

Title: Where Less Is More: Reducing Variable Annuity Fees to Benefit Policyholder and Insurer

Authors: Thorsten Moenig, Carole Bernard

Abstract: In the United States, variable annuities (VAs) are popular long-term personal investment vehicles. Recently, however, sales have begun to dwindle. In fact, financial advisers have long argued against investing in VAs due to the products' high fees. VA providers charge these fees—typically at a constant rate throughout the policy period—to cover their expenses and the costs of embedded guarantees, and lowering this constant fee rate could make the VA unprofitable. Instead, we propose and analyze a simple change to the fee *structure* that would lower fee rates overall (and thus make the product more attractive to investors) without reducing the insurer's profit.

The key insight is that this time-dependent fee rate (with moderate front-loading) implicitly discourages policy lapses and exchanges, which reduces the providers' policy acquisition expenses. Taking into account financially optimal lapse (and reentry) decisions, we determine the optimal timing and rate of the fee reduction for a competitive as well as for an innovative VA provider. An important characteristic of this feature is that it can be implemented easily and effectively to both new and existing VA policies.