Equity-Based Insurance Guarantees Conference

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The Structured Variable Annuity

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The Structured Variable Annuity

Equity-Based Insurance Guarantees Conference
November 6, 2017
Session 1B: 1045 – 1215 hours
Ari Lindner

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The Structured Variable Annuity Market Status

- Has been available in US for over 5 years
- Rapid sales growth began in 2015
  - Volume quadrupled from about $0.5b to about $2b per quarter
  - Timing coincident with finalization of DoL fiduciary rules
- This growth contrasts with falling sales of traditional VAs
  - Structured VA sales are likely to approach or exceed 10% of total VA market in 2017-18
- Also vastly outpacing growth of Fixed Annuities – both fixed-rate and indexed
- Sizable issuers – AXA, Allianz, Met (now Brighthouse)
- Several new companies / products reportedly entering market in 2017

The Structured Variable Annuity
Risk / Reward

- Fixed Annuity – lowest risk / lowest return
  - No equity exposure, positive credited rate
- Fixed Indexed Annuity
  - Low equity exposure / caps, return cannot be negative
- Structured VA
  - Moderate equity exposure, some downside protection
  - Flexibility – upside potential can be traded for downside protection
- Traditional VA – highest risk / highest return
  - Full equity exposure / principal fully at risk
  - Guarantees (GLWB, e.g.) can be perceived as complex and expensive

The Structured Variable Annuity
General Description

- Tax-Advantaged Savings / Investment Vehicle
  - Competitive advantage over mutual funds include tax deferral and downside protection
- Account Value is increased / decreased based on performance of a selected index, within specified limits
- General Account product
  - Insurer directs investments
  - Guaranteed Separate Account is used for GA products with exposure to principal loss
  - Policyholder bears investment risk, but only within limits as defined in the product
  - Insurer is still responsible to provide crediting rate equivalent to return on the index as guaranteed by the product

The Structured Variable Annuity
Key Product Features

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- Duration
  - Offered for specific duration – typically between 1 and 6 years
- Index Selection
  - Various indices are available, ranging from S&P 500 to more volatile indices such as emerging markets, precious metals, and real estate
  - Selection of a longer duration typically requires selection of a less volatile index
- Upside Potential
- Downside Protection
- Fees
- Sold during a limited window or segment; repriced frequently

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Upside Potential

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- Maximum aggregate return over maturity period
- Maximum annual return during maturity period
- Fixed annual crediting rate if index return is positive
- May also be able to “purchase” more upside potential for a fee
- The payoff can be achieved through a combination of buying and selling call options

The Structured Variable Annuity Downside Protection

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- “Buffer” – company takes first dollar loss, policyholder fully exposed beyond that limit
  - Full protection in scenarios with small losses
  - Moderately reduced downside in scenarios with large losses
- “Floor” – policyholder exposed to losses up to a maximum, insurer fully exposed beyond that limit
  - No protection in scenarios with small losses
  - Substantially reduced downside in scenarios with large losses
- The protection can be achieved through a combination of buying and selling put options

The Structured Variable Annuity Structuring Example

- Duration: 1 Year
- Index: S&P 500
- Buffer: 10%
- Maximum upside: 5%
- Insurer approach:
  - Invest in 1-year Corp Bonds earning 1.5%
  - Sell S&P put struck at 90% for option premium of 6%
  - Buy S&P call spread struck at 105% / 100% for option premium of 6%
  - Use 2% investment yield (plus additional fees, if any) to cover distribution and administrative costs

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Trade-off Examples: Duration

(Examples do not reflect any single specific existing product)

- 1-year Duration Product
  - S&P 500, 10% Buffer, 5% maximum growth
  - MSCI EAFE, 10% Buffer, 6% maximum growth
  - DJ US REIT, 10% Buffer, 9% maximum growth
  - Gold SPDR, 10% Buffer, 2% maximum growth
- 5-year Duration Product
  - S&P 500, 10% Buffer, 40% maximum growth
    - Also available as 8% maximum annual growth
  - MSCI EAFE, 10% Buffer, 50% maximum growth
    - Also available as 8% maximum annual growth
  - DJ US REIT, Gold SPDR – unavailable at this duration

The Structured Variable Annuity
Trade-off Examples: Index
(Examples do not reflect any single specific existing product)

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- 6-year Duration Product:
  - S&P 500, 10% Buffer, 11% maximum annual growth
  - S&P 500, 90% Floor, 11% maximum annual growth
  - EURO STOXX 50, 10% Buffer, 25% maximum annual growth
  - EURO STOXX 50, 90% Floor, 25% maximum annual growth
- 1-year Duration Product
  - S&P 500, 10% Buffer, 5% maximum growth
  - MSCI Emerging Markets, 10% Buffer, 10% maximum growth
  - Gold SPDR, 10% Buffer, 2% maximum growth

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Trade-off Examples: Fees
(Examples do not reflect any single specific existing product)

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- 5-year Duration Product:
  - S&P 500, 10% Buffer, 40% maximum growth
  - Russell 2000, 10% Buffer, 45% maximum growth
- 5-year Duration Product with increased fee:
  - S&P 500, 10% Buffer, 65% maximum growth
  - Russell 2000, 10% Buffer, 65% maximum growth

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Trade-off Examples: Upside Potential
(Examples do not reflect any single specific existing product)

- 6-year Duration Product:
  - S&P 500, 100% guaranteed floor, 4% fixed annual credited rate if Index return is positive
  - S&P 500, 10% Buffer or 90% Floor, 11% maximum annual growth

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Trade-off Examples: Downside Protection
(Examples do not reflect any single specific existing product)

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- 5-year Duration Product – S&P 500 Index
  - 10% Buffer, 40% maximum growth
  - 20% Buffer, 25% maximum growth
  - 30% Buffer, 15% maximum growth
- 5-year Duration Product – Russell 2000 Index
  - 10% Buffer, 45% maximum growth
  - 20% Buffer, 30% maximum growth
  - 30% Buffer, 20% maximum growth

The Structured Variable Annuity Advantages vs. Traditional FIA or VA

- Transparency – Relatively simple to understand and explain
  - Could be important in a post-DOL world of increased fiduciary responsibilities
- Easy to dial into the desired risk / reward trade-off
- Compares favorably to VA guarantees with complex structures and payouts that occur over decades (GMIB, GLWB)
- Offers significantly more upside than traditional FIA
- Fees / cost – lower than standard VA with guarantees

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Disadvantages vs. Traditional FIA or VA

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- Duration – only short-term is available
  - May be hard to view as a retirement savings vehicle
- Sometimes too many choices can lead to buyer frustration
- Does not offer ratchet or roll-up features common in VA guarantees
- Offers significantly more downside than traditional FIA
- Does not offer lifetime income / longevity protection

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