The “Stacking” Strategy

By Kerry Pechter *Wed, Apr 18, 2012*

Are bond yields awful? Are investors terrified of equities? Then it’s perfect weather for indexed annuities, the unpredictable but often effective knuckleballs of the annuity world. Check out these new "stacked" offerings from Security Benefit Life and Aviva.

Earlier this month, Security Benefit Life introduced Total Value Annuity, a new fixed indexed annuity whose crediting formula includes exposure to commodity and currency futures and whose living benefit roll-up has a risk-sharing feature that goes by the somewhat inelegant name of “stacking.”

Security Benefit, a B++ (A.M. Best) and BBB+ (S&P) rated insurer based in Topeka, Kansas, is still fighting its way back from the effects of the financial crisis. It was purchased for $400 million in July 2010 by Guggenheim Partners, the institutional asset management firm that has managed the insurer’s general account since 2009.

[Another Guggenheim unit—Guggenheim Baseball Management—made the sports pages last week and business news by trying to buy the Los Angeles Dodgers for $2.16 billion. Security Benefit finance chief John Frye told *Investment News* that, if the deal goes through, “one percent or a half percent” of the insurer’s assets might end up invested in the Dodgers—subject to regulatory approval.]

Security Benefit sees indexed annuities, which it had never sold until last year, as its turnaround ticket. (Companies with less than an A rating tend not to be competitive in the variable annuity space.) Strong sales of its first entry, the Secure Income Annuity, catapulted the firm from nowhere to 13th place on the indexed annuity sales chart in 2011, according to Annuityspecs.com. That contract’s living benefit rider offered an annual deferral bonus to the benefit base as high as 8% (in some states) for the first 10 years.

The firm’s second retail FIA, Total Value Annuity, has the distinction of offering indirect exposure to alternative investments, this year’s hippest asset class. In addition to the S&P 500 Index, contract owners can link their accounts to a “5-year Annuity-Linked TVI Index,” which Security Benefit Life president Doug Wolff described as “a managed futures index that involves 24 underlying futures contracts, split three ways between commodities, currencies, and U.S. interest rate futures.” The product also offers a fixed interest rate investment option.

“This product gives clients access to a non-correlating index that, when you look at historical performance, produces a very nice risk/return profile, especially when it’s mixed with exposure to the S&P 500 Index,” Wolff told *RIJ*. “It can go long or short on the futures contracts. It uses a momentum-based formula [for buying and selling futures]; it’s not subjective, it’s all quantitative.”

Any gains from the S&P 500 Index are credited to the account every year in an annual point-to-point structure, but any gains from the more exotic ALTVI index are credited on a five-year point-to-point formula, with no upside cap. Investors must hold the contract at least five years to get full credit for ALTVI-related gains.

Stackability

Then there’s the “stacking” feature, which applies to the optional lifetime income benefit. It involves a 4% roll-up in the guaranteed benefit base—but in this case the 4% is in addition to whatever the contract earns from fixed income investments and index exposure. With a conventional 7% or 7.2% roll-up, the owner gets the greater-of the performance or the bonus. For the insurer, the smaller guarantee is easier to hedge at a time when low interest rates make hedging costly.

“Stacking shifts more of the longevity risk to the annuity buyer,” FIA expert Jack Marrion of Advantage Compendium told RIJ in an email. He added that that’s not a bad thing. “It is one way for carriers to offer potentially higher payouts during low bond-yield environments.”

“I have previously said if index annuities add on commodities or other indices that do not correlate with the broad-market equity indexes currently offered, they may offer diversification that provides positive returns during times when the S&P 500 is declining or enhanced returns in positive times,” he wrote.

By reducing its exposure on the upside, TVA can afford to offer contract owners a living benefit whose single-life payout rate starts at 5% a year at age 60 and increases 10 basis points for every year that the contract owner delays taking income. (The payout rate for joint contracts is about 50 basis points less the single rate.) The contract also keeps costs down by unbundling the living benefit and the death benefit; the policyholder chooses one, not both.

Security Benefit limited the rollout of its SIA product last year to a restricted set of marketing organizations and producers, and the strategy was so effective that the insurer has decided to repeat the formula with its new product. Creative Marketing, Gradient Financial, Impact Partnership, and Advisors Excel are the only independent marketing organizations selling the product.

“Any company that’s looking to grow their annuity business and has less than an A rating would need to look primarily at the independent agency channel for growth,” said Judith Alexander of Beacon Research, whose data shows that about 92% of Security Benefit’s fixed annuity sales in the fourth quarter of 2011 were in the independent channel. “Phoenix and Genworth went through the same process.”

“We’ve partnered with four of the best IMOs in the business, in terms of volume,” Wolff told *RIJ*. “All have strong administrative groups and strong compliance groups. As a result, we see things like the IGO [In Good Order] rate go considerably higher, which also helps keep costs down.”

The base commission for the producer is 7% for clients ages 50 to 75 and 5% for clients ages 76 to 80. Alternately, producers can opt for a 3% upfront commission and a 0.50% annual trail commission starting in the second contract year. In some states, the surrender period can be as long as 12 years.

Security Benefit isn’t the only insurer with a new FIA that features “stacking.” Aviva has a similar income rider called the Balanced Index Lifetime Income Rider, or BALIR, which the Scottsdale, Arizona-based Annexus Group began selling in March. BALIR’s “Stacked Growth Option” offers a 5% deferral bonus on top of earnings from a combination of a fixed interest rate and a link to the S&P 500 Index. There’s no exposure to commodities and the single life payout at age 60 is 4.5%, or half a percent lower than the TVA.