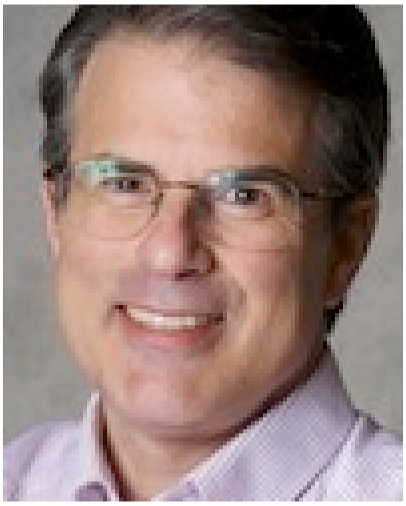
Retirement Income
JOURNAL

Warren Whitepaper Missed the Mark

By Kerry Pechter *Thu, Nov 12, 2015*

Sen. Elizabeth Warren (D-MA) thinks clients should be able to see the non-cash incentives offered to annuity salesmen. It would more useful if they could see the solutions that, in the status quo, few individual advisors have any incentive to show them.



A stock character of certain gothic novels is the crazy aunt locked in the attic of a sprawling manor—a noble clan's guilty secret. Sometimes, in an ironic twist, the aunt turns out to be the only sane and rich one in the family, who's been victimized by her scheming relatives.

In the family of annuities, the "crazy aunt" is the indexed annuity. Its "attic" is the state-regulated insurance marketing organizations and the agents they run. Its craziness involves its "Wild West" sales culture and predatory 7% commissions. But it's tolerated because it generates a lot of revenue. It's also an easy target for consumerists.

Senator Elizabeth Warren of Massachusetts, the scourge of the financial services industry, recently exposed the tawdriest side of the indexed annuity business in a well-intended but repetitive and somewhat misdirected white paper whose cover drawing, incidentally, depicts an English castle with a crenellated tower—tailor-made for a crazy aunt.

I won't bash Warren here—the world needs a few crusaders—but I do think she missed the mark.

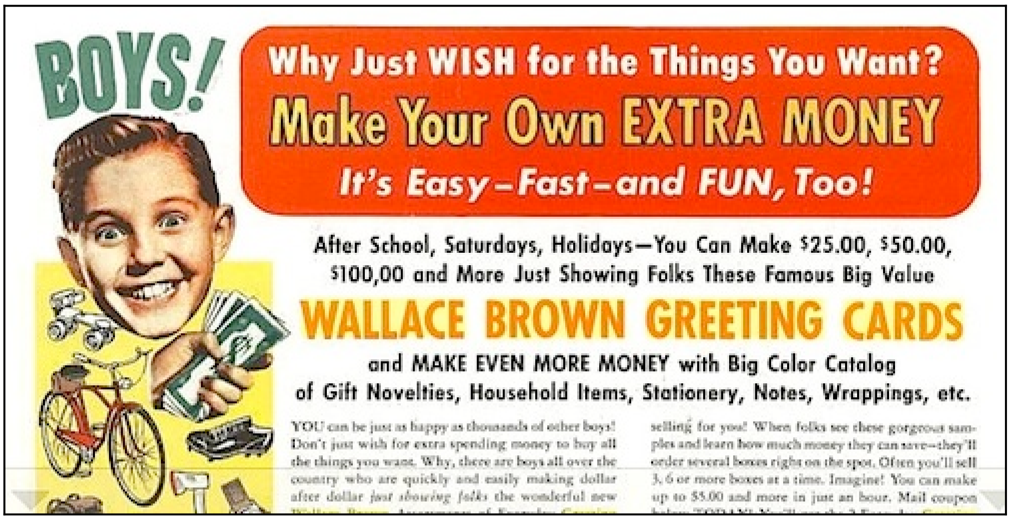
First, she indiscriminately smeared all annuities, which doesn't serve the public well. Second, she obsessed about the trinkets (e.g., NFL Super Bowl-type rings) and junkets (e.g., to the Ritz-Carlton Aruba) that annuity manufacturers use to incent and reward producers.

Warren (right) sent letters to the CEOs of 15 top annuity manufacturers and asked them to enumerate the items of non-cash compensation that they offer distributors and agents to get them to sell their products, typically indexed annuities. Only two of the manufacturers offer no prizes; the other 13 listed their Bahamian golf outings, Tag Heuer watches and other premiums.

The availability of these non-cash incentives seems to shock the senator. Perhaps she’s not familiar with sales cultures. A sales career is not for the squeamish. It may be best suited to the young. (The incentives remind me of the Schwinn bicycles and Daisy air rifles that, at age 11, I tried to win by flogging Wallace Brown greeting cards and tins of White Cloverine brand salve door-to-door.) Yes, these incentives are an embarrassment to an industry that wants to appear high-minded and public-spirited. Warren would like to see them disclosed.

But the junkets are a sideshow. If Warren had dug deeper into compensation practices in the annuity distribution channels, she might have discovered more complex problems. She would have learned that annuity manufacturers and distributors have a long history of cooperating in ways that minimize competition between products and channels and keep clients from seeing all their options in one place.

Academics claim, and I agree, that a combination of income annuities and investments can deliver the most efficient blend of downside protection and upside potential for many retirees. But these types of solutions, validated by countless research studies, continue to fall through the cracks between existing advisory channels—channels whose walls are made rigid by engrained (and ripe for disruption) compensation practices. Warren thinks advisors should disclose their non-cash incentives. I wish more clients could see the powerful solutions that, in the status quo, few advisors have any incentive to show them.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