
What Fee-based Indexed Annuities Reveal

By Kerry Pechter *Fri, Mar 17, 2017*

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That product is the no-commission or fee-based version of the popular fixed indexed annuity (FIA). Before advisory fees, this type of FIA offers significantly more potential return (while also guaranteeing against principal loss) than similar FIAs in which the selling agent's commission is embedded in the crediting rates.

Starting in the 1990s with Bob MacDonald's LifeUSA indexed annuity business, the FIA business was built with the help of compellingly high incentives (including large commissions, vacations and other sweeteners) for independent insurance agents.

Those "Wild West" days are over, and MacDonald has long since sold LifeUSA to Allianz Life and retired to Key West. But FIA commissions are still among the highest that an agent or advisor can earn, and those incentives helped turn FIAs into the fastest-growing annuity category, with some \$60 billion a year in sales. (FIA assets consist of bonds, held in the issuer's general account, along with a dash of equity options for upside potential).

The Best Interest Contract Exemption of the Obama Department of Labor's fiduciary rule (effective last June but now under review by the Trump DOL) targeted this highly effective business model. The rule was issued in the belief that the high incentives motivated agents to steer retirement clients toward FIAs even when the sale wasn't suitable for the client. The rule aimed to discourage that practice by requiring agents or advisors who earned commissions from insurance companies to sign a formal pledge, called the Best Interest Contract (BIC), that committed them to acting only in their clients' interests and not their own when selling FIAs or variable annuities (VAs) to retirement clients.

Rather than sign the BIC, which brought potential exposure to federal class action suits, many commission-based sellers of those annuities have (or are expected to) switch their compensation model to asset-based fees. To give them an FIA they can sell under that model, FIA issuers created the no-commission FIA. So far, Great American, Allianz Life and Lincoln Financial have issued such products. At least three more products are expected from other insurers.

These new FIAs can be good for investors. Because the insurance company doesn't pay the sales intermediary an upfront 4%, 5% or even much higher commission, the contract offers the client potentially higher returns. But the client isn't likely to capture that advantage, for two reasons. First, the advisors'

typical 1% to 1.5% fee on the annuity assets will likely consume all or most of the extra gains. Second, advisors may not recommend FIAs at all, because they no longer have the incentive of large carrier-paid commissions.

Under these circumstances, FIA sales would likely go down. Some inappropriate FIA sales would probably not occur. On the other hand, few investors would realize the benefits of fee-based FIAs. But there's another possibility. Advisors could recommend the purchase of no-commission FIAs and split the yield advantage with the client by charging just 50 basis points on the FIA assets. Such advice would truly be in the client's best interest and, for all the right reasons, might even stimulate sales.

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