Leveraging Technology to Align Annuities with Client Risk Profiles

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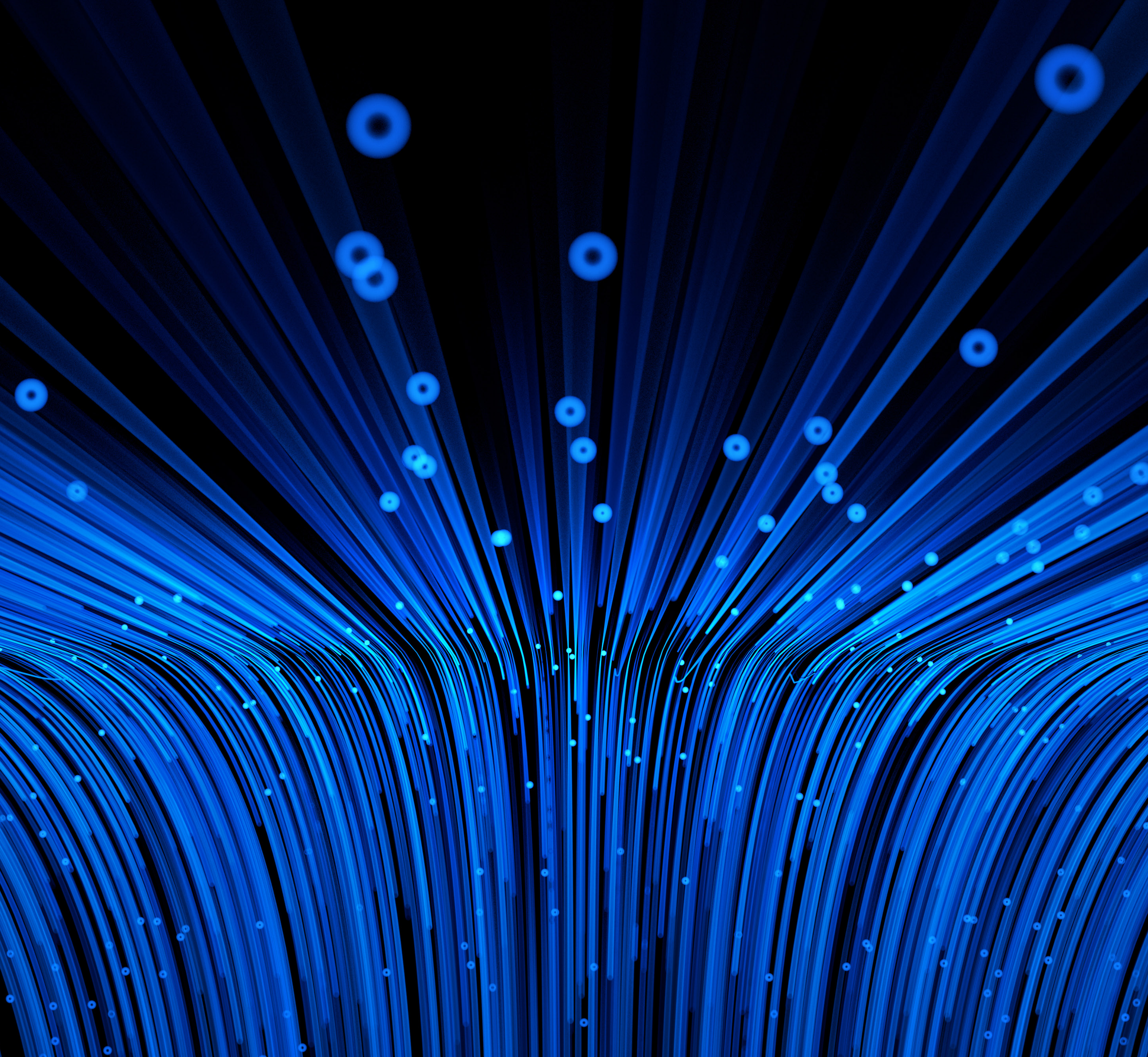

Most investors will experience three to four significant bear markets during their lifetime. For the baby boomers, these periods include the crash of 1987, the dot-com bubble burst (2000-02) and the global financial crisis of 2007-09. While each downturn was challenging, the bear market of 2022 might have been the most unsettling for many investors, especially retirees, when the average 60/40 portfolio fell 17.5%.[1] Why is this? Even though the S&P 500 fell nearly 50% from 2007-09, most baby boomers had many working years left and time for retirement account balances to recover.[2] By 2022, however, most baby boomers had entered retirement. Watching a portfolio decline by 17.5% while making withdrawals can make even the most confident retirees question their financial stability.

In 2024, the annuity industry saw record sales of $432.6 billion.[3] Notably, 80% of total sales were in annuity solutions offering downside protection – fixed annuities, fixed indexed annuities (FIAs), and structured annuities.[3] Compare that to 2014, when these three annuity types accounted for merely 34% of total annuity sales.[4]

The reason for this change relates to why, for many retirees, 2022 was a more painful experience than prior downturns. In retirement, avoiding losses is often more important than achieving an additional 20% return. These retired investors seek protection. The questions their advisors should contemplate are:

- How much protection suffices?
- How much additional upside can we expect if we move from a known return with 100% protection (fixed annuity) to an unknown return tied to an index with 100% protection (FIA) to an unknown return tied to an index with some protection (structured annuity)?
- How do we quantify these trade-offs to best match the annuity with each client's risk profile?

Let's assume an advisor is considering three options[5] for a client:

1. A five-year MYGA (multi-year guaranteed annuity) with a fixed, 5% rate.
2. A FIA with a one-year point-to-point on the S&P 500 with a 10% cap.
3. A structured annuity with a six-year point-to-point on the S&P 500 with a 250% cap and a 15% buffer.

The MYGA offers a fixed interest rate, guaranteed for the term, and so a client knows how their investment will grow. A FIA also has 100% downside protection, though its return each year is contingent upon the price change of the S&P 500 and the renewal rate of the cap. While these two factors make the future return impossible to determine, iCapital's annuity analytics can calculate a hypothetical return by applying a 10% cap to every one-year period over the last 60 years.

Exhibit 1: Fixed Indexed Annuity Example

One-Year Point-to-Point with 10% Cap Rate on SPX

Past Performance Statistics One-Year Indexed Term 12/31/1964 - 04/15/2025	
Performance	**Indexed Terms**
Best	10.00%
Average	6.33%
Worst	0.00%
Frequency of Returns	**Indexed Terms**
Positive	74.17%
Zero	25.83%
Negative	0.00%

Source: iCapital Annuities Platform, as of March 1, 2025. Assumes a five-year surrender charge period and a minimum initial premium of $10,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.

This analysis informs us that the average return of these thousands of possible one-year periods would have been 6.33%. The client would have received a positive return up to the 10% cap, 74.17% of the time. The advisor can now better assess whether the potential additional return over the 5% MYGA would justify taking on unpredictable returns.

What about the implications of the structured annuity choice? Here, we have introduced the potential to lose money. If the price of the S&P falls more than 15% over the six-year crediting period, the client will suffer a loss equal to the percentage drop in excess of that amount. How often has that happened over a six-year period? How much extra return could we have earned by accepting this additional risk? When we run this strategy on iCapital's platform for annuities, analyzing every six year-period over the last 60 years, the average return of this strategy would have been 61.9%, or 8.36% compounded per year.

Importantly, the 15% buffer would not have fully protected the downside just 2.27% of the time, and the maximum loss would have been 24.89% back in 1968-1974. Lastly, the strategy would have resulted in a 0% return (where the price of the index declined but by no more than 15%) 12.7% of the time.

The goal is to match the right product and the right strategy within that product to the client's risk profile. In efficient markets, as risk and uncertainty increase, expected returns should rise accordingly. Some clients may prefer the 5% guarantee. Others may be comfortable with an uncertain annual return, knowing they are likely to exceed 5% on average while still fully protecting the downside. And, based on 2024's record structured annuity sales, many clients will accept the possibility of losing money over the term in exchange for hoping to achieve 8%+ per year. To minimize guesswork and more effectively evaluate annuity trade-offs, advisors need data. Fortunately, today's data-driven tools make it easier than ever to optimize product selection.

Exhibit 2: Structured Annuity Example

Six-Year Point-to-Point Strategy with 250% Cap and 15% Buffer on SPX

Past Performance Statistics Six-Year Indexed Term 12/31/1964 - 04/15/2025	
Performance	**Indexed Terms**
Best	243.11%
Average	61.90%
Worst	-24.89%
Frequency of Returns	**Indexed Terms**
Positive	85.03%
Zero	12.70%
Negative	2.27%

Source: iCapital Annuities Platform, as of March 1, 2025. Assumes a six-year surrender charge period and a minimum initial premium of $25,000. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.

ENDNOTES

1. Morgan Stanley: Big Picture, Return of the 60/40, April 2024.
2. Investopedia: The Stock Market Crash of 2008, November 2024.
3. LIMRA: 2024 Retail Annuity Sales Grow 12% to a Record $432.6 Billion.
4. LIMRA: US Individual Annuity Yearbook 2023.
5. Source: iCapital annuities platform, as of March 1, 2025. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.

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