

# Why Are Par Rates So High?

It's Math, Not Magic

In recent years, participation (par) rates in fixed index annuities (FIAs) have risen substantially. It is no longer uncommon to find par rates over 100%, which is generally a good thing for returns, and that has led to some financial professionals and consumers proclaiming, “it must be magic!”

But it isn't. The climb of par rates has coincided with the rise in credit yields and here's why.

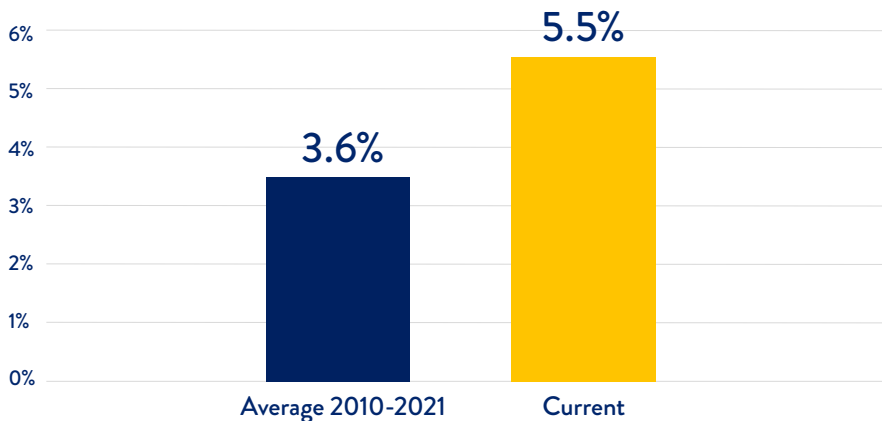
During the Global Financial Crisis interest rates were lowered to stimulate the economy, and both bond and credit yields fell accordingly. This had put insurance carriers into a tough spot as they would typically invest in a range of investment-grade bonds to generate returns – when BBB credit yields averaged approximately 3.6% during that period, returns on their investment portfolios were low. After deducting business costs, there was not much left for buying options required to offer crediting strategies in indices used in FIAs, which in turn kept par rates at lower levels.

In order to show higher par rates (usually around 100%) under such circumstances, index providers created an innovative solution: volatility control indices.

Lower volatility means lower risk which translates to cheaper option prices. For example, the long-term average volatility of the S&P 500 Index is about 15%, but a risk control index typically sets its target volatility at 5%, which means the option on this index would be significantly cheaper than an option on the S&P 500 Index (very roughly one-third of the price, on average, although the S&P 500's swings can at times make it much more than three times more expensive).

Since 2022, there has been a notable increase in credit yields, primarily driven by increased inflation and the Fed raising interest rates. BBB-graded bonds currently have a yield above 5.5%, significantly expanding carriers' budget for purchasing options on FIA crediting strategies.

#### YIELD ON CREDIT INSTRUMENTS



\* Source: St Louis Fed, yields on the ICE BofA BBB US Corporate Index. Past performance is not indicative of future performance.

At the same time, carriers have continued to offer risk control indices in the 5%-target range, which still provide cheap options. In addition, many of the custom indices used in FIAs are developed to deliver cheap options whose cost is relatively insensitive to market conditions.

While credit yields have now increased from 3.6% to 5.5%, i.e. by a factor of more than 150%, the cost of options has remained quite similar. Carriers are passing on to consumers the benefit of combining increased carrier budgets and cheap, stable option prices, hence par rates have got much higher, sometimes over 200%.

So you see soaring par rates in FIAs is not a wave of the magic wand, it's just simple math: option budgets have increased, but costs have remained the same.

Get in touch and learn more about The Index Standard® service offerings.  
(+1) 212-823-6201 | [info@theindexstandard.com](mailto:info@theindexstandard.com)

## About The Index Standard

The Index Standard offers unparalleled expertise in independently evaluating indices and ETFs, providing clear insights into the \$1 trillion annuity and structured products markets. We simplify complex products with our suite of solutions including rating, forecasting, and annuity allocations, all presented in easy-to-understand reports in plain language. Our solutions are integral in streamlining the sales process, aiding clients in navigating choices and strategically allocating premiums, while also demonstrating best-interest intent and meeting due diligence requirements.



**Laurence Black, Founder**

Laurence is the founder of The Index Standard and an index advisor to Robert J. Shiller, Sterling Professor Emeritus of Economics at Yale University. Previously, Laurence was Managing Director, Head of Quantitative Indices and Strategies at Barclays where he oversaw the development of the Barclays index family, including the highly successful Barclays-Shiller indices and some of the first smart beta/factor indices. Laurence has an MBA degree from the University of Warwick, UK.



**Jay Watson, Head of Analytics**

Jay spent 20 years in investment banking as an expert in interest rates and quantitative investment strategies. He was previously Managing Director and Head of Multi-asset Index Structuring EMEA at Barclays in London, where he was instrumental in building Barclays' index business globally for over a decade. Jay holds an MA and a DPhil in theoretical physics from Oxford University, and a master's degree in mathematics from Cambridge University.



**Branislav Nikolić, Head of Insurance**

Branislav is an established thought leader in annuities and retirement income planning. He joined The Index Standard after a decade at Cannex Financial Exchanges, where as Vice President of Research he was instrumental in extending Cannex's strong presence in the retirement income space. Branislav holds a master's degree in probability and financial engineering and a PhD in applied mathematics from York University in Toronto, where he is also a lecturer in finance and mathematics.



**Cynthia Ma, Chief Operating Officer**

Cynthia has had a career in financial communications across Hong Kong, London and New York. She worked at Deutsche Bank then as Head of Internal Communications at Nomura in London she managed the Lehman Brothers staff integration following Nomura's acquisition. Most recently at InterOil, a NYSE-listed company, she was part of the award-winning IR team during the company's takeover by ExxonMobil. Cynthia has an MBA degree from the University of Warwick, UK.



**Trent McKinnon, Associate Vice President**

Trent joined The Index Standard after earning his dual master's degrees. He brings his financial engineering expertise to the team where he is involved in index research, product development, as well as client onboarding and liaison. Trent holds a BS in applied computational mathematics and statistics, and a BBA in accounting from the University of Notre Dame. In addition, he holds a MS in finance and a MS in economics from the University of Wisconsin-Madison.

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