

Episode #341 - Price and Excess Return Volatility-Controlled Indices

Hello and welcome to another episode of Money Script Monday. My name is Sean Brady, and today we're going to delve into an important aspect of fixed index annuities, price return and excess return volatility controlled indices. By now, you've likely noticed that many of today's FIAs offer these types of indices. Understanding them can help you better navigate FIA allocation options and help predict their future renewal rate experiences. Now let's breakdown what these indices are and how they impact renewal rates.

Price return indices measure the change in the price of an underlying index over a specific period known as the crediting period. To illustrate, suppose an index starts at \$100 at the beginning of the crediting period. At the end of this period, if the index has risen to \$110, the price return index would show a return of 10%. Now this is calculated simply by taking the final value, subtracting the initial value, and dividing by the initial value. So you take $110 - 100$, divide it by 100, and that equals .1 or 10% return.

Excess return indices measure the price return of the index in excess of an expected growth rate. This expected growth rate is typically a benchmark interest rate. For example, let's use the same index values starting at \$100 and ending at \$110. Let's assume the expected growth rate is 3%. To find the excess return, you first calculate what the index value would be if it had grown at the expected rate over that timeframe.

Take 100 times 1 plus 0.03, that equals 103. That's your expected growth rate or expected growth number. The excess return index then compares the actual end value to this expected value. You take 110, divide 103 minus that by 1, that equals .068 or 6.8% return. This calculation shows how much of the return exceeds what was the expected base based on the benchmark growth rate.

Understanding these indices is crucial, especially when it comes to how they affect FIA renewal rates. Price return indices are influenced by short term interest rates. When these rates rise, the financial derivatives used to hedge price return indices become more expensive. This can lead to a decrease in renewal caps and participation rates for price return indices because the costs of hedging increases. Conversely, when interest rates fall, the cost of these derivatives decreases, and as a result, renewal caps and participation rates for price return indices tend to increase because the hedging cost is lower.

Excess return indices are generally less sensitive to fluctuations in short term interest rates. This is because the financial derivatives used for excess return indices are structured in a way that their cost is less affected by short term interest rate changes. Thus, renewal caps and renewal participation rates for excess return indices tend to remain more stable even during volatile interest rate environments.

In summary, price return indices track the simple price change of an underlying index, reflecting the capital appreciation. Excess return indices, on the other hand, measure returns relative to an expected growth rate, showing how much return is above the benchmark. The choice between these indices can significantly impact the FIA's renewal rates. Price return indices can be more volatile in response to short term interest rate changes affecting their renewal rates, while excess return indices offer more stability in such environments. Understanding these differences helps you better anticipate how market conditions might influence your FIA returns and renewal experiences.

Of course, no single allocation option will perform best in all markets, and that's why the return structure of an index should just be one consideration when choosing an allocation option within an FIA. If you have any questions and you want to learn more about fixed index annuities and these volatile volatility control indices, please reach out to your financial

advisor today. Thank you for your attention today and we'll see you again next time on Monday Script Monday.