Retirement Income
JOURNAL

Will RIAs Sing This ARIA?

By Kerry Pechter *Tue, Mar 13, 2012*

ARIA Retirement Solutions and AEGON/Transamerica have created a stand-alone living benefit (SALB) for the $1.3 trillion managed account market.

When Charles Schwab & Co. decided to look at the feasibility of wrapping lifetime income guarantees around mutual fund and ETF accounts a few years ago, it tapped its chief legal counsel for insurance, David Stone, to co-lead the evaluation effort.

Schwab's executives eventually decided to pass on the idea, but Stone didn't let it go. He saw a huge opportunity in offering living benefits to the registered investment advisors who manage big custodial accounts, and he had a high-tech plan for seizing it.

So Stone, 53, left Schwab in late 2008 and, with former Schwab technology guru R. Scott Strait and two others, started ARIA Retirement Solutions in early 2009. (ARIA denotes "Access to RIAs".) The San Francisco-based start-up, bankrolled since January by Polaris Ventures, sells a no-load stand-alone living benefit (SALB) to RIAs called RetireOne.

"We said, 'Let's build an income product that appeals to the $1.3 trillion in assets [at the big custodial firms] that don't have annuity penetration, by eliminating all the reasons why RIAs won't adopt them," Stone (at right) told RIJ in a recent interview.

Transamerica Advisors Life, a new entity organized specifically for this venture by AEGON/Transamerica, is thus far the only insurer writing guarantees for the product. (See prospectus.) But ARIA's open-architecture hub is built to accommodate multiple insurers, as well as dozens of custodians and hundreds of potential investment options.

ARIA itself doesn't manage, insure or custody money. Instead, it's a cloud-based technology platform whose servers connect RIAs, their clients, the custodians of their managed accounts, the insurers who write guarantees for ARIA, and a team of licensed agents that provides compliant services. It's a formula that Stone and his backers believe will finally open the huge RIA market to income guarantees.

“You can view us as the hub,” Stone said. “We do the administration for the insurance company. We connect the insurance company, the advisor and the end client. The clients deal directly with ARIA in Louisville. There’s a friendly front-end for the advisor.

“We do the suitability determination, and provide feeds from the custodial firms to the insurance company,” he added. “Once the product is up, it’s going to be open architecture from an insurance point of view. Transamerica is just the first insurance company to participate.”

“We’ve been watching the evolution of the SALB, and we felt that the independent RIA channel is an underserved market from a guarantee perspective,” said Anne Spaes, head of institutional relationships at Transamerica Advisor Life. Since the mid- 1990s, AEGON’s Monument Life unit has sold a no-load variable annuity to brokers and RIAs, called Advisor’s Edge. But Advisor’s Edge had—and still has—an M&E pricing structure, no income guarantee, and places the assets at the insurance company—none of which fit the RIA practice model.

SALBs: a brief history

RIAs, as a rule, avoid insurance products. They’re generally not insurance-licensed and only a small percentage of them take any commissions. Paid to assemble portfolios, they have little appetite for the portfolios that come bundled into VAs. But, as the advisor channel with the largest average balances, they’re too big a market for insurers to be left out of.

So insurers created SALBs—living benefits that were unbundled from VA investment options. These stand-alone living benefits could be sold to RIAs, unified account (UMA) managers, and third-party asset-management programs (TAMPs), and wrapped around almost any moderate-risk taxable or tax-deferred portfolio.

Lockwood Management promoted the first official SALB in late 2007, with The Phoenix Companies providing the living benefit. In the post-crisis summer of 2009, Nationwide Financial and Morgan Stanley Smith Barney announced a partnership to wrap a living benefit around wirehouse portfolios. Introduced during tumultuous times, neither venture got far.

A life insurer faces certain constraints when building a SALB. The investment options have to be tame enough and generic enough to be insurable at an acceptable price but exciting enough to interest investors. To hedge the investment properly, the insurer also needs to monitor them. That’s easy with a variable annuity because the investments live in the insurer’s subaccounts, but harder when the protected investments live at Schwab or Fidelity or TD Ameritrade (for example), as they do with a SALB.

Enter ARIA

ARIA’s RetireOne addresses those issues, but doesn’t conquer the laws of physics and finance while doing it. The annual expense of the guarantee (or certificate) starts at 1% of the account value for portfolios with no more than 50% equities and rises to 1.75% for portfolios that hit the limit of 80% equities. International exposure is limited to 25%, small/midcap to 10% and alternatives to 5%.

Big deposits earn fee discounts: the fees on a $2 million contract go as low as 85 basis points. On the other hand, clients who take advantage of quarterly high-water marks to step up their benefit base to the account value will have to pay more for the privilege. The maximum contract fee is 2.50%.

As for approved investment options, the current batch includes over 140 funds and ETFs from families that RIAs like: American Funds, DFA, iShares, Pimco, Schwab, TIAA-CREF, Vanguard and other favorites. Stone expects a lot of RIAs to build new insured portfolios from these approved options at their custodian of choice, rather than try to put an income floor under an existing portfolio.

But what's novel about ARIA isn't the pricing or the investments. It's the technology that lets the insurance company watch the investments on any of 50 different custodians and hedge them as they fluctuate.

"ARIA's technology allows us to receive files from the custodians so that we can monitor the positions as we would any of our variable annuity subaccounts, and to use our risk management protocols and hedge accordingly," said Transamerica's Spaes. "We can see the same type of data, as if it were on our own platform."

A tri-fold market

That leaves the marketing strategy, and Stone seems to understand his target end-client.

"There are three categories of people who might buy this product. There's the person in his 50s who wants to insure his retirement savings until he gets to retirement. This product gives you sequence-of-returns protection while allowing you to grow your asset base," Stone told *RIJ* in an interview last week.

"Then there's the person who buys it at 65 who wants to control his assets but still get guaranteed income," he added. "Third, there's the 55-year-olds who will buy it and hold it until they die. We expect 70% of our customers to buy the guarantee before reaching retirement age. We tell the advisor, once your client gets to retirement, you can recalculate. If the GLWB is in the money"—that is, if the benefit base is higher than the account value—"you keep the contract. If it's not in the money, you reevaluate."

The contract pays out 4% to 8% a year, depending on the age of client and the 10-year Treasury rate at first withdrawal. In a departure from the typical VA living benefit, ARIA's payouts are based on two factors—the age of the client and the 10-year Treasury rate when guaranteed payments commence—instead of on the client's age alone. Even after payments begin, the payout percentage can move up or down according to whether the 10-year Treasury rate shifts far enough up or down.

In another departure from custom, ARIA assesses the insurance fee on the account value rather than the benefit base. Consulting actuary Tim Pfeifer, who represented ARIA in its collaboration with the actuaries at Transamerica Advisors Life, told RIJ that the initial insurance expense ratio for a 50% equity portfolio could have been about 15% lower if it were levied on the benefit base. But Stone believed that said that assessing the fee on the account balance would be cheaper for the client in the long run. And, since advisors are used to asset-based fees, he expected them to find that formula more palatable.

Last January, ARIA received an undisclosed amount of funding from Polaris Ventures, a nationwide venture capital firm that "tends to invest in platforms," said Alan Spoon, the Polaris general partner who is working with ARIA. "This couldn't happen without real-time, cloud-based platform technology that can link the clients, the RIAs, the custodians and insurance companies. It would have been impossible a few years ago, because the insurance companies wouldn't have been able to tweak its hedges on a daily basis," Spoon told *RIJ* this week.

Polaris, which manages about $3.5 billion worth of institutional money in six venture funds, also has a stake in Focus Financial Partners, a New York-based wealth management platform that supports about two dozen RIAs that manage some $50 billion in assets.

It was partly because of Focus Financial's enthusiasm for the Stone's venture that made Polaris eager to invest in ARIA Retirement Solutions. "The Focus firms aren't guaranteeing distribution," said Spoon said Spoon, a former president of The Washington Post Company. "But when they put their hands up it told us that there was enthusiasm for this" in the marketplace.

"Ultimately," he said, "ARIA is promising for macro reasons. If you look at the demographic factors, recent events in the financial markets, and the state of people's personal balance sheets, there are a lot of forces moving in favor of this."

Editors note: In an e-mail to RIJ, Nationwide Financial offered this statement about the status of its SALB program with Morgan Stanley Smith Barney:

"Our goal is to help advisors create lifetime income for their clients. We are committed to offering stand-alone living benefits. However, we have faced some challenges that have caused us to put our current SALB offerings temporarily on hold. The challenges include obtaining state approvals for large states, and technology integration. We plan to re-launch Select Retirement with Morgan Stanley Smith Barney once their platforms have been integrated. We remain committed to the SALB business, and continue to work on making it easier for firms to offer these benefits and on bringing new solutions to market."