

Alternative indices and the quest for customer value



Retirement planning has changed

Fewer retirees today have access to pensions that provide guaranteed income, while years of low interest rates have sent investors into more volatile parts of the market in search of higher yields. In this environment, financial professionals and their clients have sought new ways to add a mix of relative stability and growth potential to their retirement income plans—leading to the growth of fixed indexed annuities (FIAs) as a popular retirement planning tool.

FIAs offer the opportunity to earn interest credits based in part on the growth of an underlying market index, such as the S&P 500®. Index interest crediting strategies combine protection from loss due to market downturns with the potential for growth that many people want in their retirement income plans. This combination has made FIAs increasingly popular, with sales reaching \$60.9 billion in 2016, up 12 percent over the previous year.*

Amidst that growth, another trend has emerged as insurance carriers look to differentiate themselves from competitors: an explosion of crediting strategies that track alternative indices. Yet this proliferation of choices can be daunting to financial professionals seeking the right options for their clients' needs. How do these strategies differ, and how can you determine which alternative indices provide real customer value?

To answer these questions, it's important to understand the objectives behind alternative indices and then assess whether a crediting strategy linked to a particular index is designed to deliver on the potential it offers.



*LIMRA, "LIMRA Secure Retirement Institute: Fixed Annuity Sales Hit Record \$117.4 Billion in 2016," February 21, 2017.

This material is provided by Athene Annuity and Life Company headquartered in West Des Moines, Iowa, which issues annuities in 49 states and D.C., and Athene Annuity & Life Assurance Company of New York headquartered in Pearl River, New York, which issues annuities only in New York. Products not available in all states.

For financial professional use only. Not to be used with the offer or sale of annuities.

The rise of the alternative index

FIAs work by crediting customers with an interest rate that's based in part on the performance of a market index. When the index rises in value, customers participate in a portion of those gains in the form of an interest credit. They are protected from loss due to market downturns because the interest rate will never fall below zero. While it's possible to earn zero percent interest in any given interest crediting period, they can never earn less than zero.


The first generation of FIAs typically used the S&P 500® as an index "measuring stick" to calculate interest credits. With little variety in the marketplace, it was difficult to differentiate any single product.

So the annuity industry innovated. Today, nearly a quarter of fixed indexed annuity premium is allocated to interest crediting strategies that track hybrid or alternative indices in an effort to provide more value to customers and differentiate products in the marketplace. For example, rather than tracking the S&P 500®, a strategy might track an index made up of a custom blend of asset classes or global markets. Another might track an index that's negatively correlated with the S&P 500®, offering the potential for upside when traditional equity indices are down.

Using volatility controls to produce more stabilized returns

Alternative indices generally include volatility control overlays that limit the range of both the positive and negative performance of the index, striving to make index performance more stable and predictable over time by avoiding very high positive returns and very low negative returns. These control mechanisms typically consist of two components: the underlying index and a stable asset, usually cash. A rules engine rebalances assets between the two based on measured volatility. The idea is to manage volatility to a specified target. It's a bit like a thermostat: adjusting the "mix" of heating and cooling to achieve the desired room temperature.

This combination of alternative indices and volatility controls is designed to produce more consistent returns, allowing insurance carriers to offer higher participation than may be possible with traditional broad-based indices. What's more, the proprietary relationships that carriers develop with index sponsors means that they can negotiate terms for the financial instruments they use to protect against downside risk—potentially allowing them to pass a greater portion of any gains on to customers. This way, a carrier can differentiate not only through bespoke index selection, but also by implementing efficient hedging strategies that can translate into higher participation rates passed to the customer.



An experienced annuity carrier can differentiate through index selection and hedging strategies that translate into higher participation rates for customers.

Assessing alternative indices

The proliferation of alternative—and, in some cases, esoteric—indices has created greater differentiation among products in the FIA marketplace. But it has also made it more important for financial professionals to understand how various factors can affect an annuity's features and benefits, including the raw index performance and the degree to which the customer participates in the index return.

One common method of comparing annuities is through backtesting hypothetical results over a past time period. However, backtesting inherently reflects historical market performance, which may not occur in the future. For an annuity based on an alternative index to make sense, we believe that advisors must assess the index according to the following criteria:

Design.

Is the construction of the underlying index based on sound economic theory that supports its objective? For example, consider an index with a goal of providing more stable returns. If that index is made up of high-dividend paying stocks, you might be confident in its design intent because historically, predictable dividend payments have smoothed out a portfolio's returns.

Fit.

Is the index likely to offer different performance characteristics than other indices? For example, if an FIA's other crediting strategies track the S&P 500®, alternative indices might include different assets or provide noncorrelated performance to represent a truly alternative option.

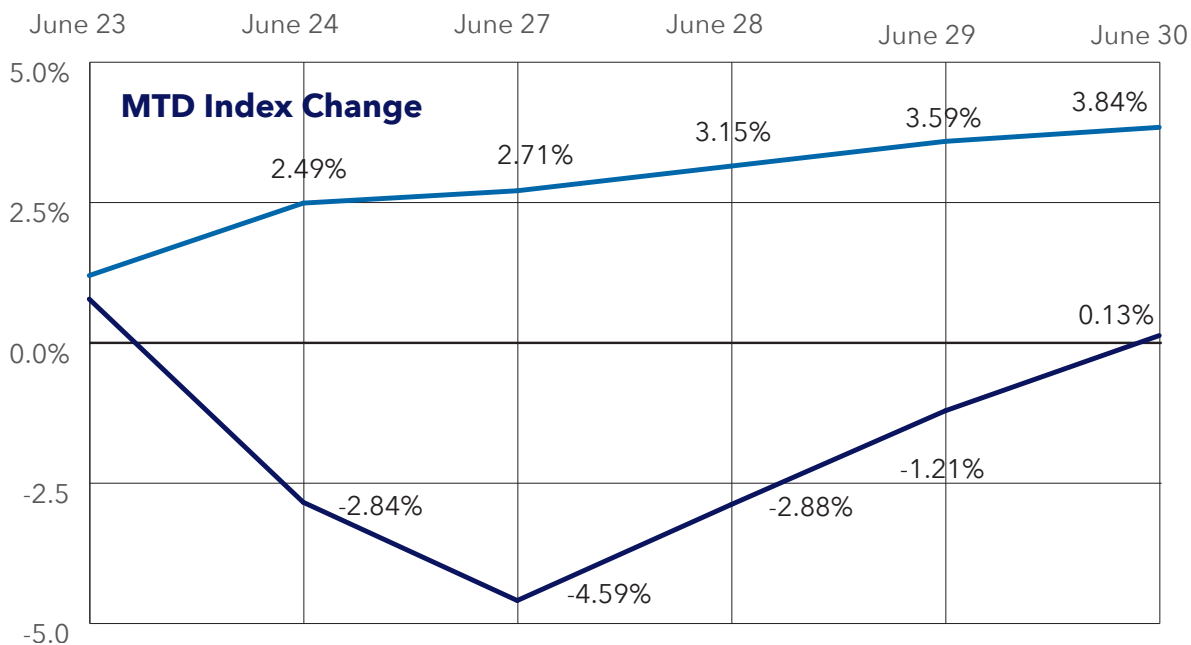
Value.

The alternative index space often relies on proprietary relationships between annuity providers and index sponsors. Providers must be in a strong position to negotiate with sponsors to ensure the lowest possible cost, which will allow them to offer potentially higher participation rates—and greater potential value for customers.



To see this analysis in action, consider the BNPP Multi-Asset Diversified 5 (MAD 5) Index, which Athene tracks in several of its index crediting strategies. The index design is based on a diversified portfolio of stocks, bonds, and commodities from various global markets in an attempt to diversify against the swings of the S&P 500®. That underlying mix of assets is rebalanced daily using a rules-based methodology that seeks a hypothetical portfolio with the highest past returns¹ subject to a certain level of volatility and weighing constraints.² A volatility control overlay targets an annualized realized volatility of 5 percent. If the volatility of the index rises above that rate, daily controls rebalance the portfolio into larger holdings of cash.

This construction means that the BNPP MAD 5 Index tends to move differently than the S&P 500®. The chart below compares the seven-day period following the United Kingdom’s June 2016 “Brexit” vote to leave the European Union. The S&P 500® fell sharply during the period, while the BNPP MAD 5 maintained steady upward momentum due to rebalancing and volatility controls. Keep in mind that this is a singular occurrence that is not representative of future events.



The steady performance of the BNPP MAD 5, combined with our decade of experience negotiating downside protection tools with index providers, has allowed Athene to offer additional participation potential to annuity customers. It’s the approach we use to determine whether any new index should be added in order to help achieve our goal of passing greater value on to customers.

Financial professionals can adopt a similar strategy to navigate the complicated world of FIAs on behalf of their clients. Carefully examine whether an annuity’s underlying index appears to be based on sound theory, offers an opportunity for diversification, and comes from a sponsor with the track record and market presence to negotiate affordable means of downside protection. When a product meets these criteria, there is a better chance that you can successfully use the FIA as part of a diversified retirement savings and income plan that provides the mix of stability and growth potential that today’s retirees are seeking.

Discussing alternative indices may result in giving securities advice. Athene has a dedicated phone line to help insurance-only agents ensure they are not giving securities advice.

¹ Computed based on a trend indicator that compares current component level to past component level over a one-year period.

² The BNPP MAD 5 Index is an "Excess Return Index," meaning its returns are derived from changes in the price of its underlying components (known as "price return") and profit or loss gained from rolling from one futures contract to another (known as "roll return"). Unlike Total Return Indices, it does not derive returns based on interest earned on cash or other collateral deposited in connection with the purchase of futures contracts (known as "collateral return").

ATHENE ANNUITIES ARE PRODUCTS OF THE INSURANCE INDUSTRY AND NOT GUARANTEED BY ANY BANK NOR INSURED BY FDIC OR NCUA/NCUSIF. MAY LOSE VALUE. NO BANK/CREDIT UNION GUARANTEE. NOT A DEPOSIT. NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY. MAY ONLY BE OFFERED BY A LICENSED INSURANCE AGENT.

Guarantees provided by annuities are subject to the financial strength and claims-paying ability of the issuing company.

The S&P 500® (the "Index") is a product of S&P Dow Jones Indices LLC or its affiliates ("SPDJI"), and has been licensed for use by Athene Annuity and Life Company. Standard & Poor's® and S&P 500® are registered trademarks of Standard & Poor's Financial Services LLC ("S&P"); Dow Jones® is a registered trademark of Dow Jones trademark Holdings LLC ("Dow Jones"); and these trademarks have been licensed for use by SPDJI and sublicensed for certain purposes by Athene Annuity and Life Company.

Athene Annuity and Life Company's Products are not sponsored, endorsed, sold or promoted by SPDJI, Dow Jones, S&P, any of their respective affiliates (collectively, "S&P Dow Jones Indices"). S&P Dow Jones Indices makes no representation or warranty, express or implied, to the owners of the Athene Annuity and Life Company's Products particularly or the ability of the S&P 500® to track general market performance. S&P Dow Jones Indices' only relationship to Athene Annuity and Life Company with respect to the S&P 500® is the licensing of the S&P 500® and certain trademarks, service marks and/or trade names of S&P Dow Jones Indices and/or its licensors. The S&P 500® is determined, composed and calculated by S&P Dow Jones Indices without regard to Athene Annuity and Life Company or the Athene Annuity and Life Company's Products. S&P Dow Jones Indices have no obligation to take the needs of Athene Annuity and Life Company or the owners of Athene annuity and Life Company's Products into consideration in determining, composing or calculating the S&P 500®. S&P Dow Jones Indices are not responsible for and have not participated in the determination of the prices, and amount of Athene Annuity and Life Company's products or the timing of the issuance or sale of Athene Annuity and Life Company's Products or in the determination or calculation of the equation by which Athene Annuity and Life Company's products are to be converted into cash, surrendered or redeemed, as the case may be. S&P Dow Jones Indices have no obligation or liability

in connection with the administration, marketing or trading of Athene Annuity and Life Company's Products. There is no assurance that investment products based on the S&P 500® will accurately track index performance or provide positive investment returns. S&P Dow Jones Indices LLC is not an investment advisor. Inclusion of a security within an index is not a recommendation by S&P Dow Jones Indices to buy, sell, or hold such security, nor is it considered to be investment advice.

S&P DOW JONES INDICES DOES NOT GUARANTEE THE ADEQUACY, ACCURACY, TIMELINESS AND/OR THE COMPLETENESS OF THE INDEX OR ANY DATA RELATED THERETO OR ANY COMMUNICATION, INCLUDING BUT NOT LIMITED TO, ORAL OR WRITTEN COMMUNICATION (INCLUDING ELECTRONIC COMMUNICATIONS) WITH RESPECT THERETO. S&P DOW JONES INDICES SHALL NOT BE SUBJECT TO ANY DAMAGES OR LIABILITY FOR ANY ERRORS, OMISSIONS, OR DELAYS THEREIN. S&P DOW JONES INDICES MAKE NO EXPRESS OR IMPLIED WARRANTIES, AND EXPRESSLY DISCLAIMS ALL WARRANTIES, OR MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE OR AS TO RESULTS TO BE OBTAINED BY ATHENE ANNUITY AND LIFE COMPANY, OWNERS OF THE ATHENE ANNUITY AND LIFE COMPANY'S PRODUCTS, OR ANY OTHER PERSON OR ENTITY FROM THE USE OF THE INDEX OR WITH RESPECT TO ANY DATA RELATED THERETO. WITHOUT LIMITING ANY OF THE FOREGOING, IN NO EVENT WHATSOEVER SHALL S&P DOW JONES INDICES BE LIABLE FOR ANY INDIRECT, SPECIAL, INCIDENTAL, PUNITIVE, OR CONSEQUENTIAL DAMAGES INCLUDING BUT NOT LIMITED TO, LOSS OF PROFITS, TRADING LOSSES, LOST TIME OR GOODWILL, EVEN IF THEY HAVE BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES, WHETHER IN CONTRACT, TORT, STRICT LIABILITY, OR OTHERWISE. THERE ARE NO THIRD PARTY BENEFICIARIES OF ANY AGREEMENTS OR ARRANGEMENTS BETWEEN S&P DOW JONES INDICES AND ATHENE ANNUITY AND LIFE COMPANY, OTHER THAN THE LICENSORS OF S&P DOW JONES INDICES.

The BNP Paribas Multi Asset Diversified 5 Index (the "BNPP MAD 5 Index") is the exclusive property of BNP Paribas or one of its affiliates (BNP Paribas and its affiliates collectively, are hereinafter called "BNPP") and is determined, composed and calculated by BNPP. "BNP", "BNPP", "BNP Paribas", "BNPP MAD 5 Index" and "BNP Paribas Multi Asset Diversified 5 Index" (collectively, the "BNPP Marks") are trademarks or service marks of BNPP and have been licensed by Athene Annuity and Life Company ("Company") for use in a fixed indexed annuity offered by the Company (the "fixed indexed annuity"). The fixed indexed annuity is not, in whole or in part, sponsored, structured, priced, endorsed, offered, sold, issued or promoted by BNPP or any of its affiliates, or by Standard and Poor's or any of its affiliates (collectively, "S&P") or by any third party licensor of information to BNPP (the "Third Party Licensors"). BNPP's only relationship to the Company is the licensing of the BNPP MAD 5 Index and BNPP Marks for certain purposes. S&P®, S&P 500® and S&P GSCI® are trademarks of Standard & Poor's Financial Services LLC and have been licensed for use by BNPP. None of S&P, BNPP or any Third Party Licensors has any obligation to take into consideration any of the needs of the Company or any of the owners, annuitants or beneficiaries of the fixed index annuity.

BNPP, S&P OR ANY THIRD PARTY LICENSOR DOES NOT GUARANTEE THE ACCURACY, ADEQUACY, TIMELINESS, COMPLETENESS OR AVAILABILITY OF THE BNPP MAD 5 INDEX OR ANY COMPONENT THEREOF OR DATA INCLUDED THEREIN, OR THAT NO ERROR, OMISSION, DELAY OR INTERRUPTION WILL EXIST THEREIN. NONE OF BNPP, S&P OR ANY THIRD PARTY LICENSOR MAKES ANY REPRESENTATION OR WARRANTY, AND EACH OF BNPP, S&P AND THE THIRD PARTY LICENSORS EXPRESSLY DISCLAIMS ALL REPRESENTATIONS AND WARRANTIES, EXPRESS OR IMPLIED, REGARDING THE BNPP MAD 5 INDEX, ANY BNPP MARK, AN S&P INDEX, TRADEMARK (INCLUDING S&P 500® OR THE S&P GSCI®) OR SERVICE MARK OF S&P (COLLECTIVELY, THE "S&P MARKS") OR THE FIXED INDEXED ANNUITY, INCLUDING, WITHOUT LIMITATION, THOSE REGARDING (I) MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, OR (II) THE ADVISABILITY OF ANY PERSON INVESTING IN THE FIXED INDEXED ANNUITY.

BNPP, S&P or any Third Party Licensor does not have any liability with respect to the fixed indexed annuity in which an interest crediting option is based on the BNPP MAD 5 Index is included, and is not liable for any loss relating to the fixed indexed annuity, whether arising directly or indirectly from the use of the BNPP MAD 5 Index, its methodology, any BNPP Mark or S&P Mark or otherwise.

No purchaser, seller or holder of the fixed indexed annuity, or any other person or entity, should use or refer to any BNPP Mark or other BNPP trade name to sponsor, endorse, market or promote the fixed indexed annuity without first contacting BNPP. Under no circumstances may any person or entity claim any affiliation with BNPP without the prior written permission of BNPP.

In calculating the performance of the BNPP MAD 5 Index, BNPP deducts a servicing cost of 0.50% per annum, calculated on a daily basis. In addition, the BNPP MAD 5 Index methodology embeds certain costs which cover among other things, rebalancing and replication costs. Such costs may vary over time with market conditions. These costs reduce the potential positive change in the BNPP MAD 5 Index and thus the amount of interest that will be credited to the fixed indexed annuity that includes the BNPP MAD 5 Index.

The volatility control applied by BNPP may reduce the potential positive or negative change in the BNPP MAD 5 Index and thus the amount of interest that will be credited to the fixed indexed annuity that includes the BNPP MAD 5 Index.

This material is a general description intended for general public use. Athene Annuity and Life Company, headquartered in West Des Moines, Iowa, and issuing annuities in 49 states and D.C., and Athene Annuity & Life Assurance Company of New York, headquartered in Pearl River, NY, and issuing annuities in New York, are not undertaking to provide investment advice for any individual or in any individual situation, and therefore nothing in this should be read as investment advice.

The term "financial professional" is not intended to imply engagement in an advisory business with compensation unrelated to sales. Financial professionals will be paid a commission on the sale of annuities.



Products issued by
Athene Annuity and Life Company
7700 Mills Civic Parkway
West Des Moines, IA 50266-3862
Athene.com

We are Athene. And we are relentless when it comes to creating an innovative portfolio of fixed annuities to meet your accumulation and retirement income needs.

At Athene, we see every day as a new opportunity to measure ourselves against the best – and then we don't stop until we've set the bar even higher. We stand ready to help you achieve more.