S&P Dow Jones Indices

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InsuranceTalks

A Multi-Asset Solution for Navigating Volatile Markets

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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.

Rhonda Elming is Senior Vice President, Annuity Product Development at Sammons Financial Group. Based in West Des Moines, Iowa, Elming is responsible for fixed annuity product strategy, including new product development and managing the profitability and risk profile of the company's in-force block of business.

S&P DJI: Tell us a bit about your role at Sammons Financial Group and how you serve the insurance space.

Rhonda: I lead a team of actuaries and analysts that are focused on creating innovative fixed annuity product solutions to help people prepare for retirement, while also helping the company understand and manage financial risks. I work closely with each of our distribution channel leadership teams to identify and understand its unique business and client needs. Through that process, we do a lot of ideation to arrive at a product design that meets the needs of the target market and fits within the desired risk and profitability requirements for the company. My team is responsible for the pricing, regulatory filings, and implementation efforts to bring the products to market.

In my product management role, I have the responsibility of effectively managing the risk and profitability of both the annuity new business and the in-force block. Annuities are a spread business; a large part of this role is setting interest-crediting rates or index parameters on the products.

S&P DJI: Is risk management more of a focus now for Sammons Financial Group in the current market environment?

Rhonda: Yes, the current economic environment is a challenge! Market volatility and historically low interest rates have resulted in widespread adjustments to product portfolios including lowering crediting rates or policy benefits. In some cases, insurers have also suspended sales of products with unfavorable risk or profitability profiles.

Planning for a prolonged low interest rate environment—with the potential for negative interest rates—has been a high priority for a while now. A "lower-for-longer" outlook, particularly for longer duration assets, may lead to higher levels of spread compression on in-force blocks of business and put pressure on insurers' ability to continue to offer longer liabilities, like guaranteed living benefit riders or guaranteed universal life insurance.

The pandemic has also created unique challenges, with most insurance company employees and distributors working from home. Annuity sales have fallen this year due to shelter-in-place restrictions, record unemployment, and volatile economic conditions. Agility is the name of the game, as insurers adapt to new work arrangements, regulatory changes, and a heightened need to help policy owners, distribution partners, and their local communities through this difficult time.

S&P DJI: How does Sammons Financial Group use fixed index annuities (FIAs) to manage client risk and to help in conversations with clients about goal achievement in retirement income and capital preservation?

Rhonda: Sammons Financial Group member companies distribute annuities through several different channels. The financial professionals that represent our companies work closely with their clients to accumulate assets and manage risk to help clients work toward their retirement goals. We have to earn their business every day, so it's important to us that we offer a broad spectrum of annuity products in order to address a wide array of client needs. FIAs are designed to help clients looking to accumulate assets, while protecting against the risk of loss during market downturns. Historically, some financial professionals have used FIAs in their client's portfolio, as they tend to reduce volatility and risk for a similar return. In addition, annuities are uniquely positioned to manage the risk of outliving one's assets by providing a guaranteed lifetime income.

S&P DJI: In the FIA space, hybrid or multi-asset indices have grown in popularity in recent years. From your perspective, what has driven this?

Rhonda: Hybrid or multi-asset indices have grown in popularity for many reasons. First and foremost is the value proposition they have historically offered in low interest rate environments. Most of the indices have a volatility control mechanism built in that may help lower the cost of supporting the upside potential within an FIA. A lower cost increases the participation in index growth, and therefore makes it possible to earn more index-linked interest. This has been especially true during a period of low interest rates, when the amount of money available to support the FIA's upside potential is low.

The volatility control mechanism in these types of indices also seeks to reduce volatility and deliver more consistent index returns over time. Consistency and stability are important to FIA policy owners. Lastly, the indices offer an opportunity to create products for clients looking to diversify their premium allocations within the FIA, giving them exposure to different asset classes, geographies, and in some cases, asset managers.

S&P DJI: Does the underlying index matter when developing a new product?

Rhonda: The selection of indices and index crediting methods within an annuity product are an important part of the product design, because that drives the accumulation value growth in the annuity.

For that reason, it's important to us that we offer FIAs built on a range of indices and index crediting methods. We know that no single index or crediting method will consistently outperform in a variety of economic environments, so we want policy owners to have choices to meet their individual goals. For example, we can offer a higher participation rate on an FIA built on the S&P 500® framework when market volatility is low and we can offer a higher cap on the same index within a monthly cap crediting method when market volatility is higher. We give policy owners the flexibility to reallocate their funds into strategies tracking different indices or crediting methods at the end of each index crediting term. The index serves as the blueprint for the strategy, and the policy owner then gets to choose the right tool for achieving their goal.

S&P DJI: What are the key characteristics you look for in an index in your product development process?

Rhonda: The key characteristics we seek in an index include:

- A differentiated value proposition that will appeal to the target market;
- Historical index performance and strong potential performance within an FIA;
- Simple to understand and explain;
- Brand-name recognition of the index provider or the index components; and
- The ability to cost effectively hedge the index to support the index-linked interest in the product.

In addition to the index characteristics, we evaluate the experience, reputation, and financial strength of the index provider. Annuities are long-term liabilities, so we want to make sure that the index will be viable for a long time. We also look for a certain level of sales and marketing support, including the ability to have index information and performance readily available on the index provider's website.

S&P DJI: Specific to the S&P MARC 5% (Multi-Asset Risk Control) Index, what characteristics have contributed to its use in the FIA space?

Rhonda: The S&P MARC 5% Index checks all of the boxes above and has demonstrated strong performance in a variety of market conditions. It is a multi-asset index that dynamically allocates to equities, bonds, and gold within a simple risk-weighting framework, and it has an allocation to cash as part of the volatility control mechanism. It is a relatively simple design, with only one index used from each asset class. The indices used should be familiar to consumers; the index used for the equities allocation is the S&P 500 and the indices used for the bonds and commodities allocations are the S&P 10-Year U.S. Treasury Notes Futures Index and S&P GSCI Gold, respectively.

S&P DJI: How does the volatility control framework incorporated into the S&P MARC 5% Index help policy owners?

Rhonda: The design of the index, including the volatility control mechanism and excess return framework, strives to create more stable index performance. The design also creates lower and more stable hedging costs that provide several potential benefits to FIA policy owners, including the following.

- Lower hedging costs should increase the policy holder's participation in index growth, making it possible to potentially earn more index-linked interest. This can be enhanced by placing the S&P MARC 5% Index within crediting methods that do not have a cap rate (although a participation rate or index margin would commonly apply).
- The stability of hedging costs should also contribute to more stable annuity renewal rates. These benefits would be of even greater value in an economic environment like today's, where interest rates are low and market volatility is high.

S&P DJI: How has the S&P MARC 5% Index performed relative to its peers?

Rhonda: The index has demonstrated strong performance relative to other hybrid indices. Its diversification across equities, bonds, and commodities and the simple, risk-weighted approach to combining the three underlying component indices has allowed the index to perform well during a range of economic conditions. There are more than 80 hybrid indices offered within FIAs today. As of July 31, 2020, the S&P MARC 5% Index ranked fourth, with a YTD index growth of 7.70% and also ranked fourth over the past 12 months, with index growth of 11.92%. Past performance is never a guarantee of future results, but the index data available on S&P DJI's website can help policy owners see how the index has behaved across a range of market environments.