"Face-Off" at the IRI Marketing Conference

By Kerry Pechter *Thu, Feb 25, 2010*

Annuity manufacturers and distributors went eyeball-to-eyeball at the Insured Retirement Institute's marketing conference in New York this week, where medical economist J.D. Kleinke (pictured here) was a featured speaker. Photo by IRI.

With the U.S. and Canadian Olympic hockey teams facing off in Vancouver, B.C., last Sunday night, a hockey metaphor seemed to pervade the Insured Retirement Institute's annual marketing conference, held in New York early this week.

That was apt, given that much of the annual meeting could be characterized as a friendly face-off between annuity manufacturers and their third-party distributors. But in this case, of course, the product manufacturers don't want to beat the distributors. They want to supply them.

Easier said than done. This year's marketing conference, which drew some 530 or so registered guests and 22 listed exhibitors, wasn't as crisis-stricken as last year's meeting. But the basic marketing challenge facing annuity manufacturers hasn't changed much in twelve months.

Manufacturers are still trying to convince brokers and advisors in every distribution channel from wirehouses to banks to independent broker/dealers to fee-based advisory practices that annuities are the financial products that aging Boomers need and—with proper education—will want.

But many intermediaries still regard insurance products as alien to their DNA. Because of complexities related to compensation, regulation, cultural differences and general unfamiliarity, annuities still trigger the equivalent of a negative immune response from the non-insurance world.

 Annuities, to continue the biological analogy, are still perceived as antigens—rather than, say, vitamins, life-saving drugs or legal stimulants—by much of the financial products distribution system. That's why some observers think that the unbundled income guarantee, or "stand-alone living benefit," applied to managed accounts, could turn out to be the dominant income "app."

But it's too early to tell who the winners and losers will be. There are so many uncertainties and so many strategies afoot in financial services today that it's hard to see anything clearly through the fog of war. Or through the scrum of stick-waving hockey players, you might say.

The distributors' perspective

Executives from big distributors like Wells Fargo, Morgan Stanley Smith Barney, UBS, and Edward Jones, were present in force at the conference. They made it clear that the retirement market is huge for them. But whether they will champion annuities was not as apparent.

Morgan Stanley Smith Barney, which was born when Morgan Stanley bought Smith Barney from a strapped Citigroup in January 2009, came across as especially receptive to annuities. With 20,400 advisors at a thousand brokerage locations, the combined firm has a big distribution footprint.

In a panel discussion called, "Retirement Income, Service or Product?" Mike Stern, a national sales manager at MSSB, said that his firm had established a Retirement Standard last September, which included a 10-point checklist for evaluating a client's future income needs.

Over 1,000 advisors signed up to receive support materials and resources for the program, Stern said. The firm also adopted a time-segmented, "bucket" approach to income planning after the start of this year. These efforts have produced "significant wins" in rollovers, attracting $250 million in new money so far, he said.

Certainly, wirehouse customers have an enhanced appetite for safety. "We're hearing that the proposition of a guarantee is impactful," Stern said, adding that he wants to integrate insurance solutions into income plans. "We're working toward introducing an insured retirement solutions the same way as we introduce a large cap fund."

Among registered reps, however, annuities are still new. If he questions a rep about a given mutual fund, Stern said, the rep can rattle off every detail of the prospectus. If he asks about a guaranteed lifetime withdrawal benefit, "I get a blank stare." Going forward, he thinks a rising tax environment will lift variable annuities. "Tax efficiency will be big in 2011," he said.

UBS Financial Services' Wealth Management division has about 8,000 financial advisors in the U.S. and its over-55 clients account for 75% of its assets, so it is another object of courtship by annuity manufacturers. Like MSSB's Stern, UBS managing director Ed O'Connor sounded receptive.

Internal surveys show that retirement income is one of his clients' top three concerns, O'Connor said. Clients are telling UBS they would prefer a 5% guaranteed income to an uninsured systematic withdrawal income of 4.5% to 5%, he said.

Not every distributor sounded convinced about annuities, however. Bernie Gacona, director of annuities at Wells Fargo Company, said that annuities aren't getting much traction among his force of some 16,000 reps nationwide.

"We have not added any of those products," he said in reference to some of the new variable annuity contracts that have appeared since last summer. Participating in a panel called "Simple Annuity and Other New Products Designs," Gacona said that the commissions on simplified contracts are too low while the expenses on the more elaborate contracts are still too high.

"The low compensation product doesn't sell in a commission environment," he said. "If your commission is in the 2% range and other products pay 5% or 6%, how will your products get sold?" L-shares of variable annuities, which have no up-front charges but higher trailing fees, are not getting traction either.

The manufacturers' perspective

While Gacona was talking, his fellow panelist, John Egbert, national sales manager in the wire/bank channel for John Hancock Annuities, was visibly stressed. Last summer, his company introduced a simplified A-share variable annuity with a three-percent commission and total annual expenses of only

1.74%. Distributors don't seem to want it.

Called AnnuityNote, the product has no death benefit, no credits for delaying withdrawals, and involves passive investments. It pays out 5% of the original investment or the contract value on the fifth anniversary, if greater. Income starts five years after issue.

Though simplicity seemed to be just what the post-crisis world wanted, AnnuityNote has not sold well. Egbert and his team are still trying to figure out why. "We were either early or we were wrong," he said. "But we're not stopping." The product is the right thing for the 80% of producers who don't currently sell annuities and for mass-market investors, Hancock still believes.

Hancock's approach was just one of many. Executives from New York Life, The Phoenix Companies, Genworth Financial, Hartford Financial, ING Annuities, Nationwide, Lincoln Financial, and AXA Equitable also took part in panel discussions and described their approaches to the market.

ING, like John Hancock, has gone the simplified, low-cost var iable annuity design route. Michael Katz, head of variable annuity product development at ING Financial Services, described ING's rational from reducing client expenses on its VAs from 314 basis points before the crisis to 225 basis points after.

"The equity markets are stabilizing, and the chirping over costs will start as markets recover," he said. Advisors won't like a product that pays out 5% a year in income but costs 3.50% a year, he said, and clients won't like accumulating 30% less over 20 years because they owned a high-cost contract.

Hartford and AXA Equitable, represented at the conference by Peter Stahl and Steven Mabry, respectively, have gone another route entirely.

They've decided to "decouple" the investment and income segments or "sleeves" of their products into a bucket dedicated to accumulation and a bucket dedicated to income. The manufacturer only takes on the risk of insuring the assets that the owner allocates to the much-tamer income bucket.

Robert Grubka, vice president, Retirement Solutions Products at Lincoln Financial Group, said that his company tries to exploit parts of the market that other companies neglect. "If everybody goes to the same spot on the ice," he said, using a hockey metaphor, "it gets very crowded and you get jostled around."

Lincoln will go its own way, he said, perhaps by putting its weight behind a long-term care annuity hybrid product. Such products, which were blocked by regulatory barriers until January 1, 2010, enable annuity owners to, in effect, use their annuity assets or guaranteed income streams to buy low-cost, high-deductible long-term care insurance.

Chris Blunt, the head of the Retirement Income Security at New York Life, the largest mutual life insurer, came at the market from still another angle. "We want to take immediate annuities into the world of broker-dealers," he said.

So far there have been "operational" obstacles to doing that in a big way, he said, but eventually New York

Life would like to see "guaranteed income treated as an asset class alongside mutual funds." Demographics will drive the market his way, Blunt added: "Our target clients are in their mid-60s to 70s, so we're still five years from seeing a tsunami of interest" from Boomers.

Stand-alone living benefits

Although there was no panel discussion devoted purely to stand-only living benefits (SALBs), several panels touched on them. Genworth Financial, the Phoenix Companies, Nationwide and Prudential have already launched group or individual forms of these income guarantees. Although their progress was slowed by the financial crisis, they have by no means disappeared.

Applicable to after-tax managed accounts or to qualified money, SALBs provide advisors and investors with the income guarantee of a variable annuity without the restricted fund selection, fund expenses, or marketing costs associated with one. Their sales potential is unknown, but could extend far beyond the traditional market for variable annuities.

The only conference panelist specifically representing SALBs was Philip Polkinghorn, president, Life & Annuity, at The Phoenix Companies. Phoenix, whose financial strength rating slipped out of the A range in the financial crisis, created the first SALB with Lockwood Asset Management, a Philadelphia-area managed account provider, in late 2007.

"The vast amount of retirement money is not in variable annuities," Polkinghorn said, referring to the managed account market, which is $1.5 trillion and growing, as well as 401(k) and 403(b) accounts that will eventually roll over to IRAs. SALBs will appeal to that market than variable annuities, he thinks.

"[SALBs] focus entirely on longevity risk—the tail risk," he said. They are contingent on both the owner's life and the exhaustion of the covered portfolio. Deferred income annuities, aka longevity insurance, also cover that risk, but have no cash value. "We're putting a liquidity feature in longevity insurance."

Best of all, perhaps, SALBs are not perceived as annuities.