

Insights

Life Insurance CFO Survey #26

Trends in the Retirement Income Marketplace

Towers Watson's Life Insurance CFO Survey program provides ongoing research on issues of importance to the life insurance industry in North America.

This report summarizes the findings of the 26th survey in the series and the second survey in 2010. It focused on trends in retirement income products in the retail, institutional defined contribution (DC) and institutional defined benefit (DB) markets. It also explored CFOs' expectations for second quarter 2010 results. We conducted the web-based survey in May and June 2010.

Key Findings

- Increasingly, insurers are focusing on retirement income products. Though their attention is directed primarily toward the retail market now, respondents expect to shift their focus to the DC market over the next three years.
- The financial crisis has done nothing to dampen insurers' interest in retirement income products. For a number of products, they expect significant growth — more than 10% per year.
- CFOs in the industry are increasingly optimistic about the outlook for new life and annuity premiums, GAAP net revenue and GAAP net income. This trend, which we highlighted in our last three surveys, is a significant change from the low levels of optimism reported in the first quarter of 2009.

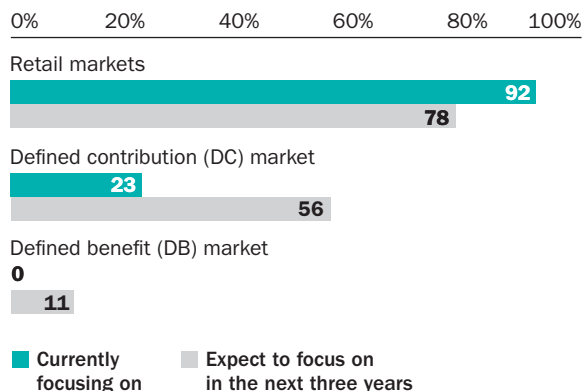
Insurers Focusing on Retirement Income Products

Retirement income products are becoming an increasingly important part of respondents' product portfolios. Nearly two-thirds say that, over the past

year, retirement income products have increased as a proportion of their product mix. One-half expect this trend to continue over the next 12 months.

Most of the insurance companies we surveyed (92%) are currently focusing on the retail retirement income product market (Figure 1). Only about one-quarter are focusing on the institutional DC market, and none are focusing on the institutional DB market. This is likely to change over the next three years. The number of respondents focusing on the institutional DC market is expected to more than double.

Figure 1. Retirement Income Focus



This shift away from the retail market and toward the DC market is not surprising, given the challenges inherent in the retail retirement income market. Respondents likely view the institutional DC market as being a "greener pasture," especially with the federal government's current efforts to open the doors for insured vehicles in 401(k) plans.

Among the companies surveyed, the most popular retirement income products are fixed immediate annuities (offered by 85% of respondents) and stable value products (offered by 46% of respondents). Very few insurers currently offer longevity insurance, but over the next 12 months, nearly two-thirds of respondents plan to offer it. This growing popularity is consistent with the prevailing view in the insurance industry that longevity risk is underinsured.

Financial Crisis Does Not Dampen Interest in Retirement Income Products

The financial crisis has not adversely affected respondents' interest in retirement income products. Nearly one-quarter say their appetite for retirement income products has increased, and nearly two-thirds say that their appetite has not changed (Figure 2). On

Figure 2. Impact of Financial Crisis on Appetite for Retirement Income Products

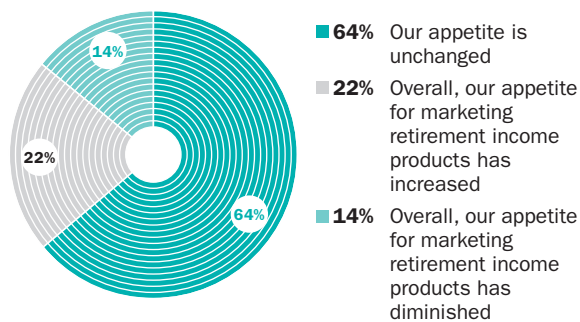


Figure 3. Impact of Capital Constraints on Retirement Income Products



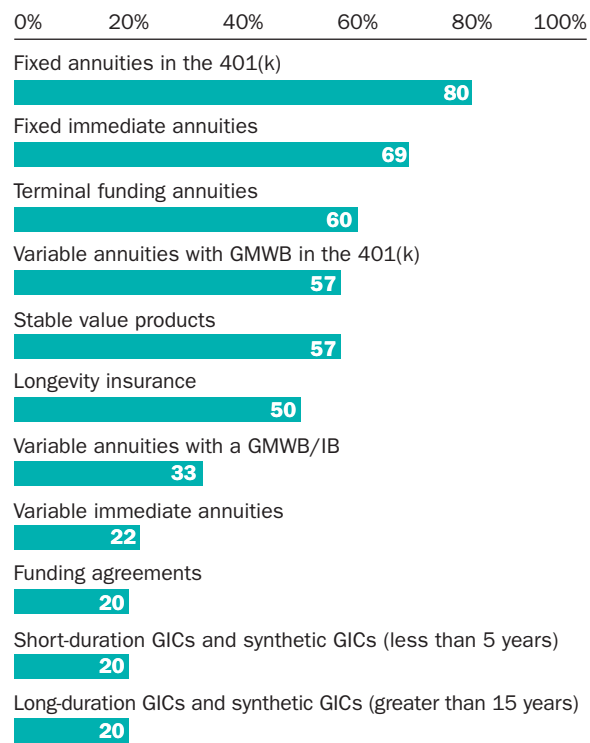
the surface, it might seem surprising that insurers' interest in these products has not waned. However, the explanation could lie in the fact that, compared with term and universal life products, the financing requirements for retirement income products are not that significant, and the risk is not that great.

More than one-third of respondents say capital constraints have not affected their retirement income products (Figure 3). However, capital constraints have affected the other two-thirds in a wide variety of ways. Some have had to increase their prices; others have had to constrain their growth plans.

Significant Growth Expected in Key Retirement Income Product Markets

In several retirement income product markets, a majority of respondents expect growth of more than 10% per year. At least half of the respondents expect significant growth in fixed annuities in the 401(k), fixed immediate annuities, terminal funding annuities, variable annuities with a guaranteed minimum withdrawal benefit (GMWB) in the 401(k), stable value products and longevity insurance (Figure 4). Two of these products — longevity insurance and variable annuities with a GMWB in the 401(k) — are offered by fewer than 10% of respondents.

Figure 4. Retirement Income Markets Where Significant Growth Is Expected



“The number of respondents focusing on the institutional DC market is expected to more than double.”

Respondents' expectations about the time frame for growth vary by product. They expect fixed immediate annuities and stable value products to grow significantly within two years. They expect fixed annuities in the 401(k), variable annuities with a GMWB in the 401(k) and longevity insurance to grow significantly within two to five years.

Drivers of Retail Market Expected to Shift

The survey found that the top three drivers of demand for retirement income products offered in the retail market are withdrawal benefits, flexibility and investment options (Figure 5). Insurers expect those three drivers to become less important over the next three years, with participant protection, longevity and cost becoming the new drivers of demand.

The decrease in the importance of investment options is consistent with what we are seeing in the 401(k) market. It reflects a "back to basics" trend among consumers who seem to be looking for simpler, "plain vanilla" options and approaches. The increase in the

importance of longevity shows a growing concern about people outliving their income and a desire to protect retirees against this risk.

Respondents believe the primary roadblocks to the widespread acceptance of retirement products in the retail market are product complexity, consumer preferences and insufficient education. They are responding by increasing their investment in participant and distributor education and by simplifying product design.

Cost Remains Key Driver in DC Market

The top drivers for retirement income products offered in the institutional DC market are cost and investment options (Figure 6). While respondents expect cost to remain a key driver over the next three years, they believe participant protection will become significantly more important in this market — as in the retail market. They also expect flexibility to become more important and investment options to become less important. Further, unlike in the retail market, longevity

“Nearly one-quarter say their appetite for retirement income products has increased.”

Figure 5. Top Drivers for Retirement Income Products Offered in the Retail Market

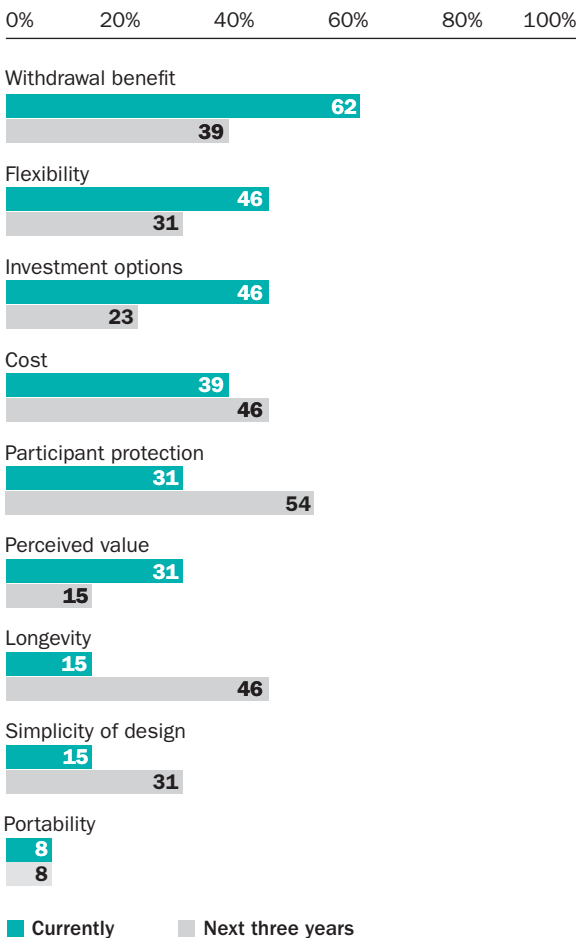
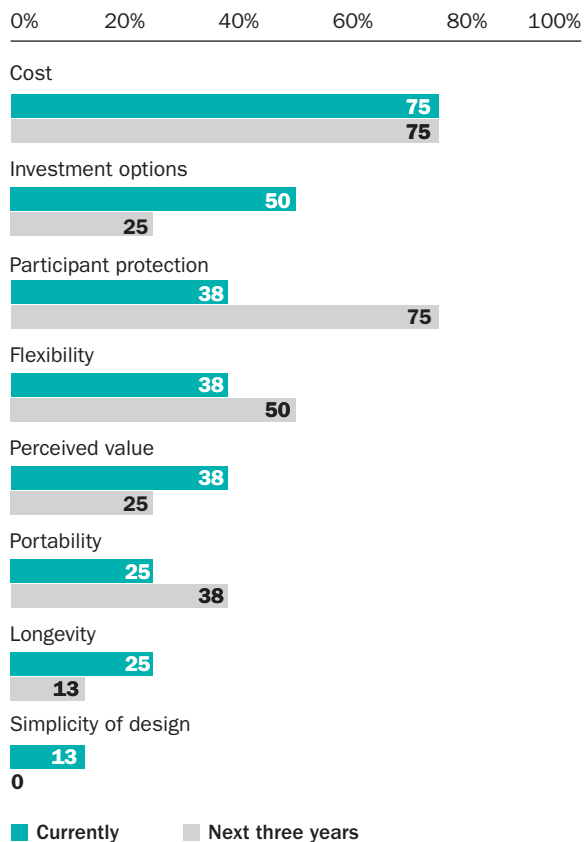


Figure 6. Top Drivers for Retirement Income Products Offered in the DC Market



is not seen as a key current or future driver of demand in the institutional DC market. We were surprised to find that respondents do not consider the simplicity of design to be a key driver.

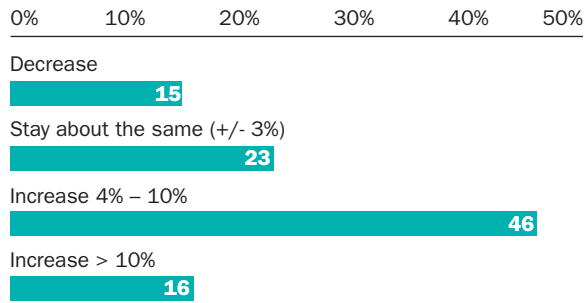
Insurers believe the primary roadblocks to the widespread acceptance of retirement products in the institutional DC market are complexity and a lack of plan sponsor demand. They are responding by simplifying product design.

CFOs Predict Growth in Premiums, Revenue and Net Income

Continuing the trend that we reported in our last survey, CFOs were optimistic about second quarter 2010 results. A majority expected increases of at least 4% in new life and annuity premiums, GAAP net revenue and GAAP net income, compared with the same quarter last year. More than 60% predicted growth in new life and annuity premiums; 23% expected premiums to stay the same, and 15% predicted a decrease (Figure 7). Slightly more than half of the respondents expected second quarter GAAP net revenue to increase, while only 9% predicted a decline (Figure 8). In addition, 73% thought GAAP net income would increase, compared with the same quarter last year, while 18% predicted a decrease (Figure 9).*

Figure 7. New Life and Annuity Premiums

(outlook for second quarter 2010 results compared to the same quarter last year)



“In several retirement income product markets, a majority of respondents expect growth of more than 10% per year.”

Figure 8. GAAP Net Revenue

(outlook for second quarter 2010 results compared to the same quarter last year)

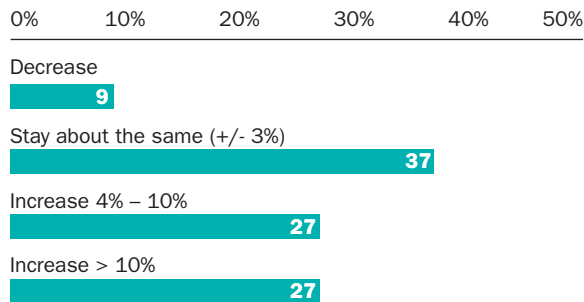
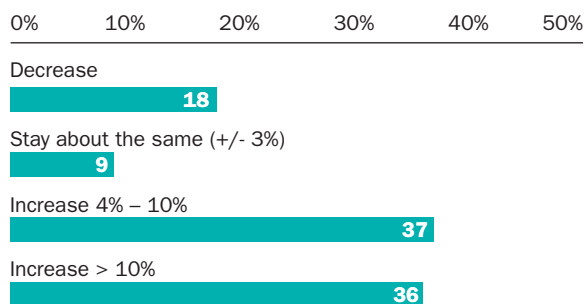


Figure 9. GAAP Net Income

(outlook for second quarter 2010 results compared to the same quarter last year)



*Most survey participants responded before June 2010, so their outlook does not reflect the market volatility that occurred during June. Also, the results reported herein reflect CFOs’ outlook at the time they responded to the survey and might or might not reflect emerging company performance.

Towers Watson has developed growth indices — based on the weighted average of survey responses — to summarize respondents' year-over-year growth outlook. We consider values between 97 and 103 to be flat growth. Ever since the precipitous drop in the revenue and net income indices in the first quarter of 2009, the indices have generally climbed upward. Since our last survey, the premium index has increased from 101 to 105. The GAAP net revenue index has risen slightly, from 105 to 106. Finally, the GAAP net income index has edged up from 109 to 110, the highest level since we began our survey in the third quarter of 2002 (Figure 10). These increases reflect the improvement in the economic climate, as well as the depressed results of most insurance companies in the second quarter of 2009.

For more information about survey results, contact:

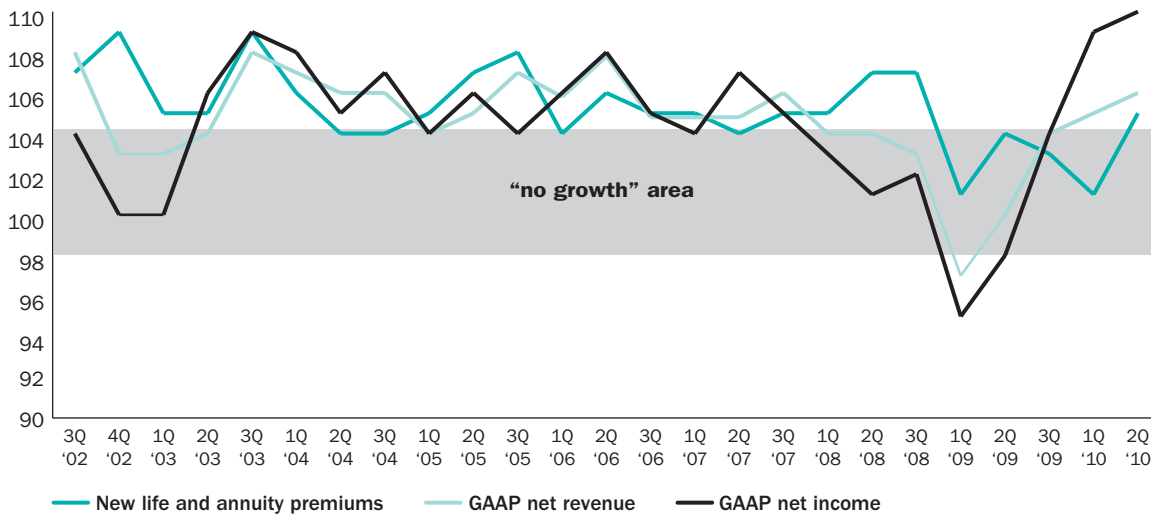
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Figure 10. Year-Over-Year Growth Index



Note: Respondent base varies from quarter to quarter.

Participant Profile

Fourteen CFOs — 20% of the program's 70 registered members — participated in this survey. As not all of the survey questions were applicable to all participating companies, the respondent base varies from question to question. The respondents are primarily CFOs from large and midsize life insurance companies in North America (Figures 11 and 12); 64% of the companies have assets of \$5 billion or more, and 7% are multinationals (Figure 13).

Figure 11. Company's Primary Line of Business

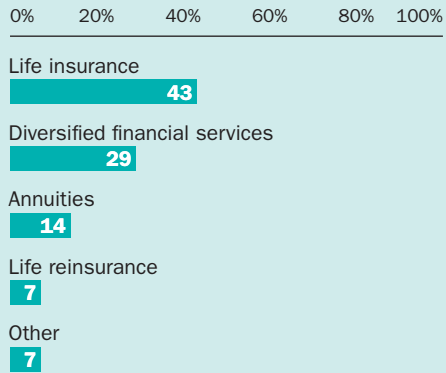


Figure 12. Company's Organization Structure

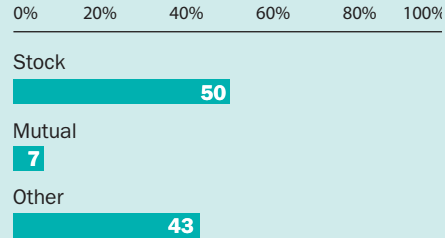
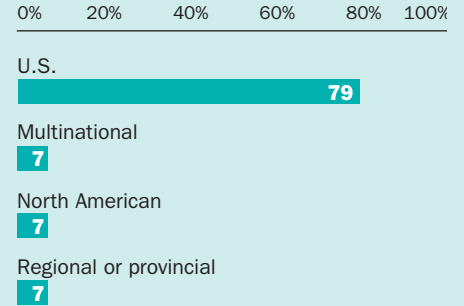


Figure 13. Company's Scope of Operations



About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.