"An inoculation, not a depredation"

By Editor Test *Wed, May 22, 2013*

Notes from all over: What a government official said privately about the $3 million cap on tax-favored accumulations; Mark Cortazzo's new business of mining old VA contracts; another New York Times article that obfuscates annuities.

There may be no need to worry about an all-out administration assault on the retirement industry's tax preferences.

At a semi-private meeting not long ago, a government official of a fairly high rank was asked a pointed question by a member of the retirement industry.

"Why is the government discouraging business owners from sponsoring 401k plans by proposing a cap of $3 million on accumulations in tax-favored accounts?" she asked. "Doesn't that send the wrong message?"

The government official (I'd like to name him but the meeting was by invitation. It doesn't matter anyway.) answered at great length before finally asking the questioner to think of the $3 million cap "as an inoculation rather than a depredation."

An inoculation "produces or boosts immunity." A depredation is an "attack."

Though the statement was probably preceded—I can't remember—by a standard disclaimer that the speaker's opinions were solely his own, I understood him to mean that if the retirement industry accepts a cosmetic reduction of its tax preferences, the Obama administration won't threaten to take away any more of them. No slippery slope. Just old-fashioned political horse-trading.

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Mark Cortazzo, founder of MACRO Consulting Group in Parsippany, N.J., has reviewed masses of variable annuity contracts with considerably more care and attention than most people devote to, say, their new car owner's manuals.

Now he has set up a new business to show owners of rich "arms-race" era VA contracts how to use their contracts to maximum advantage. And to the issuer's maximum pain.

Cortazzo's venture, called Annuity Review, sponsored a booth at the recent National Association of Personal Financial Advisors spring conference in Las Vegas. The energetic and voluble Cortazzo, a New Jersey high school pole-vaulting champion, was there to help vault Annuity Review's services into the consciousness of fee-only advisors.

RIJ will have more to say about Annuity Review during our focus on VAs in July. For the moment, we'll summarize: Cortazzo aims to charge individuals $199 to analyze up to three existing VA contracts (he offers wholesale rates to advisors whose clients have VA contracts). Each additional review will cost $49.

There's hidden gold in those six-, seven- and eight year-old contracts. They contain some of the richest living and death benefits that VA shoppers will probably ever see. But most contract owners don't know that.

Fee-only advisors encounter the contracts only when they overhaul the portfolios of incoming clients. Usually, the fee-only folks don't know from VAs. So they tell the contract owners to surrender the contract ASAP and re-allocate the separate account assets to basic investments.

But that would be foolish, says Cortazzo, who knows how to mine the contracts—by, for instance, extracting cash without nullifying the guarantees, or by maximizing the value of the roll-up, or by integrating the death benefit into an estate plan. (Cortazzo isn't the first or only one to recognize this opportunity, but few if any others are seizing it so deliberately.)

The birth of Annuity Review is unwelcome news for the life insurers who, while tending the tens of billions of dollars in those books of business, dearly hope that most contract owners will surrender them or exchange out of them or ignore the riders they've paid for. Otherwise, too many of the rich promises that issuers made before the financial crisis could return to haunt them.

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I felt frustrated after reading Paul Sullivan's article about annuities ("Getting the Full Picture on Annuities and Insurance," May 11, 2013) in the *New York Times*. The article mashed-up all kinds of annuities into a single journalistic stew. And it seemed to be written in a pitch too high for ordinary anxious Boomers to hear.

The average reader might finish the *Times'* article and conclude that every annuity offers every feature offered by any annuity. The costs, features, and benefits of fixed, variable, deferred, immediate, indexed, load and no-load products all seem to be attributed to "annuities." To try to understand annuities based on a reading of this article would be like trying to untangle an electrical system where all the wires are black instead of yellow, white, red, blue, or green.

This defect characterizes a lot of general-audience reporting about annuities. To describe all types of annuities in one article is to create confusion and rejection. Sullivan's story was actually more about tax deferral and the role that annuities play in tax-reducing strategies. The reporter's main question was, "Given the lure of tax deferred savings, how should people weigh the risks and downsides of insurance and annuities?"

The author eventually admitted the error in viewing annuities so narrowly, however. At the end of the story, he quoted an advisor as saying that most people shouldn't think about life insurance or annuities as "plug-ins for something else"—i.e., tax dodges—but as "risk-adjusted investments" that mitigate the impact of risks that "we really can't do anything about," like early death (in the case of life insurance) or outliving our savings (in the case of annuities).