A Reader Comments on the ARIA CDA

By Editor Test *Tue, Apr 3, 2012*

CFP Mark Cortazzo of MACRO Consulting Group says that the fee-assessment mechanism of the ARIA contingent deferred annuity taketh away even as the product's living benefit giveth.

Surprise: There's no free lunch in the CDA world.

Last week, Mark Cortazzo of MACRO Consulting Group in Parsippany, NJ, called *RIJ* after reading our March 21 story, "Will RIAs Sing This ARIA?" Cortazzo, whose internal research team spends more hours dissecting living benefit riders than the cast of "Bones" spends on skeletons, said he had a bone to pick with the ARIA product.

Indeed, Cortazzo had just spoken with David Stone, the former Schwab counsel who is CEO of ARIA Retirement Solutions platform, which enables RIAs to attach a stand alone living benefit—also known as a CDA or contingent deferred annuity—to a managed account. So far, Transamerica Advisors Life is the sole provider of the ARIA income guarantee, but other insurers are expected to join the platform.

Cortazzo said he likes the product's ability to bring an income guarantee to a managed account. But he questioned the ARIA product's technique for assessing the advisor's asset-based fees. To illustrate, he compared the ARIA CDA's fee mechanism with that of a variable annuity with a GLWB (guaranteed lifetime withdrawal benefit).

With an advisor sells a B-share GLWB, he or she receives a commission from the insurer, who recovers it over several years by deducting fees from the underlying assets, which reside in a separate account at the insurer. The assessment of fees does not affect the guaranteed income stream, which is a percentage of the benefit base.

The ARIA CDA works a bit differently, in part because the protected assets are in custody at a firm like Schwab or Fidelity rather than in the insurer's separate account. In the CDA, the RIA's annual asset-based fee (say, 1.5%) is not drawn from the protected assets. Instead, it comes from one of the client's other accounts.

Cortazzo concedes that under the CDA, the client's guaranteed income (4% of $500,000 or $20,000, say) stays level. But he notes that if another client account ($500,000, for instance) were to drop by $7,500 (.015 x $500,000) because of fees, then the net income from owning the CDA would be just $12,500, or 2.5%.

Stone said he spoke with Cortazzo and he doesn't dispute the advisor's math. But, in Stone's view, there's an upside to ARIA's method. The protected assets are more likely to grow during the accumulation phase, and to achieve new high water marks, precisely because the protected account doesn't feel the drag of a 1.5% asset-based fee.

“When we built our product, we wanted consumers to maximize their guaranteed benefit or ‘high water’ amount,” Stone told *RIJ* in an email. “If the RIA fee comes out of the covered account, the client will have less for retirement. What RIAs like Mark are saying is that it’s easier to sell to clients the idea that they walk away with 4% . . . net of all fees.”

Either way, the fees still come from one of the client’s pockets. With the CDA, they come out a side fund. With the VA/GLWB, the fees aren’t as noticeable because, in a sense, they come off the back end. The contract owner’s beneficiaries, if any, will simply get a smaller legacy payment.

Stone said that ARIA recognizes this issue and is responding to it. “We are actually working with Transamerica on this and we hope to be able to shortly provide RIA’s with a choice: Maximize payments or put the fees in the account for a seamless experience,” he said. For his part, Cortazzo told RIJ that he “loves the concept” of CDAs and would embrace them if this particular wrinkle were ironed out.

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Are you old enough to imagine the uneasiness you might feel if a three-year-old started toying with the micrometrically balanced, diamond stylus-tipped tone arm of your beloved Acoustic Research turntable, the one with the solid maple base and the Plexiglas dust cover?

Yes? Then you can appreciate my anxiety while reading about the recent Supreme Court hearings on the Patient Protection and Affordable Care Act of 2010 (whose critics call “Obamacare”) last week.

A lot of questions came to mind. Like, why are insurance-challenged justices and lawyers deciding the future of the U.S. health insurance system? Why is the matter being decided as a constitutional issue? If actuaries and medical economists were discussing the matter, would they, like Justice Scalia, compare health insurance to a dark-green cruciferous vegetable?

Instead of exploring relevant issues—moral hazard and adverse selection, the difference between social and indemnity insurance, the “free rider” problem, the externalities of not providing basic care to 30 or 40 million people, the incentives to over-prescribe and over-treat, the power of publicly-held hospital chains and drug companies, malpractice issues, etc.—we’re parsing the Commerce Clause and rekindling the kind of antagonisms that sparked the Civil War.