In FIA Arms Race, Hybrid Indexes are the Arms

By Kerry Pechter *Thu, Jun 11, 2015*

Investors in Nationwide's New Heights fixed indexed annuities have a new index option: a globally diversified, multi-asset managed-volatility index from JP Morgan called MOZAIC.

In a year when fixed indexed annuity sales are on pace to pass $40 billion again—that figure is still a fraction of variable annuity sales but it’s indicative of the busiest sector of the annuity space—issuers continue to add new contract features. Notably, they’ve added volatility-controlled indexing options.

Nationwide furthered that trend this week when it began offering the J.P. Morgan MOZAIC Index (USD), a managed-vol, multi-asset balanced global index, as the third of three index options (with the S&P 500 and MSCI EAFE indices) on its series of four New Heights fixed indexed annuity contracts.

By giving an investor exposure to a gains of balanced index, especially one that’s also volatility-controlled, an FIA issuer can, without danger of over-promising, offer investors more participation in the index gains than it can when investors link to an all-equity index like the S&P 500—precisely because the upside won’t be as great. For the investor, it has the potential to deliver a larger piece of a smaller pie. In that respect, it resembles the managed-vol options in VAs that allow issuers to offer five-percent annual roll-ups while still controlling their risks.

For background: Though an FIA mainly holds bonds, a small percentage of the contract owner’s premium in spent on options on one or more indexes. The price of the options typically varies with the volatility of the underlying index. Options on diversified indexes, because of their lower volatility, tend to cost less, so the issuer can afford to buy more options. That can translate into potentially larger gains.

FIAs come with a variety of crediting methods, alternately offering clients all of the index upside beyond a “spread,” or all of the upside up to a “cap.” With interest rates so low, insurers have had to put establish very modest caps; as a result, uncapped spread products, which appear more generous, have gained popularity.

More than a quarter (26.7%) of all first-year indexed annuity allocations went to such hybrid indices in the first quarter of 2015, said Sheryl Moore, founder of Wink, an FIA data aggregator. “The use of these ‘hybrid’ indices is growing because they give the annuity marketers an opportunity to promote ‘uncapped’ potential for gains. They are frequently volatility-controlled or have a cash component to the index.”

“Nationwide has introduced 8-, 9-, 10-, and 12-year surrender charge versions of [the New Heights FIAs],” Moore told *RIJ* in an interview. “The eight and 10-year versions use a two-year term end point crediting method with a forced asset allocation,” she added. “The nine and 12-year versions use a three-year term end-point crediting method with a forced asset allocation.”

Nationwide said it selected MOZAIC because it adds a balanced index to the two existing equity indexes, and because it has established a six-year track record. It was created in late April 2009, and has returned a 4.9% annualized return since then. According to J.P. Morgan, if you include back-testing, it has produced a 5.53% annualized compound return (before fees and transaction costs) since the end of 1999, compared to 3.28% for the S&P500.

“The New Heights FIAs offer principal protection and earning potential beyond what’s offered by traditional fixed indexed annuities,” said Eric Henderson, senior vice president of life insurance and annuities at Nationwide, in a release.

MOZAIC “rebalances a diverse range of asset classes and geographic regions each month to create positive returns with low volatility,” the Nationwide release said. There are three U.S. asset classes, three German asset classes, two Japanese asset classes, and four commodities, encompassing equities, bonds and commodities. There’s a maximum issue age of 80 and a minimum purchase premium of $25,000.

For those who want the gnarly details, Nationwide offers this description of MOZAIC’s “stop-loss” volatility control method, which favors asset classes with the most momentum:

> “Asset classes are evaluated, selected and weighted monthly. If on any day the overall index’s weekly return is less than -3%, all allocations are removed for one week (the index is effectively uninvested). After one week, the Index re-establishes allocations based on the monthly selection and weighting described above. To the extent the week following the triggering of the ‘stop-loss’ feature sees an additional 3% decline, allocations will be removed for an additional week. This may reduce the risk of potential short-term loss in the index during a period of significant market distress, but may also cause the index to miss a potential recovery in the underlying asset classes.”

For additional fees, contract owners can add the High Point 365Lifetime Income Benefit rider and/or the High Point Enhanced Death Benefit rider. Both riders offer clients the greater of the growth of their contract value (to new high-water marks, if any) or a fixed rate roll-up. Only one of the riders can be purchased per contract.

The High Point 365 Lifetime Income Benefit rider costs 95 basis points per year. It offers the larger of a two percent annual roll-up for the first 10 contract years or until the date the lifetime income payments begin. There's an optional 3% contract bonus that, if elected, raises the rider cost to 1.25% per year. The bonus is gradually vested over 10 years, at the rate of 10% per year.

In a product illustration provided by Nationwide, a hypothetical couple invests $100,000 in a joint-life New Heights FIA at age 50 and qualifies for a higher payout percentage with every year they delay taking benefits. The payout rate in the illustration is 5.50% at age 63, gradually rising to 12.3% at age 75. But a note to the illustration says that the "payout percentages illustrated are a hypothetical model."

The Enhanced Death Benefit rider costs 50 basis points per year (rising to 80 basis points if a 3% contract bonus is elected) and guarantees at least a four percent per year appreciation in the death benefit, up to 200% or age 80, whichever comes first, minus withdrawals and fees.

New Heights will be distributed by Annexus, an FIA product designer and distributor of FIAs through independent marketing organizations, or IMOs. Annexus also contributed to the creation of the New Heights investment lineup. New Heights will also be broadly available through Nationwide's affiliated agency force, to independent distributors and in the bank and wirehouse channels.