Snoopy Takes a Cue from the Gorilla

By Editor Test *Wed, May 8, 2013*

With the brand-new MetLife Shield Level Selector accumulation annuity, as with as the similar AXA Equitable Structured Capital Strategies product, investors can get a higher cap on their index-linked crediting rate if they accept a portion of the downside risk.

The financial engineers at Manhattan-based AXA Equitable (mascot: 800-lb. gorilla) should feel flattered, because their cross-town rivals at MetLife (mascot: Snoopy) have decided to imitate one of AXA's best-selling products.

The details differ a bit, but MetLife's new Shield Level Selector closely resembles AXA's Structured Capital Strategies (over $2 billion in sales since it was launched in 2010). That's despite the fact that the MetLife product is a single premium deferred annuity and SCS is filed as a variable annuity.

Both products are accumulation vehicles, not income vehicles. They operate much like traditional fixed indexed annuities. Most of the underlying assets are invested in bonds. A small portion pays for options on a major equity index. When the indexes go up, the options can gain considerable value, and part of the value is credited to the investors' account. (When the indexes go down, the options expire out of the money.)

But these products differ from traditional FIAs in a couple of important ways. The first way involves risk of loss. FIA sellers boast that you can never lose money on an FIA (net of expenses and surrender fees). They also currently offer annual crediting rates of only about three percent.

But with the MetLife Shield Level Selector, as with as the AXA Equitable Structured Capital Strategies, investors can get a higher crediting rate limit if they accept the ugly part of the downside risk. We're talking about the tail risk—i.e., all but the first 10 to 25 percent of downside.

The second difference is that FIAs are still sold mainly through insurance agents, while the AXA and MetLife products are sold through a wider variety of channels, such as career force, banks, wirehouses and the third-party independent advisor channel. A third difference is that lifetime income benefit options are currently driving FIA sales to record levels. These two products are for accumulation, not income.

As for the details of the new MetLife product, contract owners (or, more likely, their advisors) can choose among three maturities (one-, three- or six-year contracts), five different index options, three degrees of insulation from downside risk, and two death benefit options (return of account balance or premium).

Investors who choose the S&P 500 Index can elect to have MetLife absorb negative returns up to:

- 10%
- 15%
- 25%
- 100% of index loss

The contract also offers five index options:

- S&P 500 Index of large-cap U.S. stocks.
- Russell 2000 Index of small cap stocks.
- NASDAQ-100 Index, which includes the100 largest domestic and international nonfinancial securities listed on NASDAQ, by market cap.
- MSCI EAFE Index, which includes over 1000 international stocks from companies in Europe, Australasia and Far East (EAFE).
- Dow Jones-UBS Commodity Index, which is comprised of exchange-traded funds (ETFs) on physical commodities.

Not all of the permutations and combinations are permissible. An investor who chooses the S&P 500 Index option has the maximum flexibility. He can choose one, three or six year terms and any of the buffer options. People who invest in any of the other indices may choose only the 10% buffer option; they can't buy protection against the first 15%, 25% or 100% in losses.

Here's an example of the kind of risk/reward trade-offs the MetLife product enables investors to contemplate. For instance, the one-year cap for investments linked to the S&P 500 with zero downside—MetLife absorbs 100% of the loss—is an unalluring 1.65%, according to today's rates. (Rates are adjusted every two weeks in response to market conditions.) But if the investor accepts all losses beyond the first 10%—i.e., he loses 2% if the investment falls 12%—the one-year cap jumps to a much more attractive alluring 5.75%.

If such flexibility sounds potentially overwhelming, MetLife offers an alliterative heuristic to divide and conquer the decision-making process. "With advisors, we try to talk about the three 'Ps'," MetLife senior vice president Liz Forget told RIJ this week. "They stand for Protection, which is the percentage of downside you want MetLife to absorb, Participation, which refers to the different index options, and Personalization," which means choosing among the maturity and the death benefit options.

Common sense suggests that investors will divide their premiums among the various index options in order to get diversification, and then choose their maturities and level of protection on the basis of their risk tolerance for risk or perhaps their time horizon. The product's target market is people nearing retirement, Forget said.

Since this is a fixed annuity, there are no stated fees. The fees are embedded in the computation of the crediting rate. If you choose the enhanced, return of premium death benefit, the earnings caps are about 25% lower than if you choose the standard return-of-account-value death benefit. It's difficult to tell at a glance whether the death benefit option is a bargain or not.

This product also offers a somewhat more conservative way to combine risk and return. It's called "Step Rate." Let's say that you opt for the Step Rate on a three-year investment linked to the S&P 500 with a 10% downside buffer. If the index experiences a return of zero or greater return over that period, you'll earn a cumulative 14.0% (at current rates).

On the other hand, if you chose a three-year S&P 500-linked investment with a 10% downside buffer but without the Step Rate, your crediting cap would be 23.3%. But if the three-year return happened to reach only 2%, you'd earn only 2%, not the Step Rate of 14%.