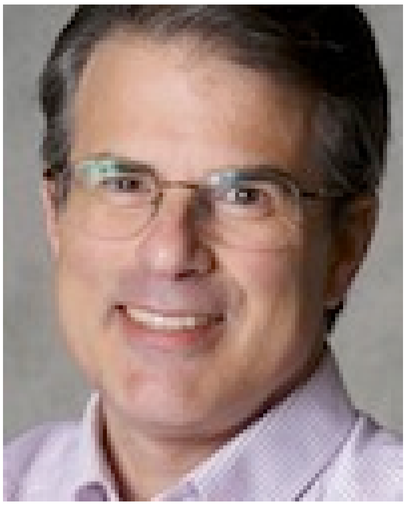
Ohio National Hits the Trail

By Kerry Pechter *Thu, Oct 11, 2018*

Advisors who sold rich Ohio National variable annuities with guaranteed minimum income benefits are fuming at the insurer's announcement that it would no longer pay "trail" commissions to certain sellers of those contracts.



Hell hath no fury like a financial advisor denied a promised trail commission on a significant book of variable annuity business.

Not long after Ohio National's September 28 announcement that it would cease paying certain financial advisor their roughly one percent annual "trail" commission on perhaps hundreds of millions of dollars worth of sales of a no-longer-issued ONcore Lite and similar variable annuities, one of the affected advisors vented about it on the phone.

An opinion-maker in the $2 trillion variable annuity universe who requested anonymity, said he was astounded. But he was far from speechless.

"It creates a tremendous conflict of interest, because advisors are left to service the contract, with all the liability that goes with that, for no revenue. They're creating suitability issues and a high probability that either the registered rep or the policyholder will engage in terrible behavior. FINRA needs to step in," he said.

Ohio National's move stings, he said, because the products in question had been highly popular and attractive (i.e., underpriced) and because it hurts advisors who were trying to get paid in a client-friendly way. That is, they accepted a trail commission from the issuer instead of the "heat" commission—a one-time up-front payment that gives the advisor minimal incentive to "service" the contract over the ensuing years.

"Those Lite products had the richest guaranteed minimum income benefits. My own money is in it. It had unlimited investment restrictions. You needed to maintain it carefully, because you could void the guarantee if you didn't annuitize at the right time, but it was gold. It had a 6% withdrawal rate, net of fees. And if you got close to running out of your own money, you could annuitize the full benefit for life with 10 years certain."

Variable annuities with lifetime income benefit riders are riddled with complex tradeoffs, not just for the contract owners, but also for the advisors. Depending on how advisors prefer to get paid (which depends on their licenses and business models), they may have several payment options: an upfront 7% commission, or a one percent trail commission, or no commission. If they choose the latter, they charge clients their usual comprehensive fee on the value of the assets in the mutual funds "inside" the insurance wrapper.

Now the advisors who took the trail are being punished. "It's a terrible precedent. For last decade, advisors have been pounded from officials about upfront commissions. They wanted us align our interest with the client and stop churning. Now everybody will want to take the front-end commission. It will set the industry back a decade," he said.

The crux of the matter is that, as long as those trail-fed contracts are in force, Ohio National may be collecting a 1.40% annual fee from the client but not transferring the agreed-upon portion of that fee to advisor. In addition, Ohio National is said to still be compensating its captive advisors (full-time employees) who sold the products in question.

A high-stakes game of chicken may be going on here. By its actions, Ohio National appears to hope that advisors will advise contract owners to cash-out of the product or exchange it for another one. That would relieve Ohio National of unwanted liabilities without the insurer making an expensive offer to buy out the contracts, which other variable annuity issuers in a similar position have done.

"[Ohio National] offered a buy-out earlier this year," the advisor said. "But it was a dried-up carrot. Now they're using a stick." He said that when John Hancock and the Hartford got out of the variable business, they continued t pay trail commissions. And when AXA and ING, for instance, wanted to escape from certain contracts, they offered attractive buy-outs.

If Ohio National is playing chicken, the strategy carries obvious reputational risks, not to mention its negative impact on others. Contract owners may feel squeezed into abandoning products they like. Advisors, with no incentive to continue advising the client, could cease to do so, perhaps unethically. Without advice, contract owners could fail to use the contract properly and lose the guarantees they've been paying for.

There's a larger context to this news item. The advisor told *RIJ*, "Ohio National has had a new president since August 22. He fired 25% of the staff. He let go 300 out of 1,300 employees. He got out of the variable business and, through a loophole in every contract, he's trying to stop paying contractual compensation to advisors."

In August, Chris Carlson, Ohio National's vice-chairman of strategic business, replaced Gary

"Doc" Huffman as CEO. In September, the Cincinnati-based life insurer announced that it would drop its annuity and retirement businesses and lay off 300 workers. On September 7, Standard & Poor's downgraded Ohio National's financial strength rating to an A rating (sixth of 21) from an A+ rating (fifth of 21), with a negative outlook.

Today, an Ohio National spokesperson gave *RIJ* this statement:

> We recently announced a new strategy focused on growing our life insurance and disability income insurance businesses. As part of our strategic planning process, we completed a comprehensive evaluation of our entire business. Based on this evaluation, we've made the strategic decision to focus Ohio National to build on our strengths in life insurance and disability income insurance.
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> As a result of our focused strategy in life insurance and disability income insurance, we are no longer selling new annuity contracts and retirement plans, but will continue to service and support our significant block of existing contract owners. This focus will increase our organizational agility, and our laser-focused business mix enables greater long-term financial flexibility to invest in growth opportunities.
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> While the majority of our selling agreements are being replaced with a service agreement or service letter as a result of our new strategy, the steps we are taking allow for advisers to continue to service their clients' needs as they do today. All advisors continue to have access to their client information and can continue to service them. Consistent with our more than 100-year history, we will continue to service and support all our existing annuity and retirement plan contract owners now and going forward.
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> Our arrangements with individual broker-dealers or categories of broker-dealers may differ due to a range of factors. While a vast majority of policies are unaffected, generally the changes made were to older generation products—those written prior to May 2010. We believe advisors do and will continue to act in the best interest of their clients.

Ohio National is only the latest life insurer to reduce its exposure to variable annuity risks. The stock market collapse in 2008 and the subsequent period of low interest rates made it difficult for many issuers to support products.

In the years that followed, some issuers "de-risked" their products (i.e., made the guarantees less generous), some bought back their riskiest products, and some left the variable annuity business. As supply has fallen, so have sales. The VA industry is now highly concentrated. Four life insurers—Jackson National, Lincoln Financial, Prudential Financial, and AIG—accounted for 40% of VA sales in the first half of this year.

Ironically, the news that Ohio National stopped paying intermediaries came only a week before a big media event in New York for the Alliance for Lifetime Income, which is trying to spruce up the image of the annuity industry and raise its popularity as a solution for Boomers without pensions (see today's lead story). Ohio National is not a member of that non-profit, industry-funded organization.

Sheryl Moore, CEO of Wink, Inc., a provider of annuity data to life insurers, told *RIJ*, "I am surprised to hear that an insurance company has opted to discontinue paying trail commissions to a select portion of their salespeople on their living benefits. I have to wonder how this will affect the sales of their other products."

Moore put a fine point on it: "I am saddened to hear that another insurance company is exiting the annuity business at a time when Americans need a guaranteed paycheck to insure their retirements more than ever."