What Life Producers Should Know About The New Landscape for Variable Annuities

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I'm John Weber with the A.M. Best Company. Welcome to our webinar: "What Life Producers Should Know about the New Landscape for Variable Annuities."

The opinions expressed by the panelists are theirs alone and do not necessarily reflect the opinion of the A.M. Best Company.

Now, let's meet our panel. They're going to tell you where they are from and give you a little bit about their background. Joining us on the phone today is Catherine Weatherford. Hi, Cathy, could you tell our audience a little bit about yourself?

WEATHERFORD: I'm president and CEO of the Insured Retirement Institute. We are a not for profit association who does education, research and advocacy on behalf of insurers, management firms, broker dealers and financial advisors.

WEBER: Thanks. And in the studio with me is Mike McCarthy. Mike, tell us a little bit about yourself.

McCARTHY: I'm senior vice president with Axa Equitable, chief sales officer, so I head up all our distributions of our wholesalers for variable annuities. We distribute through basically four distribution channels. We've got our proprietary Axa advisers, about 6,000 career advisers and then we distribute through banks and financial planners as well as the wire houses.

WEBER: Thanks. The question for simplicity: balancing income versus other benefits, the producer's role in the evaluation process and best practices of successful producers of next-generation variable annuities are all challenges in today's market and topics we'll be touching on.

We're going to begin our discussion today with Mike. Mike, what would you say are the main concerns of those about to enter retirement?

McCARTHY: We did a lot of research at Axa Equitable. In fact a couple of years ago we brought several different focus groups into New York City and we asked people who were five to 15 years away from retirement what their concerns were. What it boiled down to, basically, is we had five key concerns that they consistently brought up and brought to our attention. And we basically put an acronym together that identifies those five concerns and it's LIVIT. So those concerns are longevity, inflation, volatility – we see the volatility that's going on in the marketplace today – interest rates, our rising interest rates and taxes. So they seem to be the consistent five key concerns that retirees and pre-retirees have about going into retirement.

WEBER: Cathy, would you go along with that? Would you like to expand on what Mike had to say?

WEATHERFORD: I agree with every one of those and let me add a couple of others that our research tells us that are significant issues. For those that are looking towards retirement most of our research has been those that are looking five to 10 years out from retirement. But additionally health care costs and the cost of long-term care are eating up their savings as they are in retirement or especially in their later years. And then secondly I believe a lot of this comes from what we see every day on the news and we read it every day in the newspaper and that's that Social Security won't provide the level of protection or the cushion for guaranteed income that many boomers thought that they would be retiring on as a significant portion of their income. So in addition to what Mike said I would add those two.

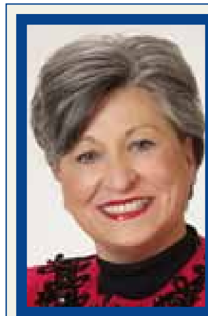
WEBER: That leads very nicely into our next question. Mike, do you think that baby boomers are looking at retirement savings differently that their parents' generation did, and why?

McCARTHY: Absolutely. I think the key reason is longevity. Everybody's aware of the fact that we're living longer today. In fact, most people retiring at age 65 can probably look forward to as long of an experience in retirement as they did during

their working years. So, they need to make sure that they have a retirement strategy to provide income for 25, 35, even 40 plus years. And as we know, with all the advances in medicine that number is just going to get bigger and bigger. So with pensions going away, most of their parents worked for one company, they spent their entire lifetime there, they retired, they got a pension. That's not available to most people today. Most people today will change jobs six or seven times. So more of the responsibility falls on them to plan for retirement and not have the guarantees that their parents had.

WEBER: Cathy, because of that do you think that the appetite for risk is changing among consumers?

WEATHERFORD: Absolutely. And Mike said the word earlier – volatility. I think consumers are still very wary about investing. And we've all seen volatility in an ongoing way and so it has left a lasting and long-term impact on investors – especially those that are in or near retirement because they're closer to the time that they will be drawing down on their savings as opposed to socking it away. So our research tells us they're beginning to move toward a recovery mentality. But they're taking more of a partnership approach on investing. They want to work with financial advisers and agents but they want more interaction. They're still a bit skeptical so we're going to have to make sure that we work with them with facts and use strategies that they understand and know will help them to get protected against that downside risk because that's what they're looking for. And we all know that they're less aggressive. They're seeking more conservative, long-term investments. Our research says that they're willing to take a lesser rate of return for the promise of guaranteed income in retirement.



"Variable annuity sales are on pace to exceed $150 billion this year, which puts us beyond pre-meltdown time. So it's clear that the consumers are coming to trust these as a product that they would like in their retirement plan."

—Catherine Weatherford, Insured Retirement Institute:

WEBER: Then I'll ask both of you – Mike, I'll start with you – how does someone know how much money they're going to need for retirement?

McCARTHY: I think that's a question that has to be handled by each person individually. I think the mistake, though, that a lot of people make, is that they make the assumption that in retirement I'm going to spend less than what I spend while I'm working and the question that I like to ask people is: When you're working, Saturday and Sunday is the weekend and you tend to spend a lot more money on the weekend than you do during the week. Well, in retirement, every day is a Saturday or a Sunday, so I think you really need to think about what type of retirement you want to have. More and more people are saying that they're going to work part time. So I think the key is do you have the necessities covered? Do you have a plan to at least cover your basics and then you can make a better plan for a longer-range plan for maybe some of the 'nice to haves' – the vacations, the second homes and what not – the key is you've got to have the basics covered.

WEBER: Cathy, your thoughts on that?

WEATHERFORD: Well, I certainly agree with Mike. I think that there is a much more realistic view of the world around retirement from what we had pre-meltdown. People are being very practical about their retirement needs but I still believe that they have not truly taken the full assessment of how they will need to meet those fixed income needs that they have in retirement as well as all of the other expenses that face them in retirement, meaning health care costs and other entertainment and living needs. So I do think it is a one-on-one story between financial adviser and their client to build that retirement story to make sure that it works for that individual client, taking all of the things Mike and I just talked about into account.

WEBER: Thanks, Cathy. I'd like to remind all our viewers and listeners that if they have a question for Cathy or Mike they can send it in to us at news@ambest.com. Mike, what would you say is the biggest myth about how much money people will need for their retirement?

McCARTHY: As I said, one of the big myths is that your needs for income will go down. When you look at the life expectancy, you look at the cost of prescription drugs – they go up significantly more than inflation in general, and I don't think people realize what effect inflation has on their purchasing power. So, to think that you could take your lump sum of money and put it in something conservative and be able to draw down the income from a fixed income investment, in this interest rate environment it just won't happen. So, people have to have a plan, they have to diversify and they have to be realistic about how much they can actually withdraw. What's an appropriate withdrawal amount and what type of expectations do you have in terms of returns from equity markets? So, again, I think the key here is you're probably going to spend more than you think and you need to have some growth exposure. You can't just put your money into a fixed income investment and think that you can take 5%, 6%, 7% and that money's going to last 25 or 30 years.

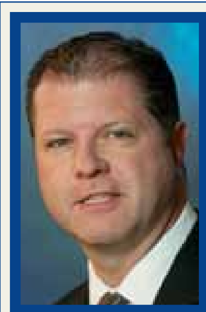
WEBER: I want to get to the subject of variable annuities. Cathy, we're going to start with you on this. Do you think there's a difference between the way men and women view variable annuities and how they're used?

WEATHERFORD: Absolutely. We have done a lot of research around women's retirements and we found that the retirement market for baby boomer women especially is highly addressable and presents a tremendous opportunity to work with the women to build a safe and secure retirement. Longevity is certainly the biggest issue on their minds and we know why – it's because women live longer than men. Women represent nearly half of all the individuals in America with at least $500,000 in investable assets and they remain underserved when it comes to retirement planning. With 51% of working women employed in management or

professional occupations, 26% of those women earn more than their husbands. And we all know that 95% of all women say that they're the financial decision makers in their household. So they are less confident that they have saved enough or will save enough to live comfortably because of longevity. So women tell us that they are looking for lifetime income – something that protects them throughout their life to be sure they have adequate money to cover fixed expenses. The other thing that we know is that today 50% of owners of VA's are men and only 40% are women and with that longevity risk out there facing them I think it is a tremendous opportunity to talk to women about this. So I think this could be a powerful conversation with working women who make the financial decisions.

WEBER: So, Mike, what's the challenge for advisers advising their clients in this current economic climate?

McCARTHY: Well I think the job of an adviser is to do what's right as opposed to what's easy. What I mean by that is the last 10 years many people are referring to the "lost decade." We've had a period here where the S&P has been basically flat for 10 years. We've had some major financial corrections and I think we have people who potentially may never get back into the equity markets again. Yet we as financial advisers know that you need to have some exposure to equities in order to avoid the pitfalls of inflation and, as I said earlier, I think the three keys here are what are you doing today, because you need to plan before it happens. What are you doing today as an adviser to position your client to either A, take advantage of, or B, be protected from, inflation which at the rate at which our Federal Government is printing money, the stimulus packages, it's inevitable that inflation comes back. So how are you protecting your clients? Getting them to do what is right isn't necessarily easy but we need to educate them on the benefits over the long term of having some of your monies exposed to equity. It's clear that many, many people are out there and they think they are in a safe investment. If we look at what happened back in 2000 with the tech bubble, we had people who didn't want to get in and all of a sudden their neighbor made 27% buying the technology stock and then it blows up. And then we see it with real estate. People didn't buy real estate and then all of a sudden they wait, they wait, they get in and it blows up. I think they're poised for the same bad experience for having so much money in fixed income that when rates do go up, they don't typically creep up, they tend to spike up. So I think as a financial advisor, again to do what's right not necessarily what's easy, we need to be talking to clients about doing something today so that when it happens it's not too late.



"The key is the variable annuity of today is not our father's variable annuity. There are a lot of different features and benefits that these contracts can provide. I think what we need to do as an industry is to get people to really focus on what annuities do as opposed to what they are."

—Michael McCarthy
Axa Equitable:

WEBER: Along those lines I want to ask both of you this question: Cathy we'll start with you. How are producers embracing variable products these days?

WEATHERFORD: We have both anecdotal and some good solid research around that. Anecdotally, I talk to adviser groups all the time and I consistently hear that advisers are using variable annuities as part of the holistic retirement plan more and more often these days. We just finished some research with a partner, Cogent, and nearly all advisers that we surveyed indicated that they'd sold a VA in the past five years and three quarters indicate that their usage of VA's in client portfolios as a holistic part of the retirement plan they're building for their clients will increase somewhat or significantly over the next five years. In addition, what we also heard from a third of annuity producers is that clients' requests for annuities when they come in and sit down and talk about financial and retirement planning has increased significantly in recent years and nearly seven in 10 tell us that a client has asked to purchase an annuity in the last 12 months. So clearly I think we're seeing from our research and the anecdotes that we hear in talking to the adviser and producer community that there's a clear up tick in reliance on VA's in a holistic retirement plan.

WEBER: Mike, would you say the same thing, that you're seeing producers embracing the variables?

McCARTHY: Yes I think we've seen a greater degree of interest from the advisers. I still think that there's a lot of reluctance out there. I think what we need to do as an industry is to get people to really focus on what annuities do as opposed to what they are. There's no doubt that the term variable annuity or annuity in general for whatever reason has a negative connotation and I go back to the AllianceBernstein Study. They [AllianceBernstsein] went out and they talked to 900 financial advisers. On average these financial advisers had $100 million in assets under management or more. When they asked the question, "would you be interested in learning more about a product or an investment that allowed you to invest in equities but have guaranteed income for life?," 77% of those advisers said yes, I want to be trained on that. I'm interested, tell me more. And then they asked them, "how many of you have a significant knowledge or feel extremely comfortable around the benefits that variable annuities offer?" Only 16% of them said they were fully aware or comfortable about how variable annuities operate. The last question they asked them was "who would be interested in more training on variable annuities?" and only 19% said tell me more. So when we told them what it did, 77% said tell me more. When we told them what the variable annuity was, 19% said tell me more. And it wasn't because they already knew how they worked, because only 16% said that they felt extremely knowledgeable about them. So I think we've got a long way to go in terms of educating people, how they work and, more importantly, what they do. I think certainly through the crisis these things have come out. We've seen a lot of positive press about the

benefits of variable annuities. It used to be said that they were too expensive and some people have come out recently and actually said maybe they're not expensive enough. Maybe they're not charging enough. So I think it's pretty interesting. I'm very excited about the opportunity going forward but we've got a lot of work to do.

WEBER: Now, Mike, we spoke on the phone last week and you told me that when it comes to retirement income there's a need for short-term income – three to five years out – medium term, which is about five to 15 years out and then everything beyond 15 years. Where do variable annuities fit into this equation?

McCARTHY: Obviously we do a lot of research on that and I think that short term is not really where annuities fit, so in that short-term bucket you're probably better off using some fixed income tool. I think where they do fit, though is medium to long term. So that five to 15-year period, we know that if we purchase a variable annuity today and we let it sit for a couple of years before we start taking withdrawals out, we give the market an opportunity to perform. We protect the benefit base so that we don't deplete that account because what we want to do is really make sure that the client is able to take advantage of the benefits whether it be a living benefit or death benefit that's offered in a variable annuity. And what we've found is if you put it in there and you immediately start taking it out, given the fees that are associated with it, the sequence of returns, you could potentially be setting your client up to take that contract down to nothing. Anywhere beyond five years I think it's appropriate. If you're going to take income in the first five years I think an immediate or some other type of fixed income instrument probably would be better.

WEBER: Cathy, where do you see annuity products headed over the next few years?

WEATHERFORD: Well, from a product perspective we work with Morningstar and we try to track the product trends. We saw a significant trend towards product adjustments, product changes, new products over the last three years and now finally in this third quarter of 2011 we're seeing a stabilization in the products and I think that what we're seeing is that there is a shift away from tremendous product innovation and development towards distribution, meaning we're in the season of opportunity. We're also seeing the new, lower fee products and an area of particular note is the ongoing release by some of our carriers of O shares that combine some of the pricing features of A shares and B shares, forego some of the upfront charges. And lastly we see that expenses are remaining pretty much level around our products. Average expense remains unchanged. Over the past couple of years we're at about a 2.49% and that's just been consistent over five years. Maybe to Mike's point, maybe these things aren't priced high enough but the costs of variable annuity products have remained steady and have not risen and we have had innovation, good products come to market, low fees and so I think that there's a significant offering that suits many different types of advisers' investment strategies.

WEBER: Mike, I'd like to get back to the advisers here for a moment because that's where the boots on the ground are. Are the products getting simpler for them to understand and also, more importantly, simpler for them to explain to their clients?

McCARTHY: I think they are getting simpler, John, and I think the reason for that is the crisis that we've gone through. We've kind of gotten into this arms race. Back in 1996 Axa Equitable actually came out with the first living benefit and it became a one-upmanship almost – everybody trying to go one step further and provide the richest benefits out there and then what happened, obviously is this Black Swan event with the financial crisis, so people really kind of got blindsided. I think you're seeing more consistency out there. Everybody's charging around the same amount, generally providing the same level of income. There are minor differences amongst the contracts but I think everybody is really kind of going out there trying to educate and tell the story of, look, your clients need some level of guaranteed income for life, let me show you how mine works. It's a little bit different maybe than some of the other ones out there but I think it's getting easier for the advisers to understand because there are not these mass amounts of differences from contract to contract. So I think the fee structure is becoming more consistent. I wouldn't say the fees are going down. I would say that they probably have remained steady. I think there's tremendous value in what they provide. And, again, I'll go back to the AllianceBernstein Study that I think surprises a lot of advisers. I don't think that they realize what their clients are willing to pay for guaranteed income for life. Again, back in 2007 AllianceBernstein went out there and interviewed 13,000 of their investors and they said "what would you be willing to pay on an annual basis for guaranteed income for life?" And I think if we asked most advisers they would probably guess somewhere around 2% to 3%. Yet most clients said that they would be willing to pay anywhere between 4 to 7% annually to have guaranteed income for life. So, generally when we talk about the cost of variable annuities it's the adviser who's caught up with the expenses, not the client. Because, again, the client looks at what it provides, what it does. So we really need to realize and if we're not talking to our clients about this, that they are willing to pay for the guaranteed income.

WEBER: So, Cathy, what's the selling environment for these products post financial meltdown?

WEATHERFORD: I think that it's almost unprecedented in this industry for where we are today with the selling environment. VA sales are on pace to exceed $150 billion this year, which puts us beyond pre-meltdown time. So it's clear that the consumers are coming to trust these as a product that they would like in their retirement plan. We've already talked about consumer/investor attitude changing and their appetite for risk has changed. We did a piece of consumer research with Woelfel Consumer Research back in April of 2011 – all of this research that I'm talking about is available free for advisers on our website and I'll cite that at the very end – one significant piece about that was that boomers who owned insured retirement strategies or annuities, VA's, have a higher confidence in their overall retirement expectations with 92%

believing they did a good job during the meltdown preparing financially for retirement. I think that that's very important. A couple of other things we found in recent research was that we did some myth busting and only one in 10 non-annuity investors said the strategy was too expensive or too complex. So I think that's significant opportunity there. Half of all non-annuity investors don't have a negative outlook. And they said that the cost would have little impact on their decision to purchase one. They want guaranteed income over rate of return. And we found that in retirement income goals first and foremost they want to ensure that they don't run out of money. They want to be sure that they have that regular, ongoing [I call it] mailbox money. Something that they know they can count on to be there regardless of the market activity. And so I think that through education and awareness these strategies will grow and they're going to play a very important role in a balanced portfolio.

WEBER: Mike, I know you touched on it a little bit, but how is the fee structure changing and how is it making VA's more attractive to the producers?

McCARTHY: The fee structure is becoming more consistent so I think they understand what the cost will be all in and then what the value is that they're getting back for that cost. On another note, we've actually seen the introduction recently of fee-based variable annuities. This has been talked about for a long time and Linsco Private Ledger actually really got behind it. They brought five carriers, Axa Equitable being one, onto their platform and launched the fee-based variable annuity back in January of this year. So we're trying to figure out ways to make these things attractive to new producers because clearly one of the biases against variable annuities, again, from an adviser's standpoint, not necessarily a client's standpoint, has been the fees. We're very excited about it. I know Linsco Private Ledger and a couple of other firms have introduced it and we're starting to see a lot of attraction and more importantly a lot of interest out there from the advisers.

WEBER: We're going to get to those biases that you spoke about in just a little bit. In the meantime let's talk about target. Who really should be considering VA's realistically and why?

McCARTHY: Well I think clearly anyone who is about to go into retirement, for those people who maybe don't have a tremendous amount of money, middle class America, you've got to be able to provide for the necessities in retirement. I would say the sweet spot is anywhere between 55 and 75 years of age. I know at Axa our average age of a client is 63 years old. I think probably if you're really young, if you're under 45 years of age you want to really consider whether or not it would be really appropriate, especially if it's non-qualified money because you do have to commit to keeping that money in there until the age of 59 ½, or you will be subject to the penalty. Clearly I think our sweet spot is between 55 and 75.

WEBER: Now are there any other areas where VA's are being used outside of this?

Trusts, things like that?

McCARTHY: Sure. We actually have a whole advanced markets group at Axa and we're constantly going out there trying to educate the advisers as well as we work a lot with CPAs and attorneys. So we do a lot of continuing education around CPE and MCLE credits and I'll give you a couple of areas where we're seeing significant growth. Number one is in defined benefit plans. So a couple of different areas in which we are having success. One is working with small business owners, I would say 10 employees or less, so doctors, dentists, lawyers, contractors, where you've got maybe one person who makes a significant amount of money in that office. So, for example, a doctor may be making $500,000 a year and might have an administrative assistant and a nurse's assistant. By funding a defined benefit plan and using a variable annuity, I could put away $150,000 a year or more, reduce my adjusted gross income and get all the tax benefits and only have to put a little bit away for the nursing assistant and the administrative assistant. So we're seeing a lot of interest there. We see a lot of interest from endowments and foundations and the reason is they've got so much of their money in fixed income so with the death benefits we're able to provide them with an alternative where we have the trust as the owner and then the beneficiary. We typically name somebody on their investment committee as the annuitant and then they've got the ability to invest in equities and then they've got a death benefit. So there are lots of other uses but trusts and defined benefit plans are areas where we're seeing a lot of interest.

WEBER: Thanks, Mike. I want to take this opportunity to remind our viewers and listeners if they have a question they can send it in to us at news@ambest.com. We have received a number of them. Hang tight. We will get to them shortly. In the meantime, Mike, getting back to this bias about VA's, what are you seeing and why?

McCARTHY: Again I think for so many years there was a negative bias towards variable annuities, saying variable annuities are too expensive, questioning the value that they provided. Then a 180-degree turn after looking at them and saying the value here is actually so great that they should be charging more. Companies that are still here are committed to the business and there's tremendous opportunity out there. There's a tremendous need for it [annuities] and I'm really excited about the potential for this industry for the next three, five and 10 years and beyond.

WEBER: What are other carriers doing? What will they be doing to address this?

McCARTHY: I think again what most companies are trying to do is come out with more product offerings. We're trying to make it more appealing to more advisers because the more that we can spread our risk around and diversify our product offerings the better it is for the insurance company and therefore the better it's going to be for the client and the long-term health and viability of the entire industry. So I think that as a group we're sharing information more. We're working collaboratively to come up with new ideas and I think that as we do that and we penetrate new markets as we talked about with defined benefit plans and trusts, it will just help the industry as a whole grow. When I look at, over the last 10 years, the growth of different sectors of the financial

services industry, be it ETF's, retirement plans, mutual funds, they've all grown at a rate much higher than the variable annuity industry. So I look at the next 10 years and I'm very encouraged and will be very interested to look back 10 years from now and see what our growth rate has done from today going forward for 10 years versus today going back 10 years. I think it's going to be dramatic.

WEBER: Now, Cathy, what are best practices of successful producers of next generation variable annuities?

WEATHERFORD: Well I have a little of old regulator blood running through my veins, so first and foremost I think that financial advisers always have to look at the suitability of this product for their clients and Mike has given a lot of tips about the right placement of VA's in portfolios. Then I think that for successful producers it's talking more with their clients on retirement planning. In our nation the way that we have built client portfolios is through accumulation and talking about building wealth and we've done a great job of doing that even with the meltdowns that we've had because we are seeing the return of portfolios. But I think that we have to pivot and we have to learn more about all ways that we can help our clients build out retirement income. This is the first time we, as a nation, in fact we as almost every developed country around the world will ever face this tsunami of people moving towards retirement. I think the thing that we hear from successful producers and the research that we've done in discussions with them is telling a simple story, really talking about what these products do in a portfolio. What they do and how they perform in a portfolio as opposed to what they are. And you must keep it always relevant to the client and the client's goal. Discussing the risks: We talked about six or seven risks here today but there are a dozen or more risks that clients will face in retirement that make them more vulnerable than any other segment of the population, so discussing those risks and how you will mitigate those risks for them through your retirement planning. And then the things that advisers tell us that they really like – they really like good, solid materials provided to them by the carrier, but explains those products and features in plain language. They like hypothetical charts that can show how they work. And then really seeing and being able to show a sequence of returns analysis for their clients. And then we've talked about what a carrier can do to help an adviser be more successful with variable annuities. The things that they're telling us is that they do want simpler materials, they like the enhanced products. They like the living benefits; they believe those are what provide value for their clients. And lastly, they're really looking for strong education and training in specifically two areas, they tell us. They really want to understand those hedging strategies and practices by the carriers around the products and they want good education around understanding the financial strength of insurance companies before they place a product into their clients' portfolios.

WEBER: We're going to get back to you in just a minute, Cathy, on those benefits but before we do, Mike, is there a space where a variable annuity would not be an appropriate part of the mix?

McCARTHY: First of all it's not the answer for everyone or everything and clearly no one should put all of their money into a variable annuity no matter how good it looks or sounds. As I mentioned earlier, if somebody is younger and they potentially will need the money before the age of 59½ and can't commit to leaving it in there I don't think it's appropriate. If somebody needs to have that money available short term, again, it's probably not appropriate. But I think for most people, for a portion of their money, it probably makes sense to add it to their portfolio.

WEBER: So, Cathy, getting back once again to the benefits what would you say are the most desirable benefits?

WEATHERFORD: Well, as Mike said earlier, for a long time we had this tremendous arms race around living benefits and the creation of more living benefits and different kinds. And what I've seen and what our research and what the sales tell us is that it's all gone through a funnel. So while we know that three quarters of all the variable annuity contracts are sold with a living benefit, nearly nine in 10 of those have either the minimum income benefit or a guaranteed living withdraw benefit. So we think that that's what advisers and consumers both have become most attracted to and provide the most value in their portfolios. We also found that the G might be the GLWB, the withdraw benefit and the GMWB, the withdraw benefit – all of these will increase. But everything centers around the two as the mainstream benefits. So we think the use of the living benefit because of the value that it does provide to the portfolio will only grow.

WEBER: Do you see the living benefit as gaining in importance, Cathy?

WEATHERFORD: Absolutely. With sales increasing overall, with our baby boomers moving closer to retirement and needing these types of benefits in retirement and with the performance of these contracts for investors throughout the meltdown, all of those things are bringing about a greater focus in usage on them, both by the consumer and by the producer.

WEBER: As promised we're going to get to some viewer and listener questions at this time. Mike, we're going to start with you on this one. A viewer writes in, I hear advisers want simpler, lower-cost variable annuity products because they are not selling them because the commission is too low. How can this be best addressed by the industry? I know you touched on this, but I'll let you hit it directly.

McCARTHY: A couple of things – when we looked at who was not selling variable annuities clearly there are more advisers who don't sell variable annuities than do. So we went to them and said, OK, what are your key objections? Basically there were three key objections that they had: cost, complexity and commitment. So, cost has always been an issue. Again, we talked about it earlier. I think it's more of an issue for the advisers than it is for their clients but again, some advisers just can't get past the thought of paying 4% for living benefits or death benefits. The second is complexity. When you hear a variable annuity wholesaler speak, a lot of times you think they are speaking a different language. We tend to speak in acronyms. We use terms like GMIB, GWB, IB, M&E

and a lot of advisers just get turned off by that because they don't understand them and they get frustrated and they just say, I'm not interested, thank you very much. The last thing is commitment. Typically, when I sell a variable annuity I could potentially be committed to it for life. What I mean by that is with the living benefits and the death benefits that are being offered, you take a 4% fee structure on top of a 5% withdraw, the odds of you getting a reset, meaning your account value will be above your benefit base becomes almost impossible, at least for a prolonged period of time. So typically what will happen is you're going to be committed to that contract for life. So at Axa one of things that we did in trying to come out with a simpler product was we said, if we could provide you a contract that had no implicit fees in it so we eliminate the cost issue, if we can provide you with something that's as simple as answering three questions like what index would you like to invest in? How much downside protection would you like? And what duration do you want to invest for – one, three or five years – and have a finish line so that you weren't committed to it for life and pay you a fair commission, is that something that you would be interested in? Over 50% of the advisers have never done business with Axa Equitable before and, more importantly, 50% of that business is non-qualified so it shows us that they're taking cash off the sidelines and putting it in there. And we've given it to them in two ways. We've said you can take your fee share commission which we pay a 5% commission for a five-year surrender charge product, basically 1% per year, or we'll give it to you on a fee-based platform where you can actually determine what fee you charge your client. So I think as more of our competitors look to do the same, that we will sell more and more of these low-cost, simple solutions and therefore expand the market and bring this out to advisers who don't typically sell variable annuities.

WEBER: Cathy, next question for you from a viewer. What are your thoughts on contingent annuities?

WEATHERFORD: Well, we know that they've been in the marketplace for a few years in a very limited way used mostly as group annuities inside a qualified plan where you have the managed money and the contingent annuity kicks in at the point of 80 or 85 years old when that deployment of that systematic withdrawal is drawn down. We have seen the IRS rule that they are annuities. The FCC has opined they are annuities and I think that what we're beginning to see is the state regulatory look at them in a way to determine what a carrier needs to have in place. I mean strong hedging strategies, pricing strategies. I think we're a ways away from being in the marketplace in a more robust way. But I know that financial advisers and some carriers are looking at these as a potential strategy to use where basically it becomes a stand alone living benefit on top of managed money as a 2013/2014 strategy so I don't really know. We're watching very closely on all regulatory fronts how they deal with this product from a regulatory perspective and how that will impact insurer's decisions around deploying these in the future. But there has been increasingly growing interest by a significant amount of advisers and broker/dealers and carriers to at least take a look at these as one of the newer products in the suite of products that are under deployment.

WEBER: Thank you, Cathy. The same viewer asks are the charges for GMWB and GLWB too high for consumers or too low? Mike, would you like to field that?

McCARTHY: Again, I think that they are not too high. I think clearly they are fair and they're right in line with what clients have said that they'd be willing to pay.

WEBER: We seem to have a number of people interested in this: there seems to be an exiting from the markets by carriers issuing VA's. Mike, how will this impact the design of VA's for carriers who choose to remain in the market. Cathy, I'll let you field that one as well if you'd like.

WEATHERFORD: Mike, do you want me to start first? Let me just say the retreats or exits that we've seen really have more to do with, we think, the holding company structure of the carrier. Some of these have new regulatory requirements on them from Solvency II from the European regulatory community because they are foreign-owned holding companies and we think that may, with Solvency II, put much greater demands on their capital than the current regulatory environment. So we think regulatory environment might be a reason. The second reason is that the ongoing volatility has hampered some companies' ability and this is a very small amount of the companies that we're seeing retreat. And third, the low interest rate environment. So I think that we have other companies that are on the up tick. They're growing their business. They have strong hedging strategies. They have a strong commitment to this marketplace. So I really don't see the exit by less than a handful of carriers really have an overall impact to the products and the design. I think we've seen the stabilization of the products and I think we can count on a stable marketplace and probably at some point a return to the marketplace by those that have retreated.

McCARTHY: Clearly the interest rate environment that we're in today makes it very difficult to offer some of the rich, rich benefits that were being offered out there. So I think that we've probably seen the last of it, at least I hope. It's not good for the industry to see competitors exit the business. I think that the more people we have out there educating and talking about the benefits of variable annuities and what they do as opposed to how they work will benefit everyone. But I think that there will be a bigger spread amongst the business. We saw a very high concentration, particularly this year, of the top three carriers garnering a huge part of the market share – much higher than historical standards. So I think what we're going to see is as some people pull back a little bit and companies come out with more and more offerings I think we'll see a broader diversification of the business and I think it will be good for everyone.

WEBER: Mike, one of our viewers asks, what do you recommend for an investor who hasn't previously invested in a variable annuity and wants a lower risk, lower volatility investment?

McCARTHY: I look at our simple solution which is called structured capital strategies and that's some that is appealing to a first-time equity investor. It's very simple. Again, no embedded fees, so the idea there is if I can get you to take

your first step into a variable annuity and make it a good experience I can probably five years down the road get you to take the next step which would be into a full-fledged variable annuity. So I would start with something that's very simple, very basic. Give the client some equity exposure, give them some downside protection but not get them all discombobulated around the terms that I mentioned earlier like a living benefit, a death benefit, M&E and whatnot. Keep it simple, get them invested and then five years from now maybe take the next step.

WEBER: OK. Cathy, one of our viewers asks, where do you see product development heading? I know we touched on it a bit, would you like to handle that?

WEATHERFORD: Well, I think we've seen a stabilization of product development. I think we might see some new innovations around this aging population. So some of the product innovations we might see could come around some of the hybrid type products. We can see innovation and trends around being able to use benefits for health care or long-term care. So I think we're really on the front end and I think we all should be very watchful. Our carriers tend to be very innovative when it comes to trying to bring to market what the advisers and what the consumers want. So those are just a couple of my reflections.

WEBER: What are your thoughts on it, Mike?

McCARTHY: I think one of the things that is going to come back in vogue, so to speak, is one of the core benefits of the variable annuity which is pure tax deferral. One of the things that people tend to forget about is the tax consequence that you have with mutual funds, particularly in a non-qualified account. So when you look at the average tax drag on an equity mutual fund, it's somewhere around 2% to 2 ½% on average that a client forfeits or loses to taxes. And I think, again, if we talk to most clients they believe that tax rates are going to go up as we have to get ourselves out of this deficit. I like to use the analogy of running water. Nobody leaves their water running all day long. You would be paying for water that you're not using. And yet we have so many people using mutual funds as long-term investments and they're paying taxes every year on money that they're not using. So the benefit of the variable annuity, of sheltering that 2 ½% instead of paying it to Uncle Sam, is the benefit of triple compounding which is interest on your principal, interest on your interest and then interest on money that you would have otherwise paid in taxes. So, again, I think one of the benefits that have been overlooked because of the arms race in the living benefits has been the pure benefit for non-qualified monies and the tax deferral that you get. Not to mention you tend to have very robust offerings in terms of the mutual funds that are available inside of these variable annuities. And what I think most advisers don't realize is that typically if you were to ask a mutual fund manager where would you rather manage money, where do you typically get a better return, is it the publicly traded mutual fund or is it inside of the sub account of the variable annuity, they're going to tell you, you get better performance inside of the sub account because it's stickier money. They don't have to keep monies in cash to meet redemptions when the fund is going down. So a lot of times those funds will actually be less expensive as well because the insurance company and the mutual fund company have agreements on breakpoints so the client gets a price break as the insurance company brings in a certain level of assets and the costs actually go down. So in a lot of cases you can put together and not even worry about a living benefit, a death benefit or any of that. You can just put together a very solid portfolio with top money managers for non-qualified monies and get your client a significant benefit. And that typically reduces their cost and increases their rate of returns and lowers their taxes. So I think that's a benefit that is going to be talked about a lot more going forward as we see tax rates go up.

WEBER: That leads right into the next question: Do you see that as part of the next generation?

McCARTHY: Well, I think it's kind of like Back to the Future. It's back to the basics. It's blocking and tackling. One of the core benefits of the variable annuity is the tax deferred aspect. I found it interesting that a few years ago so many people questioned why you would put a variable annuity inside of an IRA. The term used to be it's kind of like wearing a belt and suspenders, it doesn't make sense. Most people have the majority of their wealth tied up in their 401K. So when they come to the adviser and they say here's my $400,000 – this needs to get me 25, 30 years through retirement, how do I do it, the variable annuity is a great solution. That's one of the things that can be frustrating. I think if you asked every client would you rather have a pension plan like your parents, or would you rather have a 401K like you have, 100 out of 100 would say I'd rather have a pension. And the solution is, very simply, a variable annuity. It's like your own, personal defined benefit plan. And I think that's the way that we have to talk to advisers and that's the way advisers can talk to their clients. Again, they look at what it does and forget about what it is.

WEBER: Well this has been a very lively and informative hour. Unfortunately we are drawing to a close. It's the part of our webinar where we always like to ask our panelists what they would like attendees to take away from today's presentation. Cathy, how about we start with you? What would you like attendees that are logged on today to take away from this past hour?

WEATHERFORD: I think that variable annuities provide significant opportunities for advisers to work with their clients to build a strong, holistic retirement plan. And I think that retirement is the word of order for the next 15 or 20 years and that these can provide tremendous benefits for all of the reasons we've talked about over the last hour to a multitude of clients that they work with.

WEBER: Thank you, Cathy. Mike, what would you like attendees to take away from today's presentation?

McCARTHY: Well, I think the key is the variable annuity of today is not our father's variable annuity. There are a lot of different features and benefits that these contracts can provide. I'd like them to focus on what they do as opposed to what they are, realize that their clients are willing to pay for guaranteed income and then also think about the other

uses that we talked about as opposed to just the individual retail investor. There are tremendous opportunities out there in the endowment and the defined benefit space, so I would encourage advisers to at least be knowledgeable and have this in your repertoire to at least be able to have the discussion with your client. I think that would benefit them tremendously going forward.

WEBER: Thank you, Mike. We'd like to thank both of our panelists today, Cathy Weatherford and Mike McCarthy and, of course, our sponsor of today's webinar, Axa Equitable. We'll have an edited playback of this web cast, complete with visual elements up in a day or so and a transcript up in a week. I'm John Weber of the A.M. Best Company.

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