CUSTOM KEY FINDINGS

U.S. Annuity Markets 2020: A Decade of Adaptation

CERULLI ASSOCIATES

IRI
Insured Retirement Institute

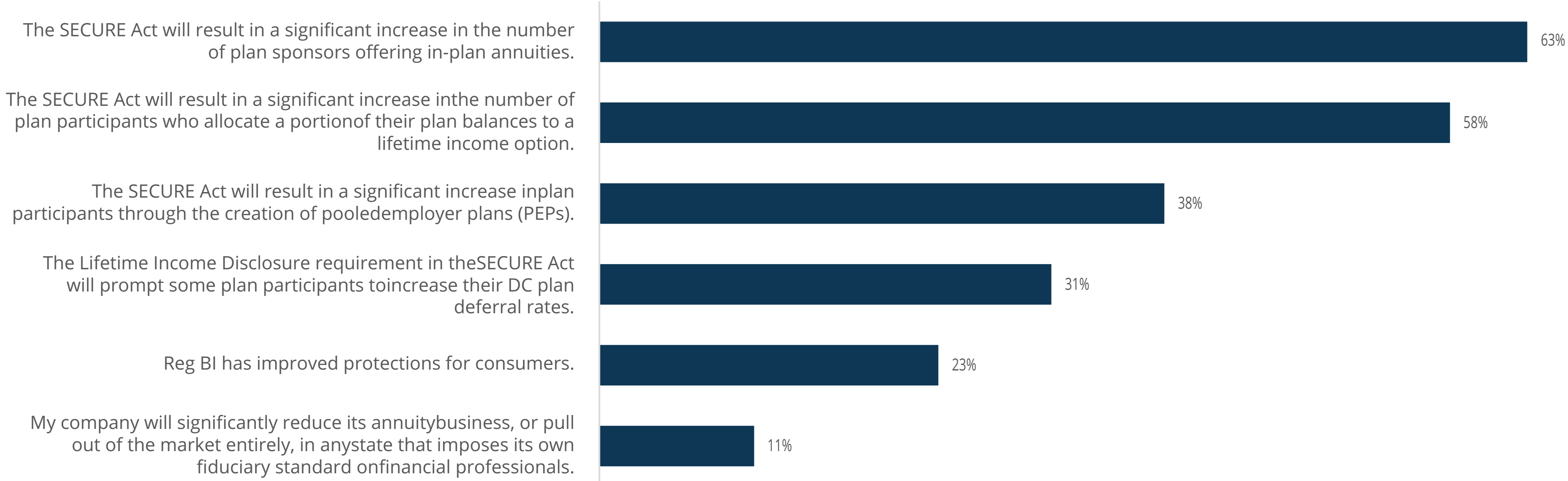
Regulation

EXHIBIT 1

Potential Regulatory Impacts, 2020

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Insurers were asked "Which of the following statements do you believe?"



Takeaways:

- Two-thirds (63%) of surveyed insurers believe the Setting Every Community Up for Retirement Enhancement (SECURE) Act will prompt more plan sponsors to offer annuities.
- Half (58%) of insurers believe the law will help more participants elect an annuity option.
- Just 23% expect the SEC's Regulation Best Interest (Reg BI) will provide improved protection for consumers.

Key Implications

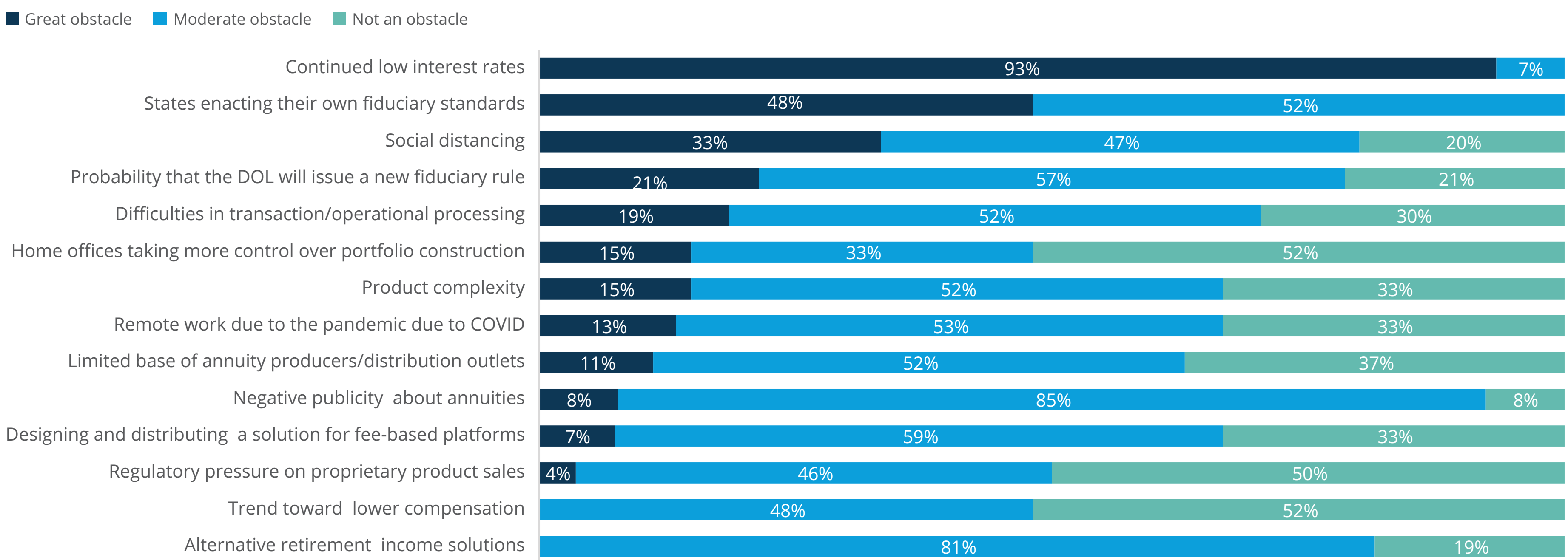
The SECURE Act, which was signed into law in December 2019, accomplished a number of things, including making it easier for employer-sponsored plans to offer annuities to their participants. It appears that a majority of insurers are optimistic that the law will help the cause of in-plan annuities and a few insurers have started to introduce products in response. It's telling that few insurers, just 23%, think the SEC's Reg BI will be of great help to consumers. Cerulli believes the larger threats will be posed by rules developed by state regulators.

Greatest Challenges

EXHIBIT 2

Insurer Perspective: Greatest Obstacles in Variable Annuity Business, 2020

Sources: Cerulli Associates, in partnership with IRI



Takeaways:

- All surveyed insurers believe low interest rates will be an obstacle for the variable annuity (VA) business over the next few years, while 81% think alternative income products will pose a challenge.
- All respondents believe that newer state regulations for financial advisors will be an obstacle, with over half thinking they will be modest obstacles.

Key Implications

To Cerulli, it's clear that annuity carriers view low interest rates as their biggest problem. Low rates reduce what insurers earn on the fixed-income investments in their general accounts, which forces them to lower fixed and indexed annuity crediting rates. They also have to lower rate-related actuarial assumptions underlying factors such as living benefit payout rates and the recovery of deferred acquisition costs. In Cerulli's view, it's too early to tell how strict newer state regulations will be—although they have been crafted to be tougher on advisors than the SEC's own Reg BI standard. As shown in the previous Exhibit, a minority of insurers think Reg BI provides investors with significant protections.

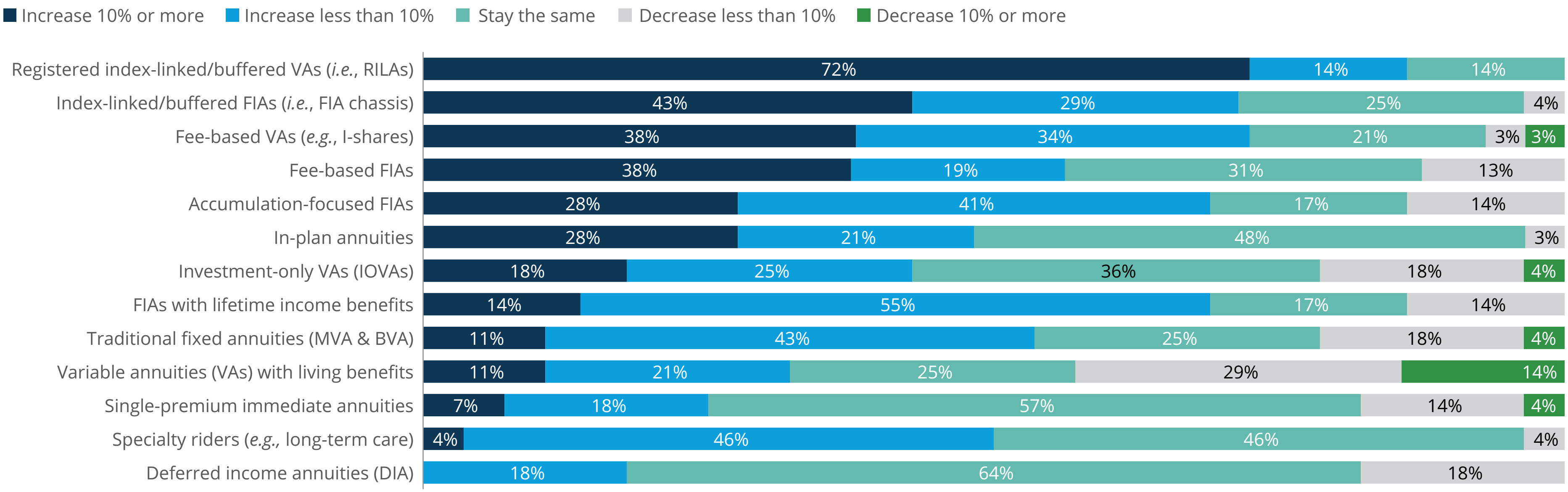
Sales Growth

EXHIBIT 3

Expectations for Sales Growth Over the Next Three Years by Product Types, 2020

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." Few survey participants anticipate any annuity type to experience a sales decrease of over 10% with exception of "VAs with living benefits" (14%).



Takeaways:

- Three-quarters (72%) of surveyed insurers believe sales of RILAs built on VA chassis will increase 10% or more over the next three years; nearly half (43%) of insurers trust that indexed annuity RILAs will experience similar growth.
- Approximately three-quarters (72%) of insurers believe I-share VAs will grow to at least some extent.

Key Implications

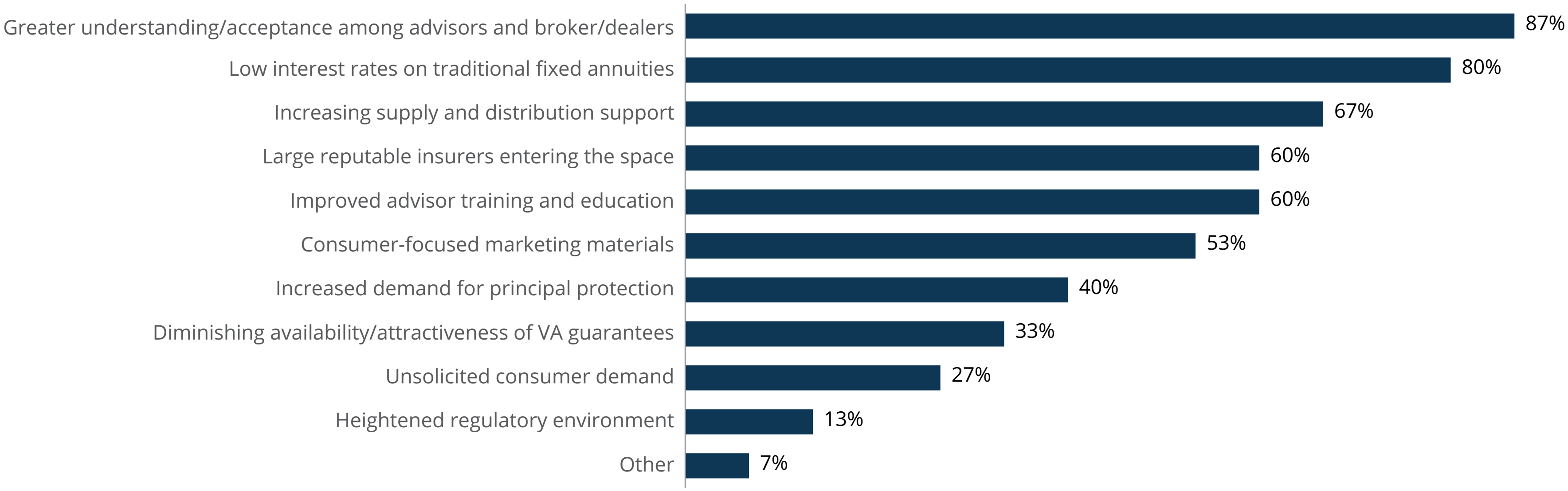
While many insurers tend to think income annuities and specialty riders have limited or no growth potential over the near term, RILAs are "the products of the moment." Most insurers believe building them on a VA chassis is the preferred method of construction, and many have followed though by introducing the solutions over the past two years. However, insurers entering this space will need to consider how these solutions will compare with FIAs when market volatility stabilizes, and issuers regain the momentum that they have achieved over the past five years.

RILA Sales Growth

EXHIBIT 4

Insurers: Factors Driving Growth of RILA Sales, 2020

Sources: Cerulli Associates, in partnership with IRI



Takeaways:

- Surveyed insurers note that RILA sales traction has been aided by insurers educating distributors and advisors on the advantages of the product.
- Current low crediting rates and caps on FIAs have also made the RILA look better in comparison.
- A steady increase in product supply and the involvement of highly rated insurers have been helpful factors as well.

Key Implications

It seems educational efforts on the part of insurers helped the RILA phenomenon to take hold. That makes sense to Cerulli because the products contain as many moving parts as FIAs. Top-tier companies have started offering RILAs and this has certainly caught the attention of broker/dealers and their advisors. Notably, the principal protection aspect is not as big of a factor behind the RILA's traction, with less than half of survey respondents deeming it important. Cerulli believes protection is more limited for RILAs than on an FIA or a VA living benefit, and the accumulation story is still a more compelling one in most cases.

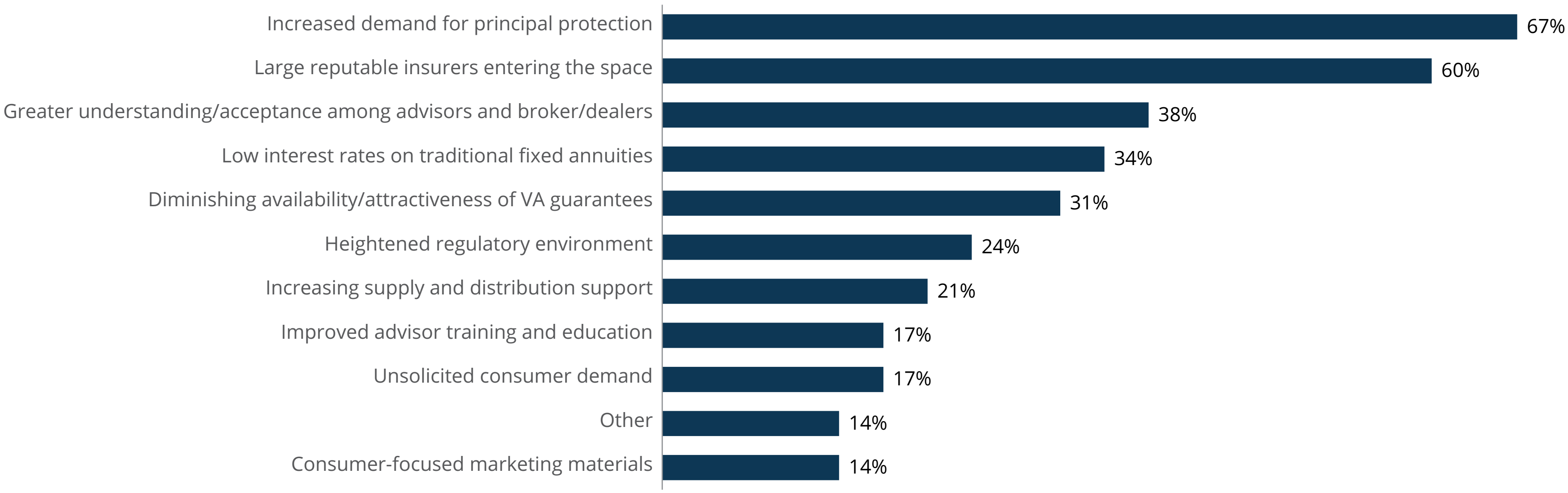
FIA Sales Growth

EXHIBIT 5

Insurers: Factors Driving Growth of FIA Sales, 2020

Sources: Cerulli Associates, in partnership with IRI

Analyst Note: Other responses included “Hedging complexities of VAs,” “Elimination of DOL Rule,” and “Advisors’ reliance on commissions.”



Takeaways:

- Two-thirds (67%) of surveyed insurers believe that the increased demand for principal protection is a big reason behind FIA sales growth in recent years.
- Other top reasons for the success of FIA sales are attributed to major insurers entering the space and growing acceptance among broker/dealers.

Key Implications

Comparing this exhibit to the previous one, one can get the impression that most insurers think principal protection is more of a draw for FIAs than for RILAs. This is a reason why Cerulli believes FIAs will eventually regain their upward momentum. They have also earned a better reputation than in years past because large, reputable insurers that had previously avoided them started to offer the solutions. Notably the FIA is still “sold not bought,” as just 17% of surveyed insurers note sales are generated directly by client demand.

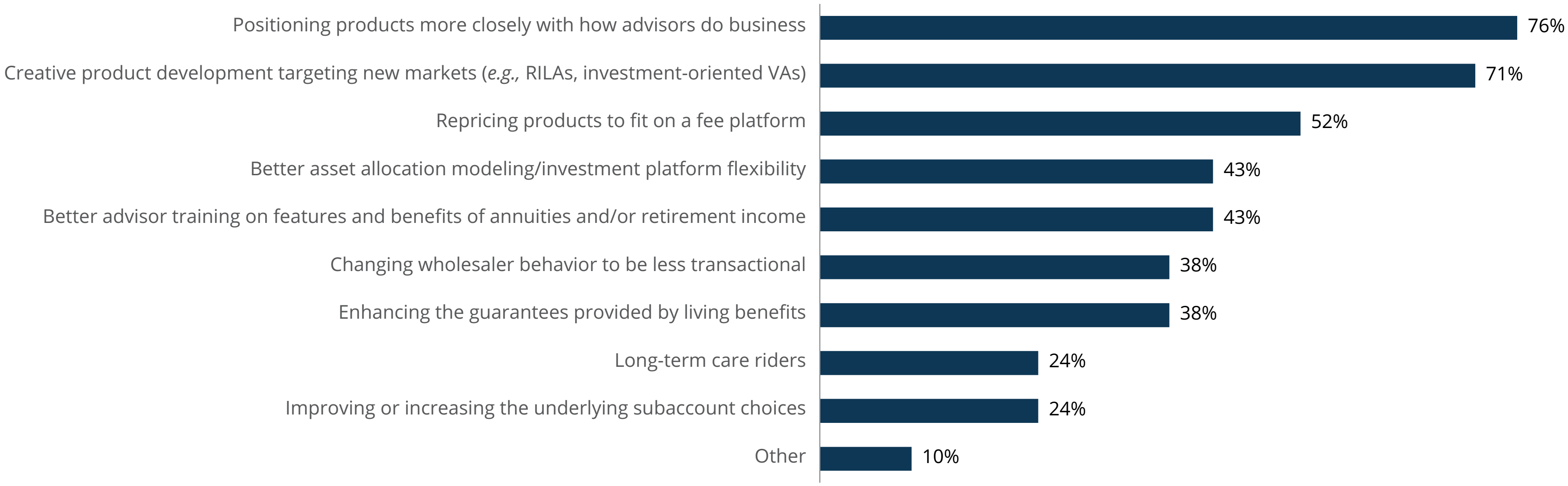
Advisor Perspectives

EXHIBIT 6

Methods for Increasing the Number of Advisors Who Sell Variable Annuities, 2020

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?"



Takeaways:

- Three-quarters (76%) of surveyed insurers believe they could do a better job of positioning VAs within advisors' business models.
- Almost three-quarters (71%) believe creative product development for new markets would increase VA sales, while 52% say pricing products for fee-based platforms will help growth.

Key Implications

Each year, Cerulli hears insurers say that they could do more to help advisors use VAs effectively in their practices, but many insurers continue to struggle with how to accomplish this. Many companies might conduct surveys or focus groups of advisors but there are already enough of those and they produce limited responses. The upshot is that a transactional mindset is still pervasive in the industry and should, overtime, be replaced with a more holistic one. Cerulli believes there are enough creative minds in the annuity space to make this happen through innovative designs.

Advisor Perspectives

EXHIBIT 7

Advisors' Views on the Benefits of Emerging Annuity Designs, 2020

Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute, and the Financial Planning Association® (FPA®)

Annuity Design	Unsure	Not Beneficial	Somewhat Beneficial	Very Beneficial
Fee-based variable annuities (*e.g.,* I-shares)	12%	28%	41%	19%
Registered index-linked annuities (RILAs)	16%	29%	39%	15%
Single-premium immediate annuities (SPIAs)	13%	29%	43%	15%
Fixed-indexed annuities with optional living benefits	18%	28%	40%	15%
Investment-only variable annuities (IOVAs)	20%	31%	36%	13%
Deferred income annuities (DIAs)	17%	25%	45%	12%
In-plan variable or fixed annuities (*i.e.,* guaranteed income in DC plans)	22%	35%	32%	11%
Fee-based fixed-indexed annuities	17%	38%	35%	10%
FINRA/SEC-registered fixed-indexed annuities	24%	35%	31%	9%

Takeaways:

- More than half of surveyed advisors feel fee-based VAs and single-premium annuities (SPIAs) could be beneficial to their practices (60% and 58%, respectively).
- RILAs and FIAs with living benefits are also viewed as potentially beneficial.

Key Implications

The current interest in fee-based annuities corresponds with advisors' continued migration to fee-based structures and concerns over all-in costs; however, only 19% find the design to be very beneficial. That 54% of advisors view SPIAs as beneficial hints at the possibility that more advisors may use them in the future as the solutions are seemingly "less expensive" and provide maximum income despite providing no liquidity. That said, insurers should know that many fee-based and fee-only practices are mixed on SPIAs. While the solutions provide sustainable income, advisors become limited in their ability to charge an AUM-based fee on annuitized assets in spite of still needing to service the contracts and manage the role that they play in broader financial plan constructs. In addition, insurers should know that almost one-quarter of advisors remain unsure whether in-plan annuities will be beneficial or not; however, Cerulli is confident that sentiment will improve (even if modestly) as educational efforts are scaled.

Advisor Perspectives

EXHIBIT 8

Factors Advisors Consider When Investing in an Annuity, 2020

Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute, and the Financial Planning Association® (FPA®)

Factor	Not important	Somewhat important	Very important
Insurer's financial strength ratings	4%	28%	68%
Pricing	2%	36%	61%
Principal protection	6%	36%	58%
Guaranteed retirement income	5%	40%	55%
Portfolio diversification	7%	39%	53%
Growth	8%	43%	49%
Tax deferral	6%	46%	48%
Client request	19%	49%	32%
Wealth transfer or estate planning	13%	57%	30%
Unique investment options	24%	52%	24%
Advisor compensation	46%	45%	8%

Takeaways:

- Greater than two-thirds (68%) of advisors surveyed believe an insurer’s financial rating is a very important factor in selecting an annuity.
- Pricing is another major consideration, with 61% of advisors rating it very important.
- More than half of advisors find principal protection, guaranteed retirement income, and portfolio diversification highly important.

Key Implications

Advisors harbor concerns as to whether insurers will be able to make good on their annuity obligations over the long term. Cerulli understands why this is an issue, as over the past decade once-formidable VA players have left the business, offered to buy back benefits that are no longer sustainable, and even stopped paying commissions on in-force contracts. Historically low interest rates have made these concerns even more acute. All that said, advisors are still attracted to annuities, especially their protective features, but will not position them to clients if they find them too expensive or if the solutions are backed by an insurer that they feel is questionable, regardless of whether their home office approves products on their platforms.

Advisor Perspectives

EXHIBIT 9

Advisors’ Reasons for Success of Fixed-Indexed Annuities, 2020

Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute, and the Financial Planning Association® (FPA®)

Reason	All Advisors
Generous living and death benefit guarantees	52%
More friendly pricing (*e.g.,* commissions, surrender schedules, participation rates)	49%
Low interest rates on traditional fixed annuities	41%
Diminishing availability/attractiveness of VA guarantees	32%
Greater understanding/acceptance among my practice and/or firm	24%
Improved advisor training and education	19%
Impact of DOL Conflict of Interest Rule	15%
Consumer-focused marketing materials	14%
Increasing supply and distribution support	11%
Unsolicited client demand	8%

Takeaways:

- Half (52%) of surveyed advisors trust that generous living and death benefits were reasons behind indexed annuity sales success, while 49% think friendlier pricing make the product attractive.
- Advisors also believe low interest rates on traditional fixed annuities make FIAs look better in comparison.

Key Implications

FIA sales began to take off in 2012 and went on a winning streak thereafter; they suffered a slight dip in 2017, only to set new sales records in the following two years. Cerulli believes this sustained growth of FIAs remains on advisors’ minds even though low rates hurt the product in 2020. That said, FIA manufactures must remain focused on innovation, mainly due to the recent success of RILAs, which Cerulli believes may limit the future success of FIAs. Many B/D home offices and practices are warming up to the concept, particularly those that are registered securities, which provides an added layer of transparency. Although Cerulli foresees FIA sales modestly rebounding from the challenges COVID-19 created in 2020, RILAs are projected to steal significant marketshare from all other annuity types over the next five years.

Advisor Perspectives

EXHIBIT 10

Advisors' Most Important Factors When Considering Fixed-Indexed Annuities, 2020

Sources: Cerulli Associates, in partnership with the Investments & Wealth Institute, and the Financial Planning Association® (FPA®)

Factor	All Advisors
Insurers' reputations/financial strength ratings	74%
High potential earnings/participation rates	57%
High guaranteed minimum interest rates	56%
Short surrender periods	40%
Ease of integrating the product(s) into my platform/technology	31%
Quantity of interest credit options	27%
Insurers' supporting personnel and processes (*i.e.,* smooth transactions/resolutions)	26%
Fee-based designs (*i.e.,* no commissions)	22%
Availability of premium bonuses	17%
Attractive commission options	12%

Takeaways:

- Three-quarters (74%) of surveyed advisors consider insurers' financial strength ratings as important to the FIA selection process, followed by high potential earnings/participation rates (57%).

Key Implications

As noted earlier, advisors considering FIAs for their clients are primarily concerned with an insurer's financial standing. Again, this is for good reason. As the markets remain volatile and interest rates are low, it's understandable why an advisor may fear that FIA carriers might repeat similar mistakes that caused VA carriers to derisk and/or depart the business. Other considerations on this list underscore how advisors still want FIAs to have attractive upside potential for clients through high participation rates, while protecting them on the downside through minimum rate guarantees.

Distribution Strategies

EXHIBIT 11

Wholesaling Strategies in the Next Three Years, 2020

Sources: Cerulli Associates, in partnership with IRI

Wholesaling Strategies	Major Priority	Moderate Priority	Not a Priority	Already Implemented
Improve use of key accounts data	43%	29%	0%	29%
Enhance predictive analytics to identify distribution opportunities	38%	29%	10%	24%
Emphasize consultative sales approach	38%	10%	10%	43%
Increase technical skills of existing wholesalers to address more sophisticated advisor teams	29%	43%	10%	19%
Introduce or expand practice management programs	15%	45%	15%	25%
Shift more resources to internal salesforce	14%	38%	43%	5%
Segment advisors by product decision-making process	14%	38%	33%	14%
Introduce or expand portfolio consulting programs	0%	30%	60%	10%
Engage advisors on active vs. passive investing	0%	25%	75%	0%

Takeaways:

- Three-quarters (72%) of insurers report that improving their use of key accounts data is a priority, with 43% rating it a major priority.
- More than two-thirds (67%) cite enhancing predictive analytics to identify distribution opportunities as a priority, while 48% say emphasizing a consultative approach is a priority.

Key Implications

The role of key accounts is to develop and maintain a good working relationship between the insurer and each distributor to understand the latter's preferences and needs, and thereby generate sales, often with a top-down approach. However, Cerulli continues to hear how many insurers continue to lag asset managers in terms of how they tap into available data and trends to drive new business. Overall, insurers can do more with technology (predictive analytics) to gather and use data to support their wholesalers and B/D partners. Likewise, mimicking asset managers' use of product and portfolio specialists could go a long way for insurers that are trying to help advisors implement annuities into their more complex processes.

Annuity Compensation

EXHIBIT 12

Insurers' Perspectives on Annuity Compensation, 2020

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 annuities and compensation structures." No surveyed participants agreed with "Eventually all VA sales will be fee-based" or disagreed with "There will always be a need for commissionable VAs."

	Agree	Neutral	Disagree
There will always be a need for commissionable VAs	86%	14%	0%
Independent RIA channel has tremendous potential for the annuity industry	86%	11%	4%
We see tremendous growth potential in RILAs	82%	11%	7%
My firm has committed significant resources to developing fee-based VAs	46%	21%	32%
My firm has committed significant resources to developing fee-based FIAs	37%	41%	22%
Fee-based FIAs will experience significant growth in the next few years	32%	46%	21%
Fee-based VAs won't really gain traction for the foreseeable future	18%	50%	32%
Fee-based VAs will eventually account for most VA sales	14%	43%	43%
Eventually all VA sales will be fee-based	0%	25%	75%

Takeaways:

- Across surveyed insurance executives, 86% believe there will always be a need for traditional commissions.
- Greater than two-thirds (82%) foresee tremendous growth potential for RILA sales.
- The vast majority of insurers (86%) think the independent RIA channel has great potential.

Key Implications

Cerulli concurs with the majority of insurers that think traditional upfront commissions will remain important in the annuity space, even if new regulations aim to tamp down on them. Anecdotally, many fee-based advisors (i.e., not "fee-only" independent RIAs) maintain some or all of their annuity books on a commissioned basis at their B/D, as those upfront loads can help provide predictable revenues in the early years. Insurers are also very confident about the prospects of RILAs. As noted throughout this publication, product development in the RILA space remains encouraging and Cerulli anticipates that the product will continue to claim a greater share of total annuity sales over the next five years.

Methodology

The Cerulli Report—U.S. Annuity Markets 2020: A Decade of Adaptation is the fourteenth iteration of an annual series. The study is an outcome of ongoing research and analysis of the retail annuity marketplaces by Cerulli. The report focuses on three key areas—distribution, product development, and asset management opportunities. This report leverages Cerulli's continuous analysis of variable and fixed annuities, including f ixed-indexed, fee-based, and registered index-linked annuities, as well as the insurance subadvisory marketplace. Exhibits highlight key data and commentary, including the important tactical ramifications for insurers, asset managers, and wealth managers servicing the insurance market. The report is designed as a business planning tool, and additional support leveraging this data is available. Proprietary surveys of insurance company executives conducted in 3Q 2020 serve as the foundation of the report. Cerulli partners with the Insured Retirement Institute to distribute its annual surveys, effective with the 2010 edition. Also included are the results of Cerulli's ongoing surveys of f inancial advisors and U.S. households, as well as insurance companies' sales managers, heads of strategy, and product development as they pertain to annuities and retirement income, conducted throughout 2020. Financial advisor surveys were conducted in partnership with WealthManagement. com, Investments & Wealth Institute, and the Financial Planning Association® (FPA®). Data is also included from Cerulli's partnership with Phoenix Marketing International, whose PMI Global Wealth Monitor is the largest affluent study in the United States, with online surveys of nearly 10,000 households throughout the year. Phoenix also fields the Retirement Services Study, which addresses the target market of retirement providers. In addition to proprietary survey data and ongoing executive interviews, Cerulli compiled information available through third parties (including the Insured Retirement Institute, Morningstar, Beacon Research, LIMRA International, and government entities (such as the Federal Reserve), and financial publications (such as National Underwriter).

Cerulli for Research and Consulting

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Headquartered in Boston with offices in London and Singapore, Cerulli Associates is a global research and consulting firm that provides financial institutions with guidance in strategic positioning and new business development. Our analysts blend industry knowledge, original research, and data analysis to bring perspective to current market conditions and forecasts for future developments.

Cerulli's research product line includes the Cerulli Report series, the Cerulli Edge series, and Cerulli Lodestar.

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