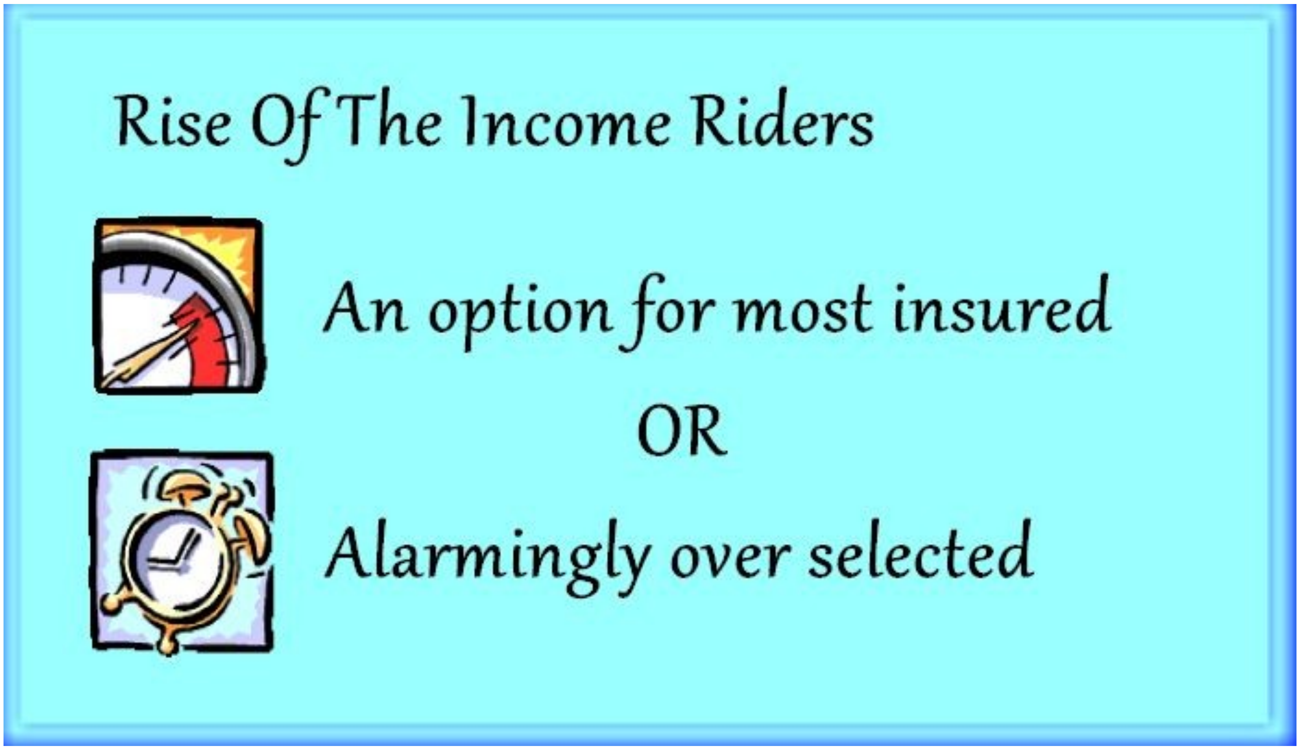

By: Jeff Affronti—April 29,2015

Rise Of The Lifetime Income Rider Paying Fees For FIA Guarantees

A Quick History

20 years ago indexed annuities came on the scene and quickly became an agent and client favorite. A chance for higher yields than regular fixed rates with no downside risk to premium. Driven by the high caps of the time and larger commissions than traditional deferred annuities sales boomed and accounts grew. Simple crediting methods with few moving parts made the indexed annuity a reasonably easy learning curve for most agents even if they did not use annuities often. The insurance companies marketed the indexed products by touting the cap rates, minimum guarantees and how the accumulation value may grow over the term. An accumulation value that once credited would not retreat. The right product at the right time with some very nice double digit returns periods that were locked in and guaranteed.

This became especially clear after the stock market correction in 2001.

Clients in "investments" lost money based on the ultimate risk they bore. The "insured" owners of indexed annuities didn't get hurt when the market tanked and in fact, in most crediting methods, actually kept all the gain accumulated in previous years. Fixed annuities sales increased and sales of variable annuities and mutual funds slowed as representatives started selling indexed annuities. The clients were looking for safety and the investment representatives found the index annuity a nice bridge for their clients.

A Switch And Then Enter Rule 151A

Since many of the representatives did not normally sell fixed products there was a loss in revenue to their registered up-lines. The up-lines were not taking a “haircut” on their representatives fixed annuity business (because it wasn't a security product needing supervision). This caused a loss of AUMs and trail commissions, through management fees and loads. Rule 151A wanted to make indexed annuities securities, not insurance products. The independent life insurance agents who marketed and sold indexed annuities would be required to have a securities license. The expenses and additional regulations would have basically blocked many independent life agencies from offering indexed annuities as they have. Rule 151A was vacated by the court. Still many registered reps. were additionally burdened by being forced to drop the independent GA channel and go under their registered up-lines for this fixed annuity. The main complaint that follow by the representatives forced to move was a lack of experienced help. The underlining issue that allowed 151A to exist was a lack of understanding/ explanation and the products were just sold incorrectly.

How Did The Mainstream Indexed Annuity Industry Respond

Changing the name from Equity Indexed Annuities (EIA) to Fixed Indexed Annuities (FIA) and then making them look more like an equity products then ever With the rise of the fee based income rider. **Fees in fixed annuities!** Who could have asked for this?

The FIA marketing is now all about the income riders. Roll-up rates, bonuses and the allure of lifetime income all in bright flashing lights. Little to no mention of the minimum guarantees and annuitization rates which are the strongest guarantees in a fixed annuity contract. These minimum guarantees need to be detailed to the client especially with all the "**8% annuity return**" type of flash ads seen on financial pages on the web. Roll ups have been presented and sold as guaranteed rates for some time and death benefits misstated. THIS IS SERIOUS! A suitability issue as far as I can see and it really needed to be spelled out to client in dollars when they started the contracts. Income rider sales should not be anywhere near as simple as a immediate annuity (SPIA) or Multi-Year Guarantee Annuity (MYGA) presentation. Income riders and how they interact with actual premium and accumulation values is not easy to get off the bat. Terminology and the multiply applications for the word "guaranteed" can get confusing for the most experience fixed annuity provider. These should be hours long conversations, no less.

Are We Are Headed Down The Same Path

Will there be a new push to regulate FIA's? By not spelling out the true minimum guarantees and focusing on commission, bonuses and assumed future values or roll up "two tier type" values is what will get an agent in trouble today. Since the indexed annuity already has a black eye these minefields could open the door for additional regulation.

The higher/longer surrender charges of FIA's is what the negative press has been focused on in the past. Recent FIA designs are much more confusing and that is troubling. The roll-up rate and payout percentages are expressed as guaranteed. To a client it could easily seem like a 7% roll-up guaranteed for 10 years is a true walk away cash accumulation value of 196.72% of premium. The client may not understand to get that 196.72% in their pocket even at a 5% lifetime payout rate would take 30 years after issue. Cut that to a 4% rate and now that client just waited 35 years. So, is the money really almost doubling in 10 years for this client or is it really taking 30 or more years? To a client who expected to walk away with the roll-up rate as a yield/gain it will be a tough reality to actually get from 0% to 40% of what they were expecting as a lump sum.

In an FIA with a rider the fees are taken from the actual cash accumulation value of the owner. Those are REAL dollars that the insurance company is taking today weather or not the client gets a chance to use the lifetime income down the road.

What is that income going to be worth and how much is given up? In the end a client with $1,000,000 may give up more than $90,000 in fees just to take the cash accumulation value in 10 years to buy a SPIA for more income than the rider would have kicked off.

Comparisons Using Math & The Guarantees

A male age 55 who put $100,000 premium in an income rider with 7% roll-up rate.
Here are the payouts at age 65 with a roll up value of $196,715

- Income at 5% = $819.65 per month
- Income at 4% = **$655.71 per month**

That same male with a $100,000 in a MYGA at 3.40% for 10 years wold grow to a $139,702. Using current SPIA rates the income to the now 65 year old male would be **$664.83 per month** for life with 20 year certain.

So that $196,715 for argument purposes is only really worth $139,702 if the payout factor is 4%. For the 5% payout a SPIA today would only need about $160,000.

Best Client For An FIA Rider

The client who says "I want $2,000 per month in 10 years, how much do I need now to guarantee that?" The rider is perfect for this client because at the end of the 10 year term the client will get his $2,000 per month from his rider but can also shop the SPIA pricing at that time for even better.

Closing

The states have and, as of now, continue to regulate insurance products and the actions of producers.The states have also approved these products for sale without maybe fully understand how fixed annuity products **should** look.

Understanding that since fixed annuities are insurance contracts the majority of any risk should be placed on the insurance carrier not the insured. The big winner I feel will be the insurance carrier in the end. They are taking fees for guarantees they always really offered while placing more risk on the insured.

My biggest problem with income riders are the fees. The accumulation value can go backwards and that is not why we sell fixed annuities. I am pleading with the insurance industry to keep fees out of MYGAs and SPIAs. Those products are easy and help people so let's leave them alone please.

The idea is to not outlive your money.
Maximizing it at the same time does not hurt. We do the math.