

VA surrenders jumped after Hartford bowed out

After The Hartford Financial Services Group Inc. announced that it was getting out of the variable annuity business, surrender rates for existing contracts jumped sharply — a sign that registered representatives might be churning their customers' accounts.

Even though The Hartford made it clear that it would continue to support its existing VA customers, the surrender rate increased to 20% in April after the firm said it was exiting the business, up from 14% in the first quarter.

The unusual increase in surrenders, which has happened at other carriers that have left the business, shows that some brokers use the exits as a rationale to encourage legacy VA holders either to cash out their contracts or exchange them for new annuities. Such actions imperil benefits worth hundreds of thousands of dollars more than the current value of accounts. At the same time, they benefit brokers selling new contracts, which carry commissions of as high as 7%, depending on the carrier and share class.

The recent exit of VA issuers “gives brokers the perfect opportunity to make a new sale by doing a 1035 exchange out of a ... contract and going elsewhere,” said Amy Lynch, president of FrontLine Compliance LLC.

Plaintiff's attorney Sara E. Hanley noted that she has seen many cases involving clients who have been encouraged to transfer out of a variable annuity, only to end up losing their benefits. Her firm has succeeded in winning judgments for customers.

“These brokers don't tell clients that their death benefit is worth \$250,000, but when you take this new product, it will be \$100,000,” Ms. Hanley said. “What they do say is, 'Here's this new annuity. It's from a better company and you'll be earning 5% each year.'”

Meanwhile, advisers have been reminding clients of the living and death benefits they have accrued in their old contracts, warning them about what they could lose if they decide to swap out of the annuity.

“People forget how good the annuity is; you have to remind them that they have it,” said Kevin VanDyke, president of Bloomfield Hills Financial. “I joked with a client the other day that if I get hit by a bus and they get a new adviser, make sure to never surrender

this annuity — you have a great death benefit built in.”

Considering the potential loss of living or death benefits is a requirement imposed on broker-dealers by the Financial Industry Regulatory Authority Inc.'s Rule 2330 on exchanges for variable annuities.

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Equity analysts who cover life insurers note that it's normal for surrender activity to increase when carriers decide to stop selling certain products.

“When a company gets out of the business, you see a pickup in surrenders — appropriately or not — and that looks like what's happening with Hartford,” said Andrew S. Kligerman, a managing director at UBS Securities LLC. “Whenever they exit, you get this shock lapse as soon as they announce it.”

While advisers note there may be valid reasons for changing policies and carriers after an insurer leaves the business, concerns about issues such as the possibility of a decline in customer and broker service, fewer investment choices or potential fee increases should not be the primary reasons to move to another contract.

Living and death benefits remain an insurer's contractual obligation, which the client or heirs will receive — provided the client stays put. That is especially important for owners of older VAs, as these products typically have massive benefits attached to small variable annuity accounts.

Some broker-dealers have stepped up their screening of exchanges involving contracts from carriers that have left the business.

“Compliance staff at firms that have been carrying these policies for a long time should expect to see these exchanges coming in, and need to scrutinize them carefully,” Ms. Lynch said.

Broker-dealer executives at **Commonwealth Financial Network** and at Raymond James Financial Inc. haven't seen any unusual increases in surrender activity, but Paul Tolley, chief compliance officer at Commonwealth, said that the firm has kept a close eye on Hartford contracts lately.

“Following their announcement, we started paying extra attention to Hartford 1035s,”

he said. “All transactions have been able to stand on their own merit.”

Still, financial advisers are adopting their own methods to keep clients aware of the benefits that are at stake if they decide to swap their annuity or cash out.

Tom Hamlin, founder of Somerset Wealth Strategies Inc. and a branch manager with **Raymond James Financial Services Inc.**, said his firm is considering a program in which clients with certain rich contracts receive regular reminders of their VA's attributes and benefits.

Mr. Hamlin noted that he's had clients who went to other brokers to transfer or cash out of their VAs. Insurers don't alert the broker-dealer or the adviser who originally sold the annuity that the money is about to be transferred elsewhere, so clients may not know what they are losing, and the insurer gets to offload a chunk of liabilities tied to the living and death benefits, he said.

“The insurance companies aren't protecting their existing clients, because they want to get out from underneath the exposure to living and death benefits,” Mr. Hamlin said. “There is no legitimate excuse to exchange or liquidate these annuities; nobody who is informed would do it.”

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Comments