

WHITEPAPER

New hedging technology for annuity carriers.

Simplify FIA and RILA portfolio management and reduce risk.

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About the author



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Diogo Barros is a seasoned Senior Sales Executive at Tecim. Diogo's strategic approach and deep understanding of the financial sector enable him to deliver tailored solutions that address the unique needs of clients.

Diogo is passionate about leveraging technology to empower financial institutions and drive industry innovation. He holds a degree in Business Administration and has a proven track record of success in the competitive financial services market.

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Introduction

An aging population is reshaping the financial landscape. By 2050, the number of individuals aged 60 and older is projected to double and populations aged 80 and above are expected to triple.¹

As life expectancies continue to climb, people around the globe are facing a growing retirement challenge – ensuring adequate funds to support a healthy and comfortable lifestyle.

According to the 2024 LIMRA Life Insurance Barometer Study, funding a comfortable retirement outranks other financial concerns across multiple age groups. Over half of millennial respondents and nearly 30% of baby boomers – an age cohort where many individuals are already retired – indicated a high level of concern about financing their post-working years.²

Rising apprehension over the state of the retirement nest egg has driven life and annuity carriers to develop a wider range of investment options. Guaranteed income products such as annuities provide predictable payments for life. They offer added security over traditional retirement instruments such as a 401k or IRA, both of which can be depleted over the lifetime of the individual.

Total annuity sales posted \$432.4 billion in 2024, up 12% year over year, according to preliminary results from LIMRA's U.S. Individual Annuity Sales Survey.³ Globally, the annuities market is predicted to climb at an annual growth rate of 5.9% through 2029.⁴

Despite increasing interest in annuities, it is not a risk-free instrument for retirees. Traditional fixed annuities lose purchasing power over time, as inflation forces the price of everyday necessities to rise.

As an example, a 3% average annual inflation rate would result in an 81% increase in the cost of living over 20 years.⁵

As insurance carriers and retirees both face the limitations of traditional annuities, innovation across the space has led to the development of lifetime income solutions that offer growth potential.

Registered Index-Linked Annuities (RILAs) and Fixed Income Annuities (FIAs) combine market-linked growth with a measure of downside protection and the potential to deliver more stable benefits over time.

However, outcomes are largely dependent upon the annuity carrier's ability to manage portfolios and risk. Hedging strategies are necessary to optimize market returns while offering downside protection. Additionally, RILAs face heightened regulatory scrutiny, increasing burdens related to suitability assessments and risk-based capital requirements, to name a few of the additional obligations.

Adding to the complexity is a lack of investment in technology to optimize portfolio management on the part of life insurance carriers.

In recent years, technology modernizations have focused on revenue-generating distribution functions. Hedging teams and portfolio managers have been left to rely on manual processes to oversee portfolios and hedge risk. Without access to updated capabilities such as automation, real-time analytics and a single source of truth, carriers are unable to integrate front-to-back-office operations or receive real-time insights, leading to high costs and elevated risks when managing annuities portfolios.

Focus on distribution modernization exposes RILA risks

In recent years, carriers have prioritized modernization of the front office, investing heavily in policy administration upgrades and digital distribution platforms.

According to a recent survey of life insurers, 66% of executives consider investments in customer service technology as critical to success.⁶

One reason is customer sentiment. According to J.D. Power, 31% of consumers seeking information on annuity products utilized a combination of agent interaction and digital sources. However, interest in self-service capabilities extends across the buying and servicing lifecycle.⁷

Electronic applications, real-time quoting, agent-friendly policy management portals and other front-office modernizations have made it easier than ever for carriers to manage and sell annuity products, but enhancements such as these do little to address the complexities associated with managing RILA portfolios.

Since RILAs combine the features of a life insurance product with those of an investment instrument, carriers face additional complexity not always present with traditional annuities.

Determining rates, caps and various crediting methods requires carriers to create comprehensive profiles – a challenging task with manual hedging tactics. Hedging teams are also often relying on data that is not updated in real time, increasing the risk of under or over hedging.

Focus on distribution modernization exposes RILA risks

While regulatory risk is always a concern for insurers, annuity carriers often face far greater exposure when managing RILAs. Since RILAs are considered both an insurance product as well as a security, insurers must comply with regulations set by both FINRA and the Securities Exchange Commission. Dual oversight can result in conflicting rules and interpretations as well as a more frequently changing landscape, resulting in higher compliance costs and risk.

Multiple regulatory requirements can also complicate hedging for annuity carriers. Since carriers are providing guarantees on returns, it's essential to manage market and longevity risk with the best hedging instrument, but some regulators restrict the derivative types that can be used for annuities and demand more robust processes for risk mitigation.

To help control the complex environment, carriers have taken different approaches to hedging and portfolio management. Smaller carriers may rely on outside resources to provide hedging solutions, favoring a lower upfront investment.

Unfortunately, this approach may not deliver the best outcomes long term. As the carrier's business grows, so does the cost of the third-party service, diminishing returns in per-transaction costs.

Eventually, carriers may choose to employ in-house teams of analysts, traders and other specialists, while building their own architecture and custom technology. Taking this approach provides greater control and the ability to customize hedging strategies but requires a tremendous financial investment, resulting in higher long-term costs.

Regardless of the approach, hedging outcomes are limited by the depth of technology underpinning the operation.

For instance, it's essential to adjust hedges as the market moves, but without access to automation and dynamic data, carriers may miss opportunities and increase exposure due to the time it takes to manually gather information and perform calculations.

For carriers working in RILAs, finding the right hedging and processing platform is essential to employing effective hedging strategies as well as overall portfolio management.

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Senior Sales Executive

From fragmentation to efficiency: Adopting a modern hedging platform

Managing indexed-linked annuities requires annuity carriers to seamlessly coordinate front-, middle- and back-office functions functions, yet many carriers continue to manage portfolios and risk with disjointed legacy systems.

Operating with on-premises infrastructure and physical servers, carrier technology can date back decades. Limited processing power and legacy customization techniques inhibit the carrier's ability to scale applications that could simplify business operations and reduce risk.

However, modernization challenges don't stop at the edge of infrastructure. Legacy technology reaches into the very core of the insurance operation, to the heart of data management. In the absence of modernized technology, siloed data continues to require tedious reconciliation processes, reducing efficiency and increasing risk.

Consider the case where risk teams are managing a RILA portfolio linked to multiple indices. Without an integrated hedging platform, front-office sales team may lack intraday insights into hedging costs. Likewise, middle-office risk managers may struggle to assess exposure accurately and back-office teams may face delays in executing hedge trades.

While front-office modernizations have driven immediate financial benefit, carriers hoping to protect profits and margins will need to prioritize investments in hedging platforms that are scalable and support the entire trade lifecycle.

Integrated portfolio management reduces operational effort such as manual reconciliation – decreasing costs and increasing efficiency. It also provides more intraday data, leading to better decision-making. A flexible solution fosters innovation and allows the integration of intellectual property, enabling differentiation.

Broad cross-asset support and structuring enables organizations to innovate with new structured products and bespoke indices, creating specific value propositions for end investors, while improved risk management leads to better capital utilization and enhanced performance.

Automated hedging strategies and advanced analytics also help carriers to maintain a competitive edge while optimizing portfolio returns.

Realizing the benefit

A fit-for-purpose solution

Annuity carriers require a specialized platform tailored to their products – one that comprehends annuities and accurately prices and models them, capturing intraday data and therefore enabling the computation of intraday risk and hedging analytics. Additionally, seamless integration of middle-office and back-office workflows such as hedging and collateral management is crucial for ensuring operational efficiency, reducing risk and enhancing the precision and timeliness of financial transactions.

Fully integrated pricing models

Integrating powerful out-of-the-box analytics for standard contracts as well as proprietary pricing models builds added efficiency. Carriers can code their pricing data directly into the platform as a packaged product or pull computation results directly from their internal models when it brings differentiation. Integrated pricing (whether proprietary or out of the box) reduces manual intervention through automation, ensures consistent data usage and enables a faster response in the face of market changes. When a solution is open, the pricing library flows seamlessly through the full lifecycle and reports.

Trade lifecycle efficiency

Specialized order building tools automate tasks from trade order creation through compliance checks, decreasing the time it takes to initiate a trade while reducing errors. Leading systems such as Sophis Invest also have the ability to monitor hedge links between derivatives and contracts or liabilities. By analyzing real-time market data and modeling different scenarios, hedging platforms can identify opportunities to maximize returns within product boundaries, including participation rates, caps and crediting methods.

Sophisticated simulation tools also support trade decisioning, allowing carriers to input a hypothetical trade, simulate market changes and see how the portfolio is impacted. Intraday risk modeling and scenario analysis link factors such as market variables, specific product features, policyholder behavior and actuarial tables to provide an accurate snapshot for both static and dynamic hedging.

Optimized collateral and risk management

The need to assess the potential risk exposure of each hedging transaction and set appropriate collateral requirements generates several complexities. Teams must consider the types of acceptable collateral at their disposal and how to manage portfolios for long-term returns, despite market volatility.

Modern technology joins all aspects of portfolio management onto a single platform, integrating automation capabilities that eliminate manual data entry and reconciliation. Carriers realize fewer errors and improved efficiency in tracking collateral positions, valuations and movements.

In addition, leading hedging platforms unite data from various silos into a single source of truth, enabling enhanced insights into collateral exposures, for more proactive risk and compliance management. Automated reporting capabilities provide detailed trails of hedging activities, improving timeliness and making it easier for carriers to demonstrate compliance with regulatory requirements.

A flexible and scalable approach to hedging and portfolio management

Managing RILA portfolios requires a cross-asset platform that covers the full scope of the annuity lifecycle. However, carriers should not give up flexibility or control when adopting a hedging platform.

Sophis Invest, for example, unites all users to a single data source across one powerful platform, to manage both the investment and hedging book. Deployable on premises, on private cloud or on public cloud, Sophis Invest supports the needs of all annuity carriers.

Sophis Invest is also customizable right down to the pricing models. Annuity carriers are free to create their own processes and customize the application to meet their needs, all while realizing enhanced efficiency and hedging outcomes.

That's why Sophis Invest by Teciem is the hedging platform of choice for one of the world's largest annuity carriers, delivering unparalleled scalability at an optimized cost.

Resources

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About Teciem

Teciem is a global provider of front-to-back treasury and capital markets software solutions, serving banks and financial institutions of all sizes. We deliver award-winning solutions for trading lifecycle and risk management, helping clients to operate seamlessly across asset classes and global markets. Built on decades of domain expertise, our solutions – Kondor, Summit, Opics, Sophis, Sophis Invest and Arc – are trusted by more than 340 financial institutions (and many of their subsidiaries) worldwide, including a majority of the top 100 global banks.

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