

What's Up, Doc Huffman?

By Kerry Pechter Thu, Nov 1, 2018

Ohio National Life's withdrawal from the annuity business continues to rile advisors and broker-dealers who carry a lot of the insurer's rich old living benefit products on their books--and say they're being deprived of due compensation.



Gary "Doc" Huffman, the chairman and CEO of Ohio National Life, was sitting in a vast ballroom in New York's Marriott Marquis Hotel Tuesday, waiting with a thousand other life insurance executives to hear former FBI director James Comey deliver a keynote address at LIMRA's annual conference.

I approached him and asked about his firm's recent industry-rattling decision to discontinue certain compensation to distributors on its once-popular but closed ONCore Lite and other variable annuity (VA) contracts with guaranteed minimum income benefits.

I told him about the perception among advisors that Ohio National is taking fees from contract owners and not passing them through to the intermediaries. I also asked why Ohio National shut down its annuity business.

With respect to the last question, Huffman (who ceded the role of president to Chris Carlson earlier this year) told *RIJ* that Ohio National looked at rising stock market values, saw the growing risk to its book of VA business, and decided it was time to contain the risk. (Over the past six months, the company has made two offers, one still open, to buy certain contract owners out of certain contracts.) He said the company's move out of annuities wasn't sudden, but rather the culmination of a five-year plan.

That's nothing Huffman hasn't said before; the Cincinnati press reported it two months ago.

But let's consider the compensation issue, and its linkage to the larger question of possibly exaggerated living benefit guarantees.

The issuer of a deferred annuity with an income benefit knows that producers will jump on a contract that promises a great payout rate (typically beginning several years after purchase). The issuer also knows that its actuaries can pump up those promises by tweaking age-related payout percentages, rider fees, deferral periods, deferral bonuses, and expected

surrender or lapse rates. The income benefit is optional, after all, and it is assumed that not everyone who pays for the option will exercise it.

Though a notional number, the promised payout rate carries credibility. It's a *guarantee*, after all, based on the superior strength rating of the carrier. Broker-dealer reps know an under-priced annuity contract when they see one. Premiums roll in. Contract owners pay an annual one percent fee for the guarantee.

A few years down the road, if premiums and equity prices combine to increase the carrier's liability on the product, perhaps requiring more reserves, the carrier closes the contract to new sales. Later, if liabilities continue to climb, it may offer to buy back the riskiest contracts (i.e., the ones that are most valuable to the owners). It can even, apparently, find a reason to end deferred compensation.

If you've ever seen Mel Brooks' 1967 movie, "The Producers," starring the incomparable Zero Mostel and Gene Wilder, you may notice a similar conflict. All goes well only if the audience walks out at intermission.

Huffman said Ohio National has relationships only with broker-dealers (B/Ds), not advisors, and that it is still paying "service fees" to B/Ds. The service fees are paid to the B/Ds to help market the contracts; they are not related to producer trail compensation. Huffman said B/Ds might use these fees to compensate advisors or producers so that they could continue to service these contracts.

A B/D executive told me that Huffman's statement matches the executive's understanding of the situation except for the "fact that they [Ohio National] are not paying the 'service fee' on about 70% of our assets [in Ohio National VA contracts]." An independent advisor with a large book of VA business with Ohio National, for whom losing a 1% annual trail is meaningful, said the service fees to B/Ds are a fraction of the producer trail fees, and that no one's offering him either one.

Variable annuities with guaranteed lifetime income benefits are labor-intensive, the advisor told *RIJ*. Circumstances are constantly changing. Retired clients' needs for income are subject to sudden changes (such as after the death of a spouse). The value of the living benefit guarantee can fluctuate with market performance. Excess withdrawals and forbidden asset allocation changes can jeopardize the guarantees.

Moreover, the income option can be exercised only on certain dates or during certain windows of time. Advisors look to trail commissions, as opposed to one-time upfront

commissions, to compensate them for monitoring the situation over the life of the contract, which can last decades.

Disputes like this one can only worsen perceptions of the annuity industry. (See last Monday's scathing critique in the *Wall Street Journal*). Several years ago, after the financial crisis, several life insurers offered to buy back rich VA contracts. It rattled producers' faith in annuities. Such events certainly don't encourage advisors who have never sold deferred variable annuities to start recommending them to clients.

Policyholders, meanwhile, are in danger of paying advisor-related fees without getting the advice that the fees are supposed to cover. And without timely attention from their advisors, they could inadvertently violate the terms of their contracts and lose benefits that they've paid thousands of dollars in rider fees to maintain. The possibility of lawsuits, not surprisingly, has been raised.

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