Ohio National launches ‘Low-Vol’ VA options

By Editor Test *Wed, Jan 11, 2012*

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It’s both surprising and not surprising that Cincinnati-based Ohio National Life is the first variable annuity issuer to offer funds that incorporate the TOPS/Milliman volatility-controlled, futures-driven, ETF-based investment technology.

Surprising, because conservative mutually owned life insurers like Ohio National usually leave radical innovation up to their more aggressive publicly held counterparts. Not surprising, because, in this case, the innovation seeks less risk, not more.

“Ohio National is a little unique in the VA space. We’re one of the few mutuals with a presence among the top 20 VA issuers. Usually it’s companies with access to fresh capital that have a more aggressive presence,” said Steve Murphy, FSA, senior vice president, Capital Management.

On January 3, Ohio National Life introduced a new GLWB Plus rider for its ONcore suite of variable annuities. The new rider offers contract owners a distinctive 5.25% payout at age 65 (single-life) along with the existing 8% annual simple-interest deferral bonus that can double the income base after 10 years without withdrawals.

To earn that extra quarter-percent payout, purchasers have to agree to put at least half their premium into TOPS Protected Balanced, Moderate Growth or Growth ETF funds (67 bps; 92 bps in 12b-1 version) and no more than half into any of four funds—an Invesco Balanced Risk Fund, the AllianceBernstein Dynamic Allocation Fund, the Federated Managed Volatility Fund II or the Legg Mason Dynamic Multi-Strategy Portfolio.

The key to the product is the TOPS—it stands for The Optimized Portfolio System—which was featured in the November 23, 2011, issue of RIJ. Using a short futures strategy in addition to dynamic asset allocation, it gives Ohio National the return-predictability it needs to offer such expensive benefits. It also uses a hedge strategy to offset risk.

Here’s how the fund prospectus describes the technique:

> The sub-adviser selects individual futures contracts that it believes will have prices that are highly correlated (negatively) to the Portfolio’s ETF positions. The sub-adviser adjusts short futures positions to manage overall net Portfolio risk exposure.
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> During periods of rising security prices, the amount of futures contracts will ratchet upwards to preserve gains on the Portfolio’s ETF positions. During a market decline, the value of the Portfolio’s ETF securities will decrease while the futures contracts will increase in value.

> Following declines, a downside rebalancing strategy will be used to decrease the amount of futures contracts used to protect the Portfolio. The sub-adviser also adjusts short futures positions to realign individual hedges when the adviser rebalances the Portfolio's asset allocation profile.

What's somewhat controversial about this approach, which Milliman designed, is that it uses the client's own money to pay for the futures in the TOPS funds, in addition to charging the client for the GLWB Plus rider (currently 95 bps for single-life; maximum 200 bps). The mortality and expense risk charge is 1.35% a year. There's also an account expense charge of 35 bps.

"Overall, it's better for the consumer," Murphy told RIJ this week. "Lower volatility funds do perform better over the long run. The client won't see the same run-ups, but in the financial crisis, some of these risk-managed funds would have experienced losses of 10% instead of 40%. People don't need to be out there swinging for the fences."

For Ohio National, which ranked 20th in VA sales in 2011, with $1.2 billion in premiums during the first three quarters of the year, the new offering represents a significant shift in product design. In the early part of the last decade, it focused on the guaranteed minimum income benefit product, whose insurance benefit requires the client to buy an income annuity after a deferral period.

"You wouldn't necessarily have been able to observe this, but we did have a conservative approach to VA guarantees," Murphy said. "We were reinsuring our living benefit riders from the point of inception in 2002 until reinsurance became unavailable in 2008. Our reinsurance served s well through the financial crisis." The company switched its emphasis to the GLWB in 2010, retooling within a period of months.

The TOPS strategy gives Ohio National the protection it needs in order to offer a competitive 5.25% payout at age 65 in a world where 5% is the norm. "We went with TOPS to preserve the income bands, Murphy said. To compete, "you can lower the price or raise the benefit, and marketing felt that raising the income bands was the better move."

The newly enriched product benefits should help Ohio National sell through third-party distributors. "About 20% of our VA sales come from our own broker dealer and our career agents," said Jeff Mackey, FSA, Ohio National's director of Annuity Product Development. "Of the other 80%, about 40-50% comes from independent advisors and about 30-40% from the national wirehouses. Bank sales account for no more than 5% to 10% of the 80%."

Every product needs a story line, and Murphy has one. "I use the analogy of an airline," he told RIJ. " An airline can't sell tickets for flights five years from now because it can't hedge the volatility of fuel prices. We're different. For us, the targeted volatility strategy keeps the cost of hedging predictable. Going forward, I think the only sustainable product designs will be in the context of risk-levered funds."