

What Does The Future Hold For FIA Renewal Rates?

Introduction

The current offered rates for fixed and indexed annuities are the highest the industry has seen in years. Both the equity and bond markets have been pummeled this year. As a result, consumers are on a flight to safety. Coupled with a rising interest rate environment, you have a perfect storm for the annuity world. Record sales numbers are an indication that clients are taking notice.

The large influx of business we've seen is due to extremely competitive index-linked rates, which makes one question top-of-mind. **Can producers and consumers count on consistent renewal rates?**

In other words, will these products look as good in five years as they do right now? Will rates hold steady on contract anniversaries when clients get their annual statements--- or will producers be in for some tough conversations with upset clients in the not-so-distant future?

Read on for our perspective and what organizations can do to put themselves in the best position moving forward.

Pricing Overview

As we've outlined in our [Index Pricing Series – Part 1](#), the initial offered rates on fixed-indexed annuities from insurance companies factor in several variables that constantly change.

How it works at a high level looks something like this:

When an annuity policy is issued, the carrier purchases assets, typically mid-duration fixed income securities that match the expected liability of the policy. The carrier then deducts a spread to cover their costs of doing business. The difference between the yield on the fixed-income assets and the spread equals the carrier's option budget. Next, options are purchased using that options budget, which ultimately determines the index-linked rates in a product.

Because the fixed-income securities that were purchased by the carrier at the time of issue match the liability of the policy, the carrier can count on a consistent yield, or coupon, every year. Put another way, the option budget shouldn't change year to year --- assuming the spread remains the same.

For example, a carrier might yield 5.5% right now on their general account portfolio. Subtract a spread of 1% = 4.5% option budget. The carrier, client and producer can count on approximately 4.5% of the initial premium being used to purchase options annually.

Knowing this --- renewals should stay consistent, right? Not so fast. There's another variable we have to consider -- the actual cost of the options in future contract years.

Option costs are mainly affected by two drivers when looking at S&P 500 crediting strategies --- *market volatility* and *interest rates*. Engineered, or vol-control indices are priced differently as outlined in our [Part 3 Video](#), and we'll cover those shortly.

If we assumed both the interest rate environment and the volatility in the marketplace remained exactly the same for the next ten years, theoretically, the renewal rates on a policy issued today should remain consistent for S&P 500 strategies. They should renew at 100% of the initially offered rate each policy anniversary moving forward.

However, what happens in an environment where volatility changes dramatically from year to year? All else equal, in periods of increasing volatility, the cost of options will *increase*. Clients could see a markdown in their renewals. [And volatility affects S&P 500 participation rate strategies more than cap strategies.](#)

If volatility *decreased*, it would drive the cost of options down. In this scenario, it's likely the carrier would be able to *hold* the rates consistent with what was issued. It's extremely rare for an offered rate to come back higher on renewal than what was issued --- insurance companies are for-profit businesses and would likely pocket any excess yield.

It's the same story for interest rates. A *rising* interest rate environment drives up the cost of options, resulting in potentially lower renewal rates.

A *decreasing* interest rate environment should lower the cost of options, with a steady renewal being the result.

For engineered indices, [the pricing mechanics are slightly different](#). The major difference between engineered indices and S&P 500 strategies is that engineered indices control volatility and interest rates within the index itself.

Future market volatility from a renewal rate perspective is irrelevant because the index itself uses a volatility control algorithm. This mechanism shifts between high and low volatility assets in order to maintain the stated volatility target, most often 5%. The volatility assumption is locked down, therefore future option prices are not affected by overall market volatility.

The vast majority of engineered indices also deduct risk-free interest rates from the returns of the index, and only the returns in excess of the risk-free rate are left over. This eliminates the interest rate component.

Ultimately, engineered indices have steady future option prices.

We know producers and consumers want steady renewal rates, so from what we've outlined, it appears engineered indices should be their golden ticket. Again, not so fast.

Although the renewals could theoretically be more stable on engineered indices compared to S&P 500 strategies, the trade-off is nullified by the performance mechanics and actual index composition. In a period of increasing volatility, engineered indices shift away from their equity allocations, often resulting in lower performance even with steady participation rates. In a period of rising interest rates, the index returns are deducted from risk-free interest rates, which again lowers performance.

What can you do?

The great thing about our current high-rate environment is that carriers are locking in higher-yielding fixed income securities. With steady annual yields, option budgets should remain flush to ultimately take to market and purchase hedges each year. But how can clients and producers protect themselves, hedging any variability in option costs, and ensure they can count on consistent rates moving forward?

Purchase a MYGA

[MYGA sales, like FIAs, are also exploding in 2022.](#) If a client doesn't want to depend on the market, or a consistent renewal rate for that matter, they can lock in a competitive multi-year guaranteed annuity with steady, fixed rates that are guaranteed for the entire term.

Competitive rates on MYGAs continue to creep upward. Below are the highest yielding rates from 3-7 year durations.

Term	Offered Rate
3-Year	5.36%
4-Year	5.40%
5-Year	5.60%
6-Year	5.45%
7-Year	5.65%

*This table excludes fee-based MYGAs and Bank/BD specific products.

With their upward trend, MYGA rates are inching closer to the historical annual return of the S&P 500 ---- and clients don't have to worry about renewals or market performance.

Leverage cap-rate guarantees

To eliminate renewal rate risk, we've seen a few carriers offer a guaranteed cap rate on the S&P 500 for the duration of the surrender schedule. Although the offered cap rates on these products are priced at a slight discount compared to top-of-market rates, clients and producers can count on the consistent renewal each policy anniversary as it's guaranteed to never go down.

The current top of market cap rate for 10-year S&P 500 Annual Point to Point strategies is 13%.

Two carriers with guaranteed S&P 500 cap rates include Pacific Life with their Pacific Index Foundation 10 with a 9.90% guaranteed high-band rate for the ten-year term.

Protective Life's Asset Builder II No ROP has an 8.30% guaranteed high-band cap rate.

As you can see, a client might be giving up some rate on the front-end but have a guarantee they can count on for the rest of the term.

Utilize bailout features

Many products in market have bailout features included. Here's how these work: if the renewal rate comes back lower than the declared bailout rate, a client can liquidate their accumulated value with no surrender charge or MVA. However, if this happens during an unfavorable time economically, a client could have some reinvestment risk and be limited to lower yielding assets in the marketplace. Also, these bailout rates tend to be fairly low relative to the current rates offered, which takes away some of their allure.

Aspida's Synergy Choice Max 10 has a 13% S&P 500 APTP cap, with a 5% bailout cap.

DE Life's Target Growth 10 has a 10% S&P 500 APTP cap, with a 5.15% bailout cap.

Write a longer-term interest crediting strategy

One anomaly here is Athene's AccuMax 7 product. With this product, a client can choose a 7-year point-to-point S&P 500 strategy with a participation rate, among other strategies that are also guaranteed for the contract term. Because the product duration is 7-years, which matches the interest crediting strategy length, there's no renewal rate risk. A client does have to wait until the end of the term to receive an interest credit, however.

Use FILA and RILA product designs

Products with downside risk exposure have characteristics that can be advantageous in an unknown future. FILA and RILA performance potential can serve as a hedge against renewal rate risk. These designs have index-linked

crediting strategies that trade downside exposure for additional upside potential --- and they feed off increased market volatility.

In future years, and in periods of high volatility, consumers have the choice to chase higher upside potential by shifting their strategy allocations and going more "risk-on". This could result in higher returns for an end client or consumer, even if the renewal rates are lower than what was originally issued --- these are choices traditional FIAs do not have.

Count on carriers with consistent renewal rate history

Not all carriers are forthcoming with their renewal rate history. However, others have been more transparent and have collateral highlighting their persistency over time. It could make sense to work with those companies who have a strong track record. Although, past behavior is no guarantee for the future.

Conclusion

Ultimately, renewal rates can be hedged using any of the strategies above. And in a general sense, renewal rates will depend on the costs of options in future years, which is driven by market forces and outside the control of any individual carrier.

We also believe this presents an opportunity for carriers to be more transparent with their rate setting philosophy. As we mentioned, renewal rate determination can be a black box. The end consumer doesn't know what goes into these pricing decisions, nor does most of the distribution funnel. Even if a carrier has to reduce a renewal rate, it would go a long way with the producers and consumers to know why ---- and what factors went into the decision.