life annuity specialist

New York Probe May Portend Shake-Up of Annuity-Heavy 403(b) Plans

By Warren S. Hersch October 7, 2019

Fixed and variable annuities have long been favored retirement savings vehicles of teachers. That could change now that New York's insurance regulator is apparently planning to investigate sales of annuities in the 403(b) retirement plan market.

The Wall Street Journal reported Oct. 2 that the **Department of Financial Services** sent letters to a dozen major insurers requesting information about their sales practices. Led by Superintendent **Linda Lacewell**, the department aims to determine whether agents are engaging in deceptive and unfair sales practices, such as failing to appropriately disclose product costs and merits.

"The industry is getting a shot across the bow," says **Stephen Wilkes**, a partner at **The Wagner Law Group.** The department's move, he adds, signals its intent to bring to the insurance sector market pressures governing mutual funds.

Anthony Domino, a New York-based advisor and past president of the **Association for Advanced Life Underwriting**, thinks that the investigation could prompt 403(b) plan participants to dump older, high-cost annuities.

"The DFS wields a pretty big stick and a lot of attention," he says. "Their efforts will perhaps encourage those who should get out of a legacy plan somewhat sooner. That's not a bad thing."

Bob Hunter, a director of insurance at the **Consumer Federation of America**, thinks the department's scrutiny is warranted, observing that many teachers have been misled into buying unsuitable and expensive products. Among them are pre-retirees who paid steep surrender charges when exchanging an older annuity for a new one that carries little additional benefit or even that pays less retirement income in the long-term, he says.

Wagner Law Group partner Stephen Wilkes

Any damping of annuity sales resulting from the department's scrutiny of 403(b) retirement plans should only affect unscrupulous distributors, according to Hunter. "Good plans should be helped by going after bad ones," he says.

Mechanics of the Plans

Also known as tax-sheltered annuity plans, 403(b) programs are available to employees of public schools, churches and other tax-exempt organizations. The arrangements are similar to employer-sponsored 401(k) plans, enabling participants to make elective deferrals via pre-tax contributions. Earnings on gains aren't taxed until distributed.

In 2019, plan participants can contribute up to $19,000 of their annual compensation to a 403(b) plan, up from $18,500 last year. Employers can contribute up to 25% of a worker's salary as a matching contribution.

In the education and non-profit arenas, a lot of the contributions are going into annuities. In 2015, variable annuity contracts accounted for 24% of investment vehicles used in large 403(b) plans that comply with the federal Employee Retirement Income Security Act of 1974, according to a 2018 study published by **BrightScope** and the **Investment Company Institute**. Just over one-fifth or 22% of retirement assets were held in fixed annuities; the balance of retirement assets, 54%, were invested in mutual funds.

These figures contrast with **Spectrem Group** data cited in a 2016 **Aon** white paper, which provides figures for all 403(b) plans, including arrangements that comply with the federal law and those that are exempt from its regulatory protections. The Aon report shows that variable annuities hold 33% of all plan assets and fixed annuities 43%. A significantly lower share of plan assets — 24% — are invested in mutual funds.

Consumer Federation's Bob Hunter

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The differing results suggest that insurers and agents may have had less success selling products under the federal law's stringent requirements.

Among other provisions, ERISA mandates that employers provide participants with information about plan features and funding, and set minimum standards for participation. The law also says that those who manage and control plan assets must adhere to a fiduciary standard.

Retirement plans not subject to ERISA law rely on state and local municipal codes that try to benchmark and regulate in a manner similar to the federal law, says Wilkes of The Wagner Law Group. But he characterizes these codes as inefficient.

Participants in these plans are potentially "more vulnerable because they don't have the overarching and uniform protections of ERISA," he says.

Annuities have historically benefited from regulations governing 403(b) retirement plans. Between 1958 and 1974, they were the only investment vehicles available in 403(b) plans. The passage of ERISA in 1974 allowed for the creation of custodial accounts permitting investment in mutual funds.

Where the DFS Is Headed

The Department of Financial Services' investigation follows other recent initiatives intended to improve consumer protection and standards governing agents and insurers.

In July 2018, the department unveiled its best interest rule for life insurance and annuity transactions, Regulation 187, which elevates the standard of care for distributing annuity and life insurance products, requiring agents and advisors to act in a consumer’s best interest when recommending a product. The state regulation began applying to sales of annuities on Aug. 1 and will cover life insurance products beginning on Feb. 1.

Strategies for Wealth advisor Anthony Domino

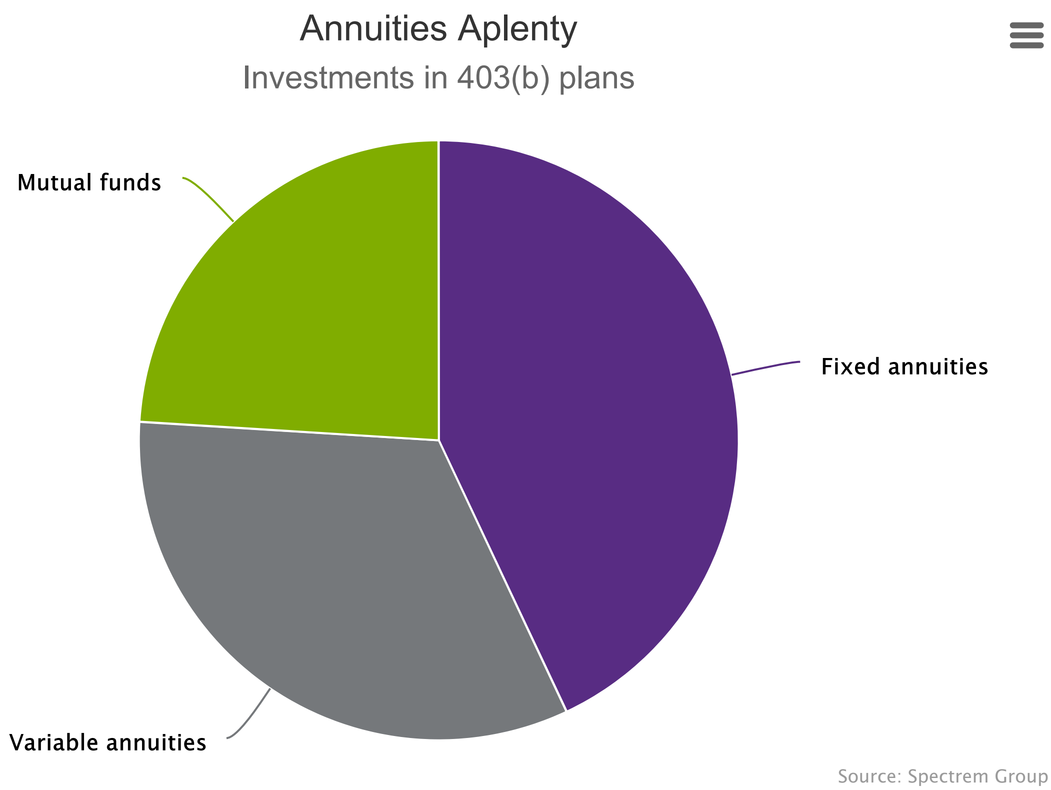
Spokespersons for New York-based **TIAA** and associations representing agents and insurers in the Empire State, including the **BIG I** and the **Life Insurance Council of New York**, were unavailable or couldn't be reached for comment on the Department of Financial Services’ reported probe of annuity sales practices. **New York Life** and the New York arm of the **National Association of Insurance and Financial Advisors** declined to comment.

A **Nationwide** spokesperson says the insurer doesn’t “publicly comment on regulatory matters such as this.” But he added that Nationwide is “fully committed to transparency and to providing expertise and multiple options for individuals as they plan for retirement.”

Hunter of the Consumer Federation of America thinks other states may follow New York’s lead in pursuing their own investigations of annuity sales practices for 403(b) plans. They may mirror the department’s actions because of the Empire State’s long-standing influence with fellow state regulators, he says.

Domino suggests that the department’s probe may result in better education of plan sponsors and participants about alternatives to guaranteed income products, and about annuities with better options. He observes many old plans are in need in review.

“This effort by the department is part of a continuum [of initiatives] to fix not-for-profit retirement plans across the board,” he says. “That’s been going on for years. Now the state is getting involved.”



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