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## Letter to the Editor

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By Glenn Daily      Wed, Nov 24, 2010

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*There are two problems with Curtis Cloke's analysis of the relative merits of fees versus commissions for income annuities ("Fees vs. Commissions in SPIA Sales," RIJ, 11/17/10), writes Glenn Daily.*

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*Glenn Daily, a fee-only insurance consultant who publishes [glenndaily.com](http://glenndaily.com), a website that describes itself as a "resource for making good decisions about insurance," e-mailed RIJ last week with a response to Curtis Cloke's [letter](#) comparing the merits of commissions and fees in the sale of income annuities. Here is Daily's comment:*

There are two problems with Curtis Cloke's analysis of the relative merits of fees versus commissions for income

annuities ("Fees vs. Commissions in SPIA Sales," RIJ, 11/17/10).

First, fees can be tax deductible, depending on the taxpayer's situation. Commissions are not immediately deductible;

they become deductible as income payments are received, in the sense that the income payments are lower than they

would be without the commissions.

The tax disadvantage of commissions is even worse for qualified annuities. If tax rates remain constant, the after-tax

rate of return on qualified money is equal to the before-tax rate of return, so any expense that reduces the return is

costly. That's why IRA plan sponsors give participants the option to pay administrative fees separately.

Second, for most consumers, separately-paid fees are more efficient than amortized commissions, because the insurer's

cost of capital is likely to be higher than the consumer's opportunity cost of money. Actuary Ralph Gorter explained

this product design issue very well in "Credit Card Approach to Pricing" (*Product Development News*, August 2000,

available at [www.soa.org](http://www.soa.org)).

Insurers pay commissions when the annuity is issued, and then they recover those costs from the annuity. They typically

seek a return on invested capital of at least 10%, so the amortized cost will reduce the consumer's benefits by more

than the amount of the commission—and probably by more than it would cost the consumer to finance those costs himself.

Upfront loads are better for long-term product performance, but consumers balk at upfront loads because they are

transparent and therefore painful. It is easier to sell products that bury the loading in interest rate spreads.