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Behavior risk is rising for FIA living benefit issuers: Ruark

By Editorial Staff *Thu, Mar 08, 2018*

Surrender rates among fixed indexed annuity (FIA) contract owners have "exhibited a secular downward trend since 2007," according to Ruark Consulting's most recent studies of FIA policyholder behavior. The studies covered products with and without a guaranteed living income benefit (GLIB).

"Surrenders at the 'shock' duration (the year after the end of surrender charge period) fell from over 50% in 2007 to 15-25% in recent quarters, and surrender rates during the surrender charge period have fallen from high single digits to below 3%," the Simsbury, Conn.-based actuarial firm reported in a release this week.

As a result, the amount of client assets protected by a GLIB outside the surrender charge period—a measure of the rising behavioral risk exposure for FIA issuers—increased 82% in the 2018 edition of Ruark's studies over the 2017 edition, the release said.

The studies, which examined the drivers of surrender behavior and income utilization, were based on the behavior of 3.3 million policyholders from January 2007 to September 2017. Sixteen FIA writers participated, comprising $215 billion in account value as of September 2017.

"Getting actuarial assumptions right can mean the difference between profitability and anti-selection, or between overhedging and underhedging," said Timothy Paris, Ruark's CEO, in a statement. Ruark's studies use industry-wide rather than single-company data to identify overall trends.

Study highlights include:

- Uncertainty over the DOL's proposed Fiduciary Rule and political factors may have encouraged a "wait-and-see" attitude among many policyholders and advisors, causing the industry-wide dip in surrenders seen in 2016 and the rebound seen in 2017.
- Contracts with a living benefit rider show much greater persistency than those without. Surrender rates during the surrender charge period for contracts with GLIBs are less than half those of contracts without. Among owners who have begun taking income withdrawals, persistency is even greater; shock duration rates are about 15%, versus 26% for contracts without GLIB.
- Low credited rates tend to stimulate surrenders. As past studies showed, contracts earning less than 2% exhibit sharply higher surrenders than those earning more. Additional experience in this study reveals differentiation among contracts with higher returns, as well.
- The in-the-money effect, by which owners have higher persistency when the account value is below the guarantee base, is subtle in the case of FIAs. We find that using an actuarial moneyness basis, which discounts guaranteed income for interest and mortality rates, has much greater predictive power than a nominal measure.
- GLIB benefit commencement rates are low: 7% overall in the first contract yearand then falling to the 2% range in years 3-10. Exercise rates spike in year 11, suggesting that benefit bonuses may be effective at delaying exercise, although experience is limited.
- Once the owner of a GLIB contract begins taking withdrawals, he or she is very likely to continue in subsequent years; average continuation rates are near 100%. But utilization of the benefit is far from fully efficient: A significant proportion of contract owners withdraw income in excess of the contractual guarantee, which degrades value of the guarantee in future years.

- GLIB commencement rates vary considerably by age and contract size. They are also influenced by the in-the-money effect. Exercise rates increase sharply when contracts move deep in the money, as policyholders recognize the economic value of the income guarantee.
- FIA contracts typically offer the opportunity to take 10% of account value annually in penalty-free withdrawals, often following a one-year waiting period. This is the true for contracts with and without a GLIB rider. Base contract withdrawals have been largely stable over the past decade. Behavior differs slightly across four groups: Those taking the full penalty-free amount; those taking less; those taking excess; and those for which no penalty-free amount applies.
- Free partial withdrawal activity on the base contract is influenced by age and required minimum distributions, as well as contract size. Notably, withdrawal sizes spike in the year following the end of the surrender charge period, when all partial withdrawals become penalty-free. Average withdrawal sizes jump eight percentage points following the end of the surrender charge period.

Detailed study results, including company-level analytics, are available for purchase by participating companies.

Ruark Consulting, LLC, based in Simsbury, CT, is an actuarial consulting firm specializing in principles-based insurance data analytics and risk management. Its industry- and company-level experience studies of the variable annuity and fixed indexed annuity markets have served as the industry benchmarks since 2007.

As a reinsurance broker, Ruark has placed and administers dozens of bespoke treaties totaling over $1.5 billion of reinsurance premium and $30 billion of account value, and also offers reinsurance audit and administration services.

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Send editorial queries to kerry.pechter@retirementincomejournal.com.

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