Prudential Files “2.0” Version of Highest Daily VA Rider

By Editor Test *Wed, Jun 6, 2012*

In the newest version of Prudential's Highest Daily lifetime income rider, the former M&E charge is split into an temporary premium-based fee to recover acquistion costs and a smaller, persistent M&E fee based on the account value.

On May 14, Prudential Financial’s Pruco Life subsidiary filed an application with the Securities and Exchange Commission for an update of its popular Premier Retirement variable annuity contracts, which includes a new version of the company’s well-known Highest Daily Lifetime Income rider.

Prudential declined to discuss the application. Under SEC regulations, companies can’t discuss contract applications until the SEC approves them.

The latest iteration of the rider is called “Highest Daily Lifetime Income 2.0.” It is the only guaranteed lifetime withdrawal benefit (GLWB) that Prudential is now offering on its Premier Retirement VA. It comes in single or joint-and-survivor versions and with or without an enhanced death benefit.

HD 2.0 maintains the 5% minimum annual increase in the guaranteed benefit base during the accumulation period (if no more than one withdrawal is taken), but alters the so-called “age-bands” so that a contract owner doesn’t qualify for a 5% annual payout until age 65 (up from 59½) and doesn’t qualify for a 6% annual payout rate until age 85. The rider is now available to contract owners who are age 50 and older, an increase from age 45.

The client must defer withdrawals—except for a one-time non-Lifetime Withdrawal—for at least 12 years to lock in a benefit base that is at least double the original account value. In the earliest version of the rider, clients could lock in this deferral bonus after just 10 contract years.

The changes, though not large, reflect the ongoing reductions by certain major issuers of variable annuities in their exposure to the risks associated with the lifetime income riders on such products. Prudential’s HD roll-up was as high as 7% going into the financial crisis and has since been reduced, in steps, to 6% and 5%.

The general industry pullback—in which some life insurers stopped selling VAs entirely while others raised prices, reduced benefits, or shifted risks to contract owners—accelerated after the market plunge last August and the Fed’s announcement that it would suppress interest rates until 2014.

For instance, MetLife, which in 2011 sold an industry-high $28.44 billion in VA contracts with a guaranteed minimum income benefit rider (whose lifetime guarantee is linked to the purchase of an income annuity), told Wall Street analysts in its first quarter 2012 earnings call that its “target range for VA sales in 2012 is $17.5 billion to $18.5 billion.”

The cost structure of the latest iteration of the Prudential Premier Retirement VA is significantly different from that of earlier versions. It splits the customary annual mortality & expense fee ratio—about 130 basis points in the past—into two separate fees: a “premium-based” fee and an M&E fee.

The premium-based fee ranges from 70 basis points to 15 basis points, depending on whether the premium is less than $50,000 or less or $1 million or more. It lasts only for the first seven years of the contract, and it is based on the size of the original premium, not the account value. The annual M&E ratio (plus an administration fee) is 85 points a year for the life of the contract, and it is based on the account value, which is subject to market fluctuations.

“They’ve changed the charging structure of the M&E fees to split out the money that goes to recoup upfront commissions from their [insurance] fee income. The advantage is that you match the known commissions outflows—and potentially other upfront fees—with a known income,” said Ryan Hinchey, an actuary and blogger at NoBullAnnuities.com.

“That minimizes DAC [deferred acquisition costs] write-downs,” he added. “This issue, among other things, got some insurers into a bit of trouble during the meltdown when they based all their fees off of AUM [assets under management]. Then when the assets performed poorly, they didn’t recoup all the upfront expenses and had to write down losses.”

The GLWB rider fee for HD 2.0 is slightly higher than the rider for the previous iteration. It is 100 bps for a single contract and 110 basis points for a spousal benefit. The optional enhanced death benefit adds another 40 basis points and the median portfolio charge is 114 basis points.

The Contingent Deferred Compensation Schedule allows for more liquidity than in past contracts and may indicate reduced compensation for the independent brokers and advisors who typically sell the product. For premiums less than $50,000, the first-year surrender fee is 5%—not the 7% or 8% associated with a typical “B share” contract, in which the insurer pays the intermediary a commission and gradually recoups it from the client. For premiums of $500,000 or more, the first-year surrender fee is only 2%.

At least since launching the HD series prior to the financial crisis, Prudential has protected itself from the product’s market risk by automatically shifting up to 90% of policyholder assets out of equities and into fixed income investments during stock market declines, and moving assets back into equities as markets recovered. This modified form of Constant Proportion Portfolio Insurance (CPPI), helped reduce the declines in policyholder account balances during the market crash of 2008-2009 by as much as 50%.