



Confessions of an Indexed Annuity Purist

March 2023



When I began to urge advisors to consider incorporating fixed indexed annuities into their practice back in 2006, I highlighted the importance of keeping the story simple. Specifically, I stressed the need to be able to answer the question: "How did the insurance company calculate the interest they credited to my policy?" To answer this question, I offered a simple solution - stick with one-year cap strategies on the S&P 500 (SPX). Why needlessly complicate things?

Increasingly, advisors are exploring other options within the indexed annuity space. According to Wink's Sales and Market Report, in the third quarter of 2022, only 44% of fixed indexed annuity sales were in a cap rate strategy tied to the S&P 500 Index.¹ In other words, more than half of all sales were tied to indices other than the S&P 500.

In addition, the Life Insurance Marketing and Research Association (LIMRA) noted in its 2021 Fixed Indexed Annuity Sales and Assets report that only 16% of total sales were allocated solely to a cap rate strategy, while participation rate strategies captured 39%. Another 22% of total sales

were allocated to a combination of participation and cap rate strategies.²

Obviously, there are a lot of advisors today who are not following my 2006 guidance. Is it time for me to follow their lead? Let's take a look at a sample of fixed indexed annuities on the market and see.

Since its inception in 1957, the S&P 500 has an average annual return of 10.67%.³ If an indexed annuity policyholder had a 11% cap rate on the S&P 500 for every possible one-year period, the average return over time would have been 6.64%. In a world where protection is a primary goal for many investors, it's easy to understand the attraction of an expected 6.64% return with full protection of principal. No one should be surprised, therefore, that LIMRA reported that indexed annuity sales hit record levels in the third quarter of last year, and then broke that record in the fourth quarter.⁴

Despite these expected results, I have to admit that it's time for me to join those advisors who have already moved beyond the simple one-year point-to-point

Exhibit 1: Fixed Indexed Annuity Example

One-year Point-to-Point Strategy with 11% Cap Rate on SPX

Past Performance Statistics 04/18/57 - 03/10/23	
Performance	Indexed Terms
Best	11%
Average	6.64%
Worst	0%

Frequency of Returns	Indexed Terms
Positive	72.31%
Zero	27.69%
Negative	0%

Using iCapital's platform for annuities, we can view the hypothetical performance metrics across one-year indexed terms between April 18, 1957 and March 10, 2023. The best return in any of those one-year indexed terms would have been 11%, or the cap. Since a fixed indexed annuity without a fee cannot have a negative return, the worst return would have been 0%. The average return across all of the observed one-year indexed terms would have been 6.64%. It is also worth noting that 72.31% of the observed one-year indexed terms would have resulted in a positive return, while 27.69% would have resulted in a 0% return.

Source: iCapital, as of March 10, 2023. Assumes a 10-year surrender charge period and a minimum initial premium of \$5,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.

Securities products and services may be offered by iCapital Markets LLC, a registered broker/dealer, member FINRA and SIPC, and an affiliate of iCapital. Annuities and insurance services provided by iCapital Annuities and Insurance Services LLC, an affiliate of iCapital, Inc. iCapital and iCapital Network are registered trademarks of Institutional Capital Network, Inc. Please see the disclaimer at the end of this document for more information.

strategies on the S&P 500. My message today is if you have not considered some volatility-controlled indices, the time to do so is now. The rapid increase in interest rates over the course of 2022 has led to a corresponding increase in the general accounts of insurance companies, enabling them allocate more funds to the “options budget” of the indexed annuity and offer more attractive rates across the board.⁵

Volatility-controlled indices also have another important advantage. Since these indices are designed to manage volatility within the index, hedging is much less costly than hedging the S&P 500, according to Barclays’ Index Pricing Model.⁶ In other words, the insurance company can buy more options with less money, given the lower cost of the options. To better understand this concept, compare the cost of buying options on a relatively stable stock, like IBM, compared with a highly volatile stock, such as Tesla – as volatility increases, the prices of options tend to rise.

Participation rates on these indices have become very competitive relative to cap rates. As an example, consider an indexed annuity from Forethought Life Insurance Company, a Global Atlantic Company. It offers a 195% participation rate on a one-year point-to-point on the PIMCO Balanced Index (PIMBAL). While this particular index doesn’t have as much history as the S&P 500, we can observe returns that would have been generated by a 195% participation rate back to the beginning of the century. The results are in Exhibit 2 below.

Historically, the current pricing on this strategy would have provided an average annual return of 9.28%, much higher than the 6.64% generated from the S&P 500 strategy with the 11% cap.⁷ In addition, this strategy would have provided significantly more positive one-year returns.

Some carriers now offer the option of paying an annual fee of 1.0-1.5% in order to add to the options budget and,

Exhibit 2: ForeAccumulation II Fixed Indexed Annuity

One-year Point-to-Point Strategy with 195% Participation Rate on PIMBAL

Past Performance Statistics 12/31/01 - 03/10/23	
Performance	Indexed Terms
Best	35.33%
Average	9.28%
Worst	0%
Frequency of Returns	Indexed Terms
Positive	85.07%
Zero	14.93%
Negative	0%

Using iCapital’s platform for annuities, we can view the hypothetical performance metrics across one-year indexed terms between December 31, 2001 and March 10, 2023. The best return in any of those one-year indexed terms would have been 35.33%. Since a fixed indexed annuity without a fee cannot have a negative return, the worst return would have been 0%. The average return across all of the observed one-year indexed terms would have been 9.28%. It is also worth noting that 85.07% of the observed one-year indexed terms would have resulted in a positive return, while 14.93% would have resulted in a 0% return.

Source: iCapital, as of March 10, 2023. Assumes a 7-year surrender charge period and a minimum initial premium of \$100,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed. The calculated results are based on iCapital’s past performance model and have certain inherent limitations, including but not limited to results being generated through the retroactive application of certain contract parameters and assumptions with the benefit of hindsight. The model may be changed from time to time and the effect on performance results could be either favorable or unfavorable. The values displayed do not include any rider fees, product level fees, or adjustments that may apply at the product level which, if included, would lower the values shown. Product terms are established by Forethought Life Insurance Company, a Global Atlantic Company.

Securities products and services may be offered by iCapital Markets LLC, a registered broker/dealer, member FINRA and SIPC, and an affiliate of iCapital. Annuities and insurance services provided by iCapital Annuities and Insurance Services LLC, an affiliate of iCapital, Inc. iCapital and iCapital Network are registered trademarks of Institutional Capital Network, Inc. Please see the disclaimer at the end of this document for more information.

therefore, increase the participation rate even further. For example, consider a fixed indexed annuity from Eagle Life Insurance Company offering 140% participation rate on a one-year point-to-point strategy on the Invesco Dynamic Growth Index (IIDGROW). In exchange for paying a 1.25% annual fee, the participation rate goes up to 220%. Advisors should keep in mind that this is a true fee, therefore, if the index does not increase in price by at least 1.25% during the year, the policyholder would get a negative return of up to ... 1.25%. "Zero will no longer be your hero."

How would these options stack up? Let's review the data from iCapital's platform for annuities.

In reviewing the performance metrics, we can observe that paying the annual 1.25% fee would have led to over a

Exhibit 3: Eagle Select Focus 7 Fixed Indexed Annuity

One-year Point-to-Point Strategy with 140% Participation Rate on IIDGROW

Past Performance Statistics 01/10/08 - 03/10/23	
Performance	Indexed Terms
Best	26.87%
Average	9.77%
Worst	0%

Frequency of Returns	Indexed Terms
Positive	87.77%
Zero	12.23%
Negative	0%

Source: iCapital, as of March 10, 2023. Assumes a 7-year surrender charge period and a minimum initial premium of \$5,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed. The calculated results are based on iCapital's past performance model and have certain inherent limitations, including but not limited to results being generated through the retroactive application of certain contract parameters and assumptions with the benefit of hindsight. The model may be changed from time to time and the effect on performance results could be either favorable or unfavorable. The values displayed do not include any rider fees, product level fees, or adjustments that may apply at the product level which, if included, would lower the values shown. Product terms are established by Eagle Life Insurance Company.

Securities products and services may be offered by iCapital Markets LLC, a registered broker/dealer, member FINRA and SIPC, and an affiliate of iCapital. Annuities and insurance services provided by iCapital Annuities and Insurance Services LLC, an affiliate of iCapital, Inc. iCapital and iCapital Network are registered trademarks of Institutional Capital Network, Inc. Please see the disclaimer at the end of this document for more information.

4% greater annual average return per year. However, the trade-off is that in 12.5% of the observed one-year indexed terms, the policyholder would have suffered a 1.25% loss. Is it worth the trade-off? The answer will depend on the individual client's investment objectives and risk profile. However, it is definitely worth considering.

iCapital gives you the data you need to weigh the pros and cons of each option.

Regardless, of whether you stick with the simple S&P strategy or venture into one of the many volatility-controlled reference indices, the current interest rate environment provides an opportunity for investors to lock in attractive fixed indexed annuity rates while managing downside risk.

Exhibit 4: Eagle Select Focus 7 Fixed Indexed Annuity

One-year Point-to-Point Strategy with 220% Participation Rate on IIDGROW and 1.25% Annual Fee

Past Performance Statistics 01/10/08 - 03/10/23	
Performance	Indexed Terms
Best	40.97%
Average	14.1%
Worst	-1.25%

Frequency of Returns	Indexed Terms
Positive	86.75%
Zero	0%
Negative	13.25%

Source: iCapital, as of March 10, 2023. Assumes a 7-year surrender charge period and a minimum initial premium of \$5,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed. The calculated results are based on iCapital's past performance model and have certain inherent limitations, including but not limited to results being generated through the retroactive application of certain contract parameters and assumptions with the benefit of hindsight. The model may be changed from time to time and the effect on performance results could be either favorable or unfavorable. The values displayed do not include any rider fees, product level fees, or adjustments that may apply at the product level which, if included, would lower the values shown. Product terms are established by Eagle Life Insurance Company.

END NOTES

1. Source: Wink's Sales & Market Report Q3 2022, as of Nov. 22, 2022.
2. Source: LIMRA, "A Deeper Dive: 2021 Fixed Indexed Annuity Sales and Assets," 2022.
3. Source: Seeking Alpha, as of Jan. 2, 2023.
4. Source: LIMRA, "2022 U.S. Retail Annuity Sales Shatter Annual Sales Records Set in 2008," Jan. 26, 2023.
5. Source: Financial Advisor, Ben Mattlin, "How Rising Interest Rates Affect Annuities," March 1, 2022.
6. Source: Barclays' Index Pricing Model, as of Jan. 2023.
7. Source: iCapital, as of March 10, 2023.

COMPOSED BY



Scott Stolz, CFP, RICP

Managing Director
iCapital Solutions



IMPORTANT INFORMATION

The material herein has been provided to you for informational purposes only by Institutional Capital Network, Inc. ("iCapital Network") or one of its affiliates (iCapital Network together with its affiliates, "iCapital"). This material is the property of iCapital and may not be shared without the written permission of iCapital. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission of iCapital.

This material is provided for informational purposes only and is not intended as, and may not be relied on in any manner as, legal, tax or investment advice, a recommendation, or as an offer or solicitation to buy or sell any security, financial product or instrument, or otherwise to participate in any particular trading strategy. This material does not intend to address the financial objectives, situation, or specific needs of any individual investor. You should consult your personal accounting, tax and legal advisors to understand the implications of any investment specific to your personal financial situation.

ANNUITIES ARE CONSIDERED COMPLEX PRODUCTS AND MAY NOT BE SUITABLE FOR ALL INVESTORS. The information is not intended as investment advice and is not a recommendation about managing or investing retirement savings. Actual annuity contracts may differ materially from the general overview provided. Prior to making any decision with respect to an annuity contract, purchasers must review, as applicable, the offering document, the disclosure document, and the buyer's guide which contain detailed and additional information about the annuity. Any annuity contract is subject in its entirety to the terms and conditions imposed by the carrier under the contract. Withdrawals or surrenders may be subject to surrender charges, and/or market value adjustments, which can reduce the owner's contract value or the actual withdrawal amount received. Withdrawals and distributions of taxable amounts are subject to ordinary income tax and, if made prior to age 59½, may be subject to an additional 10% federal income tax penalty. Annuities are not FDIC-insured. All references to guarantees arising under an annuity contract are subject to the financial strength and claims-paying ability of the carrier.

iCapital Markets LLC operates a platform that makes available financial products to financial professionals. In operating this platform, iCapital Markets LLC generally earns revenue based on the volume of transactions that take place in these products and would benefit by an increase in sales for these products.

The information contained herein is an opinion only, as of the date indicated, and should not be relied upon as the only important information available. Any prediction, projection or forecast on the economy, stock market, bond market or the economic trends of the markets is not necessarily indicative of the future or likely performance. The information contained herein is subject to change, incomplete, and may include information and/or data obtained from third party sources that iCapital believes, but does not guarantee, to be accurate. iCapital considers this third-party data reliable, but does not represent that it is accurate, complete and/or up to date, and it should not be relied on as such. iCapital makes no representation as to the accuracy or completeness of this material and accepts no liability for losses arising from the use of the material presented. No representation or warranty is made by iCapital as to the reasonableness or completeness of such forward-looking statements or to any other financial information contained herein.

Securities products and services are offered by iCapital Markets, an SEC-registered broker-dealer, member FINRA and SIPC, and an affiliate of iCapital, Inc. and Institutional Capital Network, Inc. These registrations and memberships in no way imply that the SEC, FINRA, or SIPC have endorsed any of the entities, products, or services discussed herein. Annuities and insurance services are provided by iCapital Annuities and Insurance Services LLC, an affiliate of iCapital, Inc. "iCapital" and "iCapital Network" are registered trademarks of Institutional Capital Network, Inc. Additional information is available upon request.

© 2024 Institutional Capital Network, Inc. All Rights Reserved. | 2024.01



iCapital[®]

60 East 42nd Street, 26th Floor
New York, NY 10165
212.994.7400

www.icapital.com

North America

New York City
Princeton
Greenwich
Boston
Boca Raton
Toronto
Birmingham

Europe

Zurich
London
Lisbon

Asia

Hong Kong
Singapore