The New ‘Big O’?

By Kerry Pechter *Wed, Feb 9, 2011*

The revelation of a novel share class of variable annuities--its working title is "O" shares--was perhaps the most interesting piece of news that emerged from the IRI Marketing conference in Washington, D.C., last week.

The most ear-catching idea at the IRI marketing conference in Washington, D.C., last week came from Tim Burke, principal, Insurance Solutions, at Edward Jones. Burke said that his firm is rolling out what he called “O-share” variable annuities and intends to sell them exclusively.

Speaking on a panel called “Simplifying Annuity Marketing,” Burke said the O-share contracts remove some of the complexity from the annuity sale while lowering the long-term cost to the consumer. According to Burke, the O-share’s mortality and expense (M&E) risk fee is the same as a B-share M&E until the end of the surrender period, when it drops to the lower M&E that’s characteristic of an A-share (front-end load) contract.

“We’re trying to remove as many barriers [to the sale of variable annuities] as possible,” Burke said. While his firm has traditionally favored A shares because they’re cheaper for clients over the long-term, “with the increased popularity of riders, we realized that we were putting our clients at a disadvantage with the A shares, because instead of starting off with $100,000 in their account value they were starting out at $96,500, with the commission backed out. We like the B share for that part of it, but we didn’t like the higher ongoing charges on the B share. So we came up with the best of both worlds,” he said. (Watch Burke’s video on today’s homepage.)

Known to some people as “B-to-A-shares,” the O-share concept isn’t new, according to annuity industry consultant Jeff Dellinger, owner of Longevity Risk Management Corp. American Funds, for instance, has a 529 Plan share class that drops the M&E after a few years. Dellinger said it’s no surprise that Edward Jones would pioneer such a VA share class.

“Knowing Merry Mosbacher [Edward Jones’ head of insurance marketing] and Edward Jones’ buy-and-hold, consumer-oriented philosophy, this doesn’t surprise me,” Dellinger said—even if it means lower commissions for Edward Jones advisors.

A VA sold by Edward Jones tends to have higher persistency and therefore higher profitability for manufacturers, he said, so insurers can afford to drop the M&E after recovering their commissions. From a suitability standpoint, he said, it will hard for an advisor to recommend an exchange from an O-share to a B-share at the end of the surrender period, because the O-share’s lower M&E will be hard to beat.

“This makes sense for Edward Jones because they try to bullet-proof their system so that the advisors can’t get into trouble,” Dellinger told *RIJ*.

As for manufacturers of B-to-A-shares, Burke mentioned Protective as having a contract with a “persistency credit” that functions as an O-share. Ohio National recently filed a contract that drops the M&E by 50 basis points after a four-year surrender period.

SunAmerica is said to have a B-to-A-share product, but Rob Scheinerman, SunAmerica's senior vice president of product management, deferred to Tim Burke for comment yesterday. "This is [Edward Jones'] initiative," Scheinerman said in an e-mail to *RIJ*. Prudential declined to discuss a contract filed last November that is said to be a B-to-A share product.

Burke was the lone distributor on a panel with Tom Mullen, chief marketing officer at John Hancock Annuities, Kimberly Supersano, chief marketing officer, Prudential Annuities, and Jeff Gardner, divisional vice president, Nationwide.

The topic of the panel was, "Simplifying Annuity Marketing." It started off with a dismal reminder that VAs have generated little market share growth over the past decade. A multi-colored bar chart the showed just how meek the variable annuity industry's growth has been since 1998—about 10%—while the total asset pool has more than doubled, to over $17 trillion.

Mullen's speech began with a look back at the failure of AnnuityNote—John Hancock's stab at a post-crisis, simple, inexpensive variable annuity with GLWB. He confirmed what lots of people knew. (See Mullen's video on today's homepage.)

"What pays the rents is a small core group of producers who are engaged in the full-boat annuities and who *are* interested what's hot and what's new. Breaking beyond that core group"—to advisors who traditionally don't sell annuities—"has been difficult," he said.

"And annuities are still annuities," he added. "We haven't cracked the nut of making an annuity ticket as easy to drop as a mutual fund ticket."

More successful for John Hancock, he said, has been *RetirementTalk*, a series of videos that "paint a picture of how having an annuity in a retirement portfolio helps people sleep better at night. That program has worked very well. Lots of interest from new advisors and existing advisors."

So has *AnnuityValet*, which tells advisors how to use the order-entry system. "We have dedicated team members who will hand walk a new producer through their first ticket. That has paid great dividends."

More upbeat—and why not, given her company's sales leadership in 2010—was Kimberly Supersano of Prudential. One important takeaway from her presentation was that simplifying the *product* may not be as important as simplifying the *message*.

Prudential began simplifying its message five years ago with its broad Retirement Red Zone advertising campaign, which took the impenetrably complex story of sequence risk and reduced it to a gridiron metaphor that even the most casual football fan could understood.

Implicit in the Red Zone approach was an emphasis on the needs of the consumer, not the variable annuity and not even on the ultimate benefits of the product, as so many helm-of-the-sailboat or Adirondack-chairsby-the-lake ad strategies do. "The product took a back seat to the needs," Supersano said.

Prudential then bet big on that strategy, pushing out a ton of Red Zone advertising client collateral, research, and advisor education materials. Eighteen months ago, when other insurers were reducing their exposure to VAs, Prudential was in the process of sending out 1.2 million DVDs on their Highest Daily lifetime income concept. The company sent over 800,000 DVDs to 47,500 advisors, with the result that 90% of producers are now aware of the video.

The enormous success of this strategy is somewhat ironic, considering that Prudential's VA, which uses a version of Constant Proportion Portfolio Insurance (CPPI) to help manage risk, is perhaps the least simple VA product—one that, under some circumstances, even denies advisors control over the underlying investments.

But the Prudential approach is not the only path to success in a difficult market. Nationwide has chosen to focus its attention on fee-based advisors and to pitch Stand Alone Living Benefits (SALBs)—that is, just the longevity insurance piece—to them instead of trying to sell them annuities.

That's all that advisors really want, said Nationwide's Jeff Gardner. Trying to substitute a VA investment lineup for an advisor's personal portfolio preferences makes little sense, he said, because "it's very annoying for them not to be able to use their own [investment] models."

"We put our product on a fee-based platform," Gardner added. "We give them what we do well, but in a different package. Our philosophy toward advisors is, 'We'll come to you, and not make you come to us.'"

And, to avoid trying to deliver new wine in old bottles, Nationwide created a special team of wholesalers who had specialized in the fee-based advisors rather than in annuities per se. "They knew how to spell annuity, but their background is in fee-based advisory channel," he said.

That said, annuities will continue to be tough sell at the conference. As Darla Mercado highlighted in her story on the conference in *Investment News*, advisors who spoke at the conference pointed out the awkward fact that, with living benefit guarantees getting stingier since the financial crisis, variable annuities are, in general, becoming less rather than more attractive.

Some advisors seem to have unrealistic expectations of annuity contracts. It seems that, for certain advisors, the perfect variable annuity would have low costs, unlimited investment options and no allocation restrictions, and seven percent payouts at age 65. One advisor's comment that "100 investment choices" in a variable annuity wouldn't be enough drew a bit of frustrated laughter from insurers in the crowd.