

Guaranteed Living Benefits or Guaranteed Lawsuits?

By Mark Triplett, Regional Vice President – AMZ Financial Insurance Services LLC

The tidal wave of lifetime income riders introduced to the Fixed Indexed Annuity marketplace should overwhelm even the most seasoned insurance professional. With carriers introducing or working on their latest generation of lifetime income riders, it's no wonder producers are drowning in information and to some extent misinformation. Today's producers need to understand when these riders are beneficial, and when they simply waste your client's money. When used appropriately, living benefit riders offer great value to consumers. However, it is only suitable for a niche market, and unfortunately these beneficial product enhancements are being misinterpreted and therefore misused by agents. After all, their clients will be on the losing end. Our industry does not need another black eye.

Let's Break Down These Riders

A variety of living benefit riders exist in the market today. Most of these optional riders provide additional benefits at an additional cost. With regard to Fixed Index Annuities all of the basic contractual obligations of the chosen product remain intact. The account value (premium + any applicable bonus + interest earned), death benefit, accumulation of real interest, minimum guarantees, and penalty-free withdrawals are all benefits that the client owns when he purchases the "product."

However, the addition of an income rider creates additional benefits that a client may enjoy while he or she is "living." With the "Guaranteed Lifetime Withdrawal Benefit" riders, a secondary value used for the calculation of lifetime withdrawal benefits is created at the issue of the contract. This value (income account value) is used to determine the maximum lifetime withdrawal amount. By applying the age-based "lifetime withdrawal percentage" to the lifetime income account value you can determine the withdrawal payment for the client's lifetime. The key word in all of these discussions with your clients is "**lifetime**."

The income account value — in most situations — receives a specific percentage of growth every year even if the index crediting strategies yield nothing. The guaranteed "rollup" percentage may vary from company to company, and some reach as high as 8%. This growth assures that the income account value will experience positive and rapid growth —assuming the client isn't taking income. If you include a bonus on the paid premium, you now have an income account value growing every year at a rapid pace.

The Benefits are Great, So What's the Catch?

Almost every rider costs something, and this additional expense is deducted from the account value (in most cases it is not deducted from the income account value – pushing that value even higher). It seems like a small price to pay for the benefit received; however there are three pitfalls when considering a lifetime income benefit rider. First, the income account value may not be accessed in a lump sum. Second, a penalty-free withdrawal may adversely impact the income rider and future income payments. And most importantly, the client may never live long enough (or stay in the contract long enough) to see the benefit of the rider.

No Lump Sum Access

While we all know how quickly the "income" value grows, most of these riders also allow the income value to "step up" to meet the account value. This usually happens when the actual index interest credits exceeds the income value. Have you ever considered what annual caps rates, index margins, and/or participation rates would need to be on an index annuity in order to give the product the opportunity to keep pace with an 8% compounded growth over the long term? I'll give you a hint, 6%, 7%, even 8% annual point to point caps won't cut the mustard! You would actually need an annual point to point cap rate of approximately 15% to achieve this. Year after year there will be a growing disparity between the modest account value growth and the awe-inspiring income value growth.

So, since there will be a great disparity between lump sum access, and what can be withdrawn over time, the client is less likely to terminate the contract because he will have to give up the much larger income value. Because of this disparity, and the fact that the client can't access the income account in a lump-sum, all products with an income benefit — if you really look at how the rider actually works — could be considered "two-tiered" products. Scary.

No Penalty-free Withdrawals

The second pitfall involves the penalty free withdrawal provisions, and excess withdrawal stipulations of the income benefit riders. Usually a product allows for penalty free withdrawals of 10 percent. The client has the **right** to access this withdrawal, but doing so may adversely impact the income rider. Income riders reward the client for delaying withdrawals. Often times, the first withdrawal, no matter how small, will stop future income value growth and trigger the lifetime withdrawal percentage. This is true even if the client does not intend on taking another withdrawal for years. Some carriers have remedied this by allowing the client to elect when the lifetime withdrawals begin, but taking any penalty free withdrawal often times dramatically and significantly reduces future income. Very scary.

Client Life Expectancy

Stated so eloquently by one of my colleagues, **“If the words *FOR LIFE* do not spill out of your client’s mouth when answering the question ‘How long do expect to hold this contract?’ you should not be selling it!”** If you are unsure if an income rider should even be considered an appropriate fit for you customer you need to ask yourself that exact question. If you answer “for life” then you proceed with caution. Why? In order for the client to truly benefit from an income rider, he needs to have a really long life and consume this money over that time horizon. Because as all of these riders are structured, the client is actually just having their account value and earnings paid back to them over a very long time. Only once the actual account value is completely depleted does the client even receive any benefit from the insurance company. Once the account value vanishes so does the hope of passing anything on to beneficiaries. Frightening.

What Else Should be Considered?

So you determine the client wants **income** for the rest of their life, but you still need to know the client’s objectives before you submit an application with an income rider attached. You may want to consider how long the client can defer withdrawals, at what age he or she expects to begin withdrawals, and will the client have a long enough life expectancy to reasonably assume he or she will benefit from the rider’s features.

How long the client can defer withdrawals.

The longer the client can defer withdrawals, the more the income account value will grow, and therefore a higher annual withdrawal for life. Because a younger client should wait longer for income, these riders may look more attractive.

For example, a 40 year old with \$100,000 of qualified money and a 25 year time horizon (retiring at age 65) will have a very health income account value. A 60 year old with \$100,000 of qualified money and a 5 year time horizon will have a much smaller account value and will need to hold the contract longer to see real value of the rider.

Age	Years of Deferral	Guaranteed Income Value at Retirement	Guaranteed Annual Income at Retirement
40	25	\$685,000	\$37,675.00
60	5	\$146,932	\$8,081.00

Both clients will have the same lifetime withdrawal percentage of 5.5% when they begin withdrawals at age 65, but the younger client will have a much great annual lifetime withdrawal payment relative to the amount of money they placed in the product. For the client that purchased the product at age 40, by age 68 they will have received back all of the initial premium they placed in the product, and probably in a few short years after that they will have consumed most if not all of the account’s earnings, and should see great value from the inclusion of the rider. For the older client, it will take 12 years just to get back their initial premium, and a few years after that they should have consumed all their earnings. Is it more likely that a person age 65 will live to age 70 or age 80? Sure people are living longer, but odds are that more 65 year olds will live to 70 than 80.

What age does your client expects to begin withdrawals.

What age your client begins taking withdrawals is another important consideration. A client age 65 has a much longer life expectancy than a client age 75. Statistically the 65 year old will make withdrawals for a longer period of time than the 75 year old. The longer your client consumes annual withdrawals, the greater the benefit to the client. Remember, the client is consuming his or her own money until the account value is exhausted. Then and only then is the client withdrawing the “**benefit**” from this income rider.

In order to determine if the client will benefit from a rider you need to do some simple math:

1. Determine the client's minimum deferral period and the guaranteed value of the income account value at the end of the deferral period. With the positioning of these riders we want the absolute highest minimum guaranteed values, not some hypothetical – maybe-if-the-stars-align number.
2. Determine the age at which withdrawals are desired, and therefore the lifetime percentage. This will tell you how much your client can withdrawal per year guaranteed.
3. Finally, determine what percentage, in relation to the original deposit, the annual withdrawal will be. If the customer has enough time to consume their original deposit and thereafter consume the insurer's money you may have a need for the rider. If the client's life expectancy is less than the number of years it will take to consume the entire original deposit you are wasting the client's time and money on a living benefit rider.

Alternatives to a living benefit rider

If the client will not be holding the account for life, has a short deferral period before withdrawals will begin, is in poor health, or is too old to benefit from the rider's features then you should consider alternative solutions.

A simple bucket or laddering strategy might be a better alternative for your older clients and clients with major health concerns. By creating systematic streams of income using single premium annuities (period certain 5-10 years) and deferred money (ex. fixed or index annuities) you can formulate an income stream that will often be superior to that of an income benefit rider, and potentially leave more money to heirs.

In addition, a lifetime immediate annuity with an option to commute the remaining balance and a cash refund death benefit will provide a higher income payout than an index annuity with a living benefit rider. It will also offer similar liquidity that is enjoyed with an index annuity combined with a living benefit rider. Try it for yourself, or contact me for some comparative proposals.

A Slippery Marketing Slope....

The love affair with these riders has been fueled by pitches from marketing companies and insurance carriers. There is a competitive advantage to telling a prospect that your product can double their money and provide lifetime income in less than 10 years, or that they will receive a guaranteed growth of 6%, 7%, or 8% each year they do not take withdrawals.

However, explaining the guaranteed roll up feature on an income rider as a guaranteed return, or those who explain the bonuses offered on the income account value as real interest earned are walking a very slippery slope. These “features” are only enhancements to the income value and will only be enjoyed if the customers takes withdrawals for life, **then** lives long enough to exhaust his own money therefore living of the insurer's money thereafter.

For me, it's refreshing to work for a company that delivers the unvarnished truth. We strive to provide clear understanding, and while you may not always like what you hear, you will hear the truth. If you would like a second opinion on this topic from a respected resource in the index products arena, please visit www.indexannuity.org. Jack Marrion has dedicated most of his July issue of his Index Compendium to the open discussion of Guaranteed Living Withdrawal Benefits. What do you want to hear, the marketing fluff or the unvarnished truth? Which one do you think clients want to hear?