A U.S. Perspective on Annuity Lifetime Income Guarantees

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• Defined Benefit and Defined Contribution plan trends in the U.S. and prospects for longevity bonds

• Behavioral influences on design of variable annuity and DC plan withdrawal-based lifetime income guarantees

• Introduction to variable annuity and DC plan withdrawal-based lifetime income guarantees

• Contribution of traditional fixed and variable immediate annuities and annuitization of deferred annuities toward improved retirement financial security in the U.S.
Defined Benefit Plans in the U.S.: A Different Situation

- U.S. corporate DB plans continue to be replaced by DC plans
  - 40% already or expected to be frozen within a year\(^1\)
  - By 2005, U.S. private sector DB plans had fallen to 30,000 from a peak of 112,000 in mid-1980s\(^2\)
  - In 2008, 21% of U.S. private industry workers had access to a DB plan\(^3\)

- U.S. corporate DB plans rarely offer inflation-adjusted benefits, avoiding amplified systemic longevity risk

- U.S. public DB plans generally do provide inflation-adjusted benefits

- U.S. DC plans generally do not offer any lifetime annuity benefits

\(^1\) Source: *U.S. Employer Trends for Retirement Plans: Implications for Future Retirees*, LIMRA, 2010

\(^2\) Source: Pension Benefit Guaranty Corporation, 2005

The percentage of all U.S. retirement assets held in individual accounts, including DC plans, has doubled to over 60%.

The percentage held in public employee DB plans has remained relatively stable while the percentage held in private DB plans has plummeted.

Individual includes annuities, IRAs, and employer-sponsored defined contribution plans such as 401(k), 403(b) and 457 plans.
Tackling Systematic Longevity Risk

- In the U.K., capacity for longevity risk is strained by mandated demand for inflation-adjusted lifetime annuity benefits.
- Global reinsurers step in to create capacity.
- Insurers with substantial mortality risk are best situated to hold longevity risk.
- Creating a market for longevity bonds offers advantages/challenges:
  - Sets a benchmark, facilitates a tradable market for longevity risk.
  - Market imbalance – too few natural buyers? Bid/ask spread?
- In the U.S., corporate DB plan risk reduction actions will likely vary by sponsor type and plan size:
  - Smaller frozen plans likely to transfer full risk.
  - Large frozen and closed plans may transfer retiree liability in tranches over time.
"In the UK, most workers must convert their pension pot into an annuity on retirement. In the US, where self-managed pensions are more common, only a fifth of the population aged between 45 and 70 say they would buy an annuity, according to a Society of Actuaries survey."

-- Financial Times, May 28, 2011
Three Major U.S. Defined Contribution Plan Challenges

• Participants not contributing enough to the plan
• Participant asset allocation decision-making
• Participants unprepared for capital market and longevity risks
Behavioral Considerations Influence Design of DC and Variable Annuity Lifetime Income Guarantees

• Importance to consumers of maintaining control and liquidity of retirement savings

• Risk pooling of “self-managed” retirement savings (to achieve mortality cross-subsidy) viewed differently by consumers than retirement income sources that were not “self-managed”

• Consumers still want guaranteed lifetime income!
  – Many ACLI members offer traditional and in-plan annuities and expect these markets to grow

Withdrawal-based lifetime income guarantees in variable annuities and certain defined contribution plans
Withdrawal-Based Variable Annuity Lifetime Income Guarantee Assets Exceed Traditional Annuitization

Annuities account for 83% of $544 Billion of retirement income product assets

- Variable Annuity Guaranteed Living Benefits* = 71%
- Single Premium Fixed and Variable Immediate Annuities/Annuitization of Deferred Fixed and Variable Annuities = 12%
- Reverse Mortgages = 17%
- Managed Payout Funds and Mutual Funds with Guarantees = 0%

Year End 2009 – Dollars in Billions


* Includes GLWB, GMIB, GMWB designs
Withdrawal-Based Variable Annuity Lifetime Income Guarantee Example

5% is first taken from Account Value

Protected Withdrawal Value

Withdrawals Begin

Insurance Company Funding

Source: Prudential Financial, Inc.
Variable Annuity Withdrawal Activity by Age and Duration

Age is a factor in predicting when one will begin withdrawals, but so is the length of time the person has owned the benefit.

Variable Annuity Withdrawals: “In” or “Out” of the Money

“In the moneyness” does not significantly impact withdrawal activity

"In the money"  "Not in the money"

Based on contracts issued prior to 2009 and still in-force on Dec. 31, 2009

Net Amount at Risk Illustration – Variable Annuity Withdrawal-Based Lifetime Income Guarantee

Source: Prudential Financial, Inc.
Conclusions

• Mandated inflation-adjusted annuities in U.K. present a special example

• Global insurers have capacity to assume systematic longevity risk

• Creating a market for longevity bonds offers advantages and challenges

• Lifetime income guarantees for personal retirement savings and DC plan assets must address consumer behavior biases

• Variable annuity "living benefits," mainly guaranteed lifetime withdrawal designs, were elected on 86% of variable annuities sold in 1Q 2011. Withdrawal-based income guarantees are now also being added to some U.S. defined contribution plans.¹

¹ Source: Variable Annuity Guaranteed Living Benefit Election Survey, LIMRA, 1Q 2011