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Insured Retirement Institute

2019 IRI Annual Key Findings

OVERVIEW

January 2019. The following are key findings from ***The Cerulli Report— U.S. Annuity Markets 2018: Remaining Well Capitalized and Adaptive.***

These findings were created exclusively for the Insured Retirement Institute (IRI) as part of a survey partnership in 2018. To those insurers that participated in the research processes, your insight and time are greatly appreciated. We look forward to your continuing support.

Executive Summary

- More than half (58%) of surveyed insurers believe structured/index-linked variable annuities (VAs) will garner sales growth in the next three years.
- Nearly all (93%) of insurers see fixed-indexed annuities (FIAs), with or without living benefits, also doing well over that time period.
- Overall, 88% of surveyed insurers believe fiduciary standards developed by individual state insurance departments will be large obstacles to the VA business.
- Almost all (92%) of surveyed insurers feel having an extensive subaccount lineup is most important for an investment-only VA (IOVA), including 79% believing availability of passive investments is key.
- All insurers responding to this survey believe that passively managed funds have some potential for growth in the industry over the next three years; the next-most likely to see increased use are exchange-traded funds (ETFs).
- Over the next three years, insurers believe FIA sales in the RIA channels will exhibit the greatest growth, followed by banks and independent broker/dealers.
- Overall, 59% of surveyed VA insurers believe there will always be a need for traditional up-front commissions.
- Adopting more of a consultative sales approach, increasing data mining, and building better technical skills to work with sophisticated advisory teams are among the top priorities for wholesaling teams during the next three years.
- Greater than half (58%) of surveyed insurers have informed their wholesalers about the Alliance for Lifetime Income’s Retirement Awareness Campaign, while 45% have promoted the campaign directly to advisors.

- More than half (58%) of surveyed insurers believe structured/index-linked variable annuities (VAs) will garner sales growth in the next three years.
- Nearly all (93%) of insurers see fixed-indexed annuities (FIAs), with or without living benefits, also doing well over that time period.
- One out of five insurers trust sales of VAs with living benefits will decline.

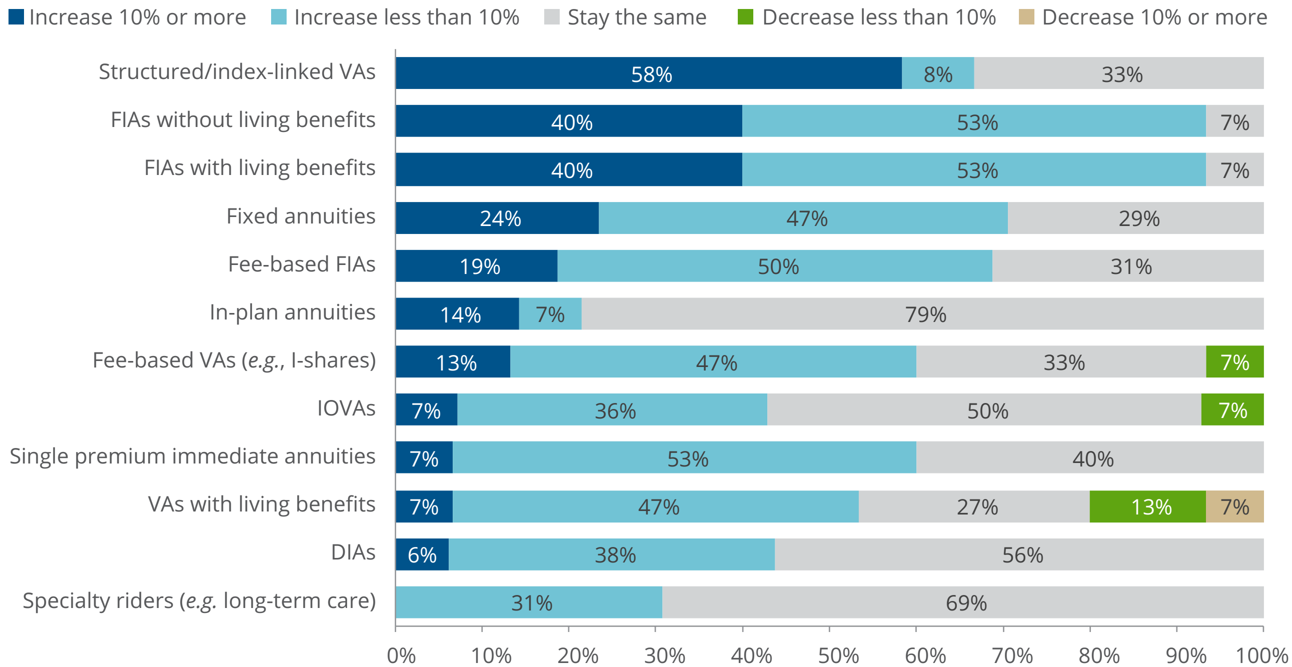
Key Implication: Cerulli concurs with surveyed insurers that the prospects of index-linked products look very promising over the next few years. Of all annuity designs, structured annuities were seen as those most likely to post growth of 10% or more annually. Sales are expected to increase as more insurers enter the marketplace and further innovate and validate the concept. Many insurers have noted that the product type can help mitigate risks, while still providing consumers with attractive upside potential and guaranteed retirement income. Meanwhile, 93% of insurers believe FIA sales will continue to increase, while the majority (56%) of carriers trust that deferred income annuity (DIA) sales will remain flat.

EXHIBIT 1

Expectations of Sales Growth Over the Next Three Years by Product Types, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked, "For each of the following product types, please indicate your firm's expectation with regard to sales growth over the next three years."



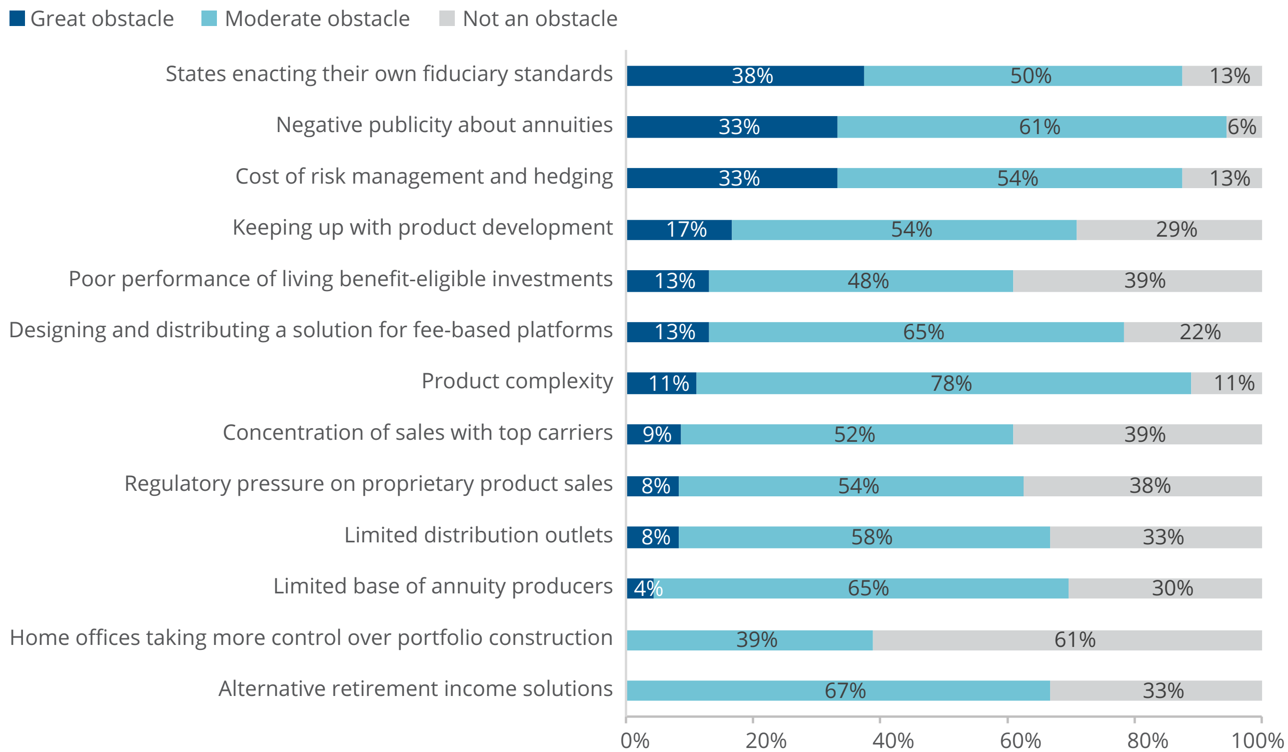
- Overall, 88% of surveyed insurers believe fiduciary standards developed by individual state insurance departments will be obstacles to the VA business.
- Meanwhile, 87% believe the cost of risk management will be a obstacle.
- The vast majority (94%) cite negative press about annuities as a major hurdle.

Key Implication: Insurers are still skittish on the regulatory front, as they spent considerable time, effort, and resources preparing to comply with the Department of Labor (DOL) Conflict of Interest Rule. Even after the rule was vacated by the US Court of Appeals for the Fifth Circuit, insurers still expressed concerns regarding states potentially enacting their own fiduciary standards. The question for now is, where will the most significant challenge come from, the states or the SEC? As Cerulli goes to press, an investment advisory board is advising the SEC to strengthen the wording of the rule it has drafted. New Jersey has a proposed rule as well. As for negative publicity, unfortunately, there is still much of it. However, Cerulli believes that there's enough positive coverage of annuities for the industry to leverage over time. Insurers must focus on designing and positioning solutions that fit into the way advisors conduct their portfolio construction processes. This is becoming critical as advisors increasingly migrate toward highly specialized fee-based team environments.

EXHIBIT 2

Insurer Perspective: Greatest Obstacle in Variable Annuity Business, 2018

Sources: Cerulli Associates, in partnership with IRI



- Almost all (92%) of surveyed insurers feel having an extensive subaccount lineup is most important for an investment-only VA (IOVA), including 79% believing availability of passive investments is key.
- Two-thirds (67%) believe a low M&E charge is very important.

Key Implication: Given that IOVAs, by definition, offer few or no guaranteed benefits, the value proposition to the client must come in other forms. One is through lower core expenses, and M&E charges on IOVAs tend to fall below the industry average of around 1.25%. A large menu of subaccounts is also highly regarded. Most of the leading contracts have in excess of 100 funds. On that note, about 74% of insurers feel it is important that IOVAs have pre-packaged model programs, no doubt to help clients select and maintain their allocations. While it's been proven that granting access to unique investing opportunities does help drive IOVA sales, greater than three-quarters (79%) of insurers recognize that the products should also offer passively managed funds, which reflects their increased demand on the retail side.

EXHIBIT 3

Insurer Perspective: Most Important Features in an Investment-Only VA, 2018

Sources: Cerulli Associates, in partnership with IRI

Features	Very Important	Important	Not Important
Lower mortality & expense (M&E) charge	67%	33%	0%
Extensive subaccount lineup	50%	42%	8%
Tax inefficient investments (*e.g.*, high yield)	21%	50%	29%
Basic death benefit (*e.g.*, return of premium)	17%	75%	8%
Unique investment managers and/or unique investment strategies	13%	67%	21%
Priced to fit on a fee based platform	13%	67%	21%
Pre-packaged models of investments	4%	70%	26%
Passive investments	4%	79%	17%
Upfront commission for advisor	4%	75%	21%
Basic living benefit	0%	25%	75%

- All insurers responding to this survey believe that passively managed funds have some potential for growth in the industry over the next three years; the next-most likely to see increased use is exchange-traded funds (ETFs).
- Nearly half (43%) of respondents believe managed volatility portfolios have no potential for growth.

Key Implication: Passively managed index funds are gaining traction in the VA space, partly due to their popularity with retail investors and partly due to these funds being easier for insurers to hedge, thus helping their GLB risk management efforts. During 2018, there has been a number of new index fund registrations. ETFs can also aid in hedging and are usually offered in a fund-of-funds environment. Cerulli has been encouraged by those insurers that have adapted to these broader investing themes and can confirm that several other companies are looking to be fast followers.

EXHIBIT 4

Most Attractive VA Subaccount Options for Future Sales Potential, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked to rate the sales potential of the following investment styles within their VA subaccount platforms over the next three years.

Investments	High Potential	Some Potential	No Potential
Passive investments	60%	40%	0%
Exchange-traded funds	47%	40%	13%
Traditional domestic fixed income	36%	43%	21%
Creating own living benefit strategies	36%	50%	14%
Traditional domestic equity	27%	60%	13%
Global equities	27%	67%	7%
Target-risk funds	20%	80%	0%
External firm acting as consultant and asset allocator for living benefit options	15%	54%	31%
Global fixed income	14%	86%	0%
Managed volatility	14%	43%	43%
Target-date funds	13%	53%	33%
Alternative strategies	7%	80%	13%

- Over the next three years, insurers believe FIA sales in the RIA channels will exhibit the greatest growth, followed by banks and IBDs.

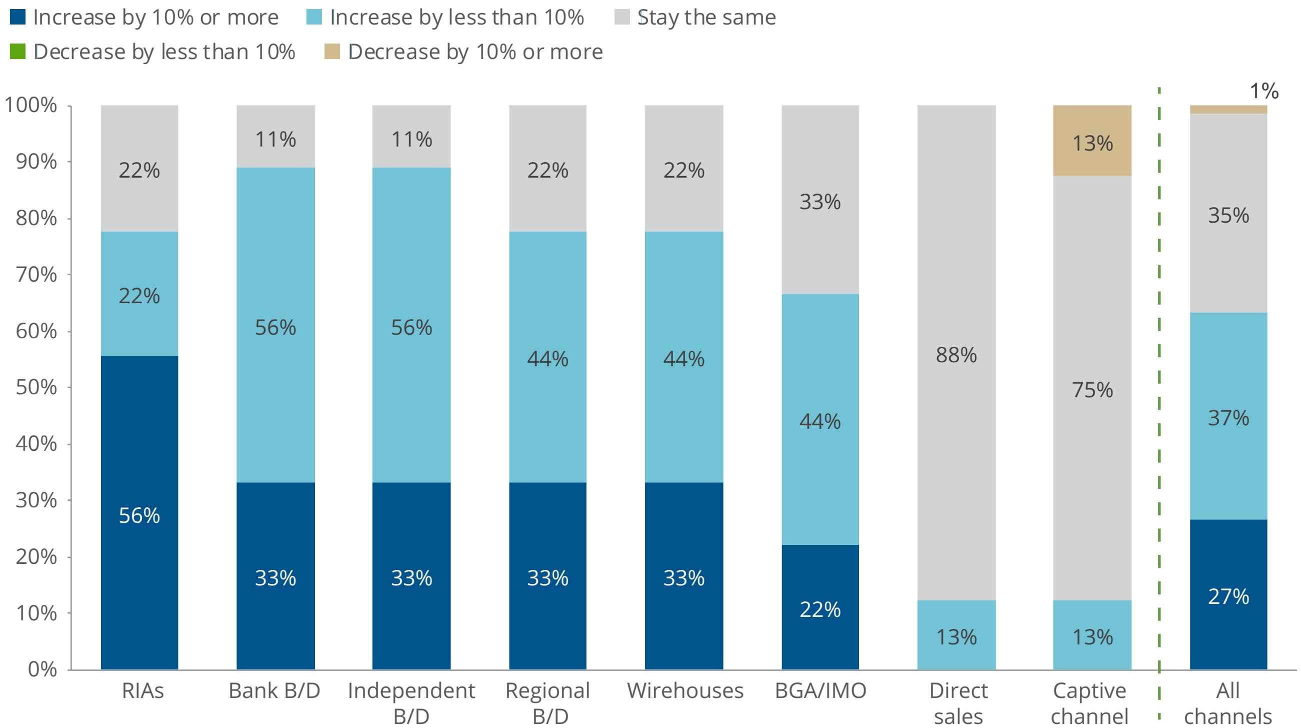
Key Implication: Cerulli is pleased with insurers having such faith in RIAs adopting FIAs over the next three years. However, to date, few can truly say they have experienced widespread success in the channel. In reality, developing fee-based FIAs is the natural first step, but Cerulli reminds insurers that very few fee-based VA issuers have found success among RIAs either. Although this is a harsh reality, it should help insurers dedicate their limited resources in the smartest way possible. While Cerulli believes it is critical that insurers find a way to engage RIAs, they must set realistic expectations. It's important to recognize that many fiduciaries will likely never consider the solutions; however, it is equally important to understand RIAs' top reason for not using annuities—"my practice can build better solutions at lower costs." Cerulli believes this is an easy statement to make in an extended bull market period, but any serious market correction could gently remind non-producers of annuities' value proposition.

EXHIBIT 5

Expectations of FIA Sales Over the Next Three Years by Channel, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked, "How do you expect your firm's annual sales of VAs/FIAs in the following channels to change during the next three years?"



- Insurers believe greater understanding/acceptance among advisors and broker/dealers (67%) and diminishing availability/attractiveness of VA guarantees (63%) are the largest growth drivers of FIA sales.

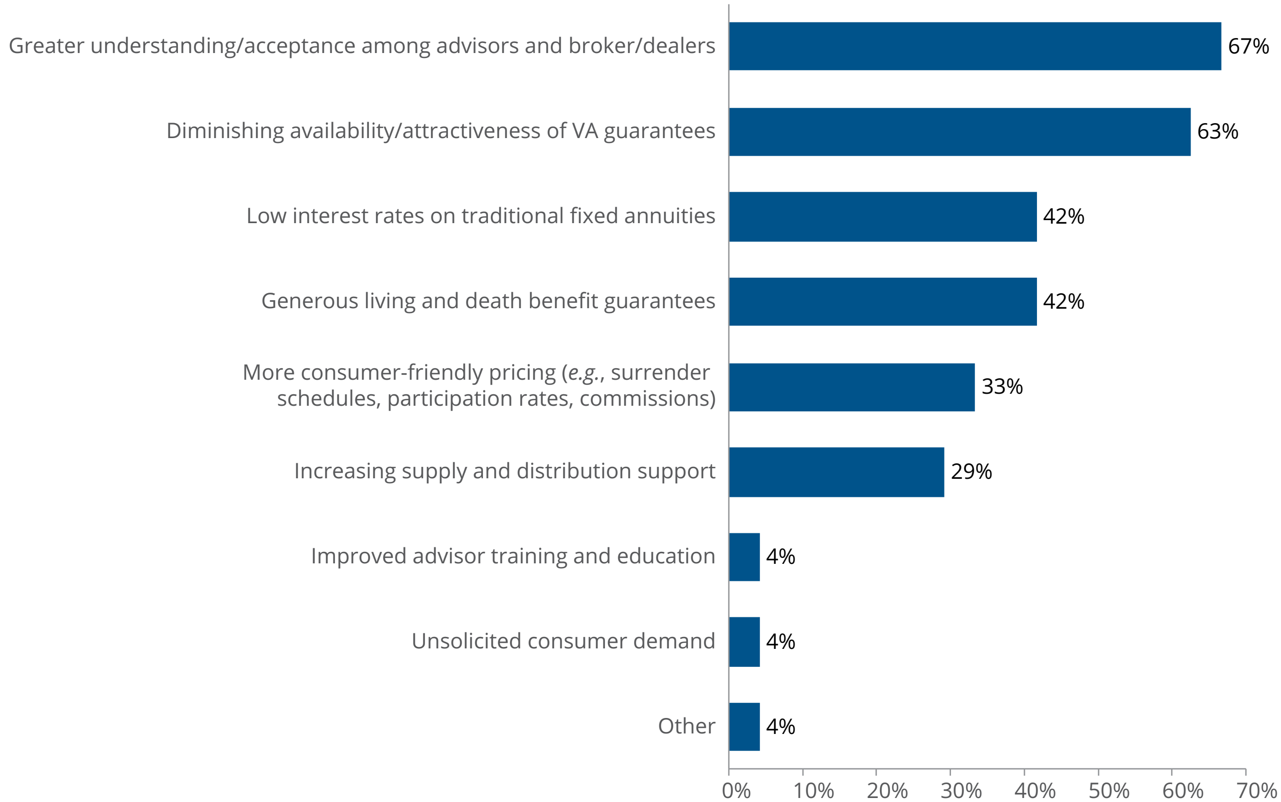
Key Implication: Although FIAs have come a long way in terms of complexity, documentation, and less aggressive compensation, Cerulli continues to believe that the relatively unattractive VA offerings of today have been the main driver of FIAs' success. This is a fact that insurers generally agree on as this data reflects the responses of insurers that do and do not offer FIA solutions. Even if increasing sales are due to a lack of attractive VAs, Cerulli is encouraged by the recent actions of FIA issuers. Many have stepped up their efforts to simplify the products, decrease too-high advisor commissions, improve pricing, and enhance educational efforts to better explain the products to partner firms, advisors, and end-clients.

EXHIBIT 6

Insurers: Factors Driving Growth of Fixed-Indexed Annuity Sales, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: "Consumer-focused marketing" was offered as an option, but was not selected in 2017 or 2018. Other responses included "flight to safety" and "heightened regulatory environment."



- Half of surveyed insurers say plan sponsors are reluctant to offer in-plan annuities due to fiduciary concerns.
- The next-most cited concerns are lack of experience in offering the solutions and portability issues.

Key Implication: On paper at least, Cerulli believes that plan sponsors should be open to having annuities on their platforms for the guaranteed lifetime income stream. However, a number of obstacles remain. One is the question of whether the plan sponsor will be on the hook in a fiduciary sense regarding the selection of the insurer and product to be offered. Other issues revolve around portability: 1) what happens when the plan switches providers, and 2) what if the employee moves to another employer? A number of insurers already offer in-plan annuities and Cerulli believes more will likely follow pending regulatory outcomes.

EXHIBIT 7

Attitudes and Decision Making Regarding In-Plan Annuities, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked, "Based on your experience with plan sponsors/participants, please indicate which of the following statements you agree with most regarding attitudes and decision-making about in-plan annuities." Respondents can select more than one option. "Many or most plan sponsors are interested in offering in-plan annuities to their participants" and "Many or most participants would choose an in-plan annuity if offered by their plan" were options but were not selected in 2017 or 2018.

- Overall, 59% of surveyed VA insurers believe there will always be a need for traditional up-front commissions.
- As for fee-based contracts, insurers are not so sure whether their sales will drop due to the discarding of the DOL Rule, with 59% taking a neutral stance.
- No insurers believe fee-based sales will outdo those of commissioned products.

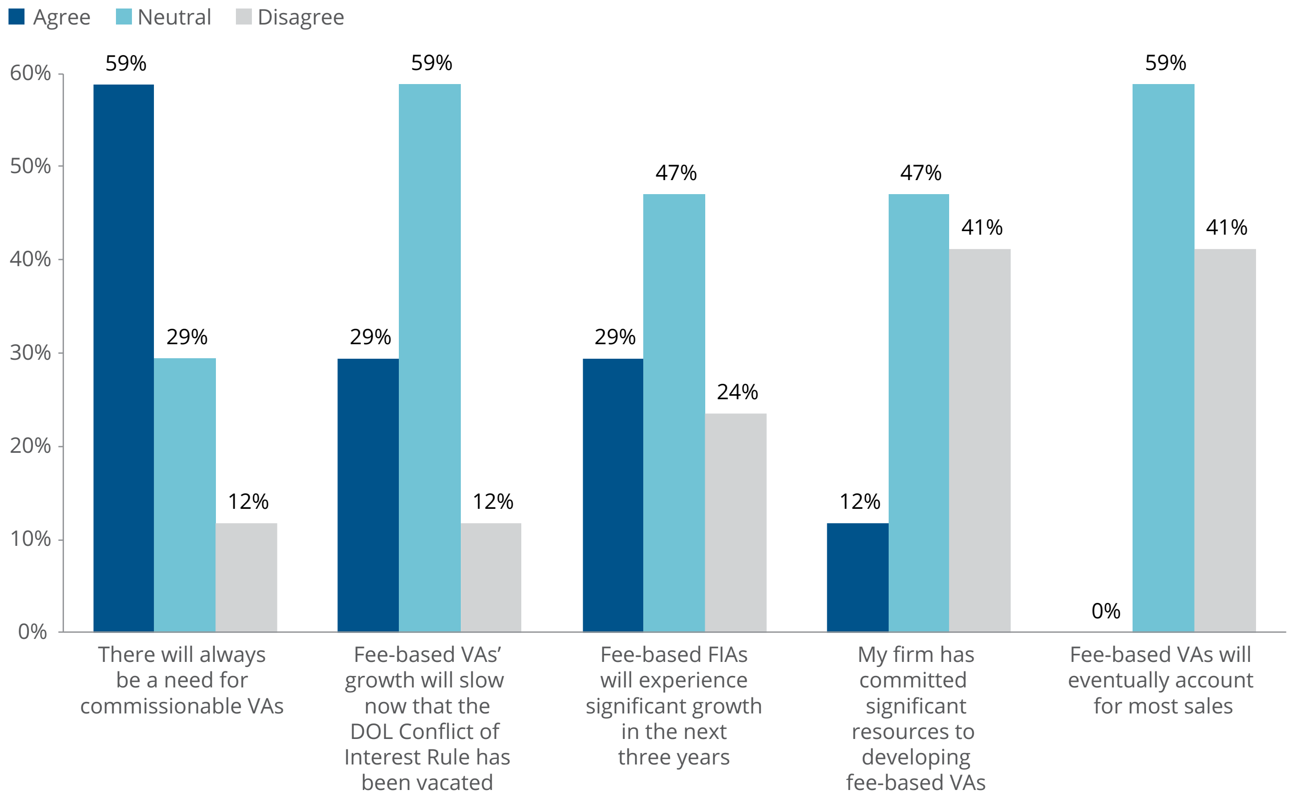
Key Implication: VA insurers are convinced they will always need traditional commissions, which Cerulli attributes to the clear preference on the part of advisors who are the greatest annuity advocates. Meanwhile, just 29% of respondents believe sales of fee-based contracts will slow down, confirming a suspicion that those contracts will exhibit at least modest growth over the next few years. Only 12% of respondents have devoted significant resources to the fee-based side. However, Cerulli suspects more will be forced to do so, while others will simply not be convinced, which could be risky given broader industry trends (*e.g.*, advisor migration to fee-based models and channels).

EXHIBIT 8

Perspective on Commission vs. Fee-Based Annuity Structures, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked, "Please indicate your level of agreement with each of the following statements about annuity compensation structures."



- Greater than two-thirds (70%) of surveyed insurers believe the best way to increase VA sales is to position them to better meet advisors' needs, while 55% believe building products for fee-based platforms would be beneficial.

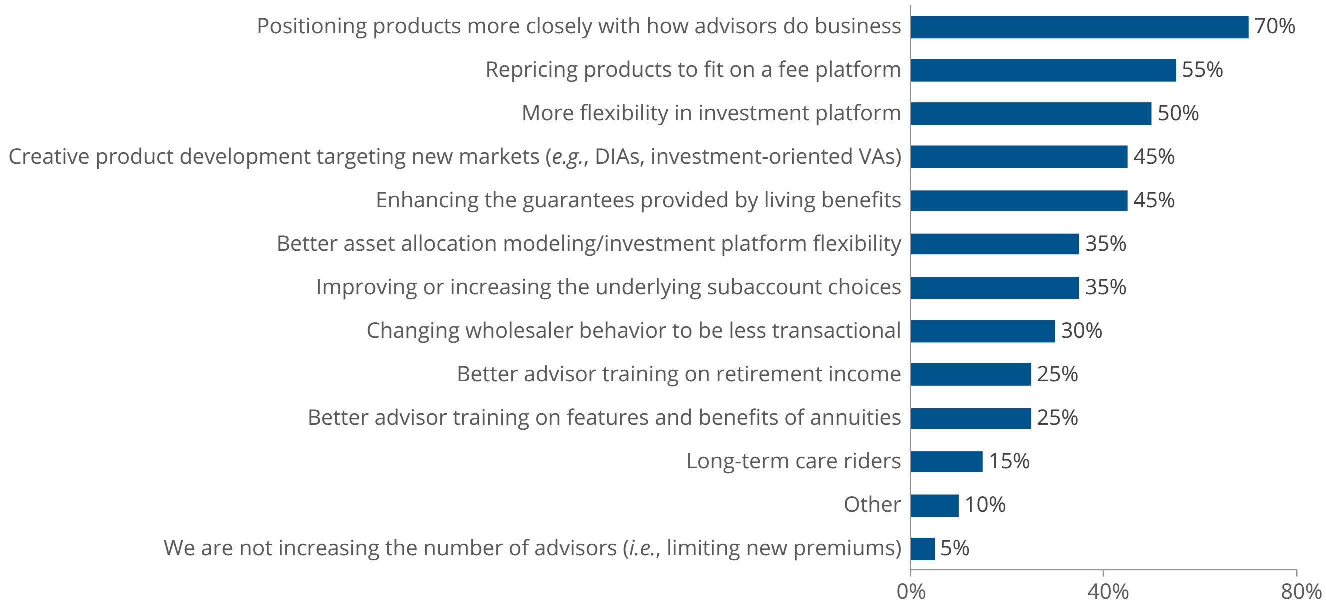
Key Implication: Insurers have been admitting for years that they need to improve their ability to fit VA designs into the advisor's way of conducting business. Progress been made in this regard. Certainly, interesting new products—including structured and fee-based VAs—have been introduced. However, in Cerulli's view, it's still not clear whether advisors regard them more as a commodity rather than a differentiated solution. There is hope that the Alliance for Lifetime Income can help encourage consideration of the products in practical ways and provide success stories to aid marketing efforts. The fact that most insurers in this survey believe fee-based pricing and greater investment flexibility will help sales suggests growing momentum for I-shares and IOVAs.

EXHIBIT 9

Methods for Increasing the Number of Advisors Who Sell Variable Annuities, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked "What strategies are most promising for broadening the number of advisors who sell variable annuities?" Other includes "Looking at opportunities outside current captive."



- Adopting more of a consultative sales approach, increasing data mining, and building better technical skills to work with sophisticated advisory teams are among the top priorities for wholesaling during the next three years.
- Few respondents believe there is a need for more consulting on the investment side.

Key Implication: The concept that wholesalers should take more of a consultative approach when engaging advisors is one Cerulli has advocated for years. This is an area where many insurers lag fund managers. It goes hand in hand with the idea that annuity providers need to tailor their marketing to advisors' business models and away from a transaction-based approach. Certainly, efforts have been made in this regard. It's noteworthy that respondents believe wholesaling teams could better leverage technology and focus on more sophisticated advisory teams to generate leads and maintain existing contacts. These are the efforts that most asset managers have taken on in addition to creating product specialists to support more in-depth conversations.

EXHIBIT 10

Wholesaling Strategies in The Next Three Years, 2018

Sources: Cerulli Associates, in partnership with IRI

Wholesaling Strategies	Priority	Already Implemented	Not a Priority
Emphasize consultative sales approach	63%	25%	13%
Improve use of key accounts data	63%	13%	25%
Increase technical skills of existing wholesalers to address more sophisticated advisor teams	63%	13%	25%
Enhance predictive analytics to identify distribution opportunities	63%	0%	38%
Introduce or expand practice management programs	63%	0%	38%
Segment advisors by product decision-making process	50%	13%	38%
Shift more resources to internal salesforce	25%	0%	75%
Introduce or expand portfolio consulting programs	25%	0%	75%
Engage advisors on active vs. passive investing	0%	0%	100%

- Greater than half (58%) of surveyed insurers have informed their wholesalers about the Alliance for Lifetime Income's Retirement Awareness Campaign, while 45% have promoted the campaign directly to advisors.
- Another 27% of insurers plan to take action on the campaign in the future.

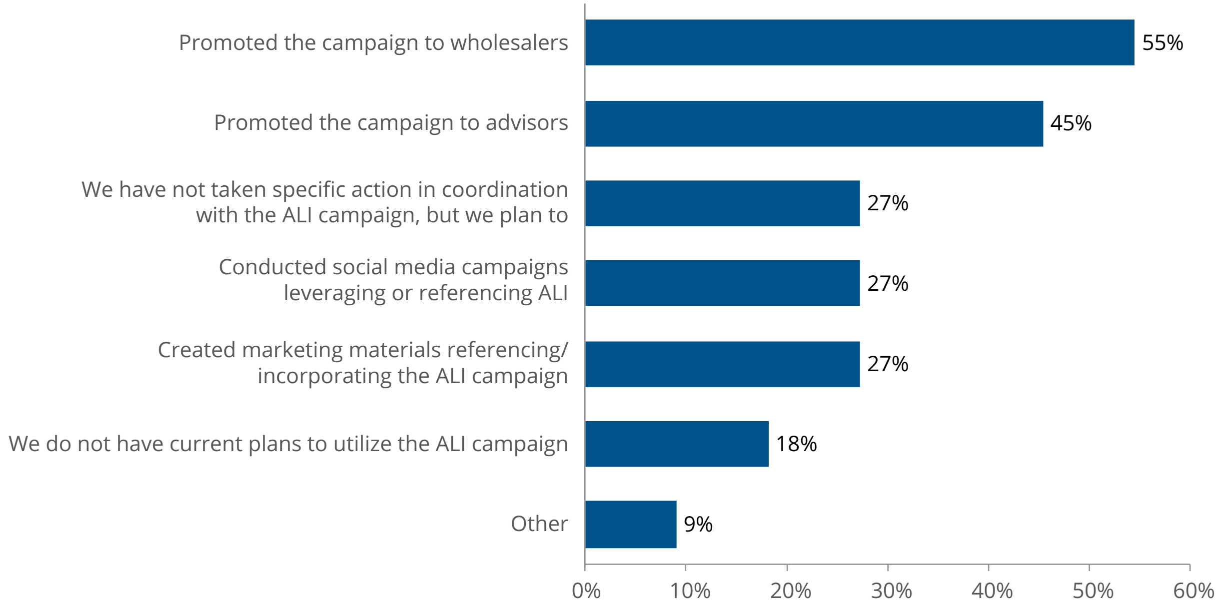
Key Implication: The Alliance for Lifetime Income, a consortium of financial firms formed to educate the public about the advantages of annuities, commenced operations in July 2018 with a print, digital, television, and radio advertising campaign. Its website provides educational materials and personal stories regarding annuity use. More than half of insurance company respondents to this survey have promoted the campaign to wholesalers. Some have gone so far as to reach out directly to advisors regarding it. Cerulli views this as a positive sign, especially because insurers believe negative press about annuities is an obstacle. If successful, the Alliance should help in this regard.

EXHIBIT 11

Capitalizing on ALI's Retirement Awareness Campaign, 2018

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked, "How is your firm capitalizing on the retirement awareness campaign launched by the Alliance for Lifetime Income (ALI)?" Other includes, "Reinforced our own retirement income marketing." Respondents can select more than one option.



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