The Big Red Stag’s Mistake

By Editor Test *Wed, Sep 8, 2010*

In ordinary times, The Hartford's letter-gate problem might vanish quickly. But investors are nervous, a big election is coming up, and the reputation of the financial services industry is fragile. A cap-gun could set off a panic.

Like many students of the variable annuity game, I have been watching The Hartford Financial Services Group’s recent public relations disaster closely. My first thought: what a terrible waste of brand strength. Even though The Hartford has struggled rather publicly through the financial crisis—it needed a $2.5 billion infusion from Allianz SE and $3.4 billion from Uncle Sam—its brand has held up pretty well.

But this latest incident could knock a few points off the Big Red Stag’s antlers.

It could also snowball into more than just a public relations disaster. At a time when the Treasury Department is about to auction The Hartford stock warrants to recoup TARP money, and when the Securities and Exchange Commission is pondering the suitability/fiduciary standard for broker-dealer reps, a news story that raises questions about the financial stability of *any* insurer or the integrity of *any* reps could have wider implications. On Tuesday, in fact, the Connecticut insurance commissioner, Tom Sullivan, said he would look into the matter.

That may be why one industry observer told me that the issue is “very touchy” and that other variable annuity issuers “are watching it closely.”

If I read Darla Mercado’s recent stories in *Investment News* correctly, someone at Hartford Life Distributors mailed letters to owners of certain Hartford variable annuities—presumably including ones with underpriced living benefits that were sold during the pre-Crisis VA ‘arms race’—suggesting that they talk to their advisors about possibly exchanging those contracts for contracts with the insurer’s less risky-to-the-issuer Personal Retirement Manager income rider. (See RIJ’s article on the product.) The letter is signed by a vice president of product management at Hartford Life Distributors.

Late last month, at least some contract owners apparently received those letters before their advisors received similar letters from The Hartford giving them a heads-up about the communication with clients. That mix-up alone would be a violation of protocol, and a good way to jeopardize Hartford’s hard-won third-party distributor relationships. It’s an unwritten law that the client belongs to the advisor, not the carrier.

The company has explained that the client letters went to people whose contracts were out of the surrender period—if it were otherwise, this would be an uglier matter—and that such letters were not unusual. “The letters to advisors simply didn’t go out on time,” according to the insurer. I’ve seen both letters. They are brief and dry. To say that the letters “entice” owners to exchange contracts, as the *Investment News* article did, seems to me like an exaggeration.

I was told by one observer that such letters, especially to clients, are “*not* typically” sent out by VA issuers, however. That person also noted that both letters contain headlines that mention an “Exchange Program.”

The use of the word "program" apparently triggers a requirement of SEC or at least FINRA approval. The implications of that, if any, aren't clear.

Worse case scenario: The letter to clients could foster speculation that The Hartford is worried about the risks associated with contracts still on its books, which leads to questions about its financial stability. The letter also allows speculation that the original contract may have been less than suitable for the client, which raises questions of advisor integrity or competence.

Those are not questions that anyone in the insurance or brokerage industries wants anyone to be asking. The annuities industry, which two years ago had to deal with the NBC Dateline fiasco involving indexed annuities, doesn't need another image-flaying scandal. Neither does The Hartford.

A few weeks ago, in Cogent Research's *Advisor Brandscape 2010* research study, the reputation of The Hartford's variable annuity business was still very high among advisors. The company's VA sales had fallen to 18th place at the end of the first quarter of this year—perhaps by design, as CEO Liam McGee suggested in statements last spring—but it still ranked as high as third in brand imagery, trailing only industry leaders MetLife and Prudential.

Advisors don't necessarily see the Hartford as an innovator, the study showed, but 34% of advisors considered the company a "leader in the VA industry." Regional broker/dealer reps in particular held it in high regard. Bank advisors ranked it second among VA issuers in terms of "good value for the money" and third overall in "offers the best retirement income products."

But the trend has been negative. From 2009 to 2010, the company slipped from fourth place to seventh place in brand equity score. And while it still ranked first in advisor market penetration, with 44% of advisors listing it among their VA providers, it lost ground in the percentage of advisors who considered it their *primary* VA provider.

Starting in late 2009, the variable annuity market has split starkly into those companies who are truly committed to the product and those who, post-Crisis, had serious doubts about the wisdom of selling long-term equity puts. Prudential, MetLife, and Jackson National are committed. The Hartford, John Hancock and ING have had second thoughts. Tellingly, the leaders have stuck with generous income riders while doubters switched to simpler products with lower fees and more modest promises. The public, and advisors, prefer the generous products.

It's somewhat ironic that The Hartford wanted to get investors out of the type of product that's justifiably more popular—because of its richer terms—than the one that it's trying to lure investors into. In hindsight, the company might have capitalized on the good will established by those rich promises rather than trying, it now appears, to renege on them. Failure to accept a sunk loss is a mistake that behavioral finance experts warn amateurs to avoid.

It is my understanding that, accounting issues aside, even the most generous-looking lifetime income guarantees don't represent a loss for the issuer unless or until the contract owner(s) are still alive when the account value (as a result of allowable withdrawals and/or poor market performance) goes to zero. Of course, there may be a method to this madness that escapes me or that The Hartford isn't sharing.

There's no need to scold The Hartford here, because Bob MacDonald, the former CEO of ITT Life, a one-time Hartford subsidiary, did a thorough job of it on his blog this week. MacDonald, a legendary and controversial figure who built an equity-indexed annuity empire at Allianz Life of North America in the first half of this decade, writes:

"It is obvious that despite all that has happened to the success and good name of Hartford over the past few years, the management of the company is still highly capable of consistently making decisions that are not in the best interests of the company. Clearly the CEO, who has no insurance experience, has demonstrated his inability to change the environment of self-destruction at Hartford.

"Knowing the past actions of Hartford management and its current arrogant attitude toward customers and the distribution system, one could rightfully question ever buying or selling a product of the Hartford. It seems – as I have suggested previously – the only way to save Hartford from itself is for the company to be acquired by another insurance organization that can clean house and return Hartford to the great company it once was."

That type of righteousness will probably be tough for the folks at Hartford to hear, knowing that it comes from the mischievious author of books with titles like *Beat the System* and *Cheat to Win*.

The Hartford's letter-gate problem might merely reflect one company's or one executive's idiosyncratic error—or, to be polite, the *appearance* of error. And, in ordinary times, the whole mess might vanish overnight. But these aren't ordinary times. Investors are nervous, markets are volatile, a potentially game-changing election is coming up, and the reputation of the financial services industry is under examination. A cap-gun could set off a panic.