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How Equitable Invented the Structured Annuity

By Kerry Pechter *Thu, Jun 11, 2020*

Indexed or "structured" variable annuities are on track to be a $20 billion business this year. The product, born of necessity, emerged from AXA's [now Equitable's] Innovation Hub ten years ago.

In 2008, the Great Financial Crisis hit Equitable (then AXA Equitable) hard. It had been a big competitor in the pre-crisis variable annuity "arms race," where life insurers outdid each other with generous deferral bonuses on guaranteed lifetime withdrawal benefit riders.

When the stock market crashed and interest rates dropped, the assets that supported those guarantees lost value. Some VA issuers had to pony up lots of fresh capital. Equitable's French parent (much like ING-USA's Dutch parent) wanted to reduce its exposure to VAs.

So Equitable developed new products (while also offering to buy back some of its most costly VA contracts). The first new contract was its Retirement Cornerstone Series of VAs. The Cornerstone product had two investment sleeves, one risky and the other not. The value of the non-risky sleeve supported the income rider, and the client decided how to allocate between the two sleeves.

Then, though Equitable wasn't a manufacturer of fixed indexed annuities, and its AllianceBernstein sibling didn't create structured notes, Equitable's in-house Innovation Hub, established after the financial crisis, invented the indexed variable annuity. Basically a structured note in an annuity wrapper, it used options to define the contract owner's upside potential and level of downside protection. Though the contract owner would have the ability to convert the IVA value to a lifetime annuity if so desired, the product was intended mainly for accumulation.

Thus was Structured Capital Strategies (SCS) born. Thriving through the teen years of the 21st century, this product sparked what today is a healthy and growing $20 billion-a-year business. SCS has led this market in sales every year ($1.227 billion in the first quarter of 2020).

Equitable recently added a new feature to the SCS product suite, called **Dual Direction**. If the S&P 500 Index has lost up to 10% by the end of a five-year term, the client receives the equivalent percentage, up to and including 10%. If the market grows, the client can experience up to 100% of the upside gain over the five-year period.

Recently, *RIJ* spoke with Robin M. Raju, head of individual retirement at Equitable. When we asked Raju for the SCS "genesis" story, here's what he told us:

Robin M. Raju

"Coming out of the [2008] crisis, it was clear that the variable annuity with living benefits was not economically sustainable. We wanted to get out of competing to offer the highest guaranteed roll-up rates. That's when we switched to our Cornerstone product, which lent itself to a rising interest rate environment. We also did what we always do: We went out and started talking to our clients.

"We're fortunate to have access to a force of 5,000 affiliated advisers. This was back in 2008 or 2009. Everyone was holding cash on the sidelines. We asked people, what type of product would you like to see in terms protecting retirement income. We also asked, what has changed for you? What are the needs of clients now? We found that people still wanted exposure to the equity markets. They also wanted some downside protection.

"Then we consulted with our internal think tank, the Innovation Hub. We have a good derivatives team, so we brought the problem to the team, and asked, Can this be solved with options in the financial markets? They said it could.

"What the client's money earns in the general account—that money would fund part of the upside. With the Dual Direction enhancement that we introduced this year, we buy a call and a put at-the-money [i.e., options to buy or sell at the current price]. We also sell an out-of-the-money put to reintroduce the downside exposure beyond -10% (i.e., create the buffer), and buy and sell an out-of-the-money call to set the upside cap and finance the structure.

"Today, in our S&P 500 Index version, we can provide protection as far down as -10%, and still give the client 100% of the upside. [See today's lead story for a description of the options strategy for more conventional IVAs.]

"Working with our affiliated advisors, we were able to sharpen the marketing story. It had to be simple, and not about all the bells and whistles of the product. So when we went to third-party distributors, we had a good story, and it was not about rates. It was about protection.

"This is a great product for these times, which are a lot like 2009-2010. There's so much money sitting in cash, and this is better than cash. But it takes time to educate, to achieve growth, and to drive more growth. Two-thirds of our current sales probably come from third-party distributors, and about one-third from our affiliated force. We love the competition from other life insurers because it increases the overall size of the pie.

"To make this more transparent to the client, we created an app. It's a simple app that advisers can use with clients or clients can use on their own. We update the cap rates every two weeks [on new contracts], and that reflects the market conditions. If volatility goes up, it produces higher upside participation. We've seen periods of high and low volatility since 2010, and the value proposition has held up well. The client benefit is always there."