Jackson Hits the Alt-Option Key

By Kerry Pechter *Tue, Mar 6, 2012*

Jackson National Life's newest variable annuity contract, Elite Access, offers a variety of high-turnover alternative investment options inside a tax-deferred wrapper--and no living benefits.

Jackson National Life’s new deferred variable annuity contains no lifetime income benefit, no roll-up, no-step ups and few if any of the insurance features that have helped make the company’s VAs so popular with independent and regional broker-dealer reps over in recent years.

Instead, the new Elite Access contract, announced on Monday, offers commissioned advisors an accumulation-phase opportunity to own funds (or funds of funds) that hold alternative investments, such as commodities, or use alternative investment strategies, such as tactical asset allocation.

Elite Access has average all-in costs of about 250 basis points. That includes 85 basis points for the mortality and expense risk (M&E) fee, a 15-basis point administrative fee, and fund expense ratios ranging from 0.57% to 2.45%. Jackson National pays the advisor a 5.25% immediate commission and a 40 basis point trail in years six and beyond. There’s a five-year surrender period, with a first year charge of 6.5%.

Advisors who prefer a more liquid option can eliminate the surrender period by having the client pay an annual fee of 25 basis points. In that case, the advisor would earn a 1.25% upfront commission and a 1% annual trail starting in the second contract year.

Elite Access is hardly the first variable annuity contract to offer alternative investment options. The Morningstar Annuity Research Center lists dozens of contracts from a wide range of insurers that offer one or more alternatives, often one or more RydexSGI Funds, ProFunds or, more recently, TOPS Protected Funds.

In fact, current owners of Jackson National’s own Perspective II variable annuity collectively hold $3.4 billion in a variety of alternative subaccount options, including two long/short funds—JNL/Mellon Capital Management Global Alpha and JNL/Goldman Sachs U.S. Equity Flex A.

Jefferson National’s Monument Advisor no-load, $240-a-year flat fee variable annuity offers exposure to alternatives inside a tax-deferred account, but it is designed specifically for the Registered Investment Advisor market. RIAs and other pure fee-based advisors aren’t Elite Access’ target audience.

Elite Access is aimed at advisors who are interested in offering alternative investments to their clients but don’t know much about them. The new product solves that problem by offering them ready-made funds or funds-of-funds that have the alterative product expertise of Jackson’s Curian Capital managed account firm and institutional money managers like Mellon Capital Management already built-in.

Product development

In an interview, Jackson National executive vice president Clifford Jack described the process, including nine months of research and 110 road shows at broker-dealers around the country—that led to the development and introduction of Elite Access and the belief that there's a significant market for it.

"Coming out of the financial crisis, people realized that buy-and-hold strategies were buy-and-hope strategies," Jack told *RIJ* in an interview last week. "When everything got so correlated, it was clear that the old way had to be re-evaluated. It didn't work anymore. We studied this issue very hard. Our research asked, Which investor group, if any, did well in the midst of the crisis and coming out of it and how did they compare to those who didn't come out well?"

Institutional investors, it turned out, weathered the financial crisis better than retail investors, thanks in part to their use of alternative investments and strategies. "We found that there was a significant performance gap and much of it was related to their use of counter-correlated or non-correlated assets, and those were alternative investments," Jack said. "That started this initiative. We said, let's follow those who seemed to have figured this out, and try to replicate [their strategy] and provide a better way for advisor and consumer to be more institutional-like."

Jackson National could have packaged the alternative investments in a number of ways—as mutual funds or through managed accounts, Jack said. The company decided to offer them inside a variable annuity because it offered the benefit of tax deferral and alternative iinvestments tend to be tax-inefficient.

Funds that are generally classified as alternative investments include commodity funds that invest in metals or natural resources as well as funds that use a variety of market-neutral strategies, long-short strategies, options and futures, target allocation and other unconventional techniques designed to reduce portfolio risk by zigging when traditional securities zags and vice-versa.

Those types of actively managed funds generally involve frequent trading and rebalancing, and therefore tend to generate large amounts of short-term gains. For that reason, holding those funds in a taxable account would be counter-productive. It makes better sense to hold them inside the tax-deferred sleeve of a variable annuity.

The gains realized in a variable annuity aren't taxed until they're withdrawn, and withdrawals typically don't occur until after the annuity owner retires, when he or she might be in a lower income tax bracket. (It doesn't make sense to put alternative funds in a variable annuity with a living benefit rider, because the lack of readily-available hedges for alternatives makes an income stream based on their performance too expensive to guarantee.

"Our reason for doing this is two-fold," Jack told *RIJ*. "First, [Elite Access] complements our existing portfolios for the retail advisor and client. Second, we like what it does for Jackson. It expands the pool of topics that our wholesalers can have conversations about."

The target market includes "managed money or ETF or separate-account folks. We think advisors will migrate to a three-pronged approach. It's not just about equity and fixed income anymore. It's also about how much you have in alternative investments," he added.

"We'll go after everybody. We believe that this product will attract three types of advisors: those selling commissioned products; the hybrid advisor who does some of each, commission and fee-based; and those in the RIA channel who don't forego the option to sell commissioned products.

"The most likely place for new assets to come from, where we expect to 'disintermediate,' will be load mutual funds and mutual funds sold in a wrap account. The average mutual fund wrap account costs the end client about 2.65%, assuming that the advisor charges 100 basis points for the wrap."

The investment options

Among the offerings in Elite Access are nine Curian Guidance funds-of-funds offered by Curian Capital, Jackson National's managed account subsidiary. "We think that the most-used of all of the investment lineup will be the Guidance portfolios," Jack told *RIJ*. These include Curian Institutional Alt 65 and Curian Institutional Alt 65, which put 65% and 100% of their assets, respectively, in alternative investments.

A big part of the Elite Access value proposition is that it delivers not just exposure to alternative investments—which an advisor could get more cheaply by investing in alternative ETFs—but also support. The support includes education from Jackson's 500 wholesalers, who have received special training and certification in alternative asset classes from The Institute of Business & Finance, and via the expertise of the fund managers at Curian Capital.

The subaccount options also include three Curian Dynamic Risk Advantage funds whose managers mitigate market risk by moving assets from equities to bonds or cash when equity prices fall and do the reverse when equity prices rise. This technique, characteristic of a risk-management process called Constant Proportion Portfolio Insurance (CPPI), is similar to the risk-management technique at the heart of the living benefit of Prudential's Premier Retirement VA.

Jackson National, a unit of Prudential plc, was the third largest seller of VA sales in the U.S. in 2011 ($17.5 billion) and 2010 ($14.7 billion) with a 10.2% market share, according to Morningstar's Annuity Research Center. Only Prudential Financial (no relation to Prudential plc) and MetLife sold more VAs over the past two calendar years. Jackson National had a total of $65.2 billion in VA assets under management at the end of 2011, or 4.34% of the total.

The company's Perspective II (7-year surrender) and Perspective L-share VAs were its top sellers. Though Jackson, like other VA issuers, reduced the richness of the benefits a bit in 2011, the contracts still offered a rich deferral bonus and placed few restrictions on advisors' choice of investments under the living benefit guarantee.

Jackson National sells most of its variable annuities in the independent broker-dealer channel and the regional broker-dealer channel, according to Morningstar. Jackson sold $2.417 billion in the independent channel in the fourth quarter of 2011, second to MetLife's $2.5 billion. In regional firms, Jackson sold $777 million in the fourth quarter, second to MetLife's $1.18 billion.

Elite Access is intended to add to Jackson's VA assets and not cannibalize sales of GLWB contracts. "Our goal is to take not one dollar from our living benefit products business,” Jack said. “There’s $160 billion in annual sales in that space, and we want a portion of it. But instead of operating in a $160 billion sales pool, we also want to operate in a trillion dollar sales pool. We want to go after asset pools that we’re not working in. Elite Access is our entrée to those other markets.”