S&P Dow Jones Indices

A Division of S&P Global

InsuranceTalks

Participating and Protecting Using Dividends

Joyana Pilquist, CFA
Vice President,
Head of Derivatives
American Equity Investment
Life Insurance Company

Insurance Talks is an interview series where insurance industry thinkers share their thoughts and perspectives on a variety of market trends and themes impacting indexing.

Joyana Pilquist, CFA is Vice President, Head of Derivatives at American Equity Investment Life Insurance Company.

S&P DJI: What is your role at American Equity, and how do you serve the insurance space?

Joyana: I am Vice President and Head of Derivatives at American Equity. My team and I hedge the embedded derivatives in our fixed index annuity liabilities for American Equity Investment Life Insurance Company and Eagle Life Insurance Company.

S&P DJI: What considerations are top of mind as you and your team are considering what index will be at the center of a fixed index annuity (FIA)?

Joyana: The most immediate consideration when contemplating a new index is whether we think the index design and objectives can help us potentially create higher risk-adjusted and stable returns for our policyholders over the long term, while still maintaining option costs. Renewal rate integrity is something that American Equity has always deemed an essential business philosophy, so stabilizing costs to hedge policyholder returns is important. It is also important to us that the index be reliable and understood with relative ease. It must fill a gap in the policyholders' ability to potentially increase account values in different economic regimes.

S&P DJI: Earlier in 2020, we saw periods of extreme volatility and sharp declines in the market. How do you try to plan for and protect against these conditions as you're developing new FIAs?

Joyana: Selecting the right type of index is an important part of our plan. We've found risk control indices to be an effective tool in mitigating the effects of extreme volatility and sharp market downturns in an investment portfolio. Volatility tends to increase as the market decreases. The risk control mechanism decreases the allocation to the underlying index as volatility increases and, therefore, mitigates its effects on the overall index. This, in turn, tends to lessen sharp declines in the risk control index compared to indices without the risk control mechanism.

S&P DJI: American Equity uses the S&P 500® Dividend Aristocrats® Daily Risk Control 5% Index within one of its FIAs. What characteristics did this index have that made it well suited for use within an FIA?

Joyana: We added the S&P 500 Dividend Aristocrats Daily Risk Control 5% Index to our index offerings back in 2014. The index was simple to understand with two components (equity and cash). We appreciated how the underlying index, the S&P 500 Dividend Aristocrats, which represents the equity component, was a proven index with a demonstrated track record for performance. The companies that make up the underlying index are all highly rated (investment grade), large (at least USD 3 billion market cap), diversified across market sectors, and have a long history (25 years minimum) of paying and increasing dividends. It was expected that, as more of the baby boom generation retires, demand for dividend-paying stocks would increase and, historically, those stocks have provided some downside protection in volatile markets. These reasons, along with the addition of the risk control mechanism, make the index attractive for our use.

S&P DJI: Why should using a transparent, rules-based index matter to clients? How do you explain this index in simplified terms for a client?

Joyana: Transparent, rules-based indices should matter to the client because the better they understand the index, the more informed of a decision they can make for strategy selection for the upcoming year and as market regimes change. The simplified explanation of the S&P 500 Dividend Aristocrats Daily Risk Control 5% Index is that it is a volatility control index that offers increased stability and returns based on companies with 25 consecutive years of positive dividend returns. The index is dynamically adjusted across two components (the S&P 500 Dividend Aristocrats and cash), based on the volatility of the underlying index, in order to target a 5% volatility.

S&P DJI: How does the volatility control framework incorporated into the S&P 500 Dividend Aristocrats Risk Control 5% Index help policy owners? Why is that important for the client's retirement outlook?

Joyana: The volatility control framework helps policyholders by stabilizing the cost of the options we use to hedge their index credits. This, in turn, allows us to better maintain renewal rates in periods of increasing market volatility. The lower volatility also leads to higher spreads and participation rates than are available to the policyholder compared to what we can offer for the same budget on our other strategies.

S&P DJI: The economic crisis brought on by COVID-19 has obviously affected dividends. What trends and impacts are you seeing in the FIA space regarding dividend strategies?

Joyana: We are actually seeing and hearing about more of our competitors following our lead and using indices based on dividend strategies as part of their FIA offerings. The dividends issued by companies are usually the least-preferred adjustment made in order to preserve cash. This is a result of their perceived longevity and importance in the stock valuation process. While the COVID-19 pandemic has put pressure on many companies' dividends, and some cuts have been seen, the strategy has remained resilient and we believe it is an essential part of the investment framework.

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