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## **Anatomy of AXA's New VA Buy-Back Offer**

By Kerry Pechter    *Mon, Jul 8, 2013*

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*The carrying costs of its VA riders are hurting AXA Equitable's bottom line. A new GMIB rider buy-back offer is intended to reduce those costs. But will contract owners want to sell their rich, once-in-a-lifetime guarantees?*

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Its generous variable annuity living and death benefits made AXA Equitable Life the top seller of VA contracts for 2007, when the so-called VA arms race was near its height. Now the unit of France's AXA Group wants to buy some of those rich guarantees back from their owners.

On July 1, AXA Equitable filed an N-4 [registration statement](#) with the Securities and Exchange Administration describing the terms of an exchange of cash for the surrender of GMIB (guaranteed minimum income benefit) rider on in-force Accumulator VA contracts, including the Plus, Elite and Select versions of the product.

The offer is voluntary, according to the statement. It is aimed at contract owners with GMIB riders that are "in the money." These would be in-force riders where the amount of money that can be used to buy a life annuity (known as the "benefit base") is larger than the current cash value of the contract.

Judging by the hypothetical examples provided in AXA Equitable's SEC filing, contract owners who accept the buyout could receive up to roughly half the difference between the benefit base and the account value in cash. For instance, if the contract's benefit base is \$150,000 and the account value is only \$90,000, the owner could exchange the guarantee for a payment of about \$30,000 (for a new account value of \$120,000).

The riders on VA assets generate fees; the fees apparently do not, in the view of AXA Equitable management, justify the level of reserves the riders require or the cost of the derivatives—options, futures, swaps and swaptions—required to hedge the equity and interest rate risks implicit in the guarantees. Today's low interest rates make hedging more expensive and they reduce the insurers' revenue on their fixed income investments.

Hence the logic of at least trying to buy back some of the benefits—benefits that the company wouldn't be trying to buy back unless they were valuable to the contract owner. It's difficult for a VA issuer to estimate its exact exposure on such riders, since no one knows exactly how the contract owners might allocate their assets or exercise their rider options in the future, or how the equity and fixed income markets might behave in the future. It's unknown if, 30 years from now, VA riders will turn out to be a net gain or net loss for an insurer. In the meantime, however, the carrying costs can be onerous.

The July 1 filing is only the latest move by AXA Equitable to trim some of the risk off its VA book. In 2012, the Company suspended the acceptance of contributions into certain Accumulator contracts issued prior to June 2009 and initiated a limited program to offer to buy back from certain policyholders the guaranteed minimum death benefit ("GMDB") rider in their Accumulator contracts. The Company also took steps to

limit and/or suspend the acceptance of contributions to other annuity products.

This morning, an AXA Equitable spokesperson sent *RIJ* this statement: "Following on the strong contractholder interest in our previous offer, we have decided to make our voluntary program available to a broader customer base. This voluntary, opt-in, no-fee program allows contractholders the option to cancel certain features of their contracts in exchange for an increase in their account value. Our commitment to meeting our promises to policy- and contractholders is unchanged. We will continue to offer and develop variable annuity products that provide retirement savings and financial protection solutions for our customers."

### **Framed as a 'win-win'**

So far, AXA Equitable, Transamerica/Aegon and The Hartford have made VA rider buy-back offers. (Both Transamerica/Aegon and AXA Equitable have European-domiciled parents, and U.S. life insurers with foreign parents have been under special pressure to de-risk or even abandon the VA business in the wake of global financial crisis that began in 2008.)

Although the fine print in the contracts is designed to give the insurers the flexibility to reduce the generosity of their products and to make buy-back offers, such moves have been controversial. A buy-back offer can suggest quiet desperation on the part of the insurer—not what a guarantee provider wants to suggest—and could put the advisor who sold it in the complicated, potentially conflicted position of reversing a previous recommendation to a client. It raises questions about the safety of the guarantee and the insurer's ability to price its guarantees. It could potentially harm the insurer's brand.

AXA Equitable is framing the buy back offer as a potential win-win, especially for people who planned to surrender their contracts or drop the rider anyway. "You would benefit because you would receive an increase in your contract's account value and your Guaranteed Benefit charges would cease," says the N-4 filing. "We would gain a financial benefit because past market conditions and the ongoing low interest rate environment make continuing to provide these Guaranteed Benefits costly to us. Providing the lump sum payments will be less costly to us than the amounts we are currently setting aside to guarantee the benefits."

The insurer is treading carefully. It may be mindful of the negative publicity triggered by The Hartford's May 1 announcement of its intention to allow current VA contract owners to keep their living benefit riders only if they accepted new reductions in their range of investment options and to cancel the living benefits if the contract owners didn't respond to the announcement within a certain period of time. The "negative option" tactic was seen as a heavy-handed move that The Hartford couldn't have risked had it not already sold its de novo annuity business to Forethought.

### **Irresistible riders**

Back in 2007, some of the riders on the Accumulator VAs were virtually irresistible. Starting in May 2007, a 6.5% "roll-up"—an annual increase in the benefit base—was offered on the GMIB and the GMDB. The roll-up lasted until age 85. What's more, a contract owner could withdraw an income of up to 6.5% of the

benefit base from the contract each year without reducing his or her right to annuitize an amount no less than the initial purchase premium.

These features helped AXA Equitable—at whose predecessor firm, Equitable Life, a group led by Jerry Golden had originated the GMIB in 1996—attract about \$15.5 billion in VA premia in 2007. But then the crash and the long interest rate drought converted those VA contracts from a mother lode to a millstone.

AXA Equitable had \$96.7 billion in VA assets at the end of the first quarter of 2013, according to Morningstar. As of last 2013, the total account value and net amount at risk of the hedged VA contracts were \$39.583 billion and \$5.966 billion, respectively, with the GMDB feature and \$22.689 billion and \$2.099 billion, respectively, with the GMIB feature, according to AXA Equitable's latest 10-Q filing. Because these programs don't qualify for hedge accounting treatment, their losses are recognized in net investment income and can hurt earnings.

And they have. According to the 10-Q, "changes in free-standing derivatives, in the fair value of GMIB reinsurance contracts, and changes in VA rider reserves" reduced AXA Equitable earnings by \$1.924 billion in the first quarter of 2013. The same factors created a loss of \$2.724 billion for the first quarter of 2012 and a loss of \$826 million for all of 2012.

Stock analysts, of course, keep a close eye on such things. AXA ADRs (American Depositary Receipts), valued in U.S. dollars, were traded on the New York Stock Exchange from June 25, 1996 to March 25, 2010, when AXA delisted. Since March 26, 2010, AXA ADRs have been traded in the U.S. over-the-counter (OTC) market and are quoted on OTCQX. AXA Equitable has an A+ rating from Standard & Poors', an Aa3 rating from Moody's and an AA- rating from Fitch.

AXA Equitable is still very much in the VA business. But over the past two years it has shifted its product focus to the Structured Capital Strategies variable annuity. This so-called "buffered" product works much like an indexed annuity but is registered as a security product with the SEC. At last month's IRI Government, Legal and Regulatory Conference, SEC staff members mildly criticized the issuers of buffered products (MetLife also offers one) for presenting them as risk-mitigating products when in fact the contract owners have potentially large risk exposure during deep market downturns. The SCS product has garnered well over \$1 billion in sales.

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