

Side-by-Side Comparison: A VA Minimum Accumulation Benefit Rider vs. an Index Annuity

By Editorial Staff *Thu, Mar 21, 2019*

Which of these two types of annuity contracts was able to offer the best principal protection and upside potential over a 10-year period? CANNEX tested them over 10,000 randomly generated scenarios. The experiment was sponsored by New York Life.

Let's imagine that one of your advisory clients is nearing retirement and wants protection against sequence-of-returns risk, a danger as treacherous to 60-something investors as, say, the cataracts of the Nile were to 19th-century British explorers like John Speke and Richard Burton.

In less adventurous terms, those clients simply want to protect their nest eggs against the potential impact of a major market downturn as they pass through what one life insurer has dubbed the "Retirement Red Zone." As a rule of thumb, the zone of peril begins about five years before the start of retirement and ends about five years afterwards.

Variable annuities (VAs) with guaranteed minimum accumulation benefits (GMABs) and fixed indexed annuities are two competing types of annuities that can protect a client's principal from loss during the red zone decade, while still allowing a chance for growth—more growth, potentially, than a plain-vanilla fixed-rate annuity could offer.

The upside potential of these products comes from their direct or indirect links to the equity markets. A variable annuity with GMAB offers direct investment of principal in trusts that closely resemble mutual funds but with different tax treatment. Typically, the GMAB rider restricts the degree of equity exposure, however.

A fixed indexed annuity works very differently. Premium is invested mainly in the insurer's general account but also in options on the equity market. If the stock market goes up, the options appreciate and generate gains. If the market goes down, contract owners can rely on the yield of the bonds in the general account to at least keep them whole.

Which of the two types of annuity contracts was better able to offer both downside protection and upside potential across 10,000 randomly generated market scenarios? [Editor's note: Insurance-licensed agents can sell FIAs but the sale of variable annuities also requires a securities license. Many, but not all, intermediaries have both licenses and can sell either product.]

To find out, CANNEX, the Toronto-based annuity data shop that has added product-comparison capabilities to its toolbox, recently compared-and-contrasted the performance of the two product types under hypothetical market conditions over a 10-year holding period. New York Life sponsored the [study](#), in which its Premier Variable Annuity II with Investment Preservation Rider 3.0 was compared with several FIAs.

Here's a summary of what CANNEX found:

- A VA with a guaranteed minimum accumulation benefit (GMAB) can provide a competitive guarantee relative to an FIA with the added benefit of certainty of the pricing structure for the guarantee term and the possibility of higher upside.
- The VA had an average annualized return of 4.99% over the 10-year period. One of the FIA strategies, using a 45% participation rate [i.e., could return up to 45% of the index return over 10 years], had an average annualized return of 5.10%, and the rest had lower returns, ranging between 2.45% and 4.54%.
- When the VA with GMAB outperformed the FIA, the average return was at least 25% greater than the FIA in the same scenario. When the VA with GMAB underperformed the FIA, the average return was no more than 19% less than that of the FIA.
- Compared against FIA designs with an annual point-to-point crediting strategy [where gains are credited to the account on each contract anniversary], the downside protection of the VA with GMAB does not have the same smoothing effects because the performance is measured once in the same period. This creates a cluster of results where the guarantee would be triggered and the client would receive the return of premium after 10 years. By contrast, the FIA very rarely has returns close to zero.
- Compared with an FIA crediting strategy using a rate cap [a limit on the gain that will be credited to the account in a given period], the VA with GMAB is more likely to have higher upside. The rate cap creates a tight banding of results with less variance but also a strict limitation on upside. The VA with GMAB outperformed the FIA most of the time and, when it did, generally did so with a high margin.
- Compared with an FIA crediting strategy using a participation rate [the maximum portion of the market gain that will be credited to the account in a given period], the VA with GMAB is not as likely to out-perform. But when it does outperform, it has the potential for greater upside.
- To out-perform the VA with GMAB (i.e., to produce better results more than 50% of the time), an FIA strategy using a rate cap must have a cap greater than 8.25%. For a strategy using a participation rate, the participation rate must be greater than 42.30%.
- GMAB terms are typically static for the full 10-year term, whereas an FIA issuer might change its rates during the life of the contract. In this study, it was assumed that FIA rates did not change. During poor market conditions, an FIA rate change might be to the disadvantage of the contract owner.

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