Prudential's New Edge: Dynamic Rate-Setting

By Kerry Pechter *Thu, Feb 27, 2014*

"If manufacturers can be more dynamic in reacting to changing conditions they don't have to set prices as conservatively. That should benefit investors," said a competitor about Prudential's ability to change VA GLWB roll-up and payout rates as often as monthly.

Our February 13 report on the new 3.0 version of Prudential's Highest Daily variable annuity income rider failed to reveal the story within the story: the role of Prudential's "dynamic rate-setting" process.

In a conversation with *RIJ* last week, Bruce Ferris, the head of sales, distribution product management and marketing for Prudential Annuities, explained what dynamic rate-setting means.

It means Prudential can tweak the rider's payout rates and roll-up rates as frequently as every month if it needs to. In the past, it needed nine months or so to file a new prospectus and wait for approval before changing those rates. There can be no *retroactive* changes, Ferris noted. The new rates affect only contracts issued after the change.

This new flexibility narrows the product's window of exposure to interest rate volatility to 30 days. Ferris characterized the change as requiring infrastructure modifications, internally and at the broker/dealer level, rather than a regulatory or legal change.

With less risk exposure, the carrier can afford to strengthen the benefit. Indeed, because of dynamic rate setting, Prudential was able to raise the new rider's annual payout rate to 5.0% at age 65 for single contracts, from 4.5% for the previous version. (The new contract does require at least a 10% allocation to a fixed return account, as a further risk-reduction measure, and the entire portfolio is still subject to Prudential's risk management algorithm, which automatically shifts money in or out of equities when equity prices rise or fall, respectively.)

'Sweet spot'

"We didn't change our fees, our step-up frequency, our minimum issue age and, at introduction, our roll-up rate. We merely introduced the same rate-setting process that we used for our PDI (Prudential Deferred Income) product," Ferris said.

"This allowed us, at launch, to raise the withdrawal rates at age 65 to the sweet spot of 5% level for single and 4.5% for spousal contracts. It lets us control our interest rate risk."

PDI is the company's entry in the three-year-old, $2.2 billion deferred income annuity (DIA) market, currently dominated by New York Life and Northwestern Mutual Life. PDI is essentially a portfolio of bonds with a guaranteed lifetime withdrawal benefit attached.

"We developed PDI with the idea of creating a dynamic rate-setting ability. The need to do that was a function of not just the volatility but also the absolute value of interest rates. We had been living in an environment where 5% to 6% was normal. Then it dropped to 1.45%,” Ferris said.

“That was new. It caused us to rethink our infrastructure and our product design. That’s what we did with PDI. The original roll-up and withdrawal rates were 6% and 6%, and even though rates pulled back later, we could afford to pull back to only 5.9%. Now we’re doing the same thing with the variable annuity as with the PDI. The good news for the marketplace and for the consumer, is that this lets us be sustainable over the long-term,” he added.

Ferris expected other annuity issuers to adopt dynamic rate-setting, if they haven’t already. At Lincoln Financial, which competes with Prudential in the VA space, a spokesman told RIJ, “We’re aware of Prudential’s approach. But we can provide input on Lincoln’s future plans.”

An executive at a major mutual life insurer told RIJ in an e-mail, “I am aware of what Pru did and I think it makes great sense. The cost of providing the guarantees can fluctuate considerably. If manufacturers can be more dynamic in reacting to changing conditions they don’t have to set prices as conservatively. That should benefit investors. I like it. I agree it will be a more widely adopted practice.”

“I’m not hearing any specifics about whether other companies will offer similar features,” said a Washington, D.C. attorney who counsels life insurers. “To the extent it represents a product evolution that is financially attractive to both carriers and customers, it would be logical to assume that other carriers will consider offering something similar.”