State of Annuity

**Introduction**

An [annuity](https://www.investopedia.com/terms/a/annuity.asp) is a contract between you and an insurance company in which you make a lump sum payment or series of payments and, in return, obtain regular disbursements beginning either immediately or at some point in the future.

The goal of annuity is to provide a steady stream of income during retirement. Funds [accrue](https://www.investopedia.com/terms/a/accrue.asp) on a tax-deferred basis, and like [401(k)](https://www.investopedia.com/terms/1/401kplan.asp) contributions, can only be withdrawn without penalty after age 59.5.

Many aspects of an annuity can be tailored to the specific needs of the recipient. In addition to choosing between a [lump sum payment](https://www.investopedia.com/terms/l/lump-sum-payment.asp) or a series of payments to the insurer, you can choose when you want to annuitize your contributions - that is, start receiving payments.

**Kinds of Annuity**

Annuities come in three main varieties - fixed, variable and indexed - that each have their own level of risk and [payout](https://www.investopedia.com/terms/p/payout.asp) potential. [Fixed annuities](https://www.investopedia.com/terms/f/fixedannuity.asp) pay out a guaranteed amount based on the balance of your account. The downside of this predictability is a modest [annual return](https://www.investopedia.com/terms/a/annual-return.asp), generally slightly higher than a [CD](https://www.investopedia.com/terms/c/certificateofdeposit.asp).

You have the opportunity for a higher return, accompanied by greater risk, with a [variable annuity](https://www.investopedia.com/terms/v/variableannuity.asp). In this case, you pick from a [menu of mutual funds](https://www.investopedia.com/articles/mutualfund/05/shareclass.asp) that comprise your personal "sub-account." Here, your payments in retirement are based on the performance of investments in your sub-account.

[Indexed annuities](https://www.investopedia.com/terms/i/indexedannuity.asp) are somewhere in between when it comes to risk and potential reward. You receive a guaranteed minimum payout, although a portion of your disbursements is tied to the performance of a [market index](https://www.investopedia.com/terms/m/marketindex.asp), such as the S&P 500.

Despite their potential for greater earnings, variable and indexed annuities are [sometimes criticized for their fees](https://www.investopedia.com/financial-edge/1210/401k-fees-you-need-to-know.aspx) and their relative complexity. For example, many [annuitants](https://www.investopedia.com/terms/a/annuitant.asp) find that they have to pay steep surrender charges if they try to withdraw their money within the first few years of the contract.

**State of Annuity 2018**

1. Tax reform was a significant tailwind to annuity transactions as more plan sponsors funded their pensions to take advantage of the 35 percent corporate tax deduction, as applicable. While plans of all different funded statuses were potential players in the pension annuity market, those with higher-funded statuses were more likely to transact.

2. “Select retiree” annuity lift-outs dominated the 2018 market, similar to the small annuity trend that started in 2016. And we saw more organizations looking at multiple transactions as different retiree (or even non-retiree) groups are analyzed.

3. Plan terminations were becoming more popular as more pension plans are fully frozen and become better funded. Remember that plan terminations can take as much as 12 to 18 months to complete and typically include significant lump-sum payouts, so different solutions were deployed to lock in economics during this lengthy process.

4. Plan sponsors needed to prepare census data that is transaction-ready. Insurers continued to improve their processes and were rightfully applying more pressure on plan sponsors to lessen the gaps in their census data. Additionally, the ability to share historical mortality and demographic trends helped insurers understand specific plan populations and typically improved pricing.

5. Robust fiduciary processes must exist. While the market had become more mature in the past few years, the need for a comprehensive fiduciary process cannot be a casualty of that experience. Each transaction was unique and required the fiduciary to ensure that it is protecting all pension participants during a proposed transaction.

**How We Did Last Year**

Here are the questions we came up with a year ago, and how we think those questions look now.

**1. How will annuity crediting rates compare with bank certificate of deposit (CD) rates?**

The annuity data streams we’re seeing these days don’t give us a clear picture of what’s happening with the spread between fixed annuity rates and bank CD rates.

**2. Will anyone buy, or sell, the new fee-based annuity contracts?**

Yes: LIMRA reported in November that, in the third quarter, sales of fee-based variable annuity sales were 43% higher than in the third quarter of November 2017.

**3. How well can issuers buy their way out of benefits obligations guaranteed when interest rates were much higher?**

The list of companies that have offered to buy back variable annuity guarantees in the past year includes AXA Equitable and Ohio National. Details about the percentage of annuity holders who take up guarantee buyback offers have been scarce.

**4. Will the aging of the boomers increase society’s overall awareness of annuities?**

At this point, probably not.

**5. Just how dead is the U.S. Department of Labor’s fiduciary rule?**

Apparently, undead.

**Looking Ahead on 2019**

**1. Will volatility change how consumers see annuity product guarantees?**

Issuers of variable annuity contracts often talk about the income and withdrawal guarantees available with the products.

But analysts at Cerulli Associates suggest in a 2019 annuity market review that indexed annuity guarantees still tend to be better than the optional guarantees available with variable annuities.

“Although a few carriers have increased the attractiveness of their optional guarantees, Cerulli does not see the sales trend reversing unless a greater of VAs follow,’ Donnie Ethier, a Cerulli director, says in a summary of the market review.

**2. How exactly are life insurers supporting their annuity guarantees?**

A new volatility stress test could lead to greater clarity about how life insurers’ derivatives arrangements work.

**3. Will financial professionals with roots outside the life insurance sector ever warm up to guarantees?**

Maybe not, but there’s nothing like a sharp drop in stock prices to get people to wondering if a well-diversified portfolio is the only protection consumers need against market volatility.

**4. How well will the new, proprietary investment indexes available in some indexed annuity products work in a year of increased investment market volatility?**

It’s possible that the performance of the derivatives arrangements supporting older, plain vanilla indexes will be different from the performance of the arrangements supporting the newer indexes.

**5. Will interest rates continue to increase, and, if so, will that change the relative appeal of annuities when compared with bonds?**

Eric Henderson, a senior vice president at Nationwide, says in his company’s 2019 outlook commentary that higher rates will increase guaranteed crediting rates on annuities.

Higher rates “will also increase the potential downside risk of bonds,” Henderson says.

That increase in potential downside risk could make indexed annuities more attractive, Henderson says.

**Trend Prediction on 2019**

The previous year had more than its share of big news for the annuities industry.

Ambiguity around the Department of Labor’s fiduciary rule led to a bit of a muted start to the year. Despite the rule’s eventual pullback, the industry forged ahead with procedures and policies designed to help increase clarity and simplicity, and provide even greater access and understanding to advisors and investors.

With an industry-wide sales rebound in 2018, there are reasons to be optimistic this year.

What does 2019 have in store for annuities? Based on the ripples that are starting to show, we expect four key trends to define the industry in the year ahead.

## ****Trend 1: Provider Consolidation Continues****

The annuities industry has gone through significant consolidation over the past year. Voya, The Hartford and Ohio National all exited the annuities sector. In 2019, industry consolidation will lead to opportunities for consumers, as the range of products offered by remaining providers continues to grow to meet consumers’ strategic needs.

For advisors, this means more products are likely to be available on platforms they already use to manage their clients’ business. You’ll see a greater emphasis on service as fee compression and demand on advisors’ time reduces advisors’ willingness to use multiple platforms to bring products to clients.

The result will be highly flexible one-stop shops for advisors to tap into a comprehensive range of products they can offer, coupled with white-glove, back-end service designed for time savings, cost savings and ease of use.

## ****Trend 2: Annuities Industry Gets ‘Amazon-ification’****

The “Amazon-ification” of financial services will reach closer to the annuities industry, increasing demand for both self-directed optionality coupled with high-touch service through personal advice. The consumer experience often weaves together self-directed and advisor-guided financial product purchases, according to LIMRA research.

We’ll see more emphasis on enabling customers to shop and get advice wherever they want — with an advisor, in the workplace or on self-directed platforms. This will give consumers the freedom to invest and buy products independently while also having options for those seeking professional advice.

Because of consumers’ preference to be able to shift from self-service to professional advice, self-service platforms will increasingly serve as a pipeline for financial professionals, supporting their business.

Financial professionals will still have a key role to play in helping people develop retirement income strategies that meet their retirement goals, and help them realize the lifestyle they want in retirement. Professional advice is even more accessible than ever and is especially critical in retirement income planning.

In 2019, we can expect to see more digital platforms opening to direct consumer access that will only continue to fuel advisors’ business.

## Trend 3: Complexity Fades; Fixed Annuities Gain Share

Investors see product complexity as a holdover from the 2008 financial crisis. This will continue to increase pressure on providers to deliver easy-to-understand, transparent products. This drive away from complexity aligns with regulatory trends, such as the Securities and Exchange Commission’s proposed Regulation Best Interest, as well as the momentum for more do-it-yourself investment options.

Expect continued growth in the fixed annuities space. Providers will bring more simplified, transparent offerings to the market. Meanwhile, investors will be more willing to accept limited upside potential for guaranteed floors and risk mitigation in retirement income.

LIMRA data shows that more than 50 percent of consumers will choose the guaranteed income over a lump-sum payment in retirement. This indicates the demand for fixed products is likely to continue as baby boomers continue to retire in record numbers.

In 2011, the annuities sector was heavily weighted toward variable annuities. The pendulum is now swinging in the other direction and fixed products are increasingly prevalent. A continued rising interest rate environment in 2019 will only add fuel to the fire, driving fixed product sales in the new year.

## Trend 4: Retirement Income Takes the Lead

The most fundamental shift in the industry is likely to be less tangible, but arguably more impactful in the long run. The financial planning mindset is fundamentally changing.

Against the backdrop of an aging population, increasing longevity, risks to Social Security and stagnant wage growth, there is a growing, silent retirement crisis of individuals entering retirement without sufficient income to fuel their lifestyle. As a result, the rates of debt and bankruptcy filings among the elderly have more than tripled since the early 1990s.

Industry-wide initiatives are underway to change the dialogue away from retirement asset accumulation and instead focus on retirement income. This momentum will continue to build in 2019, benefiting from a growing recognition of the challenges an aging population faces, as well as tailwinds from legislative efforts that could include the Retirement Enhancement and Savings Act and the Family Savings Act.

Given the challenges and barriers people face in preparing for retirement, annuities can provide part of the solution, giving them a little more security and confidence in the future. In addition to securing a steady stream of retirement income a retiree can rely on to supplement other savings; annuities can also lower the amount a consumer needs to save in order to guarantee a given amount of retirement income.

A 2017 study found that most Americans favor financial strategies that offer guaranteed lifetime income. Ninety percent of all consumers who responded to the survey said they are very interested or somewhat interested in receiving lifetime income.

Further, the new research from the Alliance for Lifetime Income found that 74 percent of households with a guaranteed retirement income stream are confident their retirement savings will last the rest of their lives.

## Annuities For A New Decade

This year will be another year of transition for the annuities industry, as the mix of both providers and products changes to suit the needs of advisors and consumers alike. A smaller group of insurers will end the year providing a wider range of product options. These products will be more accessible to advisors on the platforms they use and easier for consumers to understand.

The changing approach to retirement planning will shine a new light on annuities, which are increasingly seen as a critical tool to provide the guaranteed retirement income consumers need to provide the peace of mind and security to live their ideal retirement.

And by this time next year, annuities products and the industry at large will have preserved the best of the past, while reinventing for the new decade in 2020.

**Summary**

Annuity market situation is prone to change all the time and annuity products are crucial to everyone, especially for elderly people. These require professional planning and advice provided by firms like Legacy Financial Advisors, Inc., which can help reduce market mistakes and increase the odds of a successful outcome over time.

*Resource*

1. Investopedia
2. 5 New Questions About How the Annuity Market Will Weather 2019, by Hartford Funds, by Allison Bell, 2018
3. Key 2019 Annuity Trends: Mergers, Simplification, Amazon-ification, by Kent Sluyter

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