

## Managed-Vol: Bromide for Queasy Retirees

By Kerry Pechter      Wed, Mar 26, 2014

*Managed-volatility funds can adequately address the income volatility worries of many high net worth retirees, say Milliman and Jefferson National, both of whom are pitching such funds.*



If registered investment advisers (RIAs) resist the purchase of annuities for their older clients, then what sort of retirement risk tool, if any, might they consider? Two prominent firms are betting that managed-volatility funds are the answer.

Executives from Jefferson National, the provider of tax deferral to RIAs via a no-guarantee, low-cost variable annuity, and Milliman, the global actuarial consulting firm, each talked about their latest initiatives in managed-volatility funds at separate retirement conferences in recent weeks.

At the Insured Retirement Institute conference in New York last Monday, Jefferson National CEO Mitch Caplan unveiled a “dynamic asset allocation” fund, sub-advised by State Street Global Advisors (SSgA), that Jefferson National will offer RIAs alongside the 400 or so other investment options in its no-frills Monument Advisor VA.

Meanwhile, at the Retirement Income Industry Association conference in Chicago ten days ago, actuary Ken Mungan of Milliman presented his firm’s four new Even Keel Managed Risk Funds (basic Managed Risk, as well as “Emerging Markets”, “Traveler” and “Opportunities” Managed Risk). All use Milliman’s short-futures strategy as a volatility hedge.

Both ventures aim to meet the anticipated demand for non-insured retirement solutions from RIAs and their clients. Milliman claims that its solution can raise retirees’ safe withdrawal rate to 6%, from the classic 4%. Jefferson National says a strategy of reduced volatility, combined with tax-deferral and low fees, can provide all the risk management a wealthy retiree may ever need.

Managed volatility funds, of course, aren’t new, but they’ve grown more sophisticated of late. They were introduced into VAs after the financial crisis as part of life insurers’ effort to “de-risk” VA investment risk. But many advisers, anecdotally, say they regard the combination of managed-volatility funds and lifetime income riders as more insurance than they need or want. Hence the idea of offering managed volatility funds *without* the riders.

In an environment where bonds have lost their appeal as a risk-buffering agent, Jefferson National and Milliman and others are wagering that managed-volatility funds alone, with little or no other protection, might be the perfect Alka-Seltzer for the older clients of fee-based RIAs. But managed-volatility funds aren’t without their own trade-offs. They can cut off the market’s peaks as well as its dreaded fat tails, to

the chagrin of many who own them during bull markets (like 2013).

### **Jefferson National's solution: Tax deferral plus managed-volatility**

Jefferson National and SSgA started collaborating about six months ago on a managed-volatility fund that the insurer will offer in its Monument Advisor VA, Caplan, who is the former CEO of E\*Trade Financial, told *RIJ* this week.

The [JNF SSgA Retirement Income Portfolio](#) invests in more than a dozen State Street SPDR ETFs and has a target investment mix of 35% equities, 40% investment grade bonds, 10% global real estate and other assets. For volatility management, it uses so-called tactical asset allocation and a Target Volatility Trigger (TVT) system that “dynamically adjust[s] exposures to maintain a desired target portfolio risk,” according to the prospectus. It costs an eyebrow-raising 130 basis points a year.

This represents a slight departure for Jefferson National. Until now, the insurer's sole mission was to offer RIAs a tax-deferred sleeve in which RIAs could trade tax-inefficient funds without having to worry about immediate tax consequences. The price is only \$20 a month, plus (no-load) fund fees. There are no insurance costs, and negligible distribution expenses.

But, as Caplan explained during a break at the IRI conference, RIAs are starting to respond to their clients' worries about sustainable retirement income. So, sometime last year, Jefferson National began to consider offering a managed-volatility fund to its 3,000 or so RIAs. When RIAs combine the annual performance advantage of tax deferral (which they estimate at 100 bps) with smoother returns, Jefferson National claims, they'll wind up with more safe income, dollar for dollar, than today's fee-heavy VAs with living benefits can or will deliver.

“When we surveyed our advisers, we saw that they wanted a low cost retirement income solution,” Caplan said. “We asked ourselves, what could we offer that doesn't involve a balance sheet guarantee? We were able to show, statistically, that if you used Monument Advisor and a low-cost dividend-paying ETF from State Street, you could add a volatility overlay and still beat the GLWB [guaranteed lifetime withdrawal benefit] 90% of the time.”

Lest clients and advisor doubt that assertion, Jefferson National has created an online “Retirement Income Comparison Calculator.” Investors can use it to “compare the hypothetical performance, lifetime income potential and cumulative fees of traditional VAs with insurance guarantees versus a low-cost flat-fee VA.” Thirty competing VA products are in the calculator.

The typical Monument Advisor owner is an RIA client with \$2 million to \$20 million in overall wealth. They allocate an average of \$250,000 each to the variable annuity for tax-deferred trading and accumulation purposes. Jefferson National also has a following among RIAs who run money for other RIAs—the so-called Third-Party Investment Advisers or TPIAs.

As clients cross the age 59½ threshold (when penalties for withdrawal of tax-deferred assets end) and move into retirement (when wealth protection becomes more important than growth), Jefferson National

hopes that they gradually move more assets to the managed-volatility option. Given the likelihood of bond price depreciation going forward, managed-volatility funds may look like a more cost-effective risk management tool.

### **Milliman's solution: Even Keel funds**

About three years ago, VA issuers began requiring contract owners to invest in managed-volatility portfolios if they wanted living benefits with rich deferral bonuses. In many cases, those portfolios incorporated a short-futures based risk management technology engineered by global actuarial consulting firm Milliman, a sub-advisor on the funds.

Now Milliman is offering four stand-alone managed-volatility funds of its own, called [Even Keel Managed Risk Funds](#). The four funds track either the S&P 500, or small and midcap equities, or international equities or emerging markets equities. The "A" share-class costs 97 basis points a year. The "I" share-class, which assesses no 12b-1 marketing fee, costs 72 basis points.

At the RIIA conference, Mungan, the practice leader of Milliman Financial Risk Management LLC, which advises and manages the funds, made a case for their use as an alternative to a buy-and-hold strategy for a retirement income client.

Specifically, Mungan offered numbers showing that retirees could draw down a sustainable 6% of their assets each year from a portfolio of Even Keel funds—beating the traditional 4% systematic withdrawal rate and the typical five percent withdrawal rate provided under most VA living benefits.

"This is a different way of thinking about sustainable withdrawal rates," Mungan told an audience of RIIA members who had gathered at Morningstar, Inc., headquarters in Chicago. His firm's strategy "replicates a five-year rolling put," he said, and proposed it as an antidote to panic during market downturns. "It's ludicrous to believe that [clients] will change their behavior. You have to change the investment products themselves."

To control risk in these funds, as in the VA portfolios it sub-advises, Milliman uses a futures-base strategy. The fund managers use part of the assets to short exchange-traded futures contracts. "In a severely declining market," says a Milliman white paper on the subject, "futures gains may be harvested and reinvested in growth assets in an effort to maximize long-term returns."

On what basis does Milliman claim that such funds can sustain a *six percent* withdrawal rate from age 65 to 92 or 94? In an e-mail, Mungan told *RIJ* that it comes from a combination of things: Reducing the depth of performance dips, providing investors with the confidence not to panic-sell during downturns, and recognizing that costly inflation adjustments aren't needed during market downturns, when inflation usually abates.

Like Jefferson National, Milliman is introducing an online calculator to help deliver its message. Mungan said it would elevate a "Protected Income Planner" within the next few weeks. According to a mock-up of the website, the planner "is designed to assist financial advisors in calculating sustainable withdrawal rates

for their clients, compare results, and illustrate the potential to increase withdrawal rates through the use of risk management.”

### **Not a panacea**

It’s ironic that managed-volatility funds, after having in a sense “rescued” the VA-with-living-benefit business by moderating product risk and allowing issuers to continue offer sizable deferral bonuses, are now being marketed as *alternatives* to the living benefits of VAs.

Managed-volatility funds, which vary in technique and are difficult to compare, are not a panacea. Unlike annuities, they don’t offer guarantees. Their underperformance during bull markets (as demonstrated in 2013) may surprise and disappoint investors more than their outperformance during downturns delights them. In any case, every investor’s experience is likely to be unique.

The minority of advisors who favor safety-first income strategies based on bucketing (which draws income from stable assets) or flooring (with bond ladders or income annuities) may not want to abandon those techniques for managed-volatility funds. But, for RIAs and clients who adhere to a total return approach to retirement income, managed-volatility funds may suffice.

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