Singing from the Fee-Only Song Book

By Kerry Pechter *Wed, Nov 10, 2010*

Given their focus on planning rather than sales, fee-only advisors seem well-suited to the labor-intensive process of creating customized retirement income solutions for their clients.

If you've never heard a chorus of two hundred fee-only financial planners shouting out Johann Sebastian Bach's *Ode to Joy* in fractured, phonetic German, perhaps you haven't really lived.

You may have lived, but obviously you weren't there for the rousing start of NAPFA's 2010 Connections conference in Boston last week, where the attendees were coaxed into song by Boston Philharmonic conductor and motivational speaker Benjamin Zander (at left).

Registered investment advisors are a key market for purveyors of mutual funds and annuities. They're often the gatekeepers to wealthy individuals and families. They don't work from approved product lists, so they're free to entertain new pitches and new approaches from wholesalers.

Their independence makes them elusive, however, and the fee-only advisors who belong to NAPFA (National Association of Personal Financial Advisors) may be the most elusive. Clients pay them directly and they're typically not licensed to sell securities or insurance. So, by definition, they're indifferent to most of the usual incentives.

But fee-only planners are, by all accounts, very interested in designing retirement income strategies for their clients. Judging by the conference agenda and exhibitors, they're open to bond ladders, fixed income funds, dividend-paying stocks, long-term care insurance and even immediate annuities.

Commission-free SPIA

In a session called, "Income Now or Income Later: Comparing Immediate to Variable Annuities with a Living Benefits Rider," Western & Southern Life executive Barry Meyers made some interesting comments about inflation-protected immediate annuities and about a way that fee-only planners can get compensated for selling SPIAs.

Generally, it's better not to buy a straight inflation-protected SPIA, Meyers said. In some cases, the manufacturers play it safe and assume a high inflation rate, such as 4%, making the products expensive. "You have to pay the insurers to buy the hedge," he said.

To create your own inflation protection, "you're better off hedging yourself" by putting a little less money in the SPIA and investing the difference in equities or by "laddering in a series of immediate annuities," he said. Another strategy: buy a SPIA with a specific annual adjustment, such as two percent, rather than open-ended inflation protection.

As for compensation, fee-only planners can buy a no-commission SPIA from Integrity Life (a Western &

Southern unit) and then charge their usual fee on the SPIA premium for a limited period of five years, in lieu of the 3.5% or 3% upfront commission (sometimes with a 25-basis point trail) that insurance agents are paid. (Nationwide and New York Life also reportedly offer SPIAs with a no-commission option.)

Dividend strategy

For the many advisors who still favor non-insurance solutions to the retirement income dilemma, there was a break-out session called "Gambler's Ruin: Using Dividends to Manage Volatility," presented by Greg Thomas of ThomasPartners Inc., an RIA specializing in dividend-driven portfolio strategies with $1.2 billion under management.

Through a proprietary process, he said, his company has identified about 40 value stocks whose high dividend payouts largely eliminate the need for bonds in a retirement income portfolio, either for diversification or as a source of income. Thus ThomasPartners is able to flip conventional wisdom on its head.

"There's no demonstration of a tradeoff between risk and return," Thomas told the fee-only advisors. "Dividends mitigate the effects of volatility. They minimize the amount of principal you have to take out" to supplement other income sources. "Value is an anomaly that doesn't get diversified or arbitraged away. All you have to do is fish in that pond."

His company focuses on the 350 stocks in the S&P 500 that pay dividends, and tries to narrow it down to value stocks of companies that have added or increased their dividend ["Dividend Growers"] rather than curtailed or cut their dividend. To narrow it down further, they segment dividend-growing value stocks into five yield quintiles and focus on the fourth highest quintile rather than the fifth, on the theory that the highest quintile includes many stocks whose high dividend yields merely reflect sunken stock prices.

Short cut to LTC coverage

Quite a few people listened attentively to an overview of the new long-term care insurance hybrids, which permit investors to apply the assets of non-qualified fixed deferred annuities or the cash value of life insurance policies to the purchase of long-term care insurance, tax-free.

Although the hybrids have not been in the market for long (only since January 1, 2010, in the case of annuity/LTC hybrids), they haven't gotten much notice. But, as Jerry Skapyak of Low Load Insurance Services, Inc., explained, they offer people with existing fixed annuities or life policies a new opportunity to buy long-term care insurance at a significant discount.

"The money does double duty," he said. For example, a person with $100,000 in a fixed deferred annuity could transfer it to one of the hybrid LTC insurance/fixed annuities. Part of the interest earned on the annuity would go, tax-exempt, to the purchase of a LTC policy.

If the covered individual (or couple) goes into a nursing home, the annuity assets (or some combination of client assets and insurance) are applied tax-free to the nursing home expenses. If the annuity owner never

needs long-term care services, the assets can be passed to heirs. “It answers the number one objection to buying LTC insurance: ‘What happens if I never use it?’” Skapyak said.

After the session, a few advisors expressed mild skepticism about the expense of the product. The advisors seemed to think they could hammer together their own blend of non-qualified assets and high-deductible LTC insurance more cheaply than Skapyak’s firm, which advertises itself as “The Fee-Only Advisor’s Insurance Advisor,” could sell a packaged version. It was as if a presentation on ready-made furniture had been given to a group of master carpenters.

Marketing to fee-only advisors

Judging by the exhibitors at the conference—78 were listed in the program—NAPFA members are a strong market for sellers of no-load mutual funds. Both major fund managers and boutique fund firms were well represented. But there were also a number of exhibitors whose companies offer retirement-related products.

Aside from Western & Southern Financial Group and Low Load Insurance Services, these included Aegon Advisor Resources, Jefferson National Life, Allianz Global Investors and SBLI, and reverse mortgage lenders from Wells Fargo and MetLife.

Anyone marketing to fee-only advisors might want to be sensitive to some of their differences from other intermediaries. Judging just by NAPFA conference attendees, they include a higher percentage of women than other retail channels. They’re much more focused on the planning process than the sales event and they take their fiduciary responsibility very seriously.

Their skepticism about product-driven solutions and their disinterest in commissions might act as barriers to sellers of retirement income products. But, given their focus on planning rather than sales, they seem well-suited to the labor-intensive process of creating customized retirement income solutions for their clients.

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