Insured Retirement Institute

State of the Insured Retirement Industry

2012 Recap and a 2013 Outlook

December 2012

About the Insured Retirement Institute: The Insured Retirement Institute (IRI) is a not-for-profit organization that for twenty years has been a mainstay of service, commitment and collaboration within the insured retirement industry. Today, IRI is considered to be the authoritative source of all things pertaining to annuities, insured retirement strategies and retirement planning. IRI proudly leads a national consumer education coalition of nearly twenty organizations and is the only association that represents the entire supply chain of insured retirement strategies: Our members are the major insurers, asset managers, broker dealers, and more than 150,000 financial professionals. 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 policy makers on critical issues affecting insured retirement strategies and the consumers that rely on their guarantees. Visit www.IRIonline.org today to experience the vast resources of the Insured Retirement Institute for yourself.

The *State of the Insured Retirement Industry* report is the first of an annual series of reports examining the industry. As we near 2013, the industry is on strong footing and the future remains promising:

- Nearly three in four financial professionals had clients who requested to purchase an annuity over the past year.
- According to a survey of financial advisors, annuities are now the most unsolicited products requested by clients.
- Additionally, nearly 73 percent of annuity owners consider annuities to be a critical component of their retirement strategy.
- Annuity assets are expected to reach an all-time high in 2013.
- Life insurance companies, the issuers of insured retirement income products, remain financially strong.
- Companies are innovating with new products and are expanding into new markets and new players are entering the market.
- The fear of outliving one's assets is one of the top financial fears of many Americans and insurance companies are the only legal entities that can insure retirement income for a person's lifetime.

All industries must react to changes in external factors: The automobile industry adjusts to new government regulations regarding safety and fuel mileage and the entertainment industry uses new technology to deliver its products. The insured retirement income industry must also react to external factors, such as the economic environment and regulatory changes. Over the past year, historically low interest rates increased the cost of hedging and reserving for guaranteed lifetime income options, resulting in prudent changes to these valuable guarantees.

Key Findings

- Despite ongoing macroeconomic challenges, the life insurance industry is financially sound and in a strong position to increase its share of the retirement market due to changing demographics leading to higher consumer demand.
- Key trends coming out of 2012 into 2013:
    - **Demographics:** Continued aging of the population and increased longevity.
    - **Retirement plans:** Decline in defined benefit plans, increasing retirement assets in individually managed accounts and uncertainty over the future of Social Security and Medicare.
    - **External challenges:** Historically low interest rates, market volatility, cost of capital in providing annuities, and regulatory issues.
    - **Annuity sales:** While some companies have slowed down or eliminated new annuity sales, there has been an influx of private equity firms entering the annuity market, specifically by purchasing interests in fixed-indexed companies as well as variable annuity blocks.
    - **Product innovation:** Balancing product design to manage longevity, market, and client behavior risks while in an economic environment of continued low interest rates and high market volatility.
        - Variable annuities continue to be the dominant product sold today.
        - Companies are designing different products to address specific markets. Many new products and benefits are falling into one of

three market segments: income now, income later, and unknown income needs.
    - With a rough estimate of $1 billion in sales for Deferred Income Annuities (DIAs), 2012 marked the first year of any significant sales in the industry.

- What to look out for in 2013:
  - **Tax reform:** preservation of tax-deferred status of retirement savings and the prevention of tax increases, particularly on the middle class.
  - **Re-proposed fiduciary standard:** applied to advisors of employment-based retirement plans.
  - **Investor behavior:** driven by market volatility and desire for guarantees; annuities to play a pivotal role.
  - **Annuity product innovations:** increased product development driven by consumer demand for guaranteed lifetime income while confronting challenging economic conditions.
    - At least six companies currently offer a DIA, or have filed to offer the product in 2013.
    - Anticipation is that DIAs will be the fastest growing product in 2013, at least on a percentage basis.

2012: A Year in Review

Final 2012 industry sales and asset data will not be available until the end of February. Based on sales analysis through the third quarter 2012, total annuity sales will be off between 5 percent and 10 percent for the full year due mainly to the impact of historically low interest rates. However, assets under management will increase.

1. The industry is financially sound, and the demand has never been stronger

Macroeconomic challenges, particularly low interest rates, pose concerns for the industry yet the industry rates stable. Fitch Ratings stated the credit outlook for U.S. life insurers in 2013 is stable "reflecting strong balance sheet fundamentals and an improved liquidity profile and is well positioned to withstand the economic challenges in 2013." A.M. Best Co. in its mid-year 2012 report stated, "the U.S. life insurance and annuity sector remains stable through mid-year 2012, despite the continued pressure of the low interest rate environment on earnings." S&P is cautious on the industry given these on-going macroeconomic challenges, yet the majority of individual company ratings remain strong. S&P noted, "Strong capital and liquidity, along with sound investment portfolios with only moderate losses, support the high investment-grade financial strength ratings in the majority of life insurers rated."

In addition to financially strong companies, the demand for annuities is also strong. S&P in a 2012 report stated:

"Prospectively, we believe insurance companies' share of the overall retirement market will benefit from favorable demographic changes and insurers' expertise in underwriting and asset liability matching (ALM)…. We view life insurers, as a whole, as well positioned to take advantage of these opportunities. Since the financial crisis, most insurance companies have gone through rounds of asset and liability de-risking and have taken many new initiatives to strengthen their balance sheets. As a result, the industry currently has generally strong levels of capital and liquidity commensurate of the ratings. This provides companies with the

capability and flexibility to expand their business where opportunities arise. Individual annuities accounted for merely 9 percent of the total U.S. retirement assets at the end of the first quarter of 2012. We expect that share to grow."

Like any product or service, consumer demand and the supply of the product dictates sales. Consumer demand for guaranteed lifetime income remains strong for a number of reasons:

- *Demographics:* Pew Research Center estimates, beginning January 1, 2011, 10,000 baby boomers will turn 65 every single day for the next 19 years. IRI research showed that "guaranteed income each month" and "will not lose principal" are among the most important traits in a retirement product.
- *Increased longevity:* As people live longer, guaranteed lifetime income becomes more important. According to the Society of Actuaries, by age 65, U.S. males in average health have a 40 percent chance of living to age 85 and females more than a 50 percent chance. The survivor of a 65-year-old couple is more than 70 percent likely to reach age 85. Working longer is a proposed option for managing longevity, yet IRI research shows half of retirees reported they retired earlier than planned.
- *Decline of traditional pension plans:* The Employee Benefit Research Institute estimates that among private sector workers, 84 percent were participating in a defined benefit plan in 1979. This percentage declined sharply over the next 30 years to 33 percent in 2009.
- *Large dollar amounts in qualified plans:* According to data from the Federal Reserve Board, total assets in qualified retirement plans, as of second quarter 2012, were $16.1 trillion.

Assets in Tax Qualified Retirement Plans as of Second Quarter 2012

Total	$16.1 trillion
Private Trusteed Defined Benefit Plans	$2.3 trillion
Private Trusteed Defined Contribution Plans	$4.1 trillion
Individual Retirement Accounts (IRAs)	$5.2 trillion
State and Local Government Plans	$3.0 trillion
Federal Government Retirement Plans for Federal Employees	$1.5 trillion

Source: Federal Reserve Board

- *Concerns over Social Security and other governmental programs:* The 2012 Social Security trustees report projects the combined Old Age and Survivors Insurance and Disability Insurance Trust Fund will be exhausted in 2033. The 2012 Medicare trustees report projects the Hospital Insurance Trust Fund (Part A) will be exhausted in 2024. Current law provides financing each year to meet the next year's costs for the Supplementary Medical Insurance (SMI) Trust Fund, funding Parts B and D of the Medicare program. By 2035, the trustees estimate the costs of the SMI trust fund to equal 3.4 percent of gross domestic product.

2. Low interest rates impact the annuity market

Interest rates are a raw material cost for annuity products. Cost increases for raw materials affect the costs of other products. For example, when the price of a barrel of crude oil increases, so does the price you pay at the pump. The same concept applies to annuities. With annuities, and for that matter most financial instruments, many do not think of the products as having raw materials costs. However, there are a number of costs associated with offering annuities, and many of these costs have increased over the past year.

Specifically, interest rates continue to be near or at historic lows, affecting the annuity market in a number of ways:

- *Hedging costs for living benefits increase as interest rates fall:* A monthly hedge cost study from Milliman shows the average hedge cost for a hypothetical variable annuity (VA) guaranteed lifetime withdrawal benefit topped out at 117 basis points in July 2012, up from 102 basis points in January 2012.
- *Reserve requirements increase:* Insurance companies need to increase the amount of their reserves as interest rates fall. For example, a promise to pay someone $1,000 a year from today would require money set aside today to ensure the $1,000 next year. If interest rates were 10 percent, about $909 would be needed to ensure $1,000 a year from now. However, if interest rates were 1 percent, about $990 would be needed.
- *Fixed annuities, including single premium immediate annuities (SPIAs):* The lower the rate the insurance company earns, the lower the rate they can credit to the customer. Low interest rates also affect the cost of offering fixed-indexed annuities, resulting in a reduction in caps and participation rates

3. Product design innovation manages the various risks companies face

With all types of insurance, the customer has certain financial risks, which they pass along to insurance companies. For example, all drivers face a financial risk of getting into an accident, which could cost them tens of thousands of dollars. Clients do not want to face the risk of incurring a catastrophic cost, so they pass the risk on to the insurance company, which pools the risk among thousands of drivers. With all annuities, the risk clients pass along to the insurance company is longevity risk: Will a 65-year-old client live to age 70, or age 105?

Insurance companies often take on additional risks when issuing an annuity, including market risk and client behavior risk. Client behavior risk is not knowing what a client will do with their contract and when. For example, will they take steady income from their contract, or take out large lump sums? Will they surrender their contract? Will they keep it for life? All of these unknowns factor in to the risk of offering an annuity.

Companies are able to manage longevity by pooling this risk over a large number of individuals. Some annuity products, such as SPIAs, cover only longevity risks while VAs and fixed-indexed annuities (FIAs) with living benefits take on all three risks.

Companies have made a conscious effort to mitigate market risks when designing new products and benefits. For example, many VA providers now require the use of a predetermined mathematical formula or volatility-managed funds when electing a living benefit to help control their risks in a down market. Both techniques transfer money from riskier or more volatile equity positions into more stable investment vehicles to help limit the downside of the account value, and thus help the insurance company mitigate market risk.

There are a number of ways different annuity products can provide guaranteed lifetime income: annuitization of a deferred annuity, SPIAs, DIAs, or living benefits attached to VAs or FIAs. These different types of annuities offer different levels of guarantees and account value growth and access. There is no "right" or "wrong" with any of these products, but different products may be best suited for clients in certain situations.

Chart 1 illustrates contracts used for immediate income (generally defined as income beginning within one year of contract issue). SPIAs (right) offer the highest guaranteed income amount. However, there is no account value to grow and access to a lump sum payment is limited.

VAs and FIAs (middle) offer immediate guaranteed income via optional living benefits, but the guaranteed amounts will be lower than SPIAs. However, VAs and FIAs offer the ability to turn the income on and off, the ability to grow the account value, and the ability to liquidate one's assets at any time (surrender charges may apply). Non-guaranteed products, such as mutual funds (left), do not offer guaranteed income amounts, but they do offer account value growth potential and access.

Chart 1: Immediate Guaranteed Income

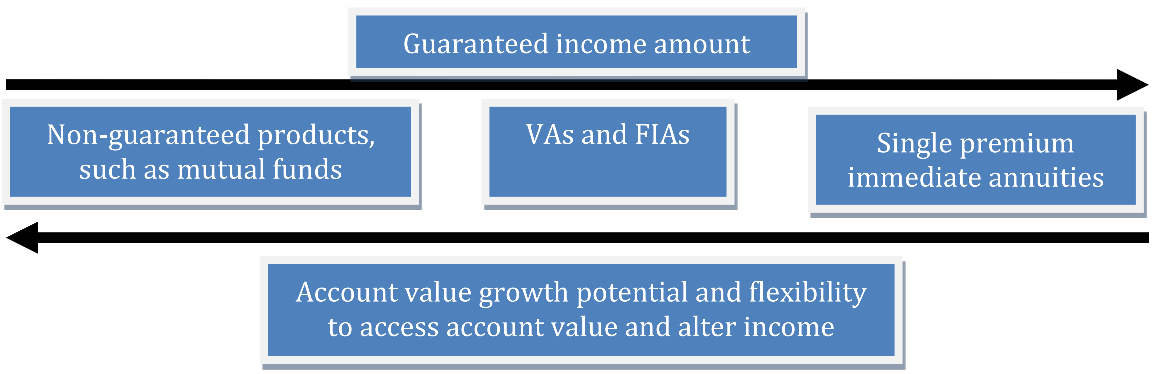
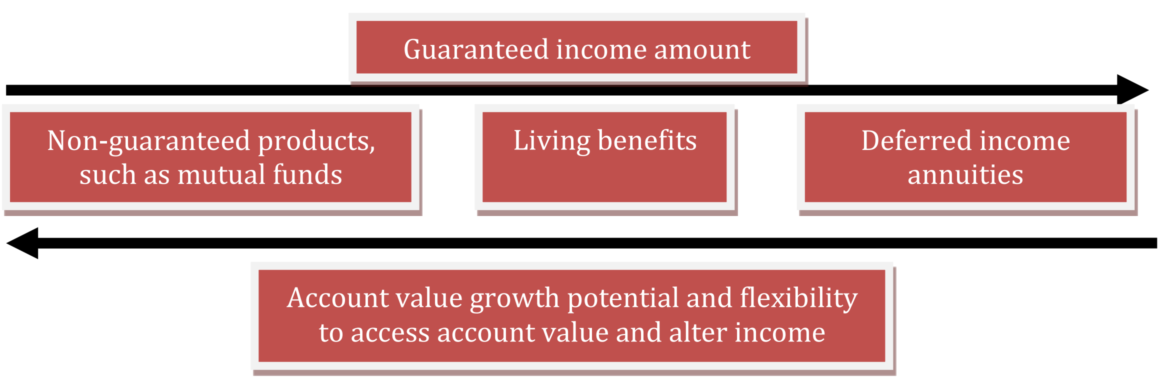


Chart 2 illustrates contracts used to provide guaranteed income at a later point in time. DIAs (right) offer the highest guaranteed income amount, but, as with SPIAs, there is no account value for the client to grow or access. Living benefits (middle) may offer a lower guaranteed income amount, but offer account value growth potential and the flexibility to access one's account value.

Chart 2: Deferred Guaranteed Income



4. Capital allocation decisions to meet the challenge of a unique set of economic circumstances

Annuities are capital-intensive products: If a company sells a variable annuity with a living benefit, for example, the company must pay the broker-dealer and financial professional, set aside money for reserves, and purchase hedge instruments. Additionally, much like financial professionals telling clients not to put all their financial eggs in one basket, insurance companies look to diversify their risks across different business lines and countries.

As the cost of reserving and hedging guarantees increases, companies examine how much capital they should allocate to their annuity business and what they can bring in for new sales relative to their other businesses. In other words, what is their capacity to bring in additional annuity business.

A unique set of circumstances over the past 12 months – low interest rates, cost of capital, regulatory issues, and expanding assets under management – resulted in lower capacity at a number of firms. Companies addressed this issue in a number of ways, including:

- Suspending new sales on certain products or types of new business.
- Limiting or closing down new sales in certain channels.
- Reducing sales force and financial support.
- Limiting additional payments on in-force business.
- Lowering guarantees.
- Two Canadian-based insurers ceased bringing in new sales in the United States. Canada has stricter reserve requirements, making doing business in the United States more expensive for them.

While some companies have slowed down or eliminated new annuity sales, there has been an influx of private equity firms entering the annuity market, specifically by purchasing interests in fixed-indexed companies as well as VA blocks. Additionally, companies are innovating with new products that are less capital intensive, which may increase the capacity at certain companies.

While several companies stopped selling new annuity contracts, this is not an indication that the annuity industry is weak, but rather that several companies decided it was in their best interest to divert capital to other businesses. It does not mean these companies are "out" of the annuity business, but rather they are no longer selling new contracts. These companies remain in the annuity business by servicing their in-force business and honoring all guarantees, including death benefits and income from living benefits and annuitization.

5. Financial tools utilized by companies to manage in-force business

There were more than $1.62 trillion of VA assets held by insurance companies as of third quarter 2012, with an estimated $600 billion having a living benefit. Many of these living benefits were sold during periods of higher interest rates and, therefore, the costs of these contracts in today's market are higher than companies originally planned. This is not to say the companies will not be able to make good on the guarantees, but rather companies are examining their in-force block of business and, in some cases, taking actions to better manage these higher unanticipated costs in their in-force business such as:

- Limiting additional premiums into existing contracts.
- Increasing rider fees on in-force business.
- Initiating optional buyback programs: A handful of companies have filed or launched programs that offer clients the opportunity to discontinue a benefit or contract in exchange for additional cash being added to their contract.

6. Regulatory changes affecting the insured retirement industry

There have been many regulatory developments affecting the insured retirement industry in 2012. The following highlights the major regulatory issues of 2012.

Federal regulatory issues

In early 2012, the Department of Labor's (DOL) Employee Benefits Security Administration stated its intention to issue a modified version of its proposal to revise the circumstances under which a person who gives investment advice to an employee benefit plan or a plan's participants is considered to be a "fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA). The original proposal was issued in October 2010, but was withdrawn in 2011 after being met with extensive opposition from industry and members of Congress. Amid the political pressures associated with the presidential election, DOL was unable to issue a revised proposal in 2012.

The consensus view within the insured retirement industry is that the proposed rule would lead to increased costs and complexity, limit consumer choice regarding retirement plans and individual retirement accounts (IRAs), and eliminate the ability of middle-income Americans to afford access to the services needed to make educated decisions related to retirement.

State regulatory issues

The National Association of Insurance Commissioners (NAIC) Life Insurance and Annuities Committee adopted a resolution in March 2012 that determined, "contingent deferred annuities (CDAs) are annuities best written by life insurance companies and subject to existing state laws and regulations applicable to annuities." The Committee also established a new CDA Working Group to "evaluate the adequacy of existing solvency and consumer protection laws and regulations applicable to annuities as such laws are applied to CDAs."

The NAIC Annuity Disclosure Working Group reconvened in May 2012 to review and revise the latest drafts of the Annuity Buyer's Guide. The current NAIC Model Annuity Disclosure Regulation, which was adopted in 2011, requires delivery of an annuity buyer's guide to purchasers of fixed, fixed-indexed, and variable annuities. Under the prior version of the Model, this requirement did not apply to variable annuities. IRI has advocated for a single Buyer's Guide covering all annuity products subject to the requirement, citing concerns regarding administrative costs and burdens on companies associated with providing multiple guides to consumers, as well as the potential for information overload for consumers. In August 2012, IRI submitted a Combined Annuity Buyer's Guide to the NAIC Working Group that covers fixed, fixed-indexed, and variable annuities. The Working Group released a revised draft for public comment in December 2012 that incorporates input from IRI, other industry groups, and the NAIC's consumer advocates.

The NAIC endorsed the National Association of Registered Agents and Brokers Reform Act of 2012 (NARAB II) in July 2012. Under NARAB II, financial professionals who have passed background checks in their home state could apply for NARAB membership to sell guaranteed lifetime income products in other states without the burden of dealing with multiple state insurance departments. This one-stop, national insurance licensing clearinghouse would streamline the licensing process and ease the regulatory burden on financial advisors, insurance agents, and broker-dealers operating in multiple states. The NAIC's endorsement of this federal legislation is important because they had expressed reservations about the concept in the past. The United States Congress is expected to consider the legislation early in 2013.

Several states adopted the NAIC Suitability in Annuity Transactions Model Regulation in 2012, including Louisiana, Nebraska, New York, South Dakota, Utah, and Washington. The current version of the Model was adopted by the NAIC in 2010 to set standards and procedures for suitable annuity recommendations. It also requires insurers to establish a system to supervise recommendations so that consumers' insurance needs and financial objectives are appropriately addressed. Unlike prior versions, the revised Model imposes training requirements for producers. The revised Model has now been adopted in more than 25 states, and has been proposed in several others.

2013: A Preview

As witnessed in 2012, the guaranteed income market is in a transition period. These changes will continue in 2013. Some changes are at the regulatory level while other changes, specifically innovative product design, will emerge from specific companies.

1. Tax and regulatory reform

With the uncertainty of the "fiscal cliff" looming, the White House and Congress will clearly need to take some actions. In addition to the fiscal cliff, there is increased talk in Washington of the need for broader tax reform. This broader reform could include tax rate increases, elimination or reduction of some tax deductions, and spending cuts. Two potential changes could have a large negative impact on the insured retirement income industry.

1. The modification of the preferential tax treatment of retirement savings
2. Tax increases and their impact on retirement savings behavior

As of the writing of this report, negotiations on a deal with regards to the fiscal cliff are in process, with the goal of reaching an agreement before December 31, 2012. Broader tax reform will likely be taken up in 2013 once the fiscal cliff issue is resolved. Congressional leaders have indicated that all tax provisions are under consideration for limits or elimination, including the tax-deferred treatment of annuities.

IRI research has shown the tax preferential treatment of retirement savings is highly valued by investors, particularly middle-income investors: Nearly 8 out of 10 (76 percent) of middle-income Boomers consider tax deferral an important criterion when selecting a retirement income product. In addition, IRI research shows that tax increases, particularly federal income tax increases, would have a negative impact on saving for retirement: 54 percent of Boomers stated they would be less likely to save for retirement if federal income taxes were increased. This increased to 59 percent among middle-income Boomers.

Saving for retirement is a challenge in any economic environment. Going into 2013, the country faces additional challenges of a slow recovery from a deep economic recession and the beginning of the retirement of the largest generation in American history. Preservation of these tax incentives will be a top priority in 2013.

Changes to the DOL's fiduciary rules are also on the horizon in 2013. As previously stated, the DOL withdrew its initial proposal to revise the rules that determine when a person is considered a fiduciary under ERISA. With the elections over and the Obama administration remaining in place, the DOL will issue a modified proposal of the rule in the next several months and industry will be focused on preserving middle class Americans' access to affordable retirement planning services.

2. Product development

With an increasing demand for guaranteed lifetime income and some companies facing capacity issues, companies are innovating new ways of bringing guaranteed income to millions of Americans. Over the past year, a number of new and innovative product designs were introduced. This trend is expected to continue in 2013.

All annuities include the ability to annuitize the contract, which cedes control of the client's assets in turn for a guaranteed annual income amount. However, over the past five or six years, product design has centered around guaranteed living benefits available on both variable and fixed-indexed annuities.

As mentioned earlier, clients transfer three risks to the insurance company when purchasing a living benefit: longevity, market, and client behavior risks. Companies will continue to design products that eliminate or lower one or more of these risks in order to continue offering competitive alternatives or to increase income amounts. Additionally, companies are looking at ways to lessen capital requirements and to diversify risks.

Another emerging trend is that companies are designing different products to address specific markets. Many new products and benefits are falling into one of three market segments:

Income Now	Income Later	Unknown Income Needs
• SPIAs • VA and fixed-indexed living benefits • Contingent deferred annuities (CDAs)	• Deferred income annuities • VA and fixed-indexed living benefits • CDAs	• VAs and fixed-indexed annuities without living benefits • Fixed deferred annuities

Income now generally refers to income beginning within one year from the purchase of the contract while income later is income slated to start after one year. Many deferred annuities are purchased without a living benefit. As all annuities offer the ability to annuitize, these contracts may eventually be used for income; however, these contracts may be purchased for other reasons as well, such as tax deferral or guaranteed account value via fixed products.

Previously, there were distinct differences among the various product and benefit types. However, as companies continue to innovate, these distinctions are less pronounced. For example, SPIAs typically did not offer any liquidity beyond a guaranteed income stream.

However, most SPIAs today offer a commutation value, which allows a client to "cash in" the actuarial value of their remaining income stream to provide liquidity.

The following is an overview of each product and of potential changes for 2013.

Variable annuities (VAs)

- VAs continue to be the dominant annuity product being sold today.
- Companies have, and will, develop products to fit each of the three market segments.
- Currently, there are four or five companies that have living benefits targeted specifically for the immediate income market, and additional companies may bifurcate their VA living benefit by offering multiple benefits: one aimed at the income now market and the other at the income later market.
- VA companies continue to adapt living benefits to an ever-changing interest rate environment. Numerous companies developed funds that helped mitigate market risk and companies are continuing to come up with new ways to manage market risk.
- While living benefit election rates have ranged between 87 percent and 90 percent since 2010, companies are now aggressively developing new VAs that do not include a living benefit. Additional companies are expected to develop VAs without living benefits to address those interested in tax deferral, or to diversify into different asset classes.

Fixed-indexed annuities (FIAs)

- While FIAs are gaining market share, due in part to the growth of living benefits in these products, sales lag behind VAs.
- Traditionally, FIAs were sold almost exclusively through non-registered financial professionals. However, FIA companies are entering outside broker-dealers and should continue to grow their business through registered financial professionals.
- Assuming interest rates remain low, FIA caps and participation rates will remain at or near their current levels.
- Several private equity firms have purchased interests in a number of FIA companies and their presence may continue to drive sales in 2013.

Single premium immediate annuities (SPIAs)

- As mentioned earlier, most SPIAs now offer liquidity options. While few clients elect to liquidate their SPIA, it does provide a peace of mind that they are not giving up total control of their assets.
- Like FIAs, SPIAs were traditionally sold via life insurance agents. However, several new players have captured significant market share, partly due to their expanding into outside channels.
- In 2013, additional companies will place more focus on SPIAs and continue to expand into other channels.

Deferred income annuities (DIAs)

- Essentially, DIAs are the same as SPIAs, except income does not start immediately. Rather, clients defer the start of income to a later date, generally two to 40 years from issue. Most DIAs are elected with an income start date of between five and 15 years.
- With a rough estimate of $1 billion in sales for DIAs, 2012 marked the first year of any significant sales in the industry.
- At least six companies currently offer a DIA, or have filed to offer in 2013. Anticipation is that DIAs will be the fastest growing product in 2013, at least on a percentage basis.

- With new product launchings, additional innovations are forthcoming, such as allowing clients to change their income start date.

Contingent deferred annuities (CDAs)

- CDAs have been on the market since 2008, but sales have not taken off as of yet.
- A number of companies are exploring this market segment. Several new entrants are expected in this space over the next year or two.
- One advantage for issuing companies is that CDAs tend to be less capital intensive compared with VA living benefits.

In-plan guarantees

- In-plan guarantees are living benefits that can be added by plan participants in 401(k) and other qualified markets.
- Sales of these guarantees remain low as there are a limited number of companies offering them. Another issue is that this tends to be a "two-tiered" sales as companies need to first have the plan sponsor agree to have the option on their plan, and then the client needs to be "sold" the benefit of electing this option
- This is potentially a growth market as companies continue to search for ways to bring guaranteed lifetime income to Americans. Like CDAs, these products require less capital.

Pension risk transfer

- Additionally, there is a trend toward companies with large defined benefit pension plans transferring the risk to an insurance company.
- To remain globally competitive, employers with defined benefit pension plans see the need to reduce the financial and longevity risks associated with these plans. With extensive experience in efficiently managing these risks, insurance companies are a logical alternative.

3. Managing in-force business

VA providers are currently managing over $1.62 trillion in VA assets with most of this business being sold in a higher interest rate environment.

Companies are exploring ways to manage these assets more efficiently. Three companies have filed or launched buyback programs on certain optional variable annuity benefits. Select clients are offered an incentive to surrender a contract or remove a guarantee to help companies lower their risk profile. These buyback programs are strictly optional with the clients under no obligation to accept.

While most annuities are purchased with a single payment, some clients continue to fund a contract over the years. Due to the low interest rate environment, some companies have suspended additional payments into in-force contracts until interest rates rebound to a certain level.

Companies are also exploring the use of volatility-managed funds for in-force business. While being used on many new contracts, these types of funds were not available when most annuity owners purchased their contracts. These funds are being accepted by new purchasers as a way to help manage the downside risk of their account value, and therefore some companies may begin offering them to their in-force clients.

4. What will drive investor behavior in 2013?
Investors will continue to look for safety and guarantees in their retirement investment products driven by continued market volatility and an aging population into 2013. IRI research in 2012 showed that "guaranteed income each month" and "will not lose principal" are among the most important traits of a retirement product. Annuity products play a vital role in meeting those needs of investors. In fact, IRI research shows that annuity owners among Boomers and Gen-Xers are more confident that they will be able to achieve their retirement goals: 94 percent of Boomers who own an annuity are extremely or very confident compared with 71 percent of Boomers who do not own an annuity; among Gen-Xers, the comparable figures are 90 percent versus 75 percent.

Given these trends, 2013 will see continued strong demand for annuities.

5. Annuity sales in 2013
Annuity sales in 2013 are anticipated to be consistent with sales in 2012. The demand for annuities will remain strong given the following factors: aging population, increased longevity, market volatility, and investor desire for guaranteed income. Yet this strong demand comes at a time of many economic challenges for the industry. Headwinds the industry must manage, such as low interest rates, cost of capital in providing annuities, and regulatory issues, will remain in 2013. The industry will be adjusting to manage this increase demand during challenging times through redesigning existing products and developing new products.

Summary
The demand for guaranteed lifetime income has never been higher. Financially strong life insurance companies, via annuities and other guarantees, are the only companies legally allowed to pool risk and offer guaranteed lifetime income. Due to a number of external factors, primarily the low interest rate environment, guarantees are lower than they once were, but will continue to be a source of certainty for consumers.

The economic challenges of 2012 will continue in 2013. Among these are market volatility, low interest rates, increased regulatory activity, and uncertainty regarding future tax policy. During these challenging times, the industry has demonstrated its ability to innovate and provide the necessary solutions for millions of Americans who seek guaranteed lifetime income. It is a role the industry will continue to provide in the years to come.