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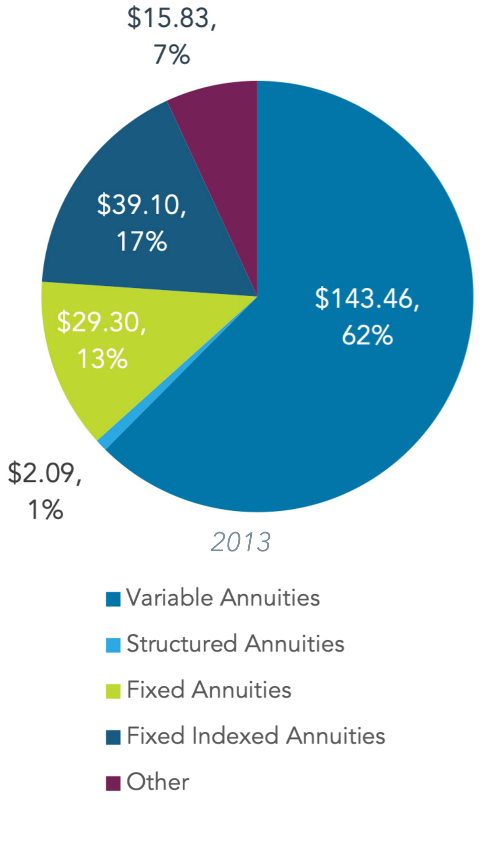
2023 Annuity Insights Report

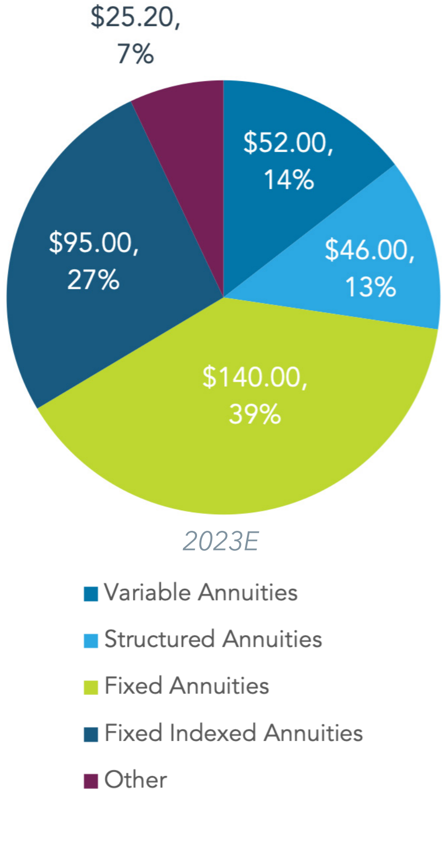
# Protection Remains Key Theme and Not Expected to Change

January 2024

When the final numbers are tallied, 2023 will be another record year for annuity sales. According to the Life Insurance Marketing and Research Association (LIMRA), total annuity sales through the first three quarters were $270.6 billion, up 21% year over year.[1] The product mix attracting investor dollars is telling (see Exhibit 1). Going back just 10 years to 2013, LIMRA data shows that over 60% of all industry sales were in variable annuities.[2] In the first three quarters of 2023, variable annuities captured just shy of 15%.[3] Meanwhile, fixed annuities and fixed indexed annuities (FIAs) – the two annuity types that provide 100% downside protection – are estimated to capture two-thirds of total annuity sales, up from just 30% in 2013.[4]

**Exhibit 1: Annuity Sales by Product Type ($ billions, % of total sales)**




*Source: LIMRA, as of Sept. 30, 2023. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.*

## WHAT'S CHANGED?

It's simple, really. In 2024, 12,000 baby boomers will turn 65 each day.[5] These individuals have a very different investment objective than they did 10-20 years ago. It's no longer about accumulation for them – it's now about protection. Yes, they would love to see their retirement portfolio grow by 30%. Who wouldn't? But they are much more concerned about it going down 10% or more. While 2022 was not nearly as painful in terms of severity as the bear markets of 2000-02 and 2007-09, anyone who retired at the start of 2022 with a traditional equity/bond allocation saw their portfolio fall 16% by the end of 2022.[6] For the majority of baby boomers who had already retired or were very near retirement, the timing of the decline made it very painful indeed.

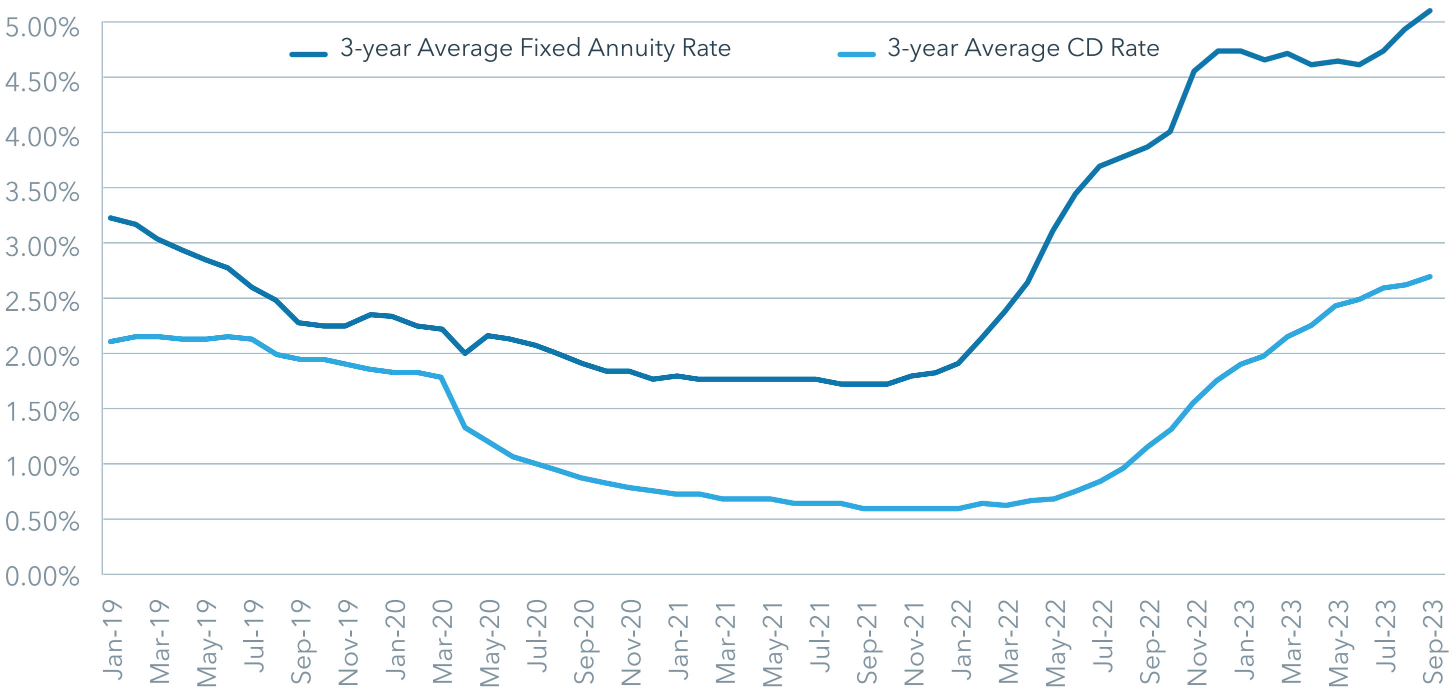
*To put it simply, most retirees and pre-retirees prioritize avoiding losses over earning gains. This loss aversion drives investors to seek protection. In the elevated rate environment, demand for annuities offering reasonable returns with 100% downside protection is only expected to grow.*

## HOW FIXED ANNUITIES MEET THIS NEED

Let's start with a simple example – a Multi-Year Guaranteed Annuity (MYGA). MYGAs are fixed annuities that guarantee a rate for the entire length of the surrender charge period, which range from three- to seven-year terms. These contracts are straightforward. If an investor puts $100,000 in a three-year fixed annuity paying 4.5% for each of the three years, the investor knows that at the end of the three-year period, there will be exactly $114,117 in the account. In the current market, we are seeing many options that credit 5% or more annually over a three-year term, and 5.5% or more annually over a five-year term.[7] Throw in the benefits of tax-deferral and it's not hard to see why LIMRA has estimated that fixed annuity sales will be a record $130 billion in 2023, up almost 25% over the previous record set just last year.[8]

Prior to the regional bank crisis that developed in March of 2023, banks credited very little interest on bank deposits and CDs, as is shown in Exhibit 2. However, concerns about bank quality combined with higher interest rates had both institutional and retail depositors rethinking where they held their capital. As banks began competing for this capital and offering higher rates on CDs, the spread between the average CD rates and the average fixed annuity rates narrowed. Despite this, the fixed annuity rates still averaged 200 basis points over the average CD rates at the end of 2023.

**Exhibit 2: Spread Between Fixed Annuity and CD Rates**




*Source: LIMRA, as of Sept. 30, 2023. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.*

### Exhibit 3: Fixed Indexed Annuity Example

*One-Year Point-to-Point Strategy with 10.25% Cap Rate on SPX*

| Past Performance Statistics One-Year Indexed Term 01/25/1965 - 12/26/2023 | |
|---|---|
| **PERFORMANCE** | **INDEXED TERMS** |
| Best | 10.25% |
| Average | 6.37% |
| Worst | 0% |
| **FREQUENCY OF RETURNS** | **INDEXED TERMS** |
| Positive | 73.6% |
| Zero | 26.4% |
| Negative | 0% |

*Source: iCapital, as of Dec. 26, 2023. Assumes a five-year surrender charge period and a minimal initial premium of $25,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.*

## FIXED INDEXED ANNUITIES SALES AT ALL-TIME HIGHS

For all of the same reasons, fixed indexed annuities (FIAs) are also at all-time highs. In 2022, we saw FIAs offering one-for-one participation on the S&P 500, up to a one-year cap rate of 4-5%.[9] Fast forward just one year and the cap rates on that same strategy are now 10% or more.[10] When one considers that an FIA with a 10.25% one-year cap rate on the S&P 500 would have produced average annualized returns in excess of 6% (Exhibit 3), it's not hard to see why this is proving to be an attractive option for a client's safe money.

## STRUCTURED ANNUITY SALES ALSO REACHING RECORD LEVELS

Same story, different product type. Higher interest rates have increased cap and participation rates in structured annuities to the point where consumers can expect to capture much of the upside of equities while protecting at least the first 20% drop in the S&P 500 over a five- or six-year period. For example, over the life of S&P 500, a 20% buffer over a six-year period would have fully protected an investor 99% of the time (Exhibit 4).[11] Despite this level of principal protection, we are seeing participation rates at 100% or above, uncapped. In other words, an investor stands to earn the entire positive change in the price of the S&P 500 over the next six years, or potentially more, while suffering a loss only if the index is down in price more than 20% over that same six years – something that has historically happened 1.01% of every six-year period since 1964.[12]

> *For investors looking to take some equity risk off of the table without fully leaving the potential upside, the current pricing on longer-term structured annuities is an appealing option.*

## WHY ARE VARIABLE ANNUITIES NO LONGER IN FAVOR?

Given retirees' desire for portfolio protection, it's not surprising that LIMRA expects the annuity category that provides the least level of protection to generate the lowest level of sales since 1995.[13] In addition, while variable annuities were once the go-to annuity product for retirement income through the addition of a living benefit rider, most of those sales today are going to income riders

### Exhibit 4: Structured Annuity Example

*Six-Year Point-to-Point Strategy with 120% Participation Rate and 20% Buffer on SPX*

| Past Performance Statistics Six-Year Indexed Term 01/19/1970 - 12/28/2023 | |
|---|---|
| **PERFORMANCE** | **INDEXED TERMS** |
| Best | 291.73% |
| Average | 73.32% |
| Worst | -19.89% |
| **FREQUENCY OF RETURNS** | **INDEXED TERMS** |
| Positive | 84.66% |
| Zero | 14.33% |
| Negative | 1.01% |

*Source: iCapital, as of Dec. 29, 2023. Assumes a six-year surrender charge period and a minimal initial premium of $25,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.*

on FIAs. FIAs not only protect the policyholder's principal, but they also reduce the risk to the insurance company that they will have to provide lifetime income on policies that have experienced a drop in the account value due to market volatility. This lower level of risk allows insurance companies to offer higher rates on FIA income riders than those offered on variable annuity contracts. This difference was amplified in 2023 by the increase in interest rates.

Despite the decrease in variable annuity sales, we think many financial professionals are missing an important use case for these products. While variable annuities may not provide protection, they can provide significant tax benefits for portfolios held outside of qualified retirement plans. As they do every year around this time, mutual fund companies have recently reported how much they will distribute in taxable capital gains for the year. This is often a confusing time for many investors, who may question why they are receiving a Form 1099 for a fund they never sold.

A variable annuity allows flexibility to reallocate money from one fund to another within the same contract, rather than sell one investment to buy another. A reallocation within the annuity does not create a taxable event and any gains grow tax-deferred, given no taxes are due until gains are withdrawn from the contract. Eventually, ordinary income taxes will have to be paid on any gains withdrawn from the account, but until that time comes, an investor's money can grow more efficiently. For buy and hold clients, a variable annuity may be an attractive way to gain the benefits of tax-deferral.

*With a greater percentage of the population reaching retirement age, we expect investors to remain focused on protecting their retirement savings in 2024.*

## WHAT TO EXPECT IN 2024

In addition, no matter what interest rates do from here, they will continue to provide a tailwind for fixed annuity and FIA sales. If rates stay the same or increase, we expect boomers to continue to seize the opportunity to earn 5%+ with full downside protection with a fixed annuity or FIA. If interest rates start to decline, we anticipate a surge in annuities sales with each announced rate drop by an insurance carrier. If this scenario plays out, we expect a significant increase in annuity sales in 2024 as investors try to lock in higher rates while they still can.

## ENDNOTES

1. LIMRA, Strong Performances in Fixed Indexed and Fixed-Rate Deferred Annuities Drive Robust Overall Sales Results in Third Quarter 2023, as of Oct. 25, 2023.
2. LIIMRA, LIMRA Annual Annuity Sales Estimates, as of Q3 2023.
3. LIMRA, Strong Performances in Fixed Indexed and Fixed-Rate Deferred Annuities Drive Robust Overall Sales Results in Third Quarter 2023, as of Oct. 25, 2023.
4. LIMRA, as of Sept. 30, 2023.
5. U.S. Census Bureau, as of Dec. 7, 2023.
6. Financial Times, as of April 18, 2023.
7. iCapital, as of Dec. 31, 2023.
8. LIMRA, Registered Index-Linked Annuity Sales Break Quarterly Sales Record Again, as of Nov. 30, 2023.
9. iCapital, as of Dec. 31, 2023.
10. iCapital, as of Dec. 31, 2023.
11. iCapital, as of Dec. 29, 2023.
12. iCapital, as of Dec. 29, 2023.
13. LIMRA, as of Sept. 30, 2023.

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## IMPORTANT INFORMATION

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