Variable Annuity Marketing from the Perspective of Consumers' Financial Awareness

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Introduction

Variable annuities have become increasingly popular as a wealth-building tool for retirement. In the U.S., the variable annuity market has grown vigorously since the early 1990s as the baby boomer generation prepares for retirement. Although introduced in Japan only in 1999, variable annuities are expected to respond to the growing demand for wealth-building tools, in view of the ongoing financial liberalization, struggling public pension system, and emphasis on individual responsibility in investment.

This paper examines the future of variable annuity marketing, focusing on a key factor for the market's growth — consumer awareness of wealth-building for retirement.

1. Description of Variable Annuities

Since assets of a variable annuity life insurance contract are invested in separate accounts or investment funds, the annuity's asset value, surrender value, account value, and death benefit are directly affected by the performance of investments. Thus the annuity's payout can increase if the account value increases, or even fall below the amount of purchase payments if the account value erodes. Products currently available in Japan severely restrict the owner's investment options.

In the event of death during the accumulation phase, the reserves are paid out to the family members. In this case, many products guarantee a minimum payout equivalent to purchase payments despite a possibly negative investment return; some products offer a stepped-up death benefit that locks in investment performance.

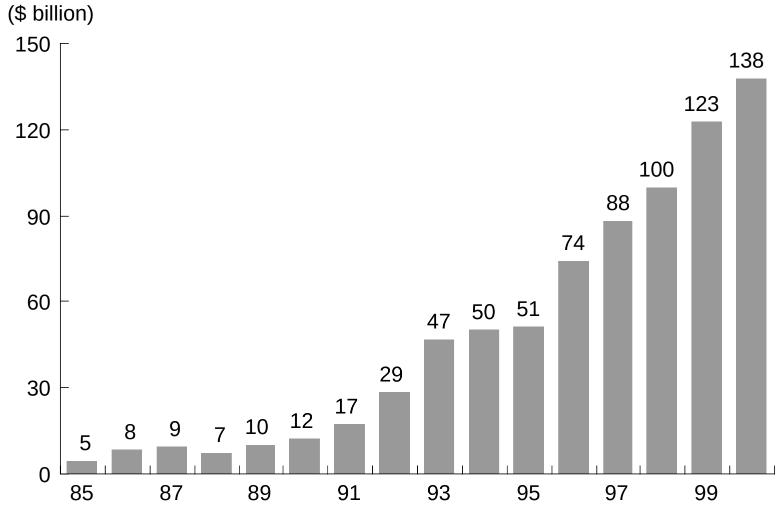
Compared to investment trusts, variable annuities enjoy several tax advantages: investment earnings are tax-deferred until withdrawal, purchases are treated as insurance premiums and tax-deductible, death benefits are exempt from the inheritance tax, and money can be transferred between investment options without paying tax at the time of transfer. On the negative side, expenses are higher because they include not only administrative fees and underlying fund expenses, but mortality and expense risk charges to compensate the insurance company for insurance risks.

2. The Variable Annuity Market in the U.S.

In the U.S., annuity sales in 2000 (premium revenues) amounted to 190.5 billion dollars. Variable annuities reached a record 137.7 billion dollars (Figure 1). While the growth is predicted to continue, some analysts are skeptical of its strength given that net sales, which take into account surrenders and payouts, have already started declining.1 Meanwhile fixed annuities, which had marked flat to negative growth in the past few years, turned upward in 1999, and reached 52.8 billion dollars in 2000.

The sharp growth of variable annuities in the past decade can be attributed to their popularity among the baby boomer generation as a long-term investment to meet retirement goals, particularly because of the strong performance of stock investments, and tax-deferred feature.2

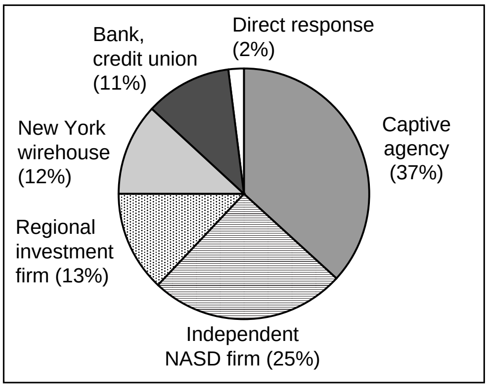
Figure 1 Variable Annuity Sales of U.S. Life Insurers (premium revenue)



Source: "Historic Annual Variable Annuity Sales," in VARDS, *The VARDS Report: An Info-One Service*, June 5, 2001. (http://www.vards.com/website/prodserv/pdf/GHVS1Q01.pdf)

With regard to distribution channels, variable annuities differ from traditional life insurance products in that stock brokerages (securities firms and independent brokers) account for approximately one-half of sales by value; when combined with captive agencies, the share exceeds 90% (Figure 2). This might be attributed to the fact that stock brokerages, who are independent of life insurers and have expertise in asset management, offer financial advice on products and investment funds.

Figure 2 Variable Annuity Market Share by Sales Channel (2000)



Source: "Sales by Distribution Channels: Industry Totals on 3/31/01 YTD," in *The VARDS Report: An Info-One Service*, as found in *National Underwriter Life & Health/Financial Services Edition*, June 4, 2001, p. 5.

A recent Gallup poll found that the average age of variable annuity owners is 65, and that approximately half are retired. The poll also found that variable annuity owners are not particularly wealthy, with approximately half (49%) having an annual household income of 50,000 dollars or less, which is below the national average of 55,000 dollars (1999).

The average age at time of purchase is 49, and ownership is for the long term. Regarding the goals of ownership (multiple answer), the overwhelming majority (over 80%) have goals related to retirement income, such as being prepared in case they live longer than expected, not wanting to burden children financially, and having a source of retirement income. In addition, approximately 70% regard variable annuities as a financial cushion against risks such as unplanned medical or long-term care needs, failure of other investments, and higher inflation.

3. Awareness of Variable Annuities in Japan

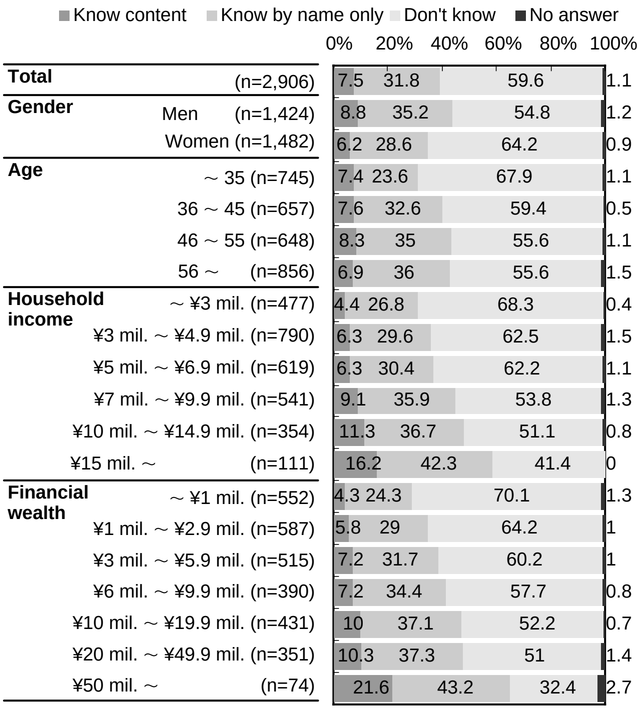
Due to the newness of variable annuities in Japan, market data is still sparse. According to the NEEDS-RADAR *Financial Behavior Survey* by the Nihon Keizai (Nikkei) Shimbun, only about 40% of ordinary consumers are aware of variable annuities: 8% know what they are, while another 32% have heard of them (Figure 3). Awareness is higher among persons age 35 and older, and tends to increase with household income and financial wealth.

Regarding preferred financial investments to meet retirement goals, variable annuities came in last place (2%), edging out "other" and "no answer" (Figure 4).

Furthermore, when asked about the attractiveness of a variable annuity, described as an annuity whose payments varied depending on investment performance, only about 3% responded affirmatively.

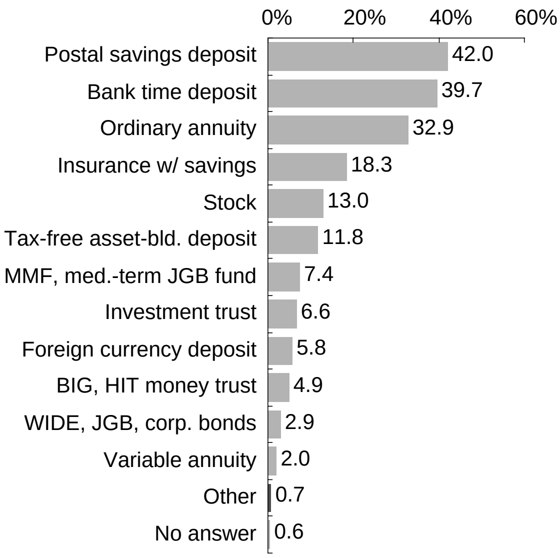
Thus in marked contrast to the U.S., variable annuities may be gaining familiarity among higher income groups, but have yet to achieve the status of an attractive insurance and investment product to meet retirement goals.

Figure 3 Familiarity with Variable Annuity



Source: Nikkei NEEDS-RADAR, *Financial Behavior Survey 2001*.

Figure 4 Preferred Investments for Retirement (multiple response; n=2,906)



Source: Nikkei NEEDS-RADAR, *Financial Behavior Survey 2001*.

4. Variable Annuity Marketing Issues

At present, the key issue in marketing variable annuities is to expand the number of purchasers and achieve greater market penetration, primarily by targeting wealthy consumers already familiar with the product. But once this is addressed, the larger issue is how to penetrate the broad market segment of ordinary consumers who are unaccustomed to risk products.

Below we consider marketing needs for consumers from three long-term perspectives: financial needs in retirement, awareness of risk products, and information sources and level of interest regarding financial products.

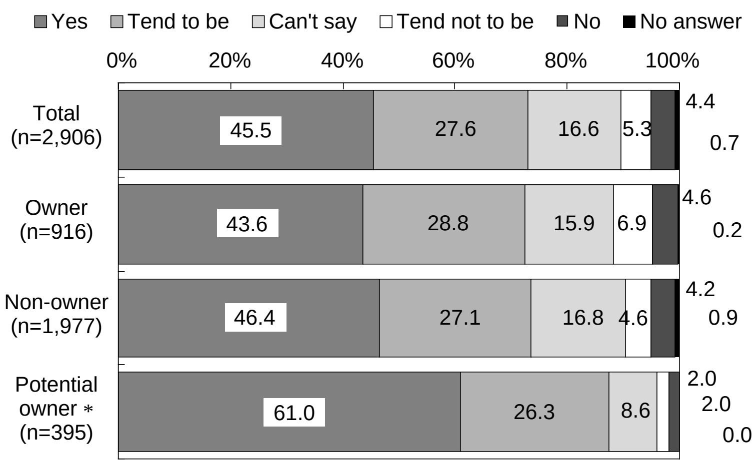
(1) Emphasize Retirement Goals, Not Retirement Anxiety

Since annuities are designed to provide financial support in retirement life, it is generally thought that people who purchase annuities do so because they have financial anxieties regarding retirement life, and want to alleviate them.

However, the Nikkei survey found little difference in financial anxiety between life insurance and postal life insurance annuity owners on the one hand, and non-owners on the other. As for persons who intend to purchase annuities in the future, a large proportion still faces financial anxiety (Figure 5).

Since these results indicate that annuity ownership may not necessarily alleviate financial anxiety in retirement, some other function of annuities should be emphasized.

Figure 5 Financial Anxiety Regarding Retirement, and Annuity Ownership (n=2,906)



Note: Prospective annuity owners are those who selected annuities as a financial product they intend to purchase in the future.
Source: Compiled from Nikkei NEEDS-RADAR, *Financial Behavior Survey 2001.*

Another survey by the Central Council for Financial Services Information (*Public Opinion Survey on Household Financial Assets 2001*) found that people intend to supplement public pension inadequacies (multiple response) mainly by working (42%) and reducing living standards (34%), while relying relatively less on spending out of savings (31%). However, people with incomes of 10 million yen or more prefer to supplement their public pension by spending out of savings (50%) rather than lowering living standards (29%).

This finding suggests that in marketing annuities, and particularly risk-bearing variable annuities, the emphasis should shift from simply guaranteeing retirement income, to achieving retirement goals such as maintaining a comfortable living standard and living in leisurely financial comfort.

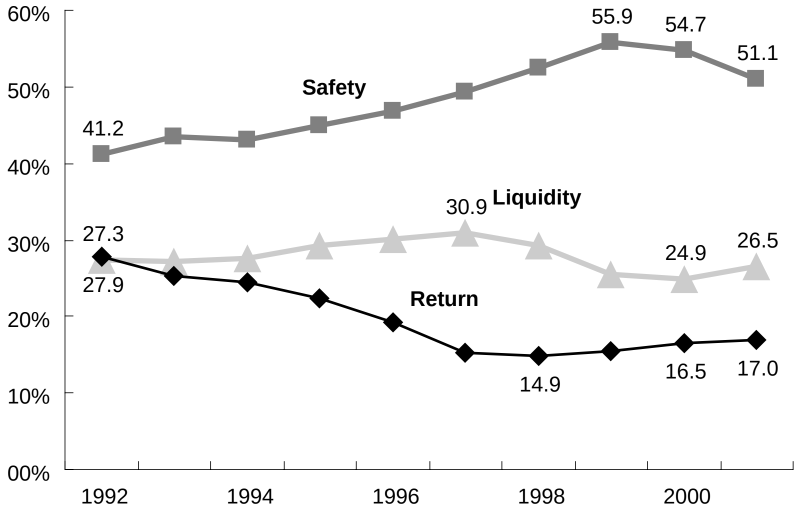
In an interview survey by NLI Research Institute of persons near or already in retirement, low anxiety and a strong inclination to enjoy retirement were found among persons who own homes and have (or expect) retirement income.

(2) Awareness of Risk Products — The Declining Emphasis on Safety

Since variable annuities involve investment risk, we next examine financial awareness with regard to risk tolerance.

According to the Central Council's survey mentioned above, with regard to the three selection criteria for financial products — safety (principle is guaranteed, have confidence in my financial institution), liquidity (can deposit or withdraw small amounts freely, easily convertible into cash), and return (high yield, expect price to rise in future) — the emphasis on safety remains strong, but in recent years a small yet growing number of households emphasize investment return (Figure 6). This suggests that preferences of Japanese consumers, known for being conservative in selecting financial products, are changing as a result of the prolonged ultra-low interest rate environment and emphasis on individual responsibility and effort.

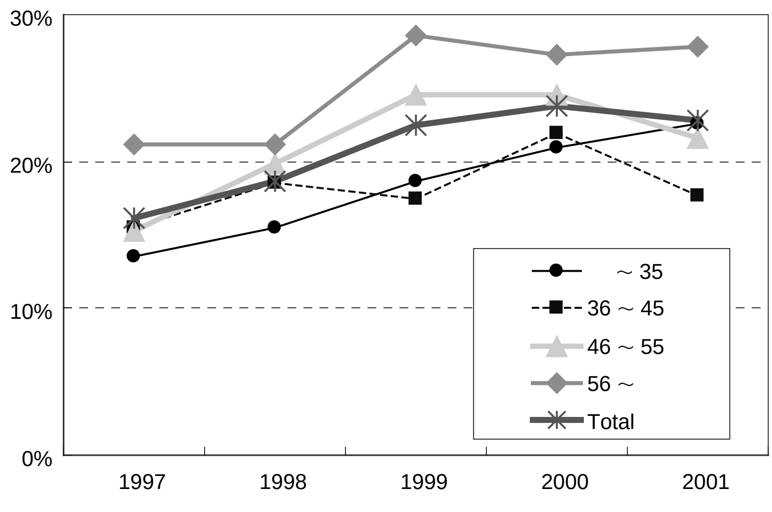
Figure 6 Relative Importance Placed on Selection Criteria for Savings



Source: Central Council for Financial Services Information, *Public Opinion Survey on Household Financial Assets 2001*.

The Nikkei survey also found an increase in people who are risk-tolerant and reject the statement, "If there is any chance of erosion of principle, I would not consider depositing or investing money regardless of a high expected return." This trend is particularly pronounced among persons age 56 and older, who are mindful of retirement life, and persons with financial assets of 10 million yen or more, who tend to be risk-tolerant to begin with (Figure 7).

Figure 7 Intention to Invest in Risk Products



Note: Shows percentage of persons who reject the statement, "If there is any chance of erosion of principle, I would not consider depositing or investing money regardless of a high expected return."
Source: Nikkei NEEDS-RADAR, *Financial Behavior Survey* (1997-2001).

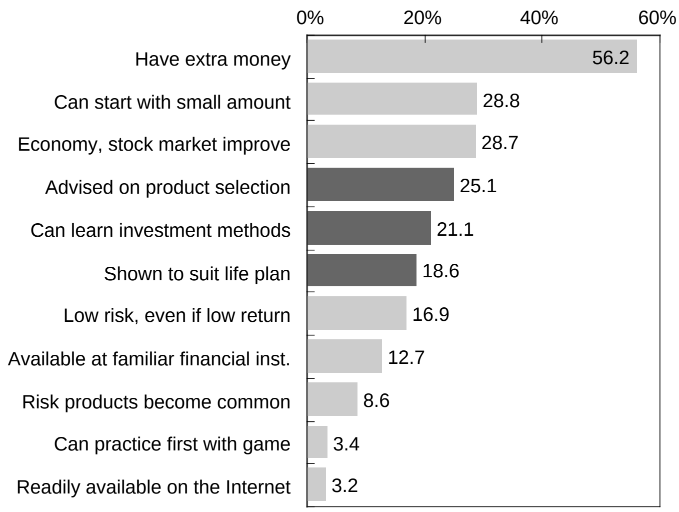
Of those who prefer to invest in risk products, slightly more tend to manage their own investments

(58%) than to invest in products managed by professionals (41%). Notably, over half prefer medium-risk, medium-return products (51%), followed by low-return, low-risk products (34%), and high-risk, high-return products (14%). This tendency is stronger among people mentioned early who have low anxiety and a strong inclination to enjoy retirement life.

Among persons who shun risk products, the top three conditions that would entice them otherwise are if they had unused financial resources, could start investing in small amounts, and saw improvement in the economy and stock market. From a marketing perspective, attention should focus on the next tier of conditions, which pertain to investment information and knowledge: availability of product selection advice, opportunities to learn about investment methods, and proposals that are compatible with a life plan (Figure 8).

While more people — particularly wealthy persons — are becoming risk-tolerant, for the majority of consumers who emphasize safety, marketing should focus on services such as providing necessary information and advice at the time of purchase, supporting the decision making process, and maintaining communication after the purchase.

Figure 8 Conditions Necessary to Consider Investing in Risk Products (multiple response)



(3) Interest in Asset Management and Information Sources — Using the Appropriate Media

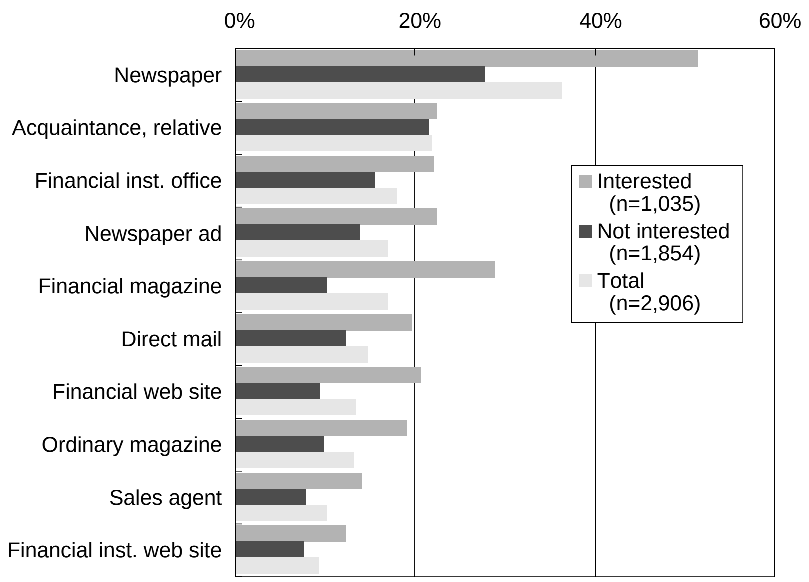
At present, since variable annuities are not well known, the first task of marketing is to increase their level of recognition. From the standpoint of efficiency, advertising campaigns aimed at doing so need to take into account the communication characteristics of the target market.

In the Nikkei survey, 36% of respondents expressed an interest in asset management, while 22% said they actively seek savings and investment related information from articles and advertisements in newspapers and magazines. In addition, persons interested in asset management strongly tend to seek information from newspapers and magazines, and the level of interest and inclination to gather information both increase with financial wealth.

Below we examine what sources of information people rely on when selecting financial products and institutions.

When selecting financial products, the top three sources of information are newspaper articles, followed by family/friends/acquaintances, and financial institution offices. However, over 30% of respondents rely solely on newspaper articles. By level of interest in asset management, interested persons rely more heavily on all information sources, the top three sources being newspaper articles, money magazine articles, and family/friends/acquaintances. The largest differences in information sources between interested and uninterested persons are in newspaper articles, money magazine articles, and financial web sites (Figure 9).

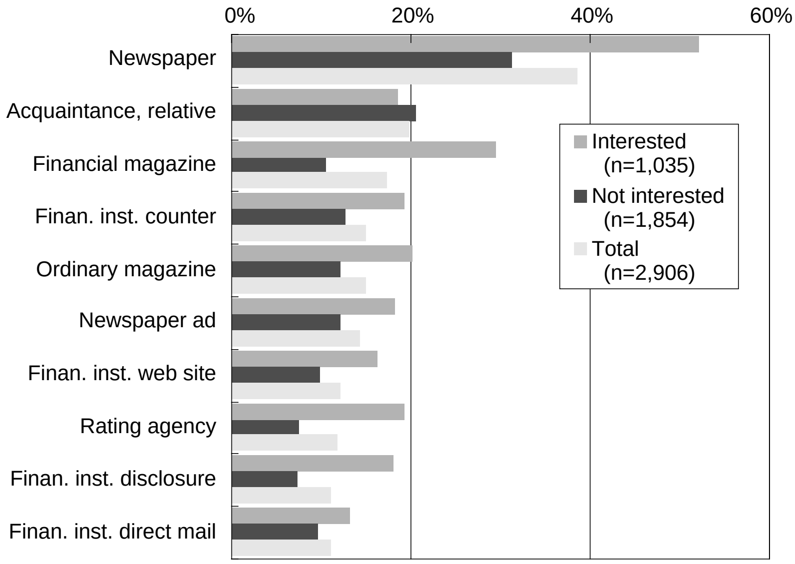
Figure 9 Information Sources for Selecting Financial Products, by Interest in Asset Management



Source: Compiled from Nikkei NEEDS-RADAR, *Financial Behavior Survey 2001*.

When selecting a financial institution, the top three information sources are newspaper articles, family/friends/acquaintances, and money magazine articles. Again, over 30% of respondents rely solely on newspaper articles. By level of interest in asset management, interested persons rely more heavily on all sources with the exception of family/friends/acquaintances, and the top three sources are newspaper articles, money magazine articles, and ordinary magazine articles. Differences between interested and uninterested persons are pronounced in newspaper articles, money magazine articles, rating agencies, and disclosure materials of financial institutions (Figure 10).

Figure 10 Information Sources for Selecting Financial Institutions, by Interest in Asset Management



Source: Compiled from Nikkei NEEDS-RADAR, *Financial Behavior Survey 2001*.

Thus when selecting financial products and institutions, the primary source of information consists of newspaper articles, which indicates the need to stress not only advertising but public relations activities. In addition, people who are interested in asset management apparently rely not only on newspaper and money magazine articles, but also refer to a broad range of professional sources. These results suggest the need to distinguish between the general and well-informed market segments when conducting advertising and PR activities.

4. Conclusion — A Variable Annuity Marketing Model

From the above analysis, the variable annuity marketing model that emerges is as follows (Figure 11).

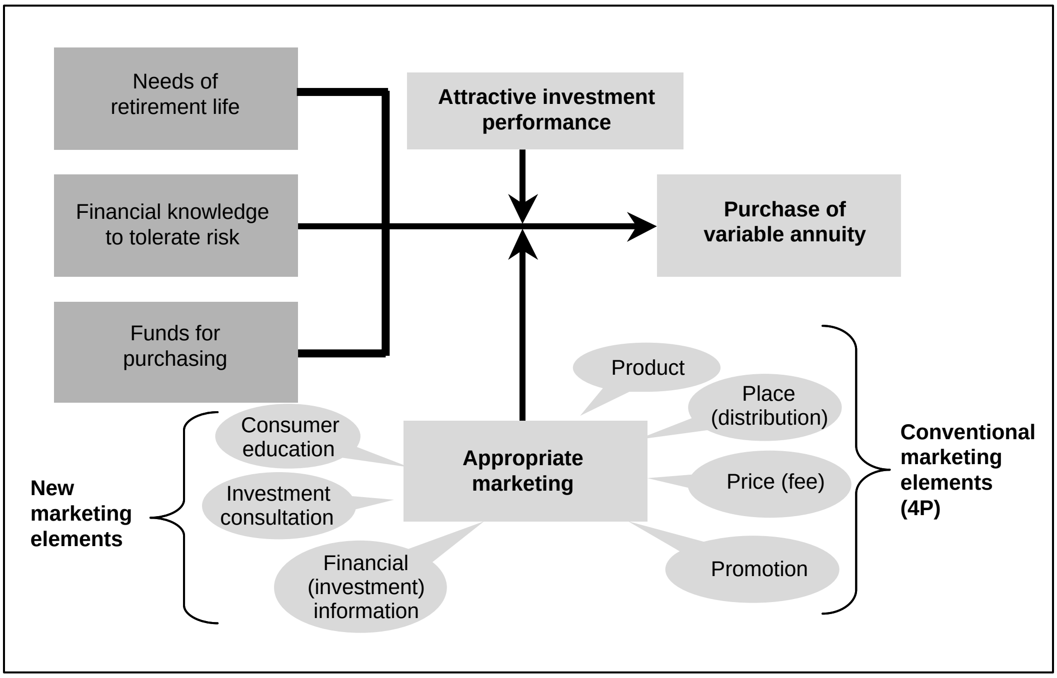
Based on the characteristics of variable annuities, the target market is as follows: (1) since the product is a long-term wealth-building product to meet retirement goals, persons seeking a comfortable retirement life, (2) since the product bears some risk, persons with knowledge of financial products who can tolerate risk, and (3) persons with a certain amount of available funds for purchase.

The marketing mix that corresponds to this target market must include not only the 4P’s of conventional marketing (product, price, promotion, and placement), but elements that reflect the characteristics of variable annuity products. Since the variable annuity market is new, and since annuity products require consumer management after purchase including transferring between funds and selecting the payout period, there is a strong need for service and communication elements as well.

In addition, of course, the performance of investment funds is also intricately tied to marketing.

Japan's consumers, long regarded as immature in financial matters, are starting to change as a result of financial liberalization, prolonged low interest rates, and the growing interest in wealth-building for retirement. From the perspective of consumers' awareness, this represents a fantastic opportunity for variable annuities. The best approach would be to prepare for a turnaround in the economy and stock market, while continually analyzing market changes.

Figure 11 Variable Annuity Marketing Model



Source: NLI Research Institute

Notes

1. A. Fliegelman, C. Slattery, R. Riegel, "Variable Annuity Sales and Surrenders: What is Really Going On," Moody's Special Report, July 11, 2001, p. 4.2.

2. H. Sugita, "Research on Variable Insurance," Fund Management, Autumn 2000, p. 16-17.