The Strongest Guarantee In A Fixed Annuity Is The Minimum Guarantee!

By: Jeff Affronti—02/24/2017

The Minimum Guarantee Is the Strongest Guarantee

The traditional fixed annuity buyer is looking for safety and guaranteed yield. An experienced fixed annuity buyer is also looking for the highest contractual minimum guarantees. The minimum guarantee clearly defines the exact amount of accumulated funds to be fully available for withdrawal or transfer at the end of a surrender period. The minimum guarantee is also the lowest accumulation interest rate the contract will pay after the surrender period and for the life of the contract.

Accessing Fixed Annuity Risk Through Minimum Guarantee Calculations

There is a risk/reward calculation when choosing one fixed annuity over another. A fixed annuity client being presented a fixed indexed annuity (FIA) product should be shown the spread between the FIA assumed values, true walk away values, available guaranteed fixed rate yields and the minimum guarantee values of each product. Below are real examples of how these spreads can be expressed by using the product illustration software. The annuity buyer can see if the upside potential is worth giving up current fixed rate guarantees.

Examples - Fixed Indexed Annuities and Multi-Year Guarantee Annuity (MYGA)

Product 1: FIA | 7 Year Surrender | 100% Participation | 5.50% Annual Pt 2 Pt Cap

- Premium $500,000
- Historical Return Last 7 Years = $630,624 (3.45% / 26.1% Overall)
- Minimum Guarantee Return 107% = $535,000
- **Spread $95,624**
  The spread between the assumed historical value $630,624 and the minimum guaranteed value $535,000 is $95,624. The annuity buyer in this case can reasonable assume they will end up with a walk away value of somewhere between $630,000 and $535,000. That is their risk/reward decision.

  Product 2: FIA | 7 Year Surrender | No Cap Volatility Control Index

- Premium $500,000
- Historical Return Last 7 Years = $742,550 (5.81% Annually / 48.5% Overall)
- Minimum Guarantee 100% = $500,000
- Spread $242,550
  The spread between the assumed historical value $742,550 and the minimum guaranteed value $500,000 is $242,550 The annuity buyer in this case can reasonably assume they will end up with a walk away value of somewhere between $742,550 and $500,000. That is their risk/reward decision, it is huge spread though.

  Product 3: MYGA Fixed Rate Annuity | 7 Year Surrender | 3.10% Interest All 7

Years

- Premium $500,000
- Accumulation Value In 7 Years = $619,128.31 (3.10% / 23.8% overall)
- Minimum Guarantee 123.8% = $619,128.31
- Spread $0.00

  There is NO spread between the assumed value $619,128.31 and the minimum guaranteed accumulation value of $619,128.31. The client in this case knows exactly what the walk away value will be. Now, this annuity buyer's risk/reward decision lies in choosing between the three products presented.

The Risk Calculation

The annuity buyer must weigh how much is to gain and lose in a worst case scenario.

- The annuity buyer knows a MYGA will guarantee a gain of $119,128.31 on their $500,000 premium. A 23.8% increase.
- The annuity buyer has seen the $242,550 hypothetical gain from the back modeling in the FIA illustration. A 48.5% increase. 25.3% more than can be guaranteed today through the MYGA.

  The annuity buyer can see a potential of making an extra $123,421 if they choose the FIA but they must willing to pass on the product that offers a guaranteed $119,128.31 gain.

Annuity buyers are looking for safety but they are just human, a bit of a greed factor can easily creep into their thought process. This is especially true when the buyer does not understand the risk in selecting a product with high assumption and weak guarantees over a product with reasonable assumptions and stronger guarantees.

Such large risk spreads spread, as in Product 2 can be harmful to the industries reputation. Expectations missed by large margins can lead to a clients poor impression all annuities. If a client does not have access to the strongest fixed rates while making their decision, they only realize the risk spread of the products shown to them. For example, if a client is only shown Product 2, and has not seen any risk calculations they will likely have very high expectations on return. The client that receives the full fixed annuity picture and misses expectations by a large margin still knows the margin could have been much less if Product 1 or 3 were chosen. In real terms the client who did not get the full picture expected $500,000 to grow to as much as $742,550 and if that client receives nothing, they could easily feel wronged. Whereas the well informed clients could easily feel **they should** have taken the guarantee, and it is kind of on them not the industry. In the hypothetical one client will likely have a better opinion of Fixed Annuities than the other, even though they started on the same playing field.

Okay, now please feel free to comment and give your opinion on either side of the argument, that is how we all learn!

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