

# **SWIPER! NO SWAPPING!**

## **JANUARY 2005**

My son Stephen is very fond of the children's program Dora the Explorer. I find the show tolerable unlike some of the other programs (*think purple dinosaur*). My favorite character on the show is a fox named Swiper. Swiper pops up from time to time on the show, sneaking up on Dora and Friends in an effort to steal something and thwart her latest quest. The only way to stop the cunning Swiper is to yell at the top of your lungs, "**Swiper, No Swiping!**" Saying it once doesn't work, you need to yell it over and over for it to be effective. After hearing it a few times Swiper gives up, snaps his paw and says, "*Oh man!*" and runs away. If it were only that simple for me to vanquish Wall Street's bad guys. Once again, we have to utilize newsletter space to cover the shady world of variable annuities.

***"Swiper, No SWAPPING!...Variable annuity swapping that is!"***

We have noticed that dubious annuity exchanges are growing at a rapid clip despite a purported regulator crackdown. Smooth talking Swiper salesmen have been on the prowl getting investors to exchange one annuity for another. Despite the efforts of Eliot Spitzer and the NASD variable annuity sales have soared over the past year, up 10% to \$126 billion. What is sickening is half of these sales are swaps.

In prior issues of the Markowski Monthly we have chronicled the dangers and pitfalls of variable annuities. This past year alone we reported on Prudential. They broke all protocol in the sales of annuities allowing swaps to be sold unchecked. Prudential also purposely showed customers erroneous sales literature regarding annuity performance. The big story this past year involved Waddell & Reed. They performed 6,700 annuity wasps with no regard to the suitability of the exchanges. The firm ordered all its brokers to swap from one annuity to another so they could increase their commissions and fees. Waddell made \$37 million in commissions and their clients paid \$10 million in surrender fees. The bottom line is that variable annuities can be a windfall in commissions for your broker with commissions in some times exceeding 10%. Variable annuities should be used in only very unique situations. It is NOT an investment vehicle for the masses.

Here is an example of swapping from a Carrie Coolidge article in [Forbes Magazine](#). According to the NASD, a Houston broker named Kevin Jones who worked for Raymond James, talked a self-employed rancher into trading in her \$300,000 Hartford variable annuity, which she had owned for six years. Jones recommended she switch to a \$315,000 ManuLife variable annuity, dangling a bonus of \$15,000 in front of her. Jones received an \$8,500 commission for making the sale. But, with the original variable annuity, the rancher had only eight months to go before being able to tap into her money penalty-free. The new account called for a new surrender charge to ManuLife Financial that lasted NINE YEARS! The swap forced the rancher to pay a \$1,600 surrender fee to Hartford Financial Services and offered no improvement in the death benefit. Swapping accomplished nothing for the rancher other than to jack up one annual fee by \$945 yearly, and another, for portfolio management by \$1,000. That \$15,000 bonus offered by ManuLife...In eight years it would be depleted entirely from fees and Hartford surrender charges.

In two cases brought to light this past month, Morgan Stanley and Merrill Lynch received secret payments and offered its brokers undisclosed incentives to sell variable annuities (big surprise). According to the [Wall Street Journal](#), the suit against Morgan Stanley was filed in the Southern District of California in San Diego in the name of William Dornan, a California resident and former Morgan Stanley client, who made similar allegations in a December complaint filed with the National Association of Securities Dealers. His attorney, Ronald Marron, said he plans to file a class action lawsuit charging Merrill Lynch with similar wrongdoing. Marron also has a complaint

pending with the NASD in which Charles Schwab is accused of wrongful variable annuity sales practices and abuse of elderly clients.

Dornan's class action alleges that at least since 1990 variable annuity underwriters and Morgan Stanley maintained "**secret contingent fee sharing arrangements**" in which a portion of commission revenue was paid to the brokerage as an incentive to sell the product. Morgan Stanley has also limited its variable annuity sales to underwriters who participated in fee-sharing deals, it adds. The suit further claims that Morgan Stanley brokers received bonuses based on sales volume (We told you so!).

Under its fee-sharing arrangements, Morgan Stanley has received 10% of first-year commissions back from underwriters as contained in an override addendum on variable annuity policies, according to information Marron says he received from Morgan Stanley during the discovery process for Dornan's NASD complaint. That is in addition to half the 7% first-year commission on such policies, he said. Morgan Stanley brokers further received volume bonuses entitling them to up to 15% of first-year commissions for booking over \$100,000 in "eligible production" on variable life insurance products, Marron said. The attorney further charges that the prospectuses Morgan Stanley provided clients included "**misrepresentations and omissions**" of its financial interests.

There is a whole world of problems with the variable annuity business today. The **Swipers** on Wall Street are taking full advantage of playing on investors fears in selling these high commission products. We have encountered entire brokerage firms which lure elderly citizens in with high CD rates and they end up leaving with an annuity that is unsuitable for their needs. If you own a variable annuity or have been approached to buy one, or even worse swap into another one, please do not hesitate to give us a call, a second opinion is a good idea when dealing with these products.

**SWIPER**



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