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Insurers working to enhance variable annuity products

Some advisors like the move but are waiting for further bells and whistles, not to mention lower fees

By Gavin Adamson

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Manufacturers of the latest variable annuity products are improving their features. But, for the price, some advisors are waiting for the bells and whistles they see in the U.S. versions of the products before they seriously promote them to clients.

Still, some of these products are doing well. Since GIF IncomePlus was introduced less than a year ago by Waterloo, Ont.-based **Manulife Financial Corp.** , it has reached sales of more than $2 billion. In October, Manulife extended its guaranteed minimum withdrawal benefit on this product to life from the earlier limit of 20 years. Manulife is not charging extra for the improvement.

"It's a substantial enhancement over the originally launched product," says Bruce Cumming, a financial planner with **Cumming and Cumming Wealth Management Inc.** in Oakville, Ont. It was especially good news that Manulife is grandfathering the changes for clients who bought the original product, he adds.

Now Toronto-based **Sun Life Financial Inc.** is making the latest waves in the market, announcing that it is "currently working on" a lifetime GMWB for its SunWise Elite product. "It's a natural evolution within the product category," Sun Life says.

But even though some advi-sors were quick to praise Manulife's improvements, they stop short of recommending it widely to clients, preferring to wait for better features for the price.

"Basically, in the U.S., you get much more generous [variable annuities] compared with what is available here," says Jim Otar, a financial planner in Richmond Hill, Ont., who has researched this type of product in both the U.S. and Canada.

GMWB products are aimed at older, retirement-age clients who are worried about outliving their savings because of poorly performing markets. The income guarantee is the most important feature to these investors.

In general, here's how it works. A client buys a $100,000 contract and, as a minimum, he or she is guaranteed to have that principal returned in 5% increments annually. The funds are invested in a portfolio of segregated funds, depending on the client's risk tolerance, goals and other factors. The contract value fluctuates with the markets, and with withdrawals and deposits the client makes. The client can take advantage of potential portfolio growth to a certain extent with several features that may allow him or her to increase the annual payout during retirement.

In Manulife's case, payments are now guaranteed for life. Sun Life's guarantee is for 20 years, but the firm is working on an enhancement. Worst-case scenario, assuming bad markets wipe out the entire value of the contract, is that your client is guaranteed his or her money back in 5% annual withdrawals from the date of the maturity of the investment.

Both products add a bonus of 5% growth to the guaranteed withdrawal balance every year that your client does not make a withdrawal — for a period of up to 15 years in Manulife's case, and 10 in Sun Life's.

And the products offer a feature that can override the 5% bonus. Once every three years, your client can choose to reset the guaranteed withdrawal balance, "stepping up" to take advantage of any growth in the contract value. If the portfolio growth is greater than 5%, the step-up makes sense.

There's no question the product homes in on a demanding market. Baby boomers are creeping toward retirement age, and that means those clients will want to guarantee they'll have enough cash to fund their golden years. "They're worried about their future income," says Mark Halpern, a financial planner at Markham, Ont.-based **Illnessprotection.com Inc.**

Clients recognize that equities markets have fed their investments' growth over the past 40 years, and that they're likely to be the best places to look for growth in the future, too. "But clients won't want the risk," HalpMr. Captor evaluation copy

The additional variable is that people are living longer into retirement. Medical advances have increased longevity. According to mortality tables available from insurers, the average 65-year-old woman, for example, has a 50% chance of being alive at 85. Your clients want assurance that they won't outlive their savings — and that's where the insurers step in.

"Essentially what people are looking for is a pension," says Moshe Milevsky, associate professor of finance at York University in Toronto and executive director of the **In-dividual Finance and Insurance Decision Centre** in Toronto. "In the old days, they got a pension from the company for which they were working. That provided longevity insurance. But a lot of people are approaching retirement without that sort of pension and they're looking around for something, nostalgically, that is as close to a pension as possible. That's what these products are filling the need for."

Advisors expect a competitive battle by insurers for their clients' retirement dollars with this type of product. That means Sun Life will meet Manulife's move. "It has to," says Otar.

In fact, Manulife's enhancement was driven by the competition in the U.S. market and the bells and whistles that have arrived there, says Milevsky: "Manulife's U.S. subsidiary, John Hancock, has been selling a variable annuity for about five years now that provides a lifetime benefit, regardless of market performance."

One improvement to watch for is to the number of intervals at which clients can reset their step-up. Some U.S. providers offer an annual step-up feature. And New Jersey-based Prudential Financial Inc. offers daily step-up options.

Otar notes that John Hancock already offers a 6% annual bonus on the guaranteed withdrawal benefit that defaults immediately to 100% bonus if the client doesn't touch the original contract investment for 10 years. Manufacturers may also increase the age limit on the feature — to 20 years from the purchase of the contract, for example.

Other features — such as genuine inflation risk coverage — have yet to arrive in either market, Otar notes, although he's speaking with one U.S. provider, trying to persuade it that it's possible "with some limits.

"So far, nobody covers inflation risk," says Otar, who has run the numbers on the Canadian products. At this time, Otar would still tend to recommend an alternative to these products — either a traditional annuity or a regular investment portfolio, which, he says, "costs less and offers more flexibility."

On Manulife's product, for example, the management expense ratio on an equities/fixed-income asset-allocation split of 80/20 is almost 3.6%, which makes it difficult for advisors to justify, adds Cumming.

"That takes away the sweet spot of what we're trying to earn for clients," he says. "If you give me your money to invest, trusting that I can put it in a diversified portfolio over a long period of time, making 5% to 8% is a good return. I can't do that paying a 3.6% fee."

It will take time for insurers to make changes to their products, but as more clients buy the products in Canada, costs will be driven downward, says Milevsky. Manulife may actually be taking a loss in its product to begin with or subsidizing the product's coffers to establish its leadership position.

"I can tell you that competition won't stop," Milevsky adds. "In a year, possibly less, somebody will come out with something more creative. There's so many different dimensions across which this can be incrementally improved."

Halpern describes the products' benefits metaphorically: many people buy comfort cars for $30,000, when they know they could get a product that gets them around town for $10,000. "It's comfort," he says. "Clients have to ask themselves if it's worth their while to have that peace of mind." **IE**

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