New Lincoln VA funds use Milliman-inspired volatility buffer

By Editor Test *Tue, Apr 3, 2012*

Lincoln Financial vice president Dan Hayes described the advent of volatility management mechanisms inside today's VAs funds-of-funds as comparable to the emergence of "4G" cellphone technology.

In a move that reflects the de-risking trend in VAs with living benefits, Lincoln Financial Group Monday introduced a new series of VA investment options called LVIP Protected Asset Allocation. The series employs a short equities futures strategy to reduce volatility of returns.

The new funds-of-funds are available to purchasers of ChoicePlus Assurance and American Legacy III variable annuities. The cost of the subaccounts, which come in conservative, moderate and growth versions, ranges from 105 to 109 basis points, which includes the fees for the underlying funds.

Lincoln's LVIP Protected Asset Allocation series resembles a similar series of TOPS Protected funds that Ohio National began offering in its ONCore variable annuities last January. In both cases, Milliman created the short futures strategy that reduces volatility. Unlike the Lincoln funds, the TOPS funds invest only in ETFs.

Managers of the LVIP Protected funds aim for a five percent cash position, to be used primarily as collateral for shorting ETF equity futures, said Dan Hayes, vice president, Fund Management at Lincoln Financial. The futures positions pay off if equity prices fall, and the gains are used to take advantage of a subsequent equity rebound. The strategy is an alternative to risk mitigation based on an asset transfer system, where assets are shifted to bonds whenever equity prices fall.

The futures strategy has already produced favorable results. "We've been running the protected strategies on our target date funds since June of last year," Hayes told *RIJ* yesterday. "We found that when markets were volatile during the third quarter, those funds only experienced about a third of the down market. This year, when we introduced Protected funds to ChoicePlus products, we've seen them deliver about two-thirds of the market upside."

The payoff for investors is more income. If they agree to put all their money in one or more of the Protected funds, they're eligible for a higher payout rate at a younger age.

"We have two versions of our core living benefit rider," said Kim Genovese, assistant vice president and senior product manager for variable annuities. "One version has these funds as a requirement. The other version has an open architecture that requires a fixed income allocation of at least 30%. With the Protected funds, you can get 5% for life at age 59. With the open architecture, you get 5% for life starting at age 70."

Lincoln Financial sold $9.22 billion worth of variable annuities in 2011, including $2.17 billion in the fourth quarter. About three quarters of the premiums are for various share classes of ChoicePlus Assurance contracts, which offer multi-manager funds-of-funds, and the rest for American Legacy III, which is dominated by American Funds. "People are gravitating toward the multi-manager approach," Genovese said. “We’ve seen that shift for some time now.”

Hayes noted the vast difference between today’s VA investment options and those of 10 years ago. “I like to use a cell-phone metaphor,” he told *RIJ*. “ Hayes said, “Balanced funds were 1G. 2G was the diversified fund-of-funds. 3G added dynamic tactical asset allocation to that. And 4G adds volatility protection on top of that.”