A New Kind of Income Annuity

By Kerry Pechter   *Thu, Jun 18, 2020*

Achaean Financial and Ash Brokerage, a large Fort Wayne, Ind., BGA, are partnering on a potential retirement game-changer: Achaean's immediate indexed income annuity, couched in Ash's JourneyGuide planning software. The underwriter has yet to be named.

The first baby boomers reached age 66 eight years ago, but still no one has brought to market a scalable, plug-and-play, broadly appealing retail financial product that middle-class Americans can use to convert savings into pension-like lifetime income streams.

While a variety of income products exist, they haven't quite satisfied the diverse (and sometimes conflicting) demands of retirees, advisers, academics, regulators, and life insurance companies. Nothing checks enough of those boxes to fill the gap that defined benefit pensions used to fill in the wallets of American retirees.

But now a group of entrepreneurs in the Midwest think they've cracked the code.

Achaean Financial, a Lake Forest, Illinois-based financial product developer, with **Ash Brokerage**, an independent brokerage general agency based in Fort Wayne, Indiana, and a soon-to-be-named life insurer are launching an immediate index-linked annuity. Starting within a year of purchase, it generates monthly retirement income that can go up with inflation but never down.

This package may be unprecedented. The indexed annuity itself is called IncomePlus+ Indexed, or IP+ Indexed. It's one of a pair of products (the other is an immediate variable income annuity, with an investment-holding sleeve or "separate account") that former Lincoln Financial executive Lorry Stensrud has been developing for the better part of a decade. (Both versions of IP+ are protected under a patent originally issued by the U.S. Patent and Trademark Office in June 2014 with subsequent patents pending.)

In Tim Ash, Stensrud has found a distributor as enthusiastic about retirement income as he is. (Ash even uses the "D word"—decumulation—on his website.) The two firms have a non-exclusive partnership where IP+ and Ash's proprietary **JourneyGuide** retirement planning software will be marketed together, but also separately, to Ash Brokerage's 8,000 affiliated advisers and other advisory and distribution organizations.

"We're at the cusp of rolling it out," Tim Ash, CEO of Ash Brokerage, told *RIJ* recently.

Tim Ash

"Dozens of broker-dealers have expressed interest in IP+, and a few hundred advisers are licensing JourneyGuide," he added. "We're working with a well-known global financial services company and hope to announce a joint-venture with it that involves JourneyGuide. The expected underwriter of IP+ Indexed is an A-rated U.S.-based life insurer, to be announced in the coming weeks."

As we did a year ago, *RIJ* is devoting much of its coverage in June to the topic of index-linked retirement products. The options strategies in indexed variable annuities (IVAs) were our focus on June 11. On June 4, we provided an analysis of first-quarter IVA sales, based on data from **Wink, Inc**. This week we write about a hybrid product that blends features of an indexed annuity and a single premium immediate annuity.

The method to our madness

Before we unpack the Ash-Achaean strategic partnership, let's pause to consider a question that might be on your mind, especially if you're a fee-based adviser: "Why annuities? Why insurance contracts? Why not rely on **Modern Portfolio Theory** (MPT) and diversify the clients' risks among uncorrelated risky assets, like good old stocks and bonds?"

The short answer: Mortality credits and guarantees. Without an annuity, a retiree can't accrue mortality credits (the extra income that comes from pooling longevity risk with other retirees) or get guarantees (which help retirees reserve their risk budgets for other opportunities). Low bond yields only make mortality credits more important. Guarantees help retirees sleep better at night.

But why an *indexed* annuity? Weren't indexed annuities the bad boys of the insurance world? Yes, but times have changed. Most life insurers now see options (the reactor core of indexed annuities) as a safer, more productive way to get upside than either stocks or bonds, especially for the delivery of lifetime income. Now back to our story.

FIA engine on a SPIA chassis

Capturing mortality credits in IP+ Indexed was an essential design goal for Stensrud, Achaean's CEO and a past retirement executive at Lincoln Financial. A SPIA can do that, but SPIAs didn't meet Stensrud's other design requirement: the ability to deliver rising income in retirement.

So, with Milliman actuary Tim Hill, Stensrud and his team welded an indexed annuity engine onto a SPIA chassis. The result is a SPIA that, like a fixed indexed annuity, captures part of the equity-market's gains though the purchase of call options. IP+ Index also has a "surplus" fund to even out the monthly income across fat and lean years.

Lorry Stensrud

"Our edge is three-fold. It's longevity-based, so you get mortality credits," Stensrud said. "Benefit two is that we have the greatest potential for increasing income. Benefit three is the surplus account."

As Hill described it, IP+ Indexed works like this: A contract owner's purchase premium would go into a life insurer's general fund. That premium, plus the growth of the general fund, finances lifetime income that can't go down, plus options on an equity index. When the index rises, those options appreciate in value and supplement the client's base income.

"We envision a three-year call option to start," Hill told *RIJ*. "For the first three years [the client's] income wouldn't increase. At the end of the third year, we'll look at how the index performed. If, for instance, the index were up 9% at the end of the third year, we would divide that by three and get 3%. In years four, five and six, we'd give the client the lesser of 3% or the inflation rate for the previous year."

If inflation were one percent in the fourth year, for example, the client's income would go up by 1%. The other two percent would go into a "smoothing" account (the surplus account), to grow at the same rate as the general fund. In years when equity gains don't cover inflation, "we can add money from the smoothing account," Hill added. "The goal is to deliver a smooth, well behaved, gradually increasing income stream using index methodology.

"Retirees might put 20%, 30% or 40% of their nest egg into IP+, to provide a layer of income on top of Social Security," he said. "Payments would start out about five to eight percent lower than a straight SPIA, but higher than an inflation-adjusted SPIA. Then they'd increase over time." Each increase establishes a new minimum guaranteed income level.

"As the surplus account grows, it can be used to offer income increases greater than inflation since the purpose of the product is to provide retirement income and not to accumulate a store of funds. Any balance in the surplus account becomes a death benefit. It is always the policyholder's money," said Lawrence Ryan, Achaean's executive vice president.

IP+ Indexed is also more liquid than a SPIA. "If your circumstances change, you can take money out," Hill said. "If you took out 20% of your money, for instance, your payments would go down by 20%. The total cash surrender value would be the [original] premium, minus income already paid out, with a market-value adjustment" for interest rate risk.

No trade-offs

Over the last several years, while Stensrud and Hill were perfecting their products and looking for a way to bring them to market, Ash was fine-tuning JourneyGuide, a tool designed not only for planning but for providing all the tests and documentation that registered reps at broker-dealers are expected to need in order to comply with the SEC's "best interest" ethical standard for advisers, which goes into effect at the end of this month.

Though JourneyGuide is product-agnostic, Ash was also looking for income annuities that would improve retiree outcomes. So, after Stensrud and Ash Brokerage had their first meeting 18 months ago, Ash asked his team (headed by former Goldman Sachs financial engineer Michael Smith) to run Stensrud's product through a JourneyGuide stress test.

JourneyGuide uses Monte Carlo simulations to see how well a product, relative to competing products or strategies, improves the size and sustainability of client's income in retirement. "We do over five million calculations to test a product's performance over poor markets, average markets, and bull markets," Ash told *RIJ*.

"The tests show us the trade-offs in the product. The interesting thing about IP+ Indexed was that there were no trade-offs. For people who want income now, it outperformed just about every other instrument in the annuity space." The competition included indexed annuities with guaranteed lifetime withdrawal benefits that deliver optimal income only after a 10-year waiting period.

A survey of Ash advisers showed demand for IP+ Indexed, at least in principle. At a recent Ash Brokerage Retirement Income Summit, 41 out of 51 advisers said they would be "highly likely" (based on a scale of 7 or more out of 10) to offer the product.

With respect to adviser compensation—always a factor in the annuity distribution world—IncomePlus+ Indexed can be sold either by commissioned registered reps or fee-based advisers. JourneyGuide uses a tool, created by CANNEX, to calculate the net present value of the expected annuity payments at any point during the life of retiree. The adviser can then apply his fee ratio to that number.

Satisfying 'Reg BI'

With the Security and Exchange Commission's Regulation Best Interest going into effect at the end of this month, advisers need products that demonstrably serve a client's "best interest." As those who familiar with the world of annuity sales know, advisers often recommend that clients swap old annuities for new ones, especially when there's no early-withdrawal penalty for doing so. These swaps—called "1035 exchanges"—have long been a large source of new annuity sales.

To discourage churning by advisers, however, regulators require that replacement contracts be more valuable for the contract owner than the old contracts. That's sometimes difficult to do, in part because older annuities—especially variable annuities with living benefits—are often more generous than newer ones.

IP+ Indexed is designed to solve this problem. Monte Carlo simulations have shown that it can deliver more monthly income, with a better chance of keeping pace with inflation, than the guaranteed lifetime withdrawal benefits on either variable annuities or indexed annuities.

What fees are associated with this product? As with most annuities that are sold by commission-taking advisers, the manufacturing and distribution costs are baked into the payout rates. The insurance company might charge 1.5% of the client's account balance each year (about a third of what it earns on the client's investment) for overhead and guarantees. Advisers might get either a 0.75% (of principal) trail each year by the insurer (if they work on commission) or 1% a year by the client (if they are fee-based) for ongoing advice.

Costs aside, IP+ Indexed, coupled with JourneyGuide, could be the solution that breaks through the insurance–investment barrier, and convinces a significant number of advisers and clients that combinations of insurance and investments are the most efficient way to finance retirement.

"This is the industry challenge," said Ash. "Advisers still don't know how good annuities are and they don't know how to integrate them into financial plans." But he believes the JourneyGuide software can show advisers how to do that, whether they use IP+ Indexed or another product in their plans. "We didn't build JourneyGuide to sell annuities," he said. "But we did prove that certain annuities may dramatically improve retirement outcomes."

For previous *RIJ* articles on Achaean Financial and JourneyGuide, click **here** and **here**, respectively.