A New Flavor of Variable Indexed Annuity

By Kerry Pechter *Thu, Jun 6, 2019*

“You can write this concept out on a cocktail napkin, and ask someone, ‘Are you comfortable with half the downside and more of the upside?’," said Thomas Layton, vice president of product management for Raymond James, who first proposed the new Great American Life contract.

Acting on a product design idea suggested by a Raymond James brokerage executive, Great American Life has launched a registered structured variable index annuity contract where the issuer splits any index losses 50-50 with the contract owner and uses the extra risk budget to boost caps and participation rates.

The new six-year product, the Index Summit 6, will be distributed through banks and independent broker-dealers by securities-registered advisors. Great American is currently the third biggest seller in each of those channels, according to **Wink, Inc**.

Distribution will not be exclusive to Raymond James and Raymond James has no proprietary claim on the product, executives at both companies told RIJ this week.

“Raymond James saw an opportunity in the marketplace, as we did in reviewing their analysis. The participation structure on both the downside and the upside is new to the marketplace,” said Joe Maringer, national sales vice president for Cincinnati-based Great American, in an interview.

The product offers crediting formulas linked to the S&P500 Index, the iShares MSCI EAFE exchange traded fund (ETF), and the iShares US Real Estate ETF through options. (In the second two choices, Great American uses options on the performances of the ETFs themselves, not on the performance of the indices they track.)

To achieve the strategy, “we sell a put and buy a call. That gives you a bigger lift from the index strategies,” Maringer added. The product has caps and participation rates on upside performance. Those will be reset every two weeks in response to changes in volatility and interest rates.

For the S&P500 Index, there are two crediting periods (at the end of which, interest is credited to the client and locked in), one-year and two-year. For each of those crediting periods, there’s a choice of cap rates (the most interest the contract owner can earn in a single term) or participation rates (the percentage of the positive index return to which the contract owner is entitled). There are one-year and two-year participation rates on the two ETFs, but no caps. There are slightly more generous sets of rates for premiums over $100,000 than under $100,000.

Since the contract owner accepts half of the downside risk, the insurer can offer attractive crediting rates. For premiums under $100,000, the current cap on the S&P500 is 10% for one-year terms and 18% for two-year terms. The participation rates on the S&P500 are currently 80% for both terms. There's also a fixed rate option, with current rates of 1.85% (over $100,000 premium) and 1.75% (under $100,000).

On the other two indexes, participation rates vary from 95% to 120%, depending on the crediting period and the premium value. Regardless of the crediting period, the client commits to holding the product for six years or paying a surrender penalty for withdrawals of more than 10% of the account value of the contract.

"GAIG [Great American Insurance Group] believes in keeping things simple, Maringer said. "There are no contract fees, no mortality and expense risk fees, no subaccounts and a return-of-principal death benefit. You need a security license to sell it and it can only be sold through a broker-dealer contract with Great American."

"You can write this concept out on a cocktail napkin, and ask someone, 'Are you comfortable with half the downside and more of the upside?'," said Thomas Layton, vice president of product management for Raymond James. Great American solicited ideas for new products from Raymond James, and Layton, a specialist in alternatives and structured products, came up with this one.

"The same concept has been used in the ETF space, where a common structure has been, 'You get 130% of the upside and 30% of the downside.' My background is in alternatives, so I'm familiar with the less common, more structurally sophisticated concepts," Layton added.

Raymond James was looking for another six-year variable index product that would fit in with the six-year structured variable index products already on its shelf, one that would offer something new while having the same compensation levels so that advisors could make unconflicted recommendations among similar products, Layton told *RIJ*.

"Our top sellers tend to be seven-year or five-year products. Index Summit at six years was targeted to align with other providers in this market," Maringer said. "AXA, Allianz Life and Brighthouse, the three core tenured providers, all have six-year products at brokerages.

We're new to the index variable annuity market. We've only been doing this for about 15 months."

Other structured variable index annuity contracts have generally offered downside buffers (where the insurer might absorb any index loss up to five percent or 10%) or downside floors (where the insurer absorbs any index loss in excess of five percent or 10%). These structures distinguish them from conventional fixed index annuities, which can insure the contract owner from any index loss.

Like other variable index annuities, the Index Summit 6 is an accumulation-oriented product with no optional or built-in income rider. "With the first generation of the product we wanted to focus on accumulation. If simplicity is important, you don't want to layer on an income rider to a product that's already complex. You can always annuitize it, though that option is seldom used," Maringer said.

Great American has simulated the performance of the Index Summit 6 (linked to the S&P500 and with a participation rate of 75%) over hundreds of one-year periods between 2001 and 2018 and found that it would have produced average one-year returns of 6.78%, with a high of 51% and a low of -24%. For the bull market years of 2009 to 2018 (inclusive), the same contract would have produced an average annual return of 8.62%, according to Great American documents.

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