life annuity specialist

Annuity Sellers to Educators Face Highwire Act Amid Regulatory Probes

By Warren S. Hersch October 5, 2020

Last October, *The Wall Street Journal* reported that New York was looking into sales practices for products in teacher retirement plans.

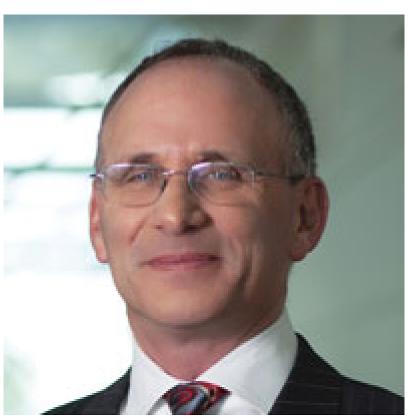
Specifically, annuities were singled out as products that were being sold heavily into the plans, despite reportedly high fees, conflicts of interest and inappropriate plan recommendations.

A year later, some penalties have been handed out as a result of similar investigations going on. Still, there don't appear to have been big shifts in the market, reflected either through depressed sales or a move away from certain products.

If insurers and advisors have revised sales practices to stay within prescribed limits, sales haven't been affected noticeably, according to **Ryan Scanlon**, an analyst with the **Secure Retirement Institute**.

"We would not be able to identify if any trends could be directly attributed to recent regulatory scrutiny," he says in an e-mail, especially since the Covid-19 pandemic is drowning out the effects.

He notes that mutual funds have experienced more growth in 403(b) plans than annuities in recent years. Even so, the slight decline in annuity contributions doesn't seem to be pronounced, according to Scanlon.



Security Benefit President **Doug Wolff** says the insurer posted strong results — a 20% rise — in sales to the 403(b) education market. He did note that the company's non-annuity platforms contributed to most of the gain.

Recent data on 403(b) plans, also known as tax-sheltered annuity plans, is sparse. The **Investment Company Institute** reports that they accounted for $1.1 trillion or 3.5% of $31.7 trillion U.S. retirement plan assets in the second quarter ended June 30.

Security Benefit President Doug Wolff

At the close of 2014, annuities still accounted for the lion's share of assets held in 403(b) plans, according to a 2016 report from **Aon Hewitt Investment Consulting**. Fixed annuities made up 43%, or $464 billion of the total. Variable annuities contributed $351 billion or 33% of assets.

The rest was held in mutual funds, which constituted $260 billion or 24% of plan assets.

Regulators on the Prowl

Last October, the *Journal* said New York's **Department of Financial Services** had begun investigating potentially deceptive and unfair sales practices respecting 403(b) plans for teachers. The regulator sent a dozen major insurers letters asking for information about their sales practices.

A key focus of the department was whether agents and employee benefit advisors were properly communicating to educators information about the costs and merits of 403(b) plan products, including annuities. The department expressed concern that teachers were being sold high-cost plans.

In January, Delaware concluded a settlement with **Horace Mann Educators** over claims that the Illinois-based insurer failed to properly supervise a representative who sold unsuitable annuities to retirement plans for teachers. Horace Mann agreed to pay a $500,000 fine and reimburse 157 educators for annuity fees they paid.

Soon after New York probe got underway, the **Securities and Exchange Commission** disclosed that it was spearheading its own investigation into 403(b) and 457(b) plan administrators. The SEC sought explanations about gifts received from companies selling investments and organizational charts illustrating ties or partnerships with 403(b) or 457(b) plan administrators.

Mark Paracer, an assistant research director at Limra

The SEC initiative bore fruit in July. An arm of **AIG**'s retirement services business, **Valic Financial Advisors**, agreed to pay $20 million for allegedly failing to disclose that its parent paid a for-profit company to promote Valic to educators in Florida.

Evolution of an Eisenhower-Era Plan

Annuities have a decades-long foothold in the 403(b) market.

When the retirement plans were first established in 1958 they had to be set up as an annuity contract. That enabled participants to annuitize their account once they reached retirement, according to **Mark Paracer**, an assistant research director at the Secure Retirement Institute.

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The plans can now be set up as annuities or as custodial accounts and invested in mutual funds, products that may or may not provide an annuity option at retirement, he notes.

Recent in-plan annuity options let participants use some of their plan assets to provide future guaranteed lifetime retirement income. These options currently exist in both in 401(k) and 403(b) plans, although adoption of annuities has been slow.

The Secure Act passed in December 2019 will help, but “it will take some time, however, to gain wider acceptance, particularly as companies have been preoccupied by Covid-19,” Paracer says in an e-mail.

Tim Walsh, a senior managing director at **TIAA**, says the insurer is seeing significant adoption of certain custom products, including the TIAA Retire Plus Pro Series. This is a managed account with an embedded annuity that behaves like a target-date fund and provides an option for lifetime income.

“This approach allows for significantly more customization for unique employee populations and automatically rebalances,” Walsh says in an e-mail.

Such customization is happening industry-wide, as is the offering of more favorable contract terms for employees, according to **Joseph Chalom**, an advisor. But he observes also a concurrent trend: a dramatic reduction in 403(b) plan providers and product choices, a decline he attributes to “increased regulation and the politics of various public employers.”

Joseph Chalom, an advisor and president of Naifa-Florida

“Annuity manufacturers have reduced contractual interest rates, lowered commissions paid to agents and introduced fixed indexed annuities with the opportunity for greater growth,” says Chalom, who is also president of the Florida chapter of the **National Association of Insurance and Financial Advisors**.

Chalom expects that annuities will remain a fixture of 403(b) plans “well into the future,” given their unique features, but cautions that sellers in the market segment are navigating something akin to a tightrope.

“The main challenge is to manufacture product that remains relevant for the client, profitable for the carrier and provides reasonable compensation to the advisor,” he says.

Weighing the Covid Factor

What's affecting the market more than the state and federal probes is Covid-19, market observers say.

Ryan Scanlon, an analyst with the Secure Retirement Institute

Virtual meetings that advisors now hold have made doing business more challenging.

"Covid-19 is creating difficulties in this market where in-person meetings are huge drivers," says Scanlon. "But the activity did not seem to decline as much as the corporate 401(k) market did in the second quarter. The third quarter may have more revealing data."

Security Benefit's Wolff says the insurer has, since the pandemic's outbreak, sought to help advisors and plan sponsors take the right steps in this "new normal." The carrier has, for example, developed content to host virtual retirement seminars and provided ideas, tips, and trends to operate in a virtual environment.