ACCUMULATION-ORIENTED VARIABLE ANNUITIES GAIN MOMENTUM

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About the Insured Retirement Institute:

The Insured Retirement Institute (IRI) is the leading association for the retirement income industry. IRI proudly leads a national consumer coalition of more than 20 organizations, and is the only association that represents the entire supply chain of insured retirement strategies. IRI members are the major insurers, asset managers, broker-dealers/distributors, and 150,000 financial professionals. As a not-for-profit organization, IRI provides an objective forum for communication and education, and advocates for the sustainable retirement solutions Americans need to help achieve a secure and dignified retirement.

IRI exists to vigorously promote consumer confidence in the value and viability of insured retirement strategies, bringing together the interests of the industry, financial advisors and consumers under one umbrella. IRI's mission is to: encourage industry adherence to highest ethical principles; promote better understanding of the insured retirement value proposition; develop and promote best practice standards to improve value delivery; and advocate before public policymakers on critical issues affecting insured retirement strategies and the consumers that rely on their guarantees.

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As traditional pension plans are in decline and defined contribution plans, such as 401(k)s, are more commonplace, Americans are more responsible for creating their own retirement income. This is especially true for younger Americans. IRI research shows that in 2012, 56% of GenXers, those aged 30 to 49, expect a 401(k) plan to be a major source of income in retirement. This compares to 39% of Boomers, those aged 50 to 66 in 2013, who expect a 401(k) to be a major source income in retirement. Now more than ever, consumers talk about self-reliance to fund retirement. IRI research shows Boomers who own insured retirement products have higher confidence in their overall retirement expectations, with nine out of 10 annuity owners believing they are doing a good job preparing financially for retirement.

Industry sales have been dominated by products specifically designed for those seeking guaranteed income. Income-oriented annuities include: single premium immediate annuities (SPIAs), deferred income annuities (DIAs), and both variable annuities and fixed indexed annuities with optional living benefits.

Another segment of the annuity industry is accumulation-oriented annuities. These annuities do provide guaranteed lifetime income via annuitization, but do not offer optional living benefits. Buyers of these products are generally more concerned about growing their asset base, or protecting their asset base from decline.

Over the past year, a number of companies have focused product design on accumulation-oriented variable annuities. A typical accumulation-oriented variable annuity includes:

- Lower mortality and expense risk charges (M+E fee)
- An account-value only death benefit, though a "richer" death benefit may be available as an option
- Expanded investment choices, including alternative investment options
- Like all annuities, clients may convert their account value into a guaranteed lifetime income stream
- Some designs link performance to an index and provide limited downside account value protection
- No optional guaranteed living benefits (GLBs)

Accumulation-oriented variable annuities are expected to have a positive impact on the industry because they diversify the risk taken on by insurers when issuing contracts, and they are likely to increase sales by attracting new investors with differing needs. Most annuity writers are innovating and expanding their products, including accumulation-oriented variable annuities, to address a wider spectrum of financial needs. Recent innovations are shown in Table 1 below.

Table 1
Annuity Product Innovations

PRODUCT TYPE	INNOVATIONS
Accumulation-Oriented Variable Annuities	• New products designed specifically for use without living benefits • Expanded investment options • May include limited downside protection
Income-Oriented Variable Annuities	• Higher payout rates with limited investment choices
Fixed Indexed Annuities (FIAs)	• New index strategies
Single Premium Immediate Annuities (SPIAs)	• Additional payout options • Trail compensation
Deferred Income Annuities (DIAs)	• Escalation of product development and sales • Offered as riders within several variable annuities

Accumulation-oriented variable annuities sales are still relatively low compared to income-oriented variable annuities, accounting for 5% to 10% of variable annuity sales, which reached $145 billion in 2012. However, accumulation-oriented variable annuities will likely continue to gain momentum as new products are launched.

OPPORTUNITIES

Accumulation-oriented variable annuities open up new possibilities for consumers, financial professionals, and annuity providers.

CONSUMERS

Many Americans desire guaranteed lifetime income that they cannot outlive, a benefit that all annuities provide. For living benefit buyers, guaranteed lifetime income is likely their primary reason for purchasing the annuity.

However, variable annuities offer other advantages, including:

- Tax-deferral
- Tax-free transfers between investment options
- Asset consolidation offering multiple asset classes
- Alternative investment options
- Limited downside protection (depending on the product)
- Death benefits

Accumulation-oriented variable annuities are likely to appeal to consumers interested in these features, but are less concerned about guaranteed lifetime income via living benefits. Also, accumulation-oriented variable annuities offering limited downside protection may appeal to more conservative clients looking for upside potential while receiving some limited downside protection.

FINANCIAL PROFESSIONALS

Accumulation-oriented variable annuities are also attracting advisors who traditionally only sold an occasional variable annuity or who previously did not sell any variable annuities. These annuities will likely attract an advisor that is more concerned with generating asset growth for clients as opposed to guaranteeing income. For those financial professionals that routinely sell variable annuities, accumulation-oriented variable annuities provide another product type to offer clients who may not be interested in a living benefit rider.

Many accumulation-oriented variable annuities offer alternative investments that allow advisors to better customize the annuity to meet their clients' unique investment needs. Alternative investments provide diversification as they often outperform the traditional asset classes under the same market conditions. Alternative investments include:

- Commodities
- Natural resources
- Real estate
- Managed futures
- Arbitrage

ANNUITY PROVIDERS

Accumulation-oriented variable annuities offer the following to annuity providers:

- Risk diversification: these products have a different risk profile than do other annuities
- Lower capital requirements than annuities with living benefits
- Expansion into new markets
- Reaching younger clientele who do not meet the required minimum age for a living benefit
- Reaching new distributors

PRODUCT DESIGN: HEADING DOWN TWO PATHS

The design of accumulation-oriented variable annuities is focused on two different types of variable annuity products, the growth-oriented variable annuity and the structured variable annuity. The growth-oriented variable annuity offers multiple investment styles and appeals to those looking to maximize account value growth. Structured variable annuities are designed to offer some upside (growth) potential with limited downside (loss) protection, which generally appeals to more conservative investors.

GROWTH-ORIENTED VARIABLE ANNUITIES

This type of accumulation-oriented variable annuity typically offers:

- A wide range of investment choices
- Alternative asset classes
- Lower mortality and expense risk charges (M+E fee)
- Account-value only death benefit
- B-share (back-end surrender charge of 5-7 years), C-share (no surrender charge), and I-share (no surrender charge and no compensation)

Table 2 provides an overview of the growth-oriented variable annuity products that have been launched or filed with the U.S. Securities and Exchange Commission.

Table 2
Overview of Growth-Oriented Variable Annuities
Launched or Filed with the Securities and Exchange Commission

	M + E^	Share Class	Standard Death Benefit	Optional Death Benefit	Investment Options	Alternative Options
Product A	1.00%	B-share	Account Value	ROP**	70+	No
Product B	1.00%	B-share	Account Value	None	100+	Yes
Product C	1.25%	C-share	Account Value	None	100+	Yes
Product D	1.00%	B-share	Account Value	ROP and HAV**	30+	Yes
Product E	1.45%	C-share	Account Value	ROP	270+	Yes
Product F	1.20%	B-share	Account Value	None	100+	Yes
Product G	1.25%	C-share	Account Value	None	100+	Yes
Product H	0.30%	I-share	Account Value	None	100+	Yes
Product I	*	I-share	Account Value	ROP**	390+	Yes

^ M+E: Includes Mortality and Expense Risk charges.
*Product I: No Mortality & Expense Risk (M+E fee) charge. There is a $20 fee per month.
**ROP: Death benefit is the greater of the Account Value or the Return of Premium (less withdrawals).
***HAV: Highest Annual Value.

STRUCTURED VARIABLE ANNUITIES

Also called "Collared VAs", there are caps on the account value growth with some downside protection. Structured variable annuities are generally filed as variable annuities, though the account value growth is similar to fixed indexed annuities, as the performance is tied to an index such as the S&P 500. Structured products offer clients the following choices:

- **Indexes:** Choice of five or more indexes
- **Duration:** This is the length of time the cap and buffer are in effect; often between one and six years
- **Buffers:**
  - Clients elect what percentage of market loss that their account value is protected from
  - Commonly available amounts include 10%, 20%, 30%, and 100%
  - Example:
    - Client invests $100,000 and elects a three-year term with a 20% "buffer". In this example, assume the cap is 10%.
    - Up market:
      - If the index grows less than 10% over the three years, the account value will be credited with the full growth of the index. For example, if the index grows 5%, the account value would be $105,000.
      - If the index grows more than 10%, the account value would be $110,000, as the growth is capped at 10%.
    - Down market:
      - If the index is down 20% or less, the account value will be $100,000 after three years.
      - If the index is down more than 20%, the account value will decrease based on the difference of the buffer (20% in this example) and the index. If the index is down 25%, the account value will be decreased to $95,000 (25% less 20%).
  - Note: one company has recently launched a product covering the "tail" risk of a down market. For example, if a 10% "buffer" is elected, the account value will not decrease more than 10%.
- **Caps:**
  - Caps are set by the company and differ based on the duration and index elected.

Table 3 on the following page provides hypothetical examples of how caps vary among different durations, buffers, and indexes. Caps will be lower for those electing shorter durations, higher buffers, and more volatile indexes. Conversely, caps are higher for those electing longer durations, lower buffers, and less volatile indexes. Please keep in mind that there may be limitations on certain combinations of durations, buffers, and indexes.

Table 3
Hypothetical Examples
Structured Variable Annuities
How Caps Vary Among Different Durations

Duration	Buffer	Index	Cap
1-year	10%	S&P 500	6%
1-year	10%	Russell 2000	7%
3-year	10%	S&P 500	20%
3-year	10%	Russell 2000	30%
3-year	20%	S&P 500	10%
3-year	20%	Russell 2000	15%
5-year	10%	S&P 500	50%
5-year	10%	Russell 2000	65%
5-year	20%	S&P 500	30%
5-year	20%	Russell 2000	40%
5-year	30%	S&P 500	15%
5-year	30%	Russell 2000	25%

To date, growth-oriented variable annuities outnumber structured variable annuities. Table 4 provides an overview of available products.

Table 4
Overview of Available Structured Annuity Products

Product	M+E^	Number of Indexes	Death Benefit	Buffers	Length
Product A	1.25%	8	Account Value	10%, 20%, and 30%	1, 3, and 5 years
Product B	1.25%	3	ROP**	10%	1 year
Product C	NA*	6	Account Value or ROP**	10%, 15%, 25%, and 100%	1, 3, and 6 years
Product D	NA*	1	Account Value	10%	1 year

^M+E: Includes Mortality and Expense Risk charges.
*NA: Not Applicable
**ROP: Death benefit is the greater of the Account Value or the Return of Premium (less withdrawals).

SUMMARY

Accumulation-oriented variable annuities are not a replacement of variable annuities with living benefits, rather they are a complimentary product that appeals to clients whose primary goal is not guaranteed lifetime income, but investment flexibility, tax-deferred growth, tax-free transfers within investment choices, and the ability to have limited downside protection.

As more companies develop accumulation-oriented variable annuities, the percentage of variable annuity sales without a living benefit will grow. Variable annuities with living benefits remain a very viable option for many retirees and pre-retirees who desire guaranteed lifetime income. However, as more Americans take control over their retirement income needs, accumulation-oriented variable annuities will likely account for a greater percentage of Americans' retirement income.

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