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Trends in Individual Annuities *(May 5, 2025)*

The individual annuity business exhibited considerable change over the last few years. The sales mix of products is substantially different than just a few years ago, and even more dissimilar from what was commonplace in the years prior to the financial crisis of 2008 and 2009.

Below are some of the characteristics of the annuity business in the 1990s up until 2008-2009:

- Variable annuities with living benefit guarantees were the primary annuity industry sales vehicle
- Companies that dominated the business included insurers owned by groups such as The Hartford, ING, John Hancock, MetLife, Prudential, Sun Life of Canada
- Insurers owned by publicly traded organizations were dominant in the industry
- Fixed Indexed Annuities were in their beginning of acceptance with bank and broker/dealer distributors
- Registered Indexed Linked Annuities had yet to become a major part of the annuity market
- Privately owned insurers were generally not market leaders in any industry business line
- Residential mortgage-backed securities were an asset type many annuity companies used to match against their product and policy liabilities

Changes started in the early part of 2009, which included but were not limited to the following:

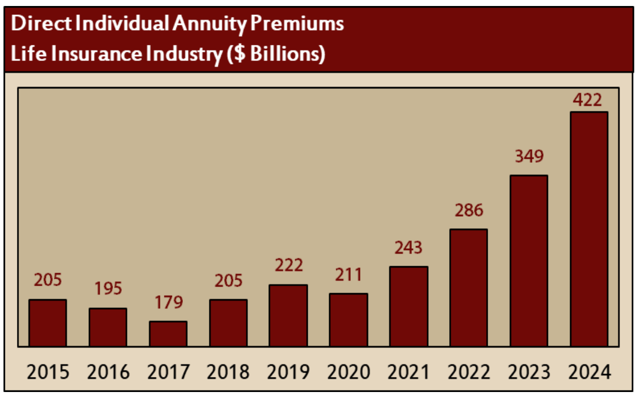
- Many insurers greatly de-emphasized or exited the variable annuity business. Later, many of these organizations (and others) exited the life insurance and annuity market altogether
- Publicly owned companies especially were under considerable pressure from their investors to reduce risks related to equity markets, and reduced exposures to the low and falling interest rates of the 2010s
    - This was a major factor in the strategic changes made by a number of insurers and their organizations
- Fixed indexed annuities and registered indexed linked annuities filled the product gap left by exiting variable annuity companies and reduced product offerings
- Fixed annuity sales remained tepid given low and generally declining interest rates from 2009-2021
- Regulatory activism at the state and federal government levels depressed sales at various points especially in the mid-2010s, as insurers and distributors prepared for the implementation of the DOL Fiduciary Rule (ultimately the rule was vacated in 2018 by a U.S. Circuit Court).
- Privately-owned organizations greatly expanded their activities in the industry, through the purchase of life insurance companies and/or the expansion of existing businesses
- Some of these private organizations included asset managers (either as owners or affiliates to the insurers), which were/are attracted to the industry for potential asset management opportunities
- As residential mortgage-backed security issuance declined, insurers (especially those focused on fixed and fixed indexed annuities) turned to structured securities and/or privately placed debt instruments

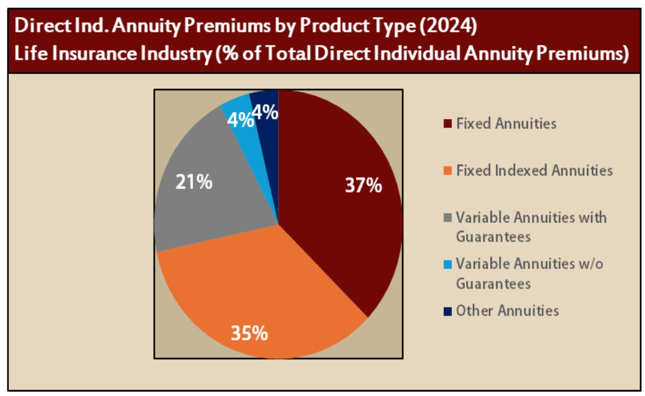
In this review, we concentrate on the recent changes in the annuity product landscape, which include:

- The industry reported robust fixed annuity sales in 2022, 2023, and 2024
- The increase in fixed annuity sales resulted from the sharp rise in interest rates in 2022 (rates remained at a higher level in 2023 and 2024)
- Fixed indexed annuities and registered indexed linked annuities continued to grow, while traditional variable annuity sales remained at a lower level
- Insurers now make significantly higher use of reinsurance to support new annuity issuance
- Annuity lapses and surrenders increased sharply in 2023 and 2024
- Privately-owned life insurers comprise some of the largest issuers of annuities

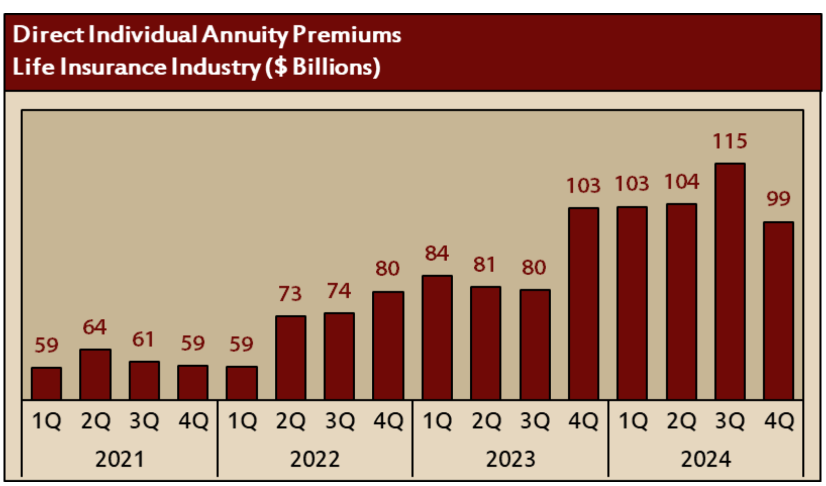
Strong Annuity Sales

Direct individual annuity premiums for the U.S. life insurance industry (=over 700 life and fraternal insurers) over the last 10 years are shown below. Premium volume varied greatly for much of the 2010s, which reflected the changing product mix away from guaranteed variable annuities and toward fixed indexed and registered indexed linked annuities, distributor and insurer focus on an increased regulatory footprint (actual and expected), and fluctuating interest rates.





The last three years represented a significant change, as annuity premium volume rose 18% in 2022, 22% in 2023 and another 21% in 2024. The growth in annuity premium volume coincided with a rapid rise in interest rates, which made fixed annuities a great deal more attractive in terms of both crediting rates and in comparison to other annuity products. The equity market volatility of the last few years also contributed to increased demand for fixed products and contracts with downside protection against falling stock markets, and reduced demand for traditional variable annuities.



The graph to the left shows a quarterly breakdown of direct individual annuity premiums for the last four years. Premium production picked up notably in the second quarter 2022 and remained at a higher level throughout the rest of 2022 and through 2023-2024. Premiums remained flat in the 1st and 2nd quarter of 2024, then rose sharply (11%) in the 3rd quarter, before declining (-14%) in the 4th quarter.

Given the recent trends noted above, fixed and fixed indexed annuities accounted for 72% of life insurers' total direct individual annuity premium in 2024 (see pie chart above). However, variable annuities with and without guarantees accounted for just 21% of total direct individual annuity premium volume in 2024. Direct premiums by annuity product type were made available in regulatory financial statements beginning at year-end 2023, but this information has been available for net premiums and reserves since 2019. However, reported net premiums are affected by the growing use of reinsurance, which has been used to a greater extent to support new fixed or fixed indexed annuities, and as a mechanism by which blocks of business are sold. Sales of business have included variable annuities with guarantees, fixed annuities with older vintage years, and to some extent fixed indexed annuities.

Below is the mix of individual annuity reserves by product type over the last five years. The mix of business by product type changes slowly, as a result of the large existing businesses for most companies, the medium to long duration of the industry's contracts, the presence of surrender charges for many contracts and lack of liquidity provisions in many policies. However, the mix of fixed annuity reserves as a percent of general account annuity reserves rose five percentage points from 2021 to 2024, which reflected the strong growth in fixed annuities in 2022-2024, as well as a decline in reserves for variable annuities with guarantees. The higher stock markets in 2023 and 2024 and the rise in interest rates since the end of 2021 allowed insurers to release reserves related to living and death benefit guarantees. In addition, natural policyholder attrition exceeded new business growth, given the reduction in new variable annuities issued from levels experienced in prior years.

Total General Account Individual Annuity Reserves: Life Insurance Industry

Year	Total ($ Bns.)	As a % of Total General Account Annuity Reserves					
		Fixed	Indexed	Variable Annuities with Guarantees	Variable Annuities Without Guarantees	Payout	Other
2020	1,366	30.3%	35.1%	18.2%	0.4%	14.5%	1.6%
2021	1,369	29.9%	36.3%	17.1%	0.4%	14.7%	1.6%
2022	1,426	31.5%	35.8%	16.4%	0.4%	14.3%	1.6%
2023	1,485	34.1%	35.4%	14.4%	0.4%	14.2%	1.5%
2024	1,526	34.9%	35.8%	12.8%	0.5%	14.6%	1.4%

Reinsurance

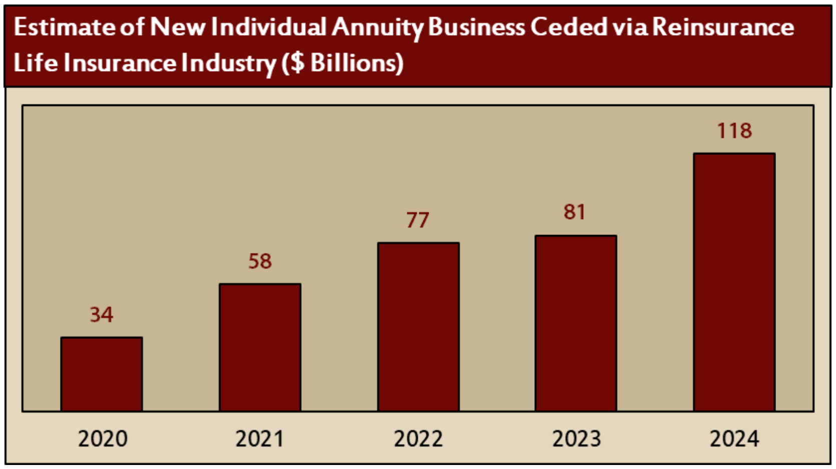
Reinsurance has long been a staple for the direct issuing insurers of life insurance, annuities, health insurance products such as disability or long-term care insurance, and other industry products. Reinsurance can be used to share either a portion of risk on policy contracts, provide protection against extreme events (mortality, morbidity, policyholder behavior, financial markets, etc.), or to sell business to another organization.

Increasingly over the last several years, reinsurance has been used as a vehicle to support new individual annuities. When a direct issuing company reinsures a portion of its business, it accomplishes one or more of the following:

- Transfer of a portion of the strain of new business (initial policy reserve, distributor commission, required capital) to a reinsurer
- Allow an insurer's parent and organization to support the direct issuing company, but in a different and more flexible way relative to making direct capital infusions into the direct issuing company
- Access potentially reduced reserve requirements, either in an affiliated reinsurer or a foreign insurer
- Access investment management expertise of a reinsurer and its organization

Offsetting these possible benefits are the potential that lower reserve levels in an affiliate could lead to the need to strengthen reserves in the future, the counterparty risks that come with a reinsurance partner, and the potential for material effects on the issuing company's reported financial results. ALIRT's October 2024 client release entitled "U.S. Life Insurers' Bermuda Reinsurance Exposure" provides more detail on the usage of reinsurance and the opportunities and risks that this presents for both issuing companies and reinsurers.

The chart below highlights an estimate of new annuity business ceded to reinsurers over the last five years. The estimate was computed by excluding companies that executed transactions to sell or reinsure existing blocks of business, which included variable annuities with guarantees and/or "old" fixed or fixed indexed annuities. As such, it is an imperfect measure but illustrates the increased utilization of reinsurance to support new annuity issuance.



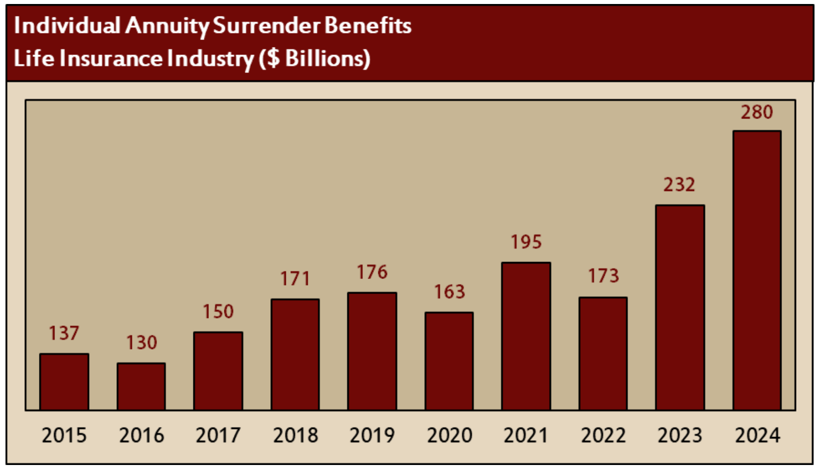
This was especially pronounced by insurers that are privately owned, as many of these companies have become sizable issuers of fixed and fixed indexed annuities. Also included among these companies are insurers owned by asset managers such as Apollo (Athene), KKR (Forethought Life), Brookfield (American National), Ares (Aspida), as well as Fidelity & Guaranty Life which is majority-owned by Fidelity National Financial.

Annuity Surrenders

A critical component of annuity product management is to maintain close matching of investment maturities and cash flows with the expected duration and cash flow requirements of policyholder contracts. Given effective matching, and assuming a low level of investment losses over any particular short time horizon, insurers would have an established pool of investments nearing maturity. This in turn would provide the necessary cash flows to support maturing policy contracts.

A significant risk for issuers of annuities, especially fixed annuities, is the potential for higher-than-expected surrenders. Should this occur, insurers could face the need to raise liquidity over a short period of time, either through existing cash holdings of their own or within their respective organizations, or to sell investments. This is called "disintermediation," and insurers are especially susceptible to this risk in an environment of rising interest rates.

The graph to the right shows surrender benefits paid over the last 10 years for individual annuities (on a net basis). For much of the 1990s, 2000s, and 2010s, disintermediation was not a factor as the low interest rate environment led to a low level of annuity surrenders.



Annuity surrender benefits also fluctuated on an annual basis, as existing contracts carried relatively attractive guaranteed minimum interest. However, the rise in interest rates in 2022 was a reversal, and for the first time since the early 1980s disintermediation became a risk that could come to pass. Despite the higher interest rates, annuity surrender benefits declined sharply in 2022 as fixed annuities did not see a notable increase in surrenders, and surrenders fell sharply for variable annuities.

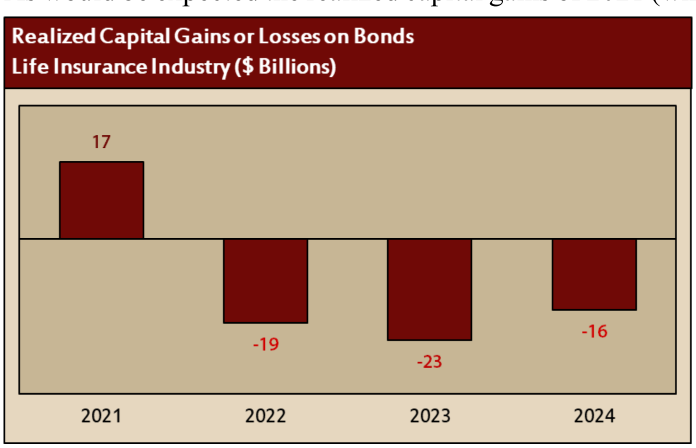
However, surrenders for individual annuities rose 34% in 2023, which was especially pronounced after the first quarter and was largely driven by fixed and fixed indexed annuities. This may have resulted from the low interest rates in 2020 and relatively robust fixed annuity sales, which were bolstered by the financial market disruption that occurred with the emergence of Covid and related economic dislocation. Beginning in 2023, any three-year duration annuities issued in 2020 reached the end of their surrender charge period, and this may have contributed to the higher surrenders. Annuity surrenders rose another 21% in 2024, driven by both fixed and variable annuities. Higher surrenders in 2024 largely resulted from an increase from variable annuities with guarantees. Fixed indexed annuity surrenders also rose in 2024, and while fixed annuity surrenders were unchanged from 2023, they remained much higher than levels observed from 2019-2022.

<u>Capital Losses on Investments</u>

As mentioned above, insurers experiencing increased annuity surrenders could face the need to sell investments, in the event that their asset/liability matching is out of balance, or annuity surrenders exceed expectations.

Should this occur in a rising interest rate environment as was the case in 2022-2024, insurers could incur capital losses as the value of fixed income investments, especially bonds, declines when interest rates rise. This is because the interest rate on the existing bonds is now lower than current yields for new bonds of equal quality, and thus the “old” bonds would only be purchased at a discount to their book value.

The table below shows realized capital losses on bonds for the life insurance industry for the last four years. As would be expected the realized capital gains of 2021 (when interest rates were still low) reversed to realized capital losses incurred in 2022 and continued in 2023-2024. However, total capital losses were manageable over that time period, which may reflect that any pressure on capitalization from higher annuity surrenders was limited for the industry as a whole and for most insurers on an individual level.



The increase in realized capital losses on bonds in 2023 was almost entirely the result of $3.7 billion of realized capital losses reported by Lincoln National Life, which was largely the result of accounting related to the company’s reinsurance transaction with Fortitude Re that required the transfer of the nearly $28 billion of investments that supported the business sold (via reinsurance)[1]. Net capital losses persisted into 2024, which were driven by continued realized capital losses from the sale of bonds (whose values have been depressed by higher rates).

Ownership Structure of Insurers that are issuing Annuities

The lineup of insurers that are actively issuing new individual annuity business has changed substantially since the financial crisis of 2008-2009. This occurred as the product migrated away from variable-type annuities and many insurers active in the business either reduced their appetite for this business or left the business entirely.

More recently, the growth in fixed annuities along with higher interest rates led to additional shifts in market share and products. This contributed to a growing list of privately-owned insurers active in the annuity market, which includes insurers owned by asset managers. A partial list of these entities is presented below.

These companies are joined by insurers that are part of publicly traded groups: Brighthouse, Brookfield, Corebridge (formerly AIG), Equitable, Fidelity & Guaranty, Jackson National, Lincoln National, Prudential Financial; foreign groups: Allianz, Protective, Standard, Symetra, TransAmerica; or mutual organizations: NY Life, Mass. Mutual, Nationwide, Pacific Life, TruStage (formerly CUNA Mutual).

It also does not include privately owned entities that are participating in the industry exclusively through the reinsurance of existing blocks of business, such as Fortitude Re, Resolution Life Group, Talcott Resolution, Venerable, or Wilton Re.

The suite of insurers and their ownership structure stands in stark contrast to the industry lineup of the early 2000s, when variable annuities with guarantees were the dominant. Issuance of product was concentrated in the insurance subsidiaries of publicly traded companies, which included AEGON (via the TransAmerica entities), AIG, Allianz Life, Hartford Financial Services, ING, Lincoln National, Manulife (through John Hancock in the U.S.), MetLife, Prudential Financial Inc., Sun Life of Canada, as well as mutual companies such as Ohio National and Pacific Life.

Significant Insurers Offering Fixed and Fixed Indexed Annuities	
Privately Owned Insurers	**Insurers owned by Asset Managers**
AuguStar Life	American Life & Security (Antarctica Capital)
Capitol Life / Liberty Bankers Life	Atlantic Coast Life (Advantage Capital)
Clear Spring Life & Annuity	Aspida Life (Ares)
Delaware Life	American National (Brookfield)
Equitrust Life	Athene (Apollo)
Guaranty Income Life / United Life (Kuvare)	Forethought Life (Global Atlantic, KKR)
Midland National / NACOLAH (Sammons)	Ibexis Life & Annuity (Investcorp.)
Nassau Financial Group	Oceanview Life & Annuity (Bayview)
Security Benefit Life	Prosperity Life (Elliott Management)
SILAC Insurance Company	Sentinel Security (Advantage Capital)

The private owners (especially asset managers) were/are drawn to the industry due to attractive pricing opportunities for new and/or legacy blocks of annuity business, the ability to vertically integrate their organizations and have a ready source of relatively stable investments to feed their asset management operations, as well as to align insurers closer to potential sourcing of investments. In addition, as banks

[1] For more on this see “ALIRT Research – Lincoln National Reinsures $28 Billion of Reserves to Fortitude Re – May 2023”

decreased lending to mid-sized companies, insurers perceived an opportunity to match annuity contract liabilities with private credit investments that have performed favorably for a long period of time and have similar durations to many annuity contracts.

With that said, it is always a possibility that an insurer can be sold at any time and this could occur if the participation in the insurance industry does not match owner expectations, and/or the owners of insurers wish to exit existing investments and/or deploy capital in other areas. Indeed, this has already occurred at a few privately owned companies in the 2010s and 2020s.

However, this risk is not unique to insurers that are owned by private organizations. The ALIRT model and methodology is focused on the underlying financial results and performance for the insurers that are obligors of insurance and annuity contracts and does not emphasize parent company financial results. In addition, the ALIRT Model does not assume that parent company support or ownership of an insurer is either infinite or indefinite in terms of time, which can protect clients somewhat from any change in strategic direction for an insurer's parent company.

Investment Mix Changes

The investment mix for life insurance companies in general, and for annuity writers specifically, has changed considerably in the years following the financial crisis of 2008-2009.

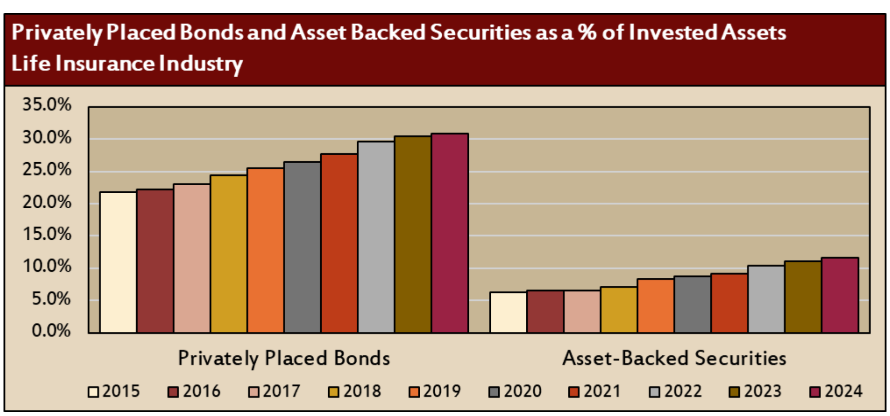
The bar charts shown below highlight the mix of some of the asset classes that have changed the most. The life insurance industry and especially insurers focused on fixed and fixed indexed annuities migrated away from residential mortgage-backed securities for the following three reasons:

- reduced issuance of such securities where payment of principal and interest on loans was not guaranteed by government agencies,
- dampened demand by insurers given the large losses incurred on such investments in 2008-2009, and
- U.S. Treasury purchases of such bonds as part of their quantitative easing efforts in the early/mid 2010s.

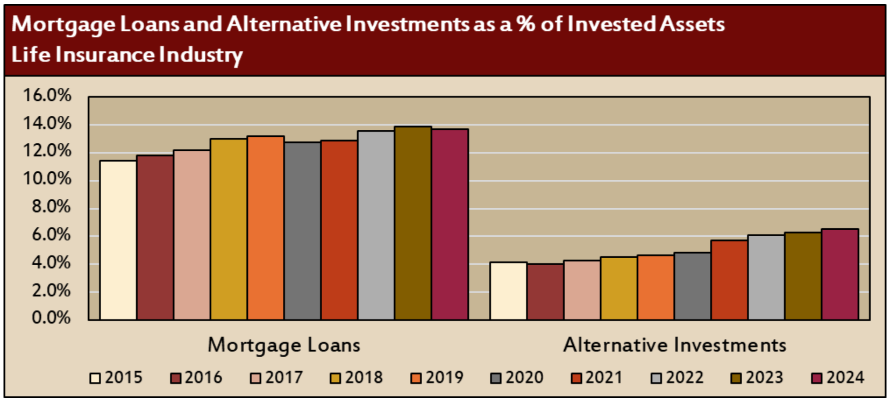
To fill this gap, insurers expanded investments in the following asset classes/types:

- Asset-Backed Securities
- Privately Placed Debt Instruments
- Direct commercial and residential mortgage loans
- Alternative Investments

The charts below show the change in holdings of these asset types as a percent of total invested assets for the life insurance industry as a whole. This may understate the level of change for annuity specialists, as they tend to have posted larger growth especially for holdings of asset-backed securities and private credit investments, nonetheless this serves as a reasonable proxy of the altered investment portfolios over the last decade.



These investments provided the industry a bump in investment yield, which counteracted to some degree falling interest rates or investment returns of the 2010s. These asset classes also performed well with limited losses, the result of generally growing economic conditions, a robust environment for lending and purchasing debt instruments, and relatively stable credit and financial markets, excluding the months in early/mid 2020 that surrounded the emergence of Covid-10 and related economic disruption.



The life insurance industry and annuity companies in particular assumed greater participation in the provision of credit and lending to American companies. This evolved as banks reduced their lending because of higher capital requirements and regulatory burdens, and as issuing private debt became an easier path for companies to raise liquidity and funding for growth. This has been an important contributor to the rise in holdings of private debt and asset-backed securities for the life insurance industry over the last 15 years.

With that said, not all of the growth in life insurance industry lending has come about as a replacement of other lenders; instead some of it reflects an expansion of lending across the economy. It is an open question as to how private debt instruments and structured credit investments will perform in conditions where credit markets are tighter and/or economic conditions are weak. Much the same can be said about alternative investments.

As for commercial and residential mortgages (direct loans), mortgage loans have been a solid asset class for the life insurance industry for at least 25 years, and life insurance company mortgage portfolios are well diversified by geographic area and property type. This helps mitigate the potential risks related to this asset class; however, it is possible that insurers and other investors could incur losses in these assets as a result of changed behavior in the wake of Covid (work from home, reduced populations in some areas) and/or in the event that economic conditions and/or employment levels deteriorate.

Conclusion

The individual annuity business of the 2020s is substantially different from that observed as recently as five years ago, but even more so when compared to the landscape of the early 2000s. The product mix that was driven to a large extent by variable annuities with guarantees in the years prior to 2009 is now led by fixed annuities, which benefited from the higher interest rates in 2022-2024. Meanwhile market share for fixed annuities increased sharply as variable annuity products changed and issuers exited the business, traditional products were restructured and more distributors approved registered indexed annuities which moved from the drafting board to a sizable share of industry production.

The rapid growth in fixed annuities led to a significant increase in industry premium volume, producing strain on reported operating earnings given the requirement under statutory accounting principles to immediately recognize in full all business acquisition costs. Companies manage the cost of this growth through the receipt of direct capital infusions from their parents and/or organizations, as well as through reinsurance. Reinsurance has long been a vehicle used by insurers to spread risk, sell businesses, and manage capital. Over the last several years insurers greatly increased the cession of business to foreign reinsurers, affiliates, or a combination of both. This provided capital relief for growing insurers and obviated to some degree the need for as much direct capital infusions, though as reserve levels can be lower in reinsurers (domestic affiliates or foreign reinsurers), this could increase the risk of possible reserve strengthening in the future.

Finally, the change in the insurers active in the annuity business, as well as a greater focus on fixed business, produced changes in the investment portfolios. This is especially reflected by the rise in private debt instruments, structured securities, and more complex assets. These assets carry higher yields than similarly rated publicly traded bonds, though they can have lower liquidity. The increase in private and structured debt instruments may also increase the risk of losses, as there are many more such assets across the fixed income market compared to 15 years ago. Losses and/or reductions in the market value of these assets could occur if credit market conditions deteriorate and/or liquidity in investment markets constricts.

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