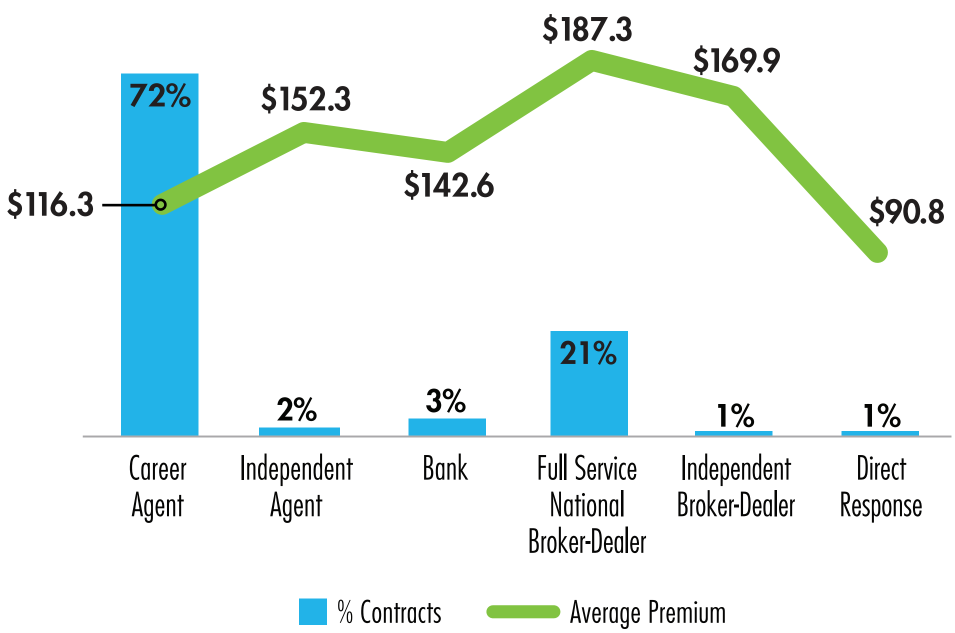
Across all channels, average DIA premium resembles that of SPIAs ($133,000) yet the channel differentiation in average premium size is even more pronounced. Half of all DIA contracts have initial premium deposits above $95,000. The highest premium sizes are generated in the full service national broker/dealer channel. Even more than SPIAs, DIAs are fundamentally planning products — and planning sales naturally correlate with higher dollar amounts.

QLAC DIA buyers tend to be older, have a longer deferral period, and a smaller average premium size than non-QLAC DIA buyers. On average, QLAC buyers are age 70, have an 11-year deferral period, and have an average premium size of $94,000. In contrast, average non-QLAC buyers are age 59, have a seven-year deferral period, and an average premium size of $134,000 over the study period.

One in six DIA contracts elected an automatic increasing income feature. Virtually none of the DIA contracts in the study had a liquidity or commutation option; none had a long-term care feature or did any type of underwriting.

FIGURE 12

DIA: PERCENT OF CONTRACTS AND AVERAGE PREMIUM AMOUNTS BY CHANNEL ($000)



SPIAs versus DIAs

INTERSTATE COMPACT

The Interstate Compact filing regulations were devised when the DIA contract was conceived as only an Advanced Aged Longevity Contract – with income starting typically at about age 85 to protect against the tail risk of an uncommonly long life. In this scenario, there was little practical application for a period-certain-only contract. As behavioral science would predict, the deferred gratification value proposition of "buy now so you are not impoverished later" just never sold. Even today, less than 3 percent of contracts start income at an advanced age. Unfortunately, while there are many market use cases for a period-certain-only DIA, the regulatory environment has not caught up. Some period-certain DIAs are available from manufacturers filing outside the compact, but most have elected the efficiency of the Interstate Compact.

Comparing SPIA buyers with DIA buyers reveals that while the product mechanics are quite similar, the use scenarios are markedly different (Figure 13).

DIAs are:

- More often bought with tax-qualified monies
- Almost always life-contingent
- Sold to a much younger buyer
- Less gender distinct

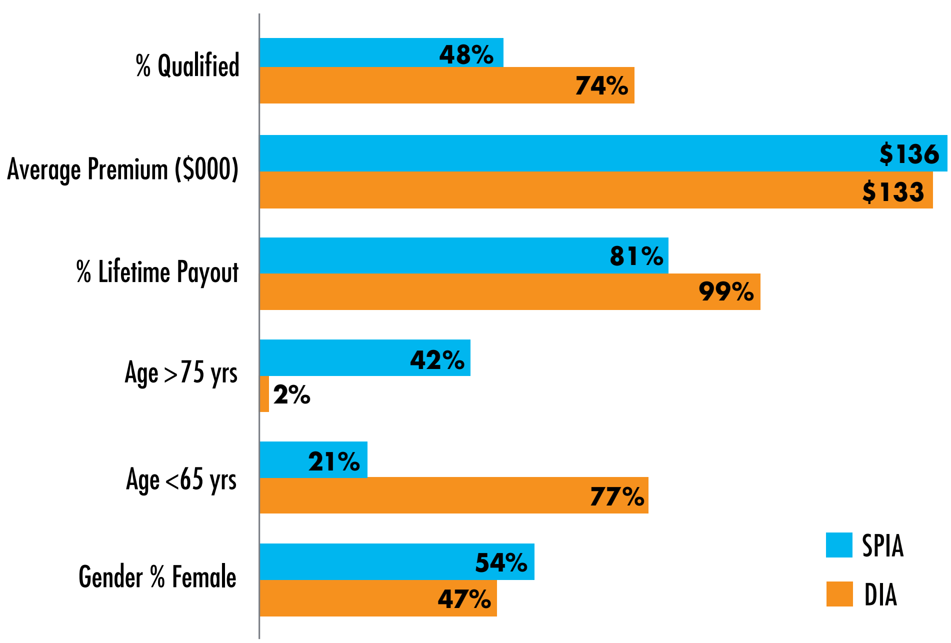
Because DIAs are purchased at much younger ages, it is not surprising that they also skew more heavily toward use of tax-qualified savings. The younger the demographic, the greater the reliance on defined contribution/IRA savings.

The fact that DIAs are also almost always a life-contingent sale is not a market demand phenomenon, but rather a practical one. Most DIA manufacturers file their contracts using the Interstate Compact, which does not allow for a period-certain-only DIA.

In terms of similarities, with both products buyers predominantly select level payouts (96 percent for SPIAs and 82 percent for DIAs). While most do offer a cost of living adjustment, few people elect it.

FIGURE 13

PRODUCT COMPARISONS: SPIA CONTRACTS VERSUS DIA CONTRACTS



**See Appendix A for average premium distribution by year.*

Both SPIAs and DIAs are most commonly based on a single life (Figure 14). However, the negligible use of period-certain-only with DIAs naturally results in higher proportion of both single life and joint life sales.

While "Life with Period Certain" has traditionally been the most common SPIA payout option, there is a growing trend toward the use of "Life with Cash Refund." This trend is strongest in DIAs because it keeps the death benefit paid prior to income start consistent with the death benefit paid after income starts. This makes it an easy, transparent story with less chance of misunderstanding.

SPIAs are more apt to attract new money, while DIAs are considerably more likely than a SPIA to come from an internal product exchange (Figure 15).

Finally, perhaps the most striking difference between SPIAs and DIAs is the average purchase age — 72 for SPIAs versus 59 for DIAs. Premium skews much older for SPIAs where more than 90 percent of all premium comes from sales to those age 60 or older.

SPIA sales are considerably (48 percent versus 34 percent) more likely to be funded with new money rather than an exchange from another annuity. When funded by an exchange from another annuity, DIA is more than twice as likely to be an exchange from an annuity with the same carrier (Figure 15).

FIGURE 14

ADDITIONAL PRODUCT COMPARISONS: SPIA CONTRACTS VERSUS DIA CONTRACTS

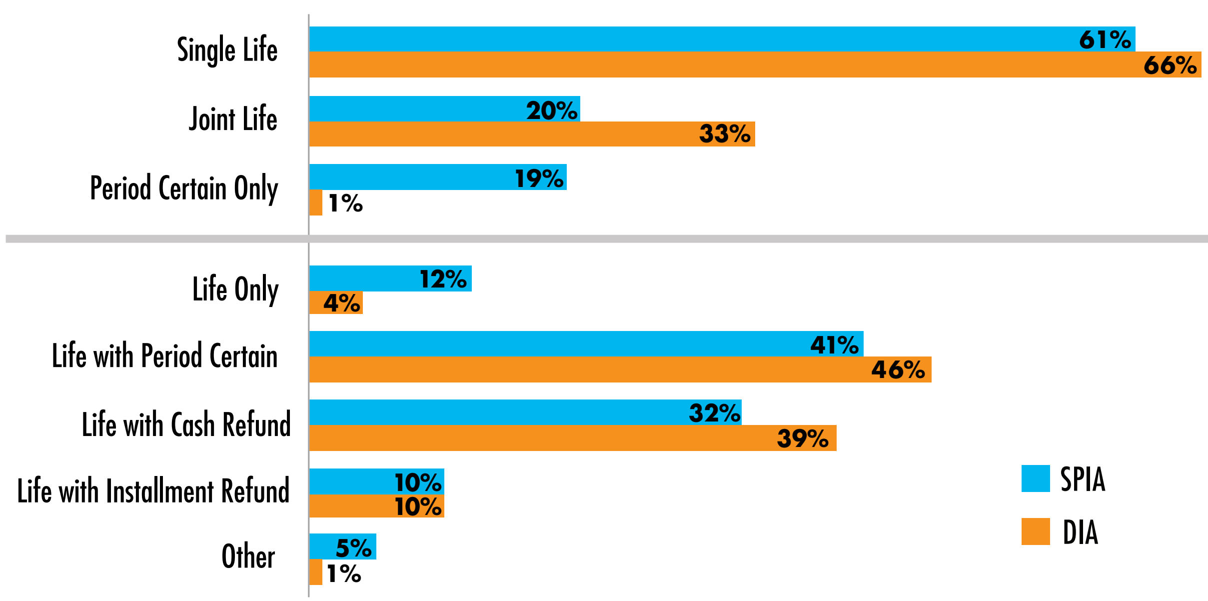
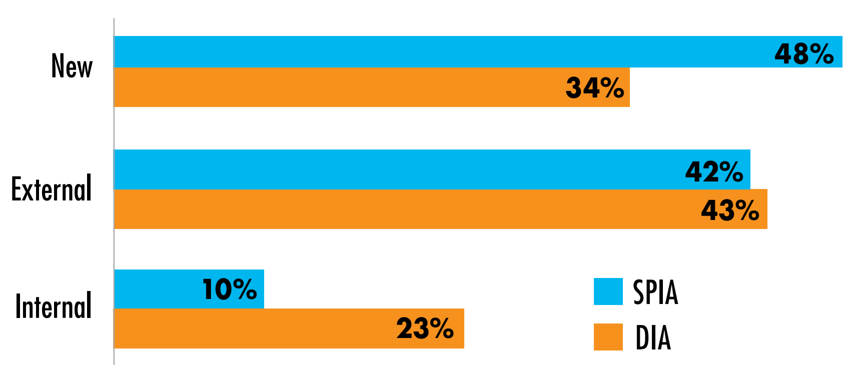


FIGURE 15

SOURCE OF FUNDS: DIA CONTRACTS VERSUS SPIA CONTRACTS



Where is the Income Market Going?

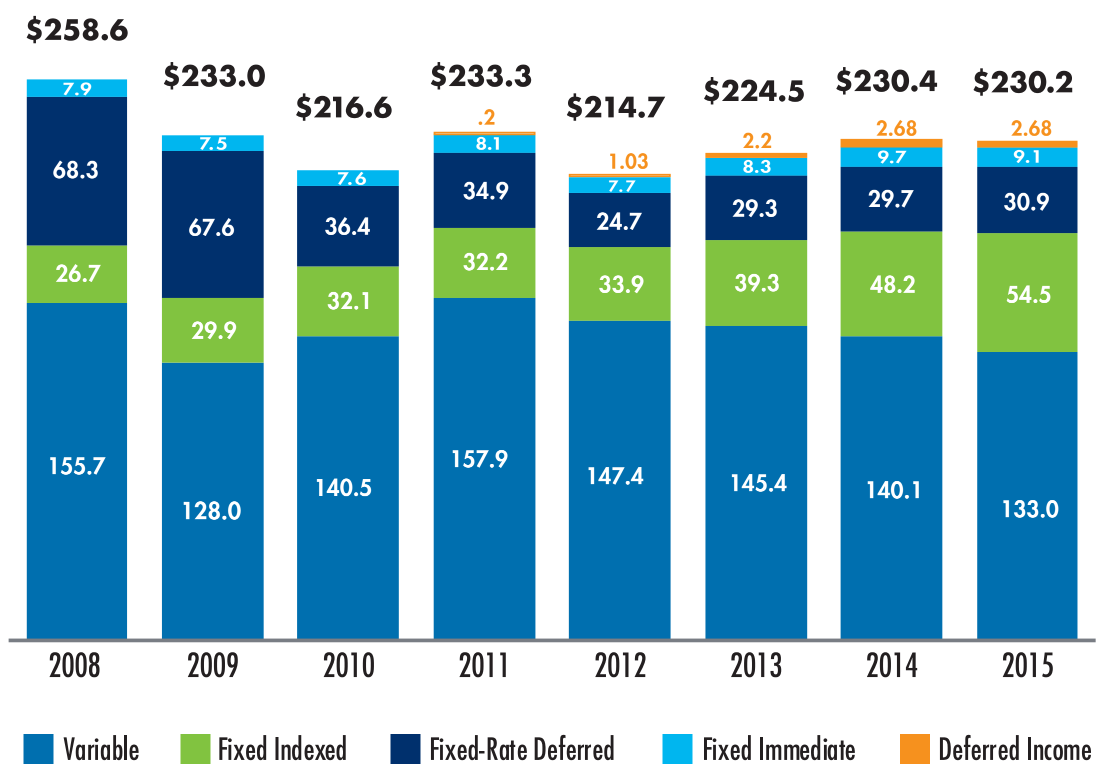
While we've seen shifts in the mix across all annuities sold since our last study, the total market has remained relatively flat. The proportion represented by pure income annuities (SPIAs and DIAs) has remained very low (Figure 16).

Still, while sales growth has been modest over the past decade, any growth during a period of rising costs represents a positive shift in demand. Even as interest rates have remained persistently low (increasing the cost of income), income annuity sales have remained steady and, in some cases, grown.

FIGURE 16

INDIVIDUAL ANNUITY SALES* (2008 – 2015)

($ BILLION)

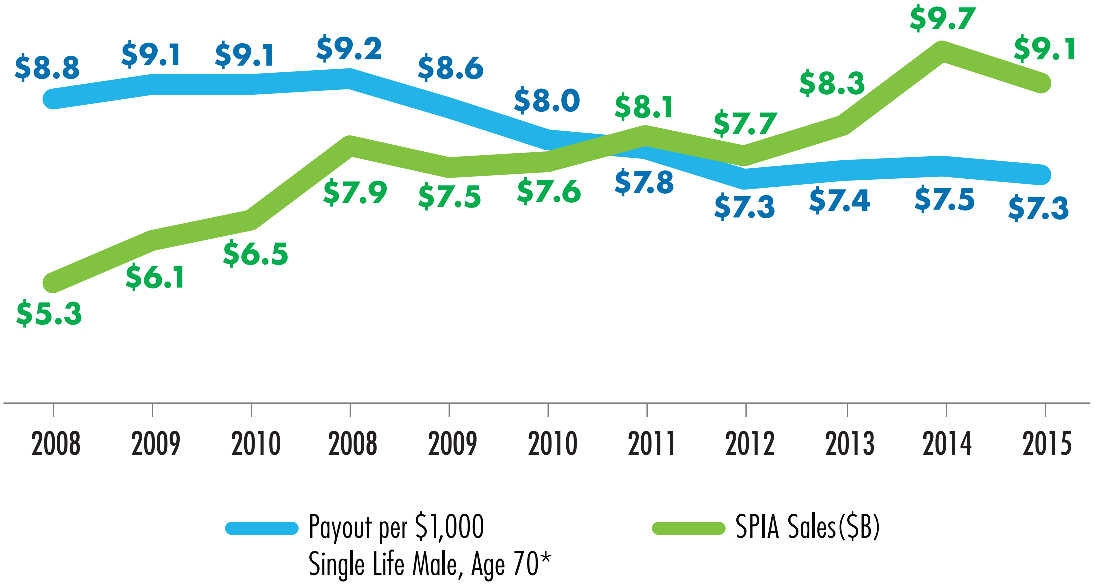


*Less Structure Settlements

LIMRA Secure Retirement Institute
Income Annuity Sales Forecast

FIGURE 17

SPIA INDUSTRY SALES VERSUS SPIA PAYOUT RATES OVER TIME

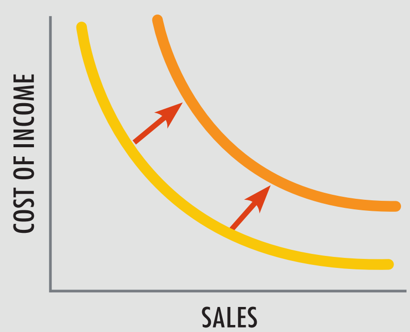


**Based on the CANNEX PAY Index™*

Shift in the Demand Curve

FIGURE 17: Decreasing payout rates mean the cost of income has been rising. During this same period, sales of income annuities has risen — a classic example of a positive shift in the Demand Curve.

DEMAND CURVE OVER TIME



CANNEX PAYOUT ANNUITY YIELD (PAY) INDEX

The CANNEX PAY Index™ is meant to provide an indication of the lifetime yield that a retiree can expect from an immediate income annuity (SPIA). The CANNEX PAY Index emphasizes actual insurance (market) quotes, and makes minimal assumptions about the current and future economic environment, the term structure of interest rates or the so-called "appetite" of insurance companies for SPIA business.

The bottom line is there are mixed signals as we look to the future

AGE

Baby Boomers have recently started to retire. Half of Americans retire between ages 61 and 65[1]. We estimate about a third of Baby Boomers retired by yearend 2015. The first Boomers will reach the deadline for taking required minimum distributions in 2017. This also coincides with the average age (72) of SPIA buyers.

DIAs are bought at much younger ages than SPIAs. There are still more Boomers under age 60 than over and as many Gen Xers following right behind. While several factors can explain a rising market demand for income annuities, the aging demographic alone can be expected to continue to push the market forward.

LONGEVITY

People are living longer and the benefits of pooling that risk is becoming better understood.

INDIVIDUAL RESPONSIBILITY

Each year the proportion of workers retiring with a pension declines and greater numbers are assuming personal responsibility for creating and managing retirement income.

DOL

The planning approach that will be required by the DOL Fiduciary Rule should foster product allocation techniques utilizing income annuities to maximize the outcome of the entire portfolio.

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[1] *Source: LIMRA Secure Retirement Institute analysis of U.S. Census Bureau's Current Population Survey, March 2014 Supplement.*

Can the Advisors Revenue Model accommodate income annuities? Historic emphasis on recurring commissions and/or AUM-based fees has disadvantaged the selling of income annuities. Can the DOL Fiduciary Rule prove a catalyst for changing this? The jury is still out.

TAX CODE

Advances in retirement income research and planning have identified new designs and ways to deploy an income annuity. These innovations have typically outpaced existing tax code policies leading manufacturers or carriers to make their own interpretation of the code until the appropriate updates can be made. One example is the July 2014 U.S. Treasury ruling where relief was granted for the deferral of income past age 70.5 from a qualified DIA. Even with this new ruling, there are still some additional open items that need to be addressed.

Planning concepts and certain managed money platforms attempt to integrate investments with annuity income much closer together for increased optimization of income strategies. In cases where a trust or custodian may attempt to own an annuity contract, various interpretations still exist around tax reporting, death benefits, and ownership changes.

BEHAVIORAL FINANCE ISSUES

The dominant guaranteed lifetime income alternative is GLWBs on Variable Annuities and Fixed Indexed Annuities primarily because they provide flexibility in the event of a change in circumstance. This comes at a cost, but historically not high enough to overcome the illusion of control.

INTEREST RATES

The belief that interest rates will rise dampens the appeal of 'locking-in' at today's rates. This can be tough to overcome even when the benefits of mortality credits are understood.

Action Items

Incorporate insurance-based guarantees in retirement income planning. While LIMRA Secure Retirement Institute research clearly reflects differing preferences for guaranteed lifetime income across market segments, industry experience shows that election of annuitized income is still influenced more by market supply and promotion than differing market segment demand. Many more retirees would elect annuitized income if presented the option.

Build annuitized income into product planning processes. Even while the institutional retirement markets begin to slowly increase the availability of annuitized payouts, today it is still predominantly an all or nothing proposition. For many retirees, a mixture of both "lifetime annuitized income" and "ad-hoc discretionary withdrawals" from retirement savings may be optimum. This may prove to be the most common and defensible rationale for a rollover to a retail product being in a client's best interest.

Promote the benefit of "peace of mind" that comes from some portion of savings being dedicated to ensuring a retirement income foundation for pre-retirees and retirees. The strength of a combined industry voice can generate increased market demand. The market can't demand what it doesn't know exists.

About the Study

LIMRA collected experience data on 83 percent of all income annuity contracts issued — both SPIA and DIA — during 2012, 2013, 2014, and YTD Q3 2015 providing an extraordinarily robust industry-level view of the income annuity market. The study is a major update to our 2010 study that collected about 40 percent of SPIA contracts sold in 2008 and 2009.

For this year's study, we partnered with CANNEX which allowed us to go beyond buying behavior to include shopping activity. CANNEX supports the exchange and analysis of pricing information for annuity and bank products between financial institutions across North America.

	2010	2016
PRODUCT	SPIA	SPIA & DIA
TIME PERIOD	Two Years	Three & 3/4 Years
NUMBER OF CONTRACTS	55,311	229,892
SHARE OF INDUSTRY	39%	83%
NUMBER OF COMPANIES	11	22

PARTICIPATING COMPANIES

AIG Companies*
Great American
Guardian Life of America*
Horace Mann Life Insurance Company
Knights of Columbus
Lincoln Financial Group*
MassMutual*
MetLife*
Minnesota Life
Mutual of Omaha*
Nationwide
New York Life*
Northwestern Mutual Life*
Pacific Life*
Penn Mutual
Physicians Mutual
Principal Financial Group*
Protective Life
RiverSource Life Insurance
Symetra Financial*
Voya Financial
Western Southern Group

**Companies that provided DIA data.*

APPENDIX A
Average Premium Size ($000)

		2012	2013	2014	Q3 YTD 2015
SPIA	**Overall Average Premium Size**	**$122.8**	**$132.7**	**$143.3**	**$147.4**
	CHANNEL				
	Career agent	$112.1	$120.7	$130.2	$134.8
	Independent agent	$146.7	$144.9	$152.5	$166.1
	Bank	$106.7	$118.8	$127.3	$130.1
	Full service national broker-dealer	$151.9	$161.3	$171.0	$169.9
	Independent broker-dealer	$144.9	$143.7	$153.3	$154.2
	LIVES COVERED				
	Single male	$121.6	$131.4	$144.2	$145.4
	Single female	$112.3	$118.2	$124.2	$129.7
	Joint	$152.0	$168.5	$181.4	$195.8
DIA	**Overall Average Premium Size**	*	**$131.9**	**$140.6**	**$146.0**
	CHANNEL				
	Career agent	*	$116.3	$122.9	$130.2
	Independent agent	*	$167.6	$163.3	$139.5
	Bank	*	*	*	$167.2
	Full service national broker-dealer	*	$182.9	$196.1	$180.5
	Independent broker-dealer	*	*	*	$194.3
	LIVES COVERED				
	Single male	*	$114.8	$126.2	$130.3
	Single female	*	$100.6	$108.0	$114.7
	Joint	*	$182.3	$187.5	$191.7
	Non-QLAC vs. QLAC				
	Non-QLAC	*	$131.9	$140.7	$151.2
	QLAC	NA	NA	NA	$94.2

*Too few companies to include.

NA = Not Applicable

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