

# U.S. Annuity Market Dynamics and Regulatory Requirements

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# U.S. Annuity Industry Assets

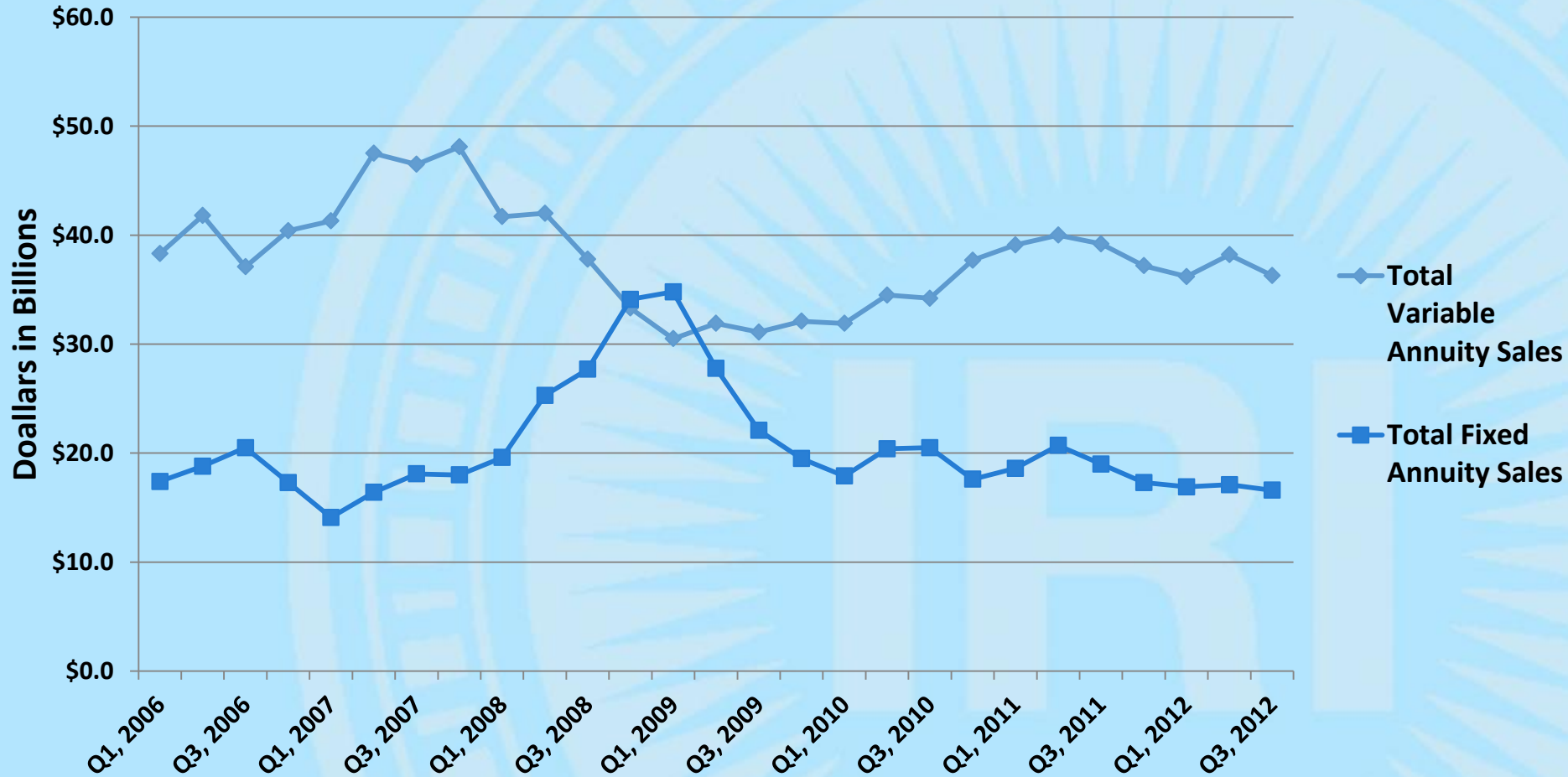
## Annuity Net Assets in Billions



Source: Morningstar and LIMRA

# U.S. Annuity Industry Sales

## Industry-Wide Annuity Sales, 2006 to Present



Source: Morningstar and Beacon Research

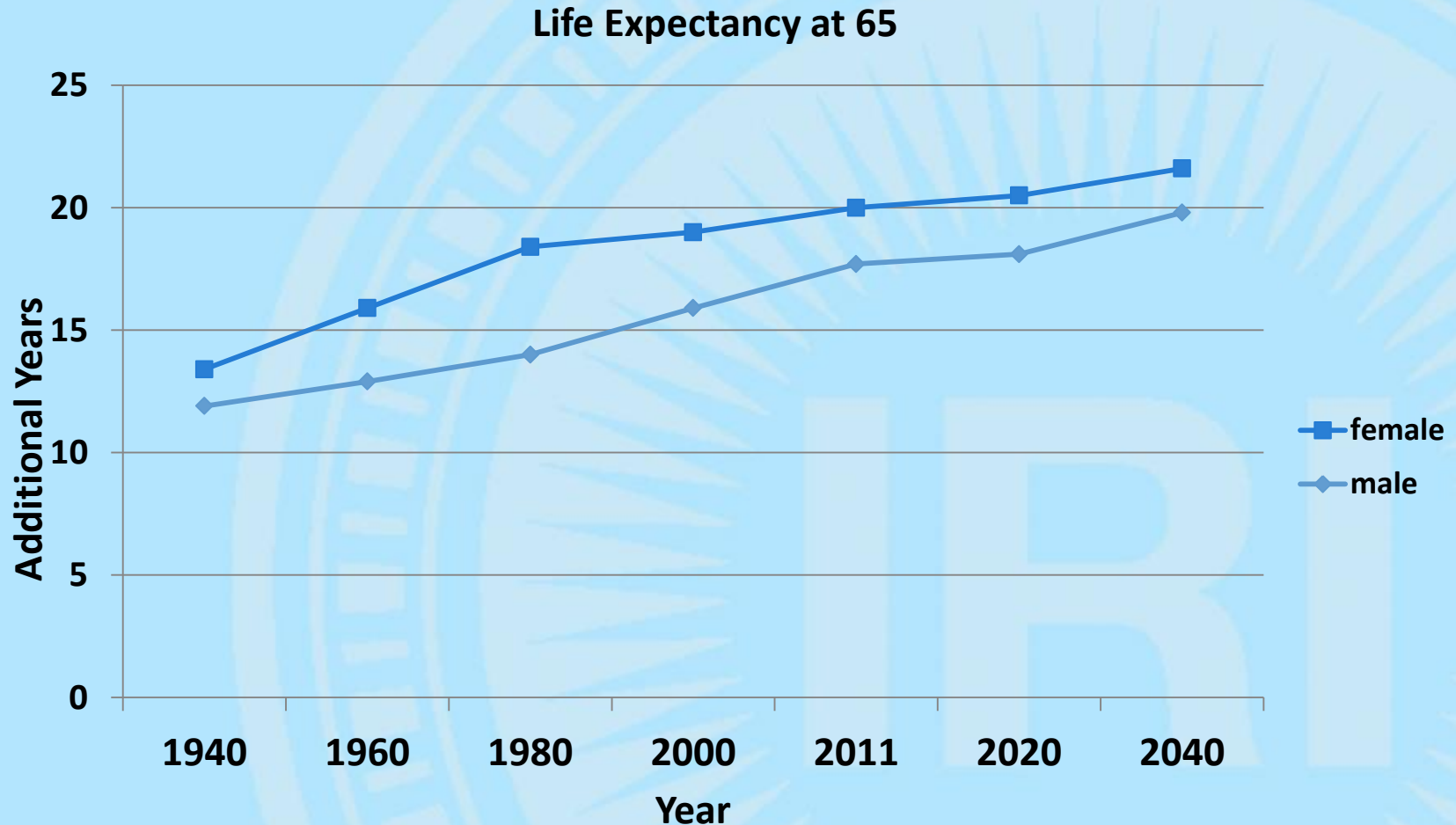
# Consumer Need for Lifetime Income

- **Basic demographics**
- **Longer lifespans**
- **Shift from defined benefit plans to defined contribution plans**
- **Rising health care costs**
- **Entitlement risk**
- **Diminished confidence**
- **Other risks**

# Basic Demographics in the U.S.

- **79 million Baby Boomers (Ages 50-66)**
- **Americans between the ages of 60-64 grew 56% from 2000-2010 from about 10.5 million to more than 16.2 million**
- **Baby Boomers control more than \$13 trillion in investable assets**

# Longer Lifespans for Americans



Source: 2012 Social Security Trustees Report; Period Life Expectancy Historical and Projected

# Longer Lifespans for Americans

- **Longevity > Life Expectancy**
- **65-year-old male: 30% chance of living to 90**
- **65-year-old female: 42% chance of living to 90**
- **A couple, both aged 65, has a 60% of at least one living to 90; 30% chance of at least one living to 95**

# Shift from DB Plans to DC Plans

- **1985: 114,000 private-sector, employer-funded defined benefit (DB) plans**
- **2011: Only 27,000 DB plans remaining**
- **Only 19% of U.S. workers today have access to a employer-funded DB plan**
- **Workers must save using defined contribution (DC) plans, annuities, and other savings vehicles (tax deferred or taxed)**



# Health Care Costs Rising in the U.S.

- **Rising health care costs:**
  - **17% of GDP in 2010; 20% of GDP by 2017**
- **Cumulative health costs and premiums:**
  - **Healthy 65-year-old male: \$369,000 on average**
  - **Healthy 65-year-old female: \$417,000 on average**
- **Only 37% of Baby Boomers are confident in covering health costs in retirement**
- **Only 24% of Baby Boomers are confident in covering long-term care**

# Entitlement Risk

- **Tremendous uncertainty regarding U.S. government systems for retirement income and medical payments (Social Security and Medicare)**
- **Require changes to remain financially viable**
- **Changes may reduce cumulative benefits retirees receive**

# Diminished Confidence

- **62% of Baby Boomers believe their personal financial situation will be the same or worse five years from now**
- **60% of Baby Boomers believe their financial security in retirement will be about the same or worse than their parents**

# Other Risks

- **Market risk**
- **Inflation risk**
- **Excess withdrawal risk**
- **Sequence of returns risk**
- **Asset allocation risk**
- **Tax uncertainty Risk**

# Financial Literacy Across the World

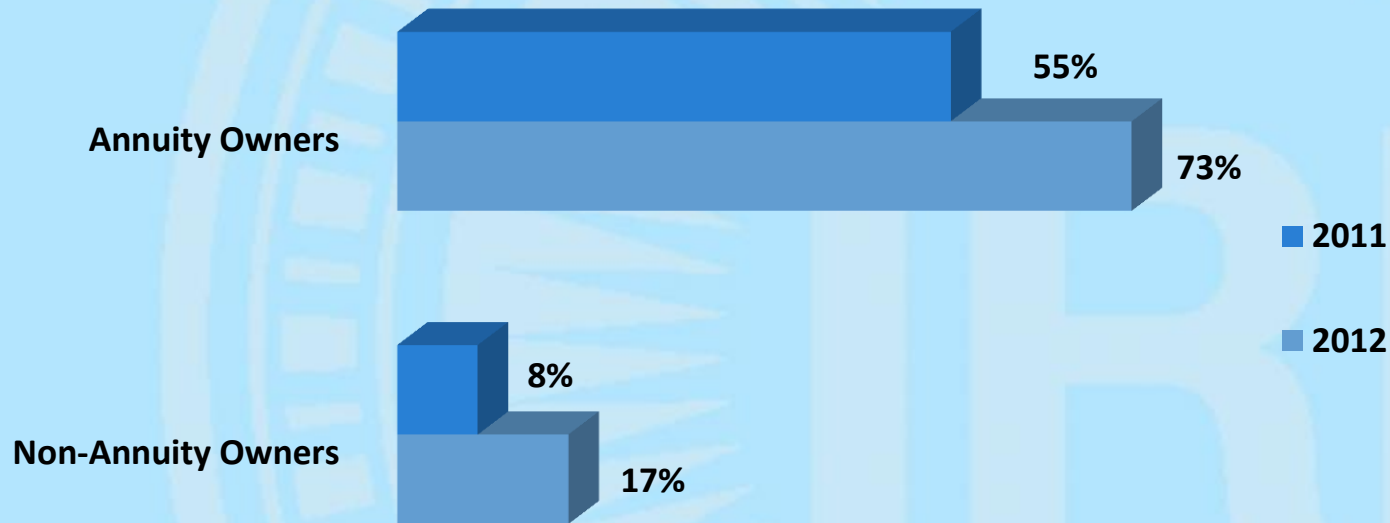
- **New research on financial literacy by:**
  - Dr. Annamaria Lusardi**
  - The George Washington School of Business**
  - Director, Global Center for Financial Literacy**
- **Questions added to national surveys in several nations across the world**
- **Financial literacy measured by understanding of three financial concepts:**
  - **Compounding interest**
  - **Inflation**
  - **Risk diversification**

# World Financial Literacy Key Findings

- **Financial literacy lowest among young adults, the elderly, and women.**
- **Financial literacy is positively correlated to retirement planning and participation in retirement plans.**
- **Lack of financial knowledge results in fewer retirement savings. Those who plan for retirement and exhibit forward-looking behaviors, on average, accumulate more wealth.**

# Importance of Annuities in Retirement Strategy

**Investors agree that annuities are a critical part of a retirement strategy**



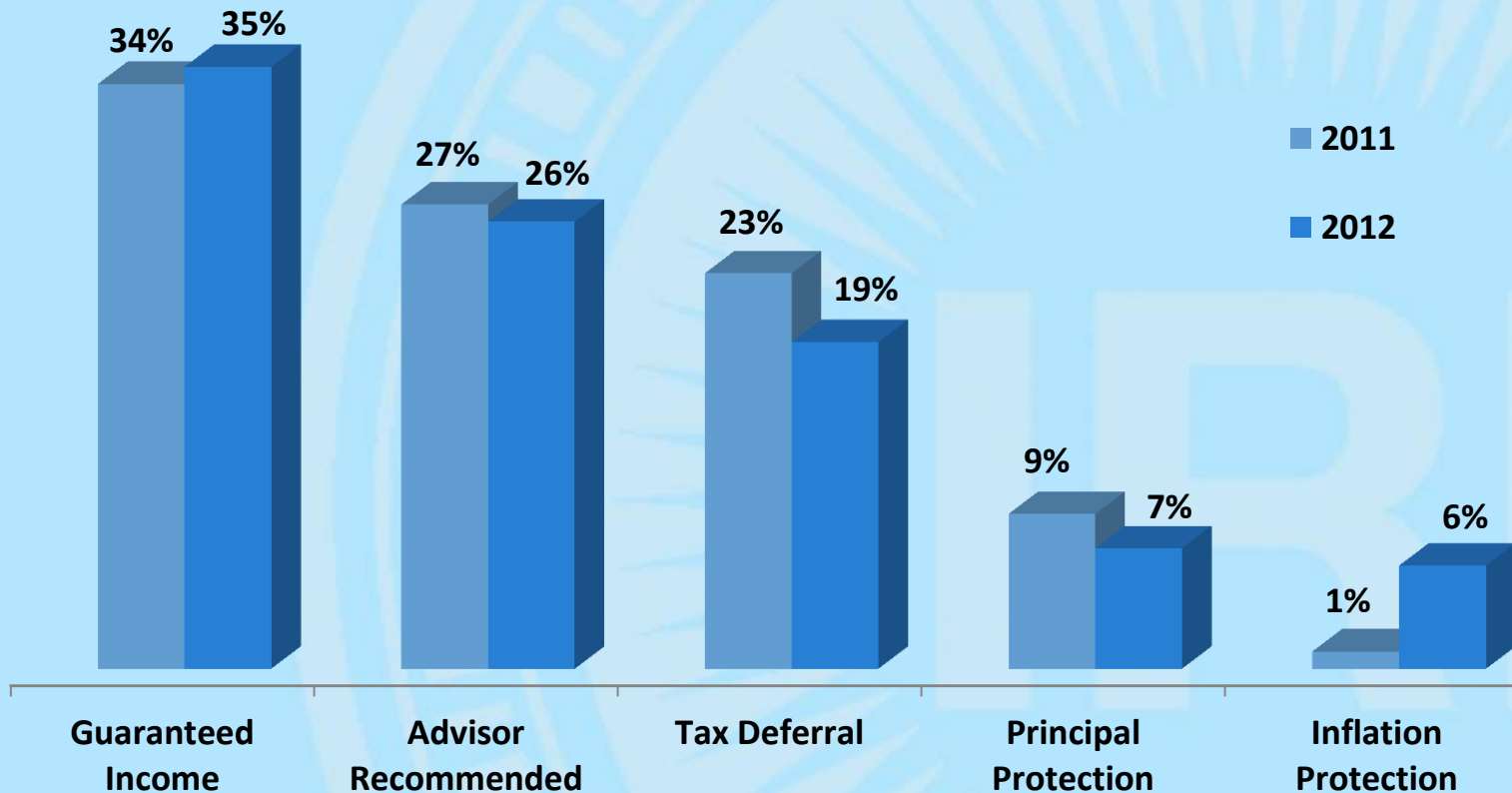
Source: IRI Baby Boomers and Generation Xers (August 2012)

# Increased Focus on Retirement Income Planning and Annuities

- **84% of advisors say that they are having more client discussions about retirement income planning**
- **71% of advisors say that they had a client request to purchase an annuity during the last year**



# Top Five Reasons to Purchase an Annuity



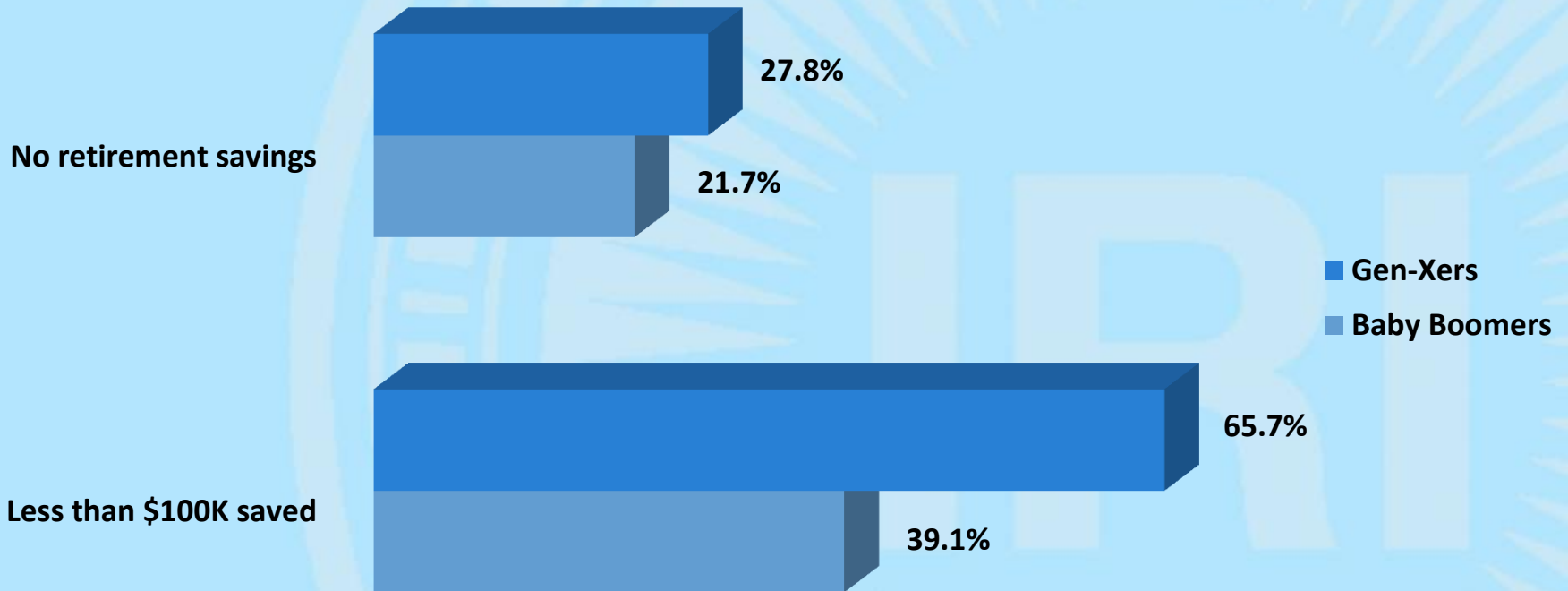
Source: IRI Baby Boomers and Generation Xers (August 2012)

# Consumer Need and Satisfaction with Annuities

- **63% of annuity owners agree that market volatility makes them more likely to consider an annuity**
- **90% of annuity owners are somewhat or very satisfied with their annuity-based investments**

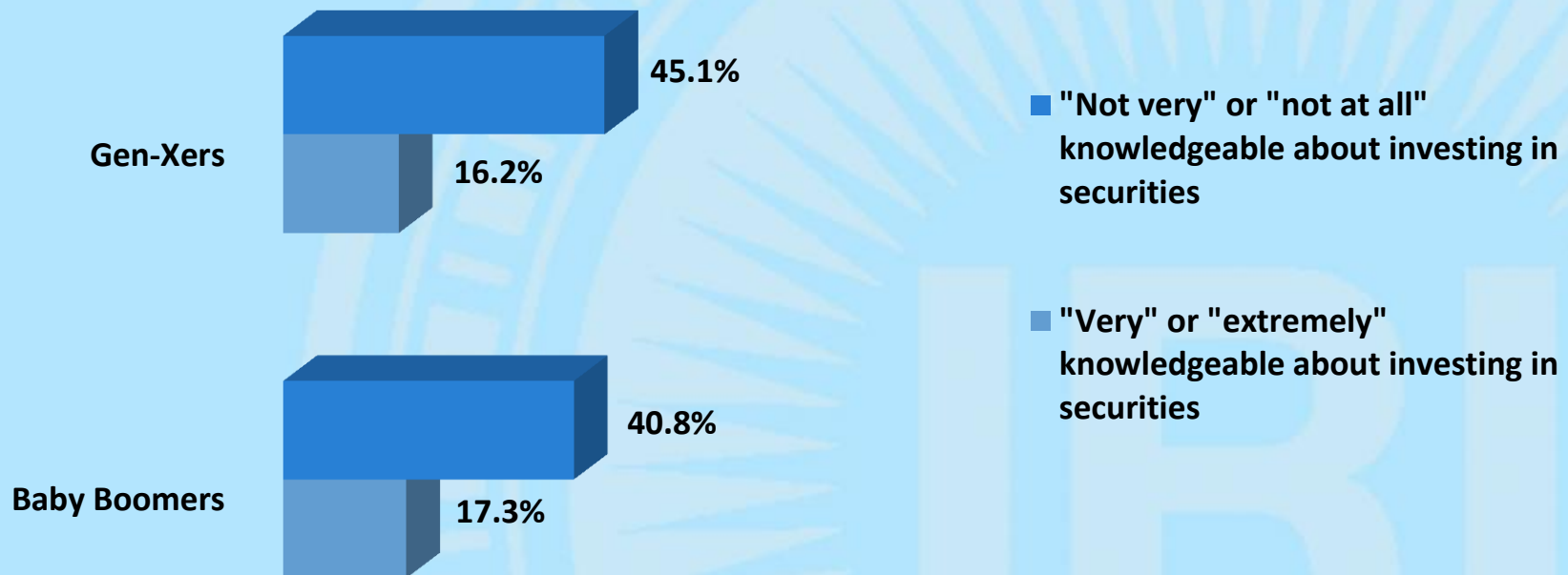
# Preparedness for Secure Retirement

## Savings = insufficient



Source: IRI Baby Boomers and Generation Xers (August 2012)

# Insufficient Knowledge of Investing

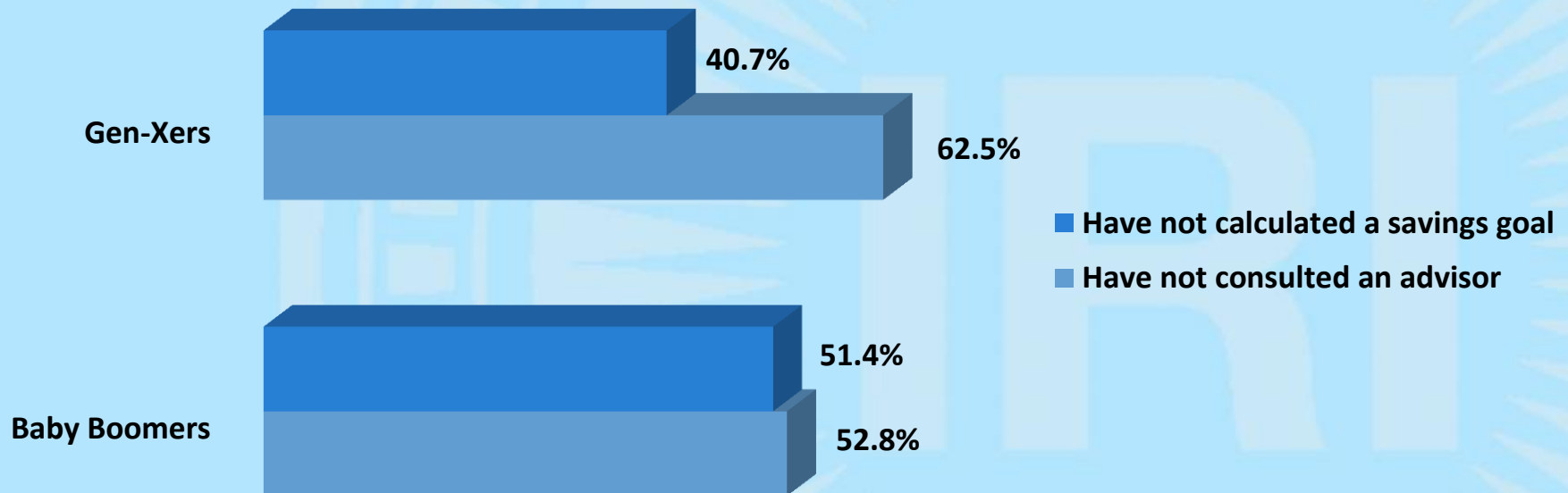


Source: IRI Baby Boomers and Generation Xers (August 2012)

# Retirement Planning Behaviors

Consulted a financial advisor = no

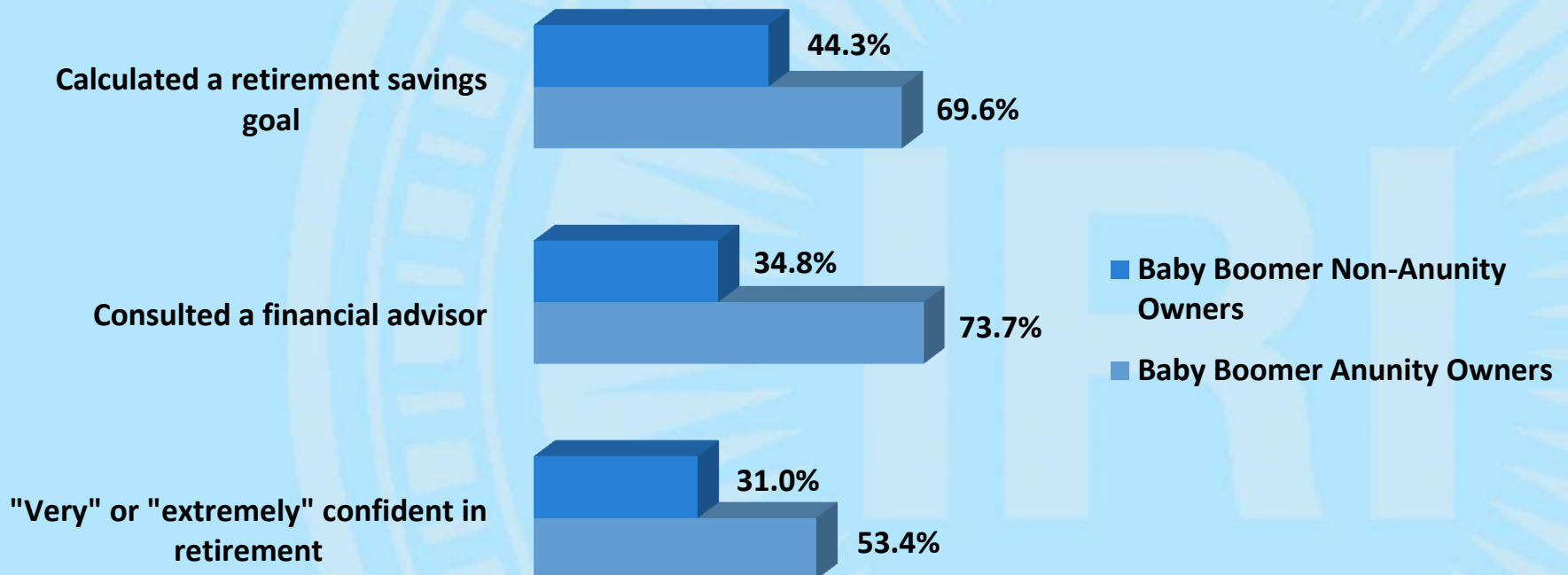
Calculated a retirement savings goal = no



Source: IRI Baby Boomers and Generation Xers (August 2012)

# Annuities = Good Retirement Plan

**Baby Boomer annuity owners are more confident and more likely to engage in positive retirement planning behaviors than Baby Boomer non-annuity owners**



Source: IRI Baby Boomers and Generation Xers (August 2012)

## Middle Class Use of Annuities – High Confidence

- **Eight in 10 buyers of nonqualified annuity contracts have annual household income of less than \$100,000; that includes 64% who earn less than \$75,000.**
- **Nine in 10 Baby Boomers who own annuities believe that they are doing a good job preparing for retirement.**

# Educational and Advocacy Efforts

- **The President's Middle Class Task Force recommended:**

**“Promoting the availability of annuities and other forms of guaranteed lifetime income, which transform savings into guaranteed future income, reducing the risks that retirees will outlive their savings or that their retirees’ living standards will be eroded by investment losses or inflation.”**



# U.S. Government Policy Initiatives

- **Departments of Labor and Treasury joint initiative to increase access to lifetime income options**
- **Lifetime Income Disclosure Act (S.267 and H.R.677)**

The background features a large, light blue watermark of the IRI logo. The logo consists of a circular emblem with a sunburst pattern in the center and the letters 'IRI' in a bold, sans-serif font. The emblem is surrounded by a circular border containing text that is partially obscured by the watermark's opacity.

# **Regulatory Requirements**

## **Consumer Protection**

# Life Cycle: Consumer Protections

## Pre-sale / Point of sale

- Product is state approved and SEC registered
- Agent is authorized to sell (insurance licensing & FINRA registration, if applicable)
- Agent training requirements
- Product marketing material authorized under insurance law and FINRA guidelines
- State Insurance and FINRA suitability review
- Prospectus / State Disclosure
- Annuity Buyer's Guide, if applicable
- Delivery of contract / certificate

## Post-sale

### *Accumulation and withdrawal phases*

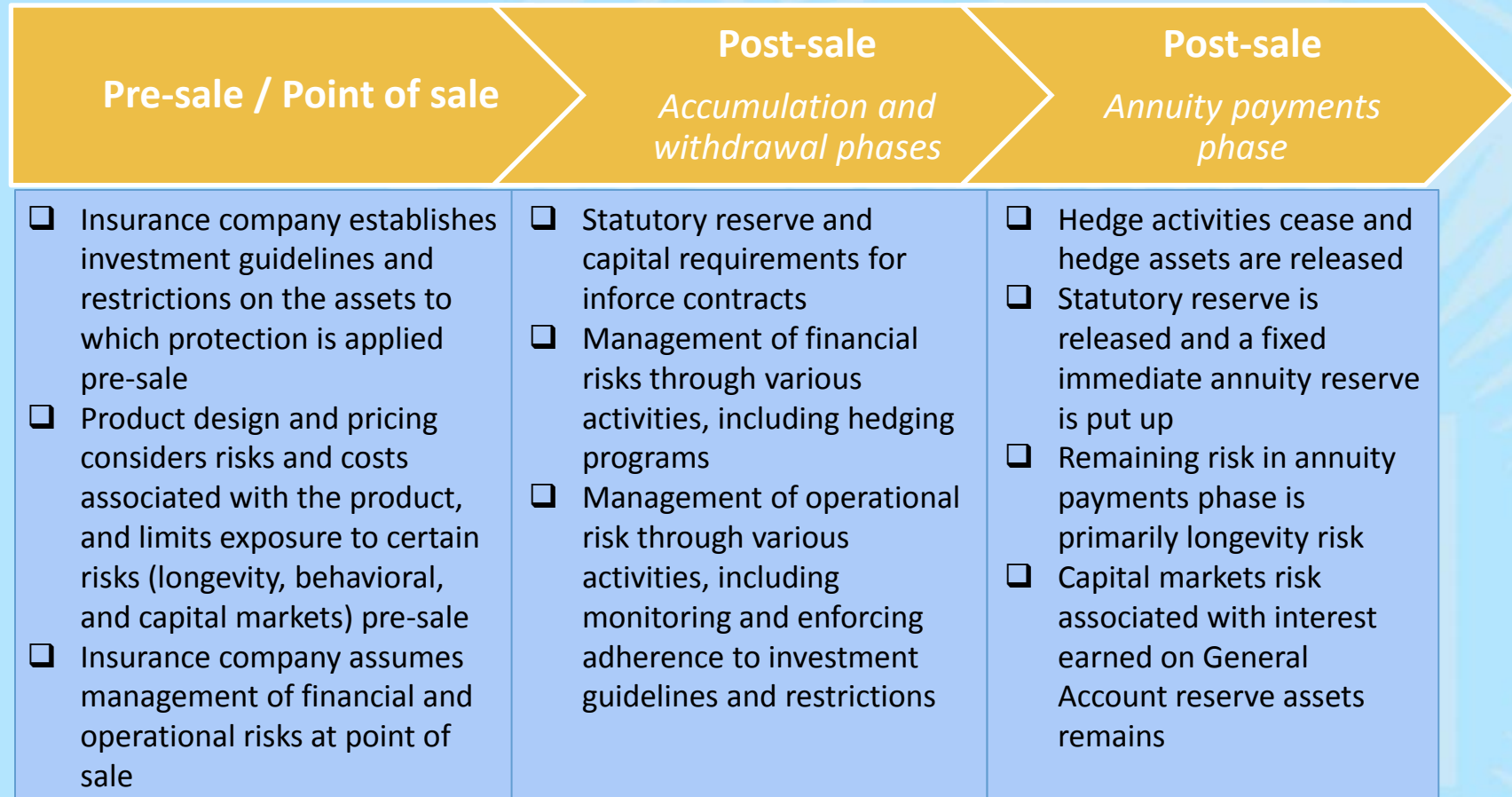
- Updated prospectus delivery
- Quarterly / Annual Statement delivery
- Consumer begins taking annual income amount from covered asset account



# **Regulatory Requirements**

## **Solvency Protection**

# Life Cycle: Solvency



**Enterprise Risk Management**

# Solvency

- **U.S. Regulatory Solvency Framework**
  - Seven principles of regulatory solvency framework
  - Statutory Reserve and Capital Guidance
- **Risks and Risk Management Associated with Guarantees**
  - Financial Risk Profile
  - Asset Parameters
- **Enterprise Risk Management**
  - Risk Capacity
  - Own Risk & Solvency Assessment (ORSA)

# U.S. Regulatory Solvency Framework

- **Regulatory oversight of insurer solvency occurs within a comprehensive framework**
- **Seven principles of regulatory solvency framework for insurance:**
  - **Regulatory Reporting, Disclosure, and Transparency**
  - **Off-site Monitoring and Analysis**
  - **On-site Risk-focused Examinations**
  - **Reserves, Capital Adequacy, and Solvency**
  - **Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities**
  - **Preventive and Corrective Measures, Including Enforcement**
  - **Exiting the Market and Receivership**

# U.S. Regulatory Solvency Framework

## Capital and Reserve Guidance for Variable Annuity Guarantees

*AG 43 and RBC C-3 Phase II provide for rigorous measurement and certification of reserves and capital*

- **Calculations based on Conditional Tail Expectation (CTE)**
  - CTE is a statistical measure which provides information about the tail of a distribution. CTE(x) is equal to the average of the worst (100-x)% of results
    - AG 43: Reserve based on CTE 70, the average of worst 30% of scenario results
    - C-3 Phase II: Risk-based capital based on CTE 90, the average of worst 10% of scenario results
- **Stochastic scenarios calibrated to NAIC RBC C-3 Phase II criteria**
- **A minimum reserve & capital requirement based on the Standard Scenario, which includes prescribed assumptions for mortality, policyholder behavior, investment returns**
- **Hedging can be reflected only if a Clearly Defined Hedging Strategy, certified by a financial officer of the company, is in place; the assumed Effectiveness Factor can be no more than 70%**
- **Appointed Actuary opines annually on reserve adequacy and compliance with Actuarial Standards of Practice**



# Enterprise Risk Management

- **Enterprise Risk Management**
  - **Risk Capacity**
  - **Own Risk & Solvency Assessment (ORSA)**

# Enterprise Risk Management

## ERM & Risk Capacity

- ERM is a framework for strategic decision making, risk management activities and governance
  - Insurers have ERM practices in place to identify, measure, and manage risk exposures across all of their activities
- The American Academy of Actuaries recommends that insurers issuing variable annuity guarantees have robust ERM practices in place
- Risk Capacity
  - A key consideration within an insurer's ERM framework is risk diversification and risk capacity
  - Diversity in business mix provides for offsetting risk exposures
  - "Monoline" enterprises take on significant risk concentration – regulators would have the ability to disallow filings by monoline variable annuity guarantee issuers

# Enterprise Risk Management

## Own Risk & Solvency Assessment (ORSA)

- ORSA is one element of a broader ERM framework
- ORSA Summary Report will be supported by internal risk management materials and more detailed underlying documentation
- At a minimum ORSA Summary Report should cover:
  - Description of risk management framework
  - Assessment of risk exposures
  - Group risk capital assessment
  - Prospective solvency assessment
- Goals:
  - Foster an effective level of ERM at all insurers
  - Provide a group-level perspective on risk and capital