New Allianz Life VA income rider enhances withdrawal rate, not benefit base

By Editor Test *Wed, May 2, 2012*

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There's a novel approach to risk and reward built into Income Focus, the new optional variable annuity lifetime income rider from Allianz Life Co. of North America and Allianz Life Insurance Co. of New York.

The new rider assures contract owners that for every year when their account value beats a certain hurdle rate (equal to the total expense ratio or, in the income phase, the expense ratio plus the payout rate), their withdrawal rate will go up by full percentage point.

In other words, instead of tempting the client with a guaranteed rollup in the benefit base every year, Income Focus enhances the withdrawal rate. And, instead of guaranteeing that enhancement, Allianz Life makes it contingent on market gains.

That's a "simplified way of managing the risks" of a living benefit rider, Allianz Life says, and managing risk is a sine qua non for U.S. VA issuers—especially for those issuers, like Allianz Life, whose parents are European-based and will be subject to the still undetermined Solvency II reserve requirements.

"To our knowledge, this is entirely new. We built this from scratch," said Robert DeChellis, president and CEO of Allianz Life Financial Services, in an interview. "Our objective was to simplify the process for people who are trying to achieve a target income in retirement."

Here's an example of how the rider works:

If a 65-year man bought a single life version of the rider and paid an initial premium of $100,000, he would be eligible to withdraw 4.25% of his contract per year. At the conclusion of each contract year prior to taking income, if contract value (net of all fees) is greater than the contract value was a year earlier, then his withdrawal percentage would go up by one full percentage point.

That is, if the client's account value after one year is greater than $100,000 after all fees had been deducted—and the annual contract fees can run to 350 to 400 basis points, all in—then the withdrawal percentage goes up by a full percentage point.

For Income Focus, the withdrawal rates are 3.75% for contract owners ages 60 to 64, 4.25% for contract owners ages 65 to 79, and 5.25% for those ages 80 and over. The withdrawal rate mark-ups are available to contract owners ages 60 to 90.

The client receives the withdrawal bonus uptick each year that the account value clears the fee hurdle rate during the accumulation period. When the income phase begins, the client can still receive an annual withdrawal bonus uptick, but only in those years when the account value clears a hurdle equal to the fees plus the distribution from the account.

As for downside protection, the contract guarantees that the owner will receive an annual income no less than the initial withdrawal percentage times the initial purchase premium. In the example above, that would be 4.25% x $100,000 or $4,250 a year.

Over the years, “the hurdle will get harder and harder to beat” if the size of the withdrawals is increasing, DeChellis conceded, “but you still have the opportunity to benefit if the market goes up by 20% or 30%.” The rider fee is based on the account value, which is likely to shrink once the client starts taking income.

Along with the Income Focus rider, which became available on Allianz Life Vision, Vision New York and Connections VA contracts issued after April 30, 2012, two alternative riders are also available: the Income Protector (a GLWB with a 7% simple interest annual deferral bonus) and the Investment Protector (a GMAB, or guaranteed minimum account balance rider). Both of those have been available since 2007.

Contract owners who choose Income Focus must invest in one of the contract’s Managed Volatility Portfolios (MVP). Several such portfolios are available, with varying asset allocations, and all “use a risk management process intended to adjust the risk of the portfolio based on quantitative indicators of market risk,” according to the prospectus. The MVP fund managers can invest up to 20% of the assets in a combination of fixed income instruments and derivatives.

The annual cost of the Income Focus rider is 1.30% of the purchase premium (maximum 2.75% for single life and 2.95% for joint and survivor contracts). The mortality and expense risk fee is 1.40 to 1.75% (depending on the share class), and the portfolio expense ratios range from 0.52% to 1.73% a year. There’s an enhanced death benefit for an extra 30 bps a year. The surrender charge begins at 8.5% and lasts for none, four, seven or nine years, depending on the share class.