

# The Impact of Volatility on Fixed Index Annuity Rates

Equity market volatility and interest rate uncertainty can affect product pricing and the rates we offer your client on a new fixed index annuity (FIA) or at renewal time. But how much these impact FIA rates varies with the index and crediting method your client chooses.

Below is an overview and examples of how index crediting options in Delaware Life Insurance Company's (Delaware Life) FIAs are priced and the relationships between equity market volatility, interest rates and interest crediting rates.

## How FIA rates are set

When a client purchases an FIA, the money is invested in the insurance company's General Account to support both the minimum rate guarantees on the contract and to purchase market instruments (e.g., options) that hedge the FIA index crediting options offered. (Note: An FIA is not invested directly in the stock market or in any securities. Instead, your client's account receives interest based on the performance of the index(es) selected.)

Because this happens at the contract outset for the expected duration of the policy, the annual budget available to purchase hedges is expected to remain consistent. However, other factors can impact the cost of the hedges year-to-year. Two of the most relevant are:

- The level of short-term interest rates (i.e., 1-year rates for a 1-year crediting strategy)
- The level of volatility on the underlying index

An increase to either can increase the cost of the hedge instruments used to price FIA crediting strategies. But different crediting strategies can be impacted to a different degree. For example:

- **"Capped"** strategies tend to be more resilient to market changes, based on the way the hedge is structured. The S&P 500<sup>®</sup> Point-to-Point with a Cap is one such strategy.
- **"Uncapped"** strategies, on the other hand, are more exposed to interest rate and market volatility increases. The S&P 500<sup>®</sup> Point-to-Point with Participation Rate strategy is an example.
- **"Uncapped Volatility Control"** strategies, such as the CROCI Sectors III USD 5.5% Volatility Control Index and Morgan Stanley Global Opportunities Index, fall somewhere in the middle. An increase in short-term interest rates raises hedge costs, but the index's volatility-targeting mechanism helps to stabilize the option costs to a degree. Also, higher volatility of the underlying index can trigger an increase to the cash allocation of the strategy.

## Hedge costs have risen

As an example of how these pricing dynamics have played out in practice, the table shows the change in annual hedge costs of three crediting strategies offered on Delaware Life's FIAs, from June 2016 to June 2018.

Hedge Cost Change: June 2016 –June 2018	
S&P 500 <sup>®</sup> 1-year Point-to-Point with Cap	+10%
CROCI Sectors III USD 5.5% Volatility Control Index	+24%
S&P 500 <sup>®</sup> 1-year Point-to-Point with Participation Rate	+27%
Sources: S&P 500 <sup>®</sup> , Numerix and Bloomberg; CROCI Index, Deutsche Bank and Delaware Life Insurance Company.	

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The cost to hedge these three crediting strategies, based on the market factors above, has changed to varying degrees over the past year. Since the available hedge budget is based on contract issuance, this change in cost could translate to decreased caps and participation rates, and increased spreads offered at renewal.

### **What does this mean for the future?**

The only certainty is that markets and interest rates will fluctuate, and it's important to remember that this dynamic could shift at the next contract anniversary. If that happens, we will adjust pricing and rates accordingly. New and renewal FIA rates could go higher or lower, depending on how market conditions change. Renewal rates are always subject to the guaranteed minimum caps, participation rates, and guaranteed maximum spreads for each strategy.

However, Delaware Life remains committed to providing pure value to you and your clients now and in the future. In terms of our FIAs, that means setting competitive rates—and the proof is in our history.

For more information on current FIA rates and our record for renewal rates, please contact your wholesaler or Delaware Life at **855-478-3673**.

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### Risk Factors

There are risks associated with any product linked to this Index:

- Allocation to a crediting method using the Index provides the potential for interest to be credited based in part on the performance of the Index.
- The Index may not increase in value due to a number of factors and as a result there may be no interest credited to the annuity contract.
- Because the Index is managed to a volatility target, the Index performance will not match the performance of the underlying Index components and may dampen the performance of the Index in rising markets.
- The Index has a limited performance history and past performance is no indication of future performance.
- The Index may be comprised of a small number of index components at any given time and the performance of the index involves risk associated with international and U.S. equities and bonds, commodities and precious metals, which may impact the Index value and the interest credited to the annuity contract.
- Premium allocated to a crediting method using the Index is not a direct investment in the stock markets, bond markets, commodities, precious metals or in the index.
- Purchasers of products linked to the Index will have no access to the components underlying the Index.

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