Retirement Income
JOURNAL

Security Benefit Life’s Secret Sauce

By Kerry Pechter   *Thu, Apr 1, 2021*

Joe Wittrock, CIO at Security Benefit Life, explains how the firm's investments outperform. Eldridge Industries, run by ex-Guggenheim president Todd Boehly, owns SBL, Billboard magazine (right, with Billie Eilish on the cover) and lots else.

There’s a belt-and-suspenders aspect to pegging the performance of a fixed indexed annuity (FIA)—a product that can’t lose money unless “surrendered” prematurely—to the movement of an index designed to move less than the market.

From a marketing perspective, however, it makes perfect sense to use a managed-volatility index inside an FIA. It allows the issuers to offer attractively high participation rates or caps on returns—or even “uncapped” returns. You don’t need to cap the returns if the cap is baked into the index.

This week, Security Benefit Life, the eighth largest seller of FIAs in the US in 2020 ($2.88 billion), according to LIMRA, added two new managed-vol index options to its Strategic Growth Series FIAs.

The two new options are the S&P500 Factor Rotator RC2 7% Index and the S&P Multi-Asset Risk Control (MARC) 5% Index. Both rebalance daily among several asset classes as they pursue 7% and 5% volatility levels, respectively. Both indexes were launched in March 2017, but they’ve been hypothetically back-tested to 2011.

A dozen years ago, people thought FIAs were “complex,” with their bewildering variety of crediting methods. Today, FIAs are even more complex. They use bespoke indexes designed by rocket scientists. Recommending the “right” index to a client (especially if you’re subject to a “best interest” advisory standard) won’t be easy.

Security Benefit Life is a highly rated (A-) life insurer with assets of about $40 billion, as of the end of 2019. Like Athene, Global Atlantic and F&GL, it is one of FIA issuers acquired by big investment firms or holding companies since the Great Financial Crisis, and which now collectively dominate the FIA market.

Factor Rotator

The Factor Rotator index includes a mechanism that shifts money between the five factors:

Quality, Value, Momentum, Low Volatility, and High Dividend. “The index varies allocations between the equity factor components, the Treasury Note Futures Index, and cash, depending on market performance on a daily basis,” according to an S&P fact sheet.

Here are the steps that the Factor Rotator Index follows:

1. Calculate historic risk-adjusted momentum based on short, medium, and long-term return horizons for the five eligible factor indices.

2. Select the two factors with the highest composite risk-adjusted momentum scores.

3. Weight 75% of the account value to the highest-ranking index, 25% to the index with the next-highest rank.

In addition, there’s a Risk Control 2.0 (RC2) overlay that tries to maintain portfolio volatility at 7% by adjusting the portfolio allocation between the underlying index and the S&P 20Year US Treasury Note Futures Index liquid bond index.

In effect, a kind of CPPI (Constant Proportion Portfolio Insurance) mechanism is built into the index. CPPI ensures that a dynamically rebalanced portfolio will always contain at least enough safe assets to cover the guarantee. It was CPPI that protected Prudential’s Highest Daily variable annuity liabilities from getting underwater during the Great Financial Crisis.

MARC

The S&P 500 Multi-Asset Risk Control 5% Index reaches for yield by using leverage (up to 150%) and keeps volatility down to 5% by rebalancing every day between three underlying indexes: the S&P 500 Excess Returns Index, the S&P GSCI Gold Index, and the S&P 10-Year US Treasury Note Futures Excess Returns Index. Its methodology:

The underlying commodities and fixed income indices are calculated and published by S&P Dow Jones Indices on a daily basis as excess return indices. [In this case, the equity component is an “excess return,” i.e., levered, version of the S&P 500, derived from the S&P 500 Total Return Index.] The indices are calculated using a risk-weighted approach that utilizes a maximum leverage of 150% and a 5% volatility target.

As the index brochure says, “In low-volatility environments, the S&P MARC 5% Index risk control mechanism increases market exposure to riskier assets by increasing the allocation to the Index (up to a leveraged position of 150%).”

Powered by former Guggenheim president

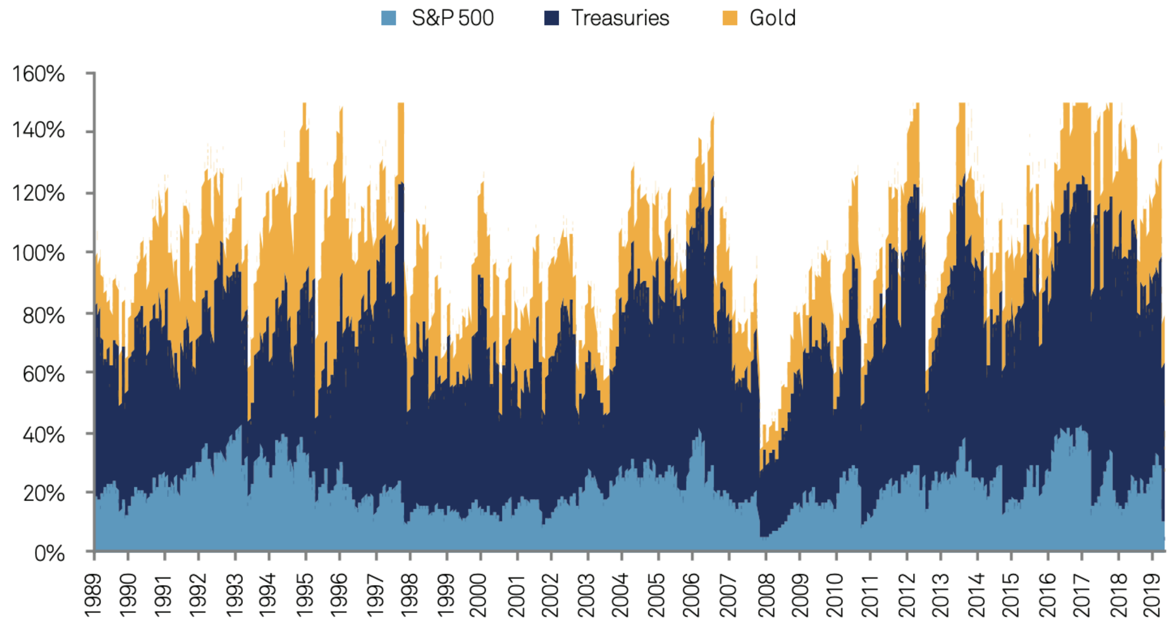
Joe Wittrock

In an interview with *RIJ*, Security Benefit chief investment officer Joseph Wittrock said, “With the Rotator, we researched the factors that produce outperformance. Everybody knows that there are certain factors driving long-term returns. But some do better in some environments than others. We asked, ‘How do we create an evergreen strategy that gives the benefits of factor outperformance all the time?’”

Guggenheim Partners bought Security Benefit in 2010 and spun off the life insurer to one of its senior executives, Todd Boehly, when he left Guggenheim in 2015. Wittrock noted that the investment skills that Guggenheim brought to Security Benefit had paid off. “When you look at track record, it speaks to consistent returns. We have the highest earn rates in industry, and that enables us to offer higher [FIA crediting] rates.”

For example, Security Benefit has, like several of its peers in the FIA business, been able to lift its general account returns by investing in CLOs, or Collateralized Loan Obligations. These are securitized bundles of the type of “leveraged loans” often made to equipment leasing, cellphone tower, or music-royalty companies with strong cash flow but weak credit. Life insurers can buy the senior or investment-grade “tranches” of these bundles, which offer higher yields than similarly rated corporate bonds.

Security Benefit’s FIA-issuing peers include Athene, Global Atlantic, F&GL, Great American, American Equity, EquiTrust, and Delaware Life. Many of these companies are owned by or affiliated with powerful asset managers or holding companies like Eldridge, Apollo, KKR, Blackstone, Guggenheim, Group1001 and others. (Great American was acquired last year by MassMutual.) Together, they accounted for 42% of all FIA sales in 2020, according to LIMRA. Their close competitors in the FIA market—AIG, Sammons, Allianz Life, and Nationwide— have quite different business models.



Daily allocations of the MARC Index (pre-March 2017 backtesting data is hypothetical.)

Wittrock said that Security Benefit allocates about 40% of its general account to CLOs, and that most of that 40% is in tranches rated BBB. "If you look at our asset allocation, and look at the other companies, you'll notice that we look very different. That's intentional. If we look like everybody else, you'll get the same outcome," he told *RIJ*.

Some of his firm's competitors enhance their earnings by moving part of their liabilities to captive reinsurers in offshore regulatory havens like Bermuda, Wittrock said, but only about one percent of his company's assets are reinsured, and those are reinsured in Vermont. [Vermont, along with South Carolina and Delaware, is a domestic insurance regulatory haven.]

What's striking about Security Benefit and at least some of the other life insurers named above, is the integrated business model they've created, which Fed economists described in a research paper a year ago. In this model, a life insurer accumulates (by purchase or new issue) blocks of long-dated liabilities, such as FIAs.

An affiliated asset manager (or strategic partner providing investment expertise) originates loans to companies with good cash flow but poor credit, bundles those loans into CLO securities, and then carves out made-to-order tranches suitable for purchase by the FIA issuer for its general account. In such cases, the FIAs are sold to provide stable assets for the purchasing and holding the tranches of the CLOs.

Within a single holding company, there might be an investment firm specializing in loan origination, an affiliated reinsurance company, an annuity issuer, and perhaps a Registered Investment Advisor or insurance marketing organization, that are vertically integrated. Security Benefit is a property of the Eldridge Industries, which is led by former Guggenheim president billionaire Todd Boehly.

Along with the investment skills and properties (including Security Benefit) that Boehly brought with him from Guggenheim in 2015, Eldridge owns or controls Maranon Capital, a private equity firm, CBAM Partners, an alternative investment management firm, SE2, a life insurance and annuity web platform, as well as a variety of media properties that earn the types of streams of royalties that can finance CLOs.

As a *Bloomberg* reporter wrote in 2019, Eldridge “incorporates some elements of both Warren Buffett’s Berkshire Hathaway and Athene Holding. Like Berkshire, Eldridge is a holding company that uses premium revenue from a captive insurer — the so-called float — to fund investments. Like Athene, the insurer whose assets are managed by Apollo Global Management, it issues annuities to create that float.”