ANNUITY INTELLIGENCE
BRIEF
Fall 2009
Volume 1, Issue 3

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The Facts About Fee Increases

Know The Impact on The Account Balance

Insurance carriers are making adjustments to their variable annuity products in response to the current economic situation. ASC has processed hundreds of contract changes over the past six months. Part of this re-trenchment by carriers includes increases in rider fee percentages. It's important to understand this area. Here is an example of how fee increases work.

Basics: Rider fee rates are charged against either the account value or the benefit base. A hike is defined as an increase in the percentage rate the carrier charges against this account value or benefit base.

Let's assume the carrier charges fee percentages against the benefit base. Also, assume the company has a provision to raise the fees if a step-up is elected. Here are two common scenarios:

Scenario 1: A 6% step-up occurs. The fee amount goes up, since the benefit base used in the calculation just increased by 6%.

Scenario 2: A 6% step-up occurs, AND the insurance company raises the fee percentage. The increased fee percentage is charged against the benefit base (which also just went up).

	Initial Case	Scenario 1 Normal Step Up	Scenario 2 Increased Rate
Benefit base	$100,000	$112,000	$112,000
Annual benefit fee percentage	0.75%	0.75%	0.85%
Annual amount collected	$750	$840	$952
Guaranteed annual withdrawal amount	$5,000	$5,600	$5,600

Under normal circumstances, fees paid can go up when a step-up to the benefit base occurs. That's what has happens in Scenario 1. The percentage rate stays the same, but the fee amount increases because the benefit base increased. On the plus side, the guaranteed benefit amount increases as well, so the investor gets a pay raise each year. This represents an increased fee for increased value, just like when a mutual fund goes up in value (a 1% annual fee yields a higher dollar amount in fees).

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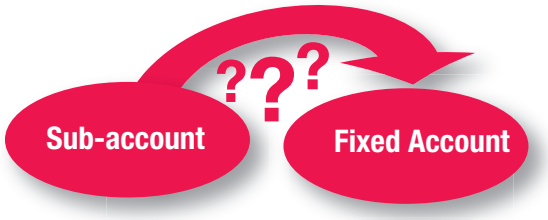
The Facts About Fee Increases (continued)

In Scenario 2, the step-up occurs AND the fee percentage increases, pushing the fee paid higher than what it normally would have been. The same justification can be made that the client is paying more and they are guaranteed more, so long as the fee percentage is not increased too much.

Be sure you understand how the VA contracts you work with handle these fee increases. Note that sometimes the insurance company does not have a provision to raise the fees if a step-up is elected. Also, some benefits charge the fee on the benefit base reduced by each withdrawal amount, so the carrier gets paid less each year.

Money In Motion Inside A Variable Annuity



Understanding How Carriers Shift Funds From Sub-accounts

Variable annuities are an investment product as well as a guaranteed contract. Insurers need to balance both sides of this equation to successfully manage their exposure. One way carriers do this is by moving VA subaccount money into the general account to reduce exposure.

This is important to understand, because once money is moved to the general account, the contract owner is subject to the bankruptcy risk of the carrier. In the current environment, your clients may need to be aware of this.

Moving money to the general account applies when a living benefit is involved. Once the insurer decides to move a client's money out of the separate account, the carrier triggers a calculation based on a pre-determined formula. Here is how three carriers currently handle this situation:

> Allianz: Terms of one of its GMAB riders states that the company has the right to transfer money to support this benefit. Allocation of the funds varies based on the time remaining before the next date that the guarantee becomes effective and the relationship between the guaranteed value and current account value.
>
> Jackson National: On one of its lifetime GMWB offerings (LifeGuard Select), JNL reserves the right to transfer funds, using a non-discretionary formula, to a GMWB fixed account.
>
> Prudential: Also moves money in one of its lifetime GMWB riders, but to a bond separate account. The company has the right to support their benefit based on their formula, which states that no more than 90% will be allocated to the bond subaccount. So in this case investment expectations are affected, but there is no increase in bankruptcy risk.

In all cases, once money is moved over, it can theoretically be moved back. But in many cases, the way the formulas work make it unlikely.

When no living benefit is attached to a VA contract, the investor can choose to have dollars placed in a general account. But beware: not only does this asset allocation subject the owner to bankruptcy risk, it can often be a red flag to compliance, since the VA positioned in a general account makes the investment ultra-conservative, much like a fixed annuity.

Keep in mind that fixed annuities and fixed indexed annuities always hold funds in the general account. These annuity assets are not separate, so the contract owner is more dependent on "the claims-paying ability of the insurance company."

It's in everyone's best interest that the insurance companies get the balance right between offering guarantees and maximizing investment gains. Nevertheless, money in motion inside a VA contract can cause work for advisors.

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Money In Motion Inside A Variable Annuity (continued)

Advisor Tips: Here are the questions to ask to understand how the contracts you work with move money into the general account:

- When a living benefit is attached to this contract, what right does the insurance company have to move money into the general account? Does the money that is moved end up in a general account or a separate account?
- When a living benefit is not involved, what right does the carrier have to move money into the general account?

For readers who have access to the Annuity Intelligence Report, you can research this issue by referring to the benefits page. Simply locate to the section entitled "Investment Restrictions" which covers this issue for all variable annuity products in the database.

Most Lifetime GMWBs are RMD friendly. Most GMIBs are not.

What's normal when it comes to RMD treatment inside a qualified account?

What happens when a client is required to take out more than the guaranteed amount?
The IRS has suspended the Required Minimum Distribution (RMD) for 2009. This is good news for those age 70 1/2 or older, who will not be required to take out (and pay tax on) RMD distributions from their qualified accounts like an IRA or 401k.

One question that often comes up with advisors who sell variable annuities is how these RMDs are handled with variable annuities held in a qualified account like an IRA. (Note that all variable annuities allow for surrender-free withdrawals that usually don't conflict with an RMD.) When a guaranteed income or withdrawal benefit is attached to a contract, an RMD can sometimes conflict with the rider. For example, the IRS may require, based on their distribution tables, a client to withdraw $5,500 out of a $100,000 IRA account investment held in a variable annuity. But the benefit may only allow for a withdrawal up to $5,000. Anything above that and the client may be negatively affected in the future. So what is an advisor to do?
Insurers handle the problem two ways:

#1: Withdrawal Reduces Benefit: The excess withdrawal reduces the benefit base and negatively affects the future withdrawal amount. The client receives a guaranteed amount that is reduced in future years based on their formula. The client is penalized. This is the case with 95% of GMIB benefits and a small handful (5%) of Lifetime GMWBs.
#2: Product is RMD Friendly: Luckily, some insurers account for this problem. These carriers treat the excess withdrawal as a normal withdrawal and the guaranteed amount stays the same. In other words, these products are "RMD friendly." About 95% of Lifetime GMWBs and about 5% of GMIBs are RMD friendly.

Tips For Advisors:

- Before the RMD rule kicks back in during 2010, be sure you know how excess Required Minimum Distributions are handled with the VA contracts you use on a regular basis.
- In general, older clients are most at risk for having an RMD conflict with a guaranteed living benefit. Age 78 is when RMD withdrawals often push a client close to the 5% withdrawal cap. Review your accounts for older clients to be sure their RMDs don't conflict with living benefit rider provisions.
- Often it does not make sense to attach a GMAB rider to a VA inside a qualified account. If the GMAB waiting period (usually 10 years) is still in effect when the client turns age 70 1/2, an RMD will terminate this benefit, and the client will have paid for a benefit they did not get.

*Note we are not considering cases where the RMD is calculated against the actuarial value of the contract because of a large benefit base.

How Many VA Riders Are "RMD Friendly"?

Lifetime GMWBs	95%
GMIBs	5%

Generally, Lifetime GMWBs are "RMD-friendly," meaning if an RMD exceeds the guaranteed withdrawal amount, the distribution will not "blow up" the benefit, so long as the contract owner follows certain guidelines and carrier policies.

For Clients Only: How To Leverage Your Investment in The Annuity Intelligence Report

Feedback from Users To Help You Maximize Your Value

We asked. You answered. Here is what our broker/dealer clients had to say about how the Annuity Intelligence Report is helping them save time, enhance suitability, and increase sales. We've compiled these tips and sorted them by function so clients can implement them immediately:

Use the AI Report to Save Time and Be More Efficient

Until our sales team joined forces with Advanced Sales Corporation, we maintained a variable annuity search engine in house. It was taking our marketing and technology team over 100 man hours a month to keep pace with getting all of the "correct" information updated and added to the system, not to mention the lag time on getting product changes added to the system. Adding ASC's technology and daily updates has lifted a HUGE burden off our team.
Wes Riemondi
Annuity Sales Manager
NFP Securities

Advisors many times print off the product and rider specs and submit it along with the application kit to their manager for review.
Diana Giraldo
Bank of America

We are no longer dependent on the carriers to provide us with product profiles. AI Report provides timely updates (typically on launch date) and accurate product information. We like having access to older contract information. It saves a call(s) to the carriers' sales desks.
Vicky Stadick
First Vice President - Senior Annuity Specialist/
Partner Relationship Manager
Robert W. Baird & Co. Incorporated

Streamline Compliance and Improve Suitability

It has helped our compliance department be much more efficient in finding information. It has saved us time and made the process of evaluating VA's much easier.
Melinda Wolfe
Senior Compliance Officer
Kovack Securities, Inc.

Our advisors when they use the tool now have the ability to show their clients the process they went through to determine how and why they have selected a certain product. In compliance, our OSJ's and sales supervisors have embraced the tool. It is very helpful for them when working on 1035 cases, new business, suitability, transfers, replacements, etc. Access to the tool by our sales supervisors has cut down on the time they were spending on the phone with carriers trying to track down information, getting answers, etc. Having accurate, reliable information is very beneficial for this group.
Wes Riemondi
Annuity Sales Manager
NFP Securities

For compliance, [the AI Report] helps those who conduct suitability reviews. Our supervisors use the tool when conducting suitability reviews of sales. It has sped up the review process. It helps fulfill our regulatory training requirement under 2821.
Diana Giraldo
Bank of America

Support Your Advisors With Industry Leading Tools

Financial advisors like having three products profiled on one spreadsheet rather than shuffling between carriers sales materials. They will have an easier time reviewing the annuity with their client at future meetings since we recommend that our FAs keep an AI Report of the annuity their clients purchased in the client's file. Features and benefits will be easier to review and will help to assure clients that their decision to purchase the annuity was sound.
Vicky Stadick
First Vice President - Senior Annuity Specialist/
Partner Relationship Manager
Robert W. Baird & Co. Incorporated

It allows the advisor to print out a copy of the report—give one to the client, keep a copy for their own records, put it in the file and then it acts as a reminder of what they sold and why when the client comes in for a review. When talking to advisors and staff, one of the things we hear is that staff people love the tool because of how much it helps when filling out paperwork.

On the Business Development Desk, our internal team uses the [AI] tool when working with reps on anything from simple contract questions to complex case design work. For education, we will incorporate the tool when we are walking our advisors through our education platform.
Wes Riemondi
Annuity Sales Manager
NFP Securities

Beware of Excess Withdrawals

Taking Out More Than the Guaranteed Percent Could Impact Clients for Years

It's extremely important to understand the impact of withdrawals on a living benefit attached to an annuity contract. The most widely used living benefit today is the Lifetime GMWB. These usually allow you to make withdrawals from your account up to an annual limit. These withdrawals are usually limited annually to 4-6% of your investment. Be aware that if you withdraw more than that percentage, future payments may be reduced. Sometimes, an excess withdrawal triggers a reset of the base on which your guaranteed amount is calculated.

Example: You purchase an annuity for $100,000 that allows you a guaranteed 5% annual withdrawal until you start receiving your monthly payments for life. You may withdraw $5,000 yearly. If you take out more than $5,000, your annual guaranteed withdrawal amount may decrease, and you won't be able to take out as much the following year. Let's say you do take out an excess withdrawal of $5,500. That excess withdrawal triggers a reset of your benefit base to equal your current account value. If the current value of your investment sub-accounts is, say, $80,000, you now get 5% of $80,000. That gives you only $4,000 annually as an allowable withdrawal.

For contracts where the benefit base does not reset, an excess withdrawal will generally reduce the benefit base either proportionately, or the greater of dollar-for-dollar or proportionately.

Note that when the excess withdrawal is due to a Required Minimum Distribution, sometimes the insurer makes an exception and does not reset the benefit base to account value. [See related article.]

According to an analysis of our database, about 25% of Lifetime GMWB riders reset the benefit base to the account value upon an excess withdrawal. When the investment sub-account values are down, that means you get less next year.

Tips for Advisors:

- Be sure you understand the impact of an excess withdrawal on a client's future income payment. About 25% of Lifetime GMWBs reset the benefit base to the account value, which reduces future payments and hurts your clients when the market is down.

We're on the Web!
Visit us at:
www.advsales.com

About Advanced Sales Corporation

The experts at ASC help financial services firms enhance profits and build relationships. We deliver strategy, sales training, and two proprietary programs: Strategic Business Planning and Territory Management, and the Annuity Intelligence Report.

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... ahead of the curve

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