CALIFORNIA BROKER

Determine Suitability, Then Sell – How Brokers Can Take Annuity Products from Commodity to Specialty

by Mark MacGillivray

In 2010, the National Association of Insurance Commissioners (NAIC) adopted the updated Suitability in Annuity Transactions, Model 275. What followed were immediate and visible changes to the annuities marketplace – changes that require many annuity brokers to participate in specific training on product features and take continuing education credits or even adopt a new sales approach.

Nearly 30 states have adopted all or most of the NAICs new model regulation, which has added specific elements to the suitability requirements. The enhanced suitability rules have further emphasized the shift of annuity brokers from taking orders to being more involved in analyzing their client's finances to better meet their needs.

Part of deviating from that commodity-based sales approach is analyzing the 12 suitability areas. This process allows a broker to gain important background information on the customer and assess suitability.

Evaluating suitability, 12 points at a time

As outlined in the NAIC model, a broker would perform a suitability analysis and collect information on 12 suitability areas:

1. Annual income: What does the customer's financial situation look like from a monthly and annual perspective?

2. Age: Is the customer close to retiring or just starting to prepare for it? Age and stage of life matter and dictate which annuity product is the best fit.

3. Financial experience: A person with no financial experience almost always needs more help understanding the basics of investing.

4. Financial status: How much total debt does the customer have?

5. Intended use of the annuity: Each individual purchases an annuity for a different reason, with a different financial objective.

6. Financial objectives: Each individual is looking to achieve a different financial objective. For instance, ask if the customer is looking for a steady stream of income, long-term growth, or safety of principal and income.

7. Existing assets: Know which assets of a customer's will be important in case they need to be transferred.

8. Financial time horizon: When does the customer want to accomplish their investment objective?

9. Liquidity needs: Can the customer convert their investments to cash without a substantial loss of principal?

10. Liquid net worth: Does the customer have enough liquid assets available after purchasing an annuity to cover both short- and long-term expenses?

11. Risk tolerance: Is the customer's risk tolerance conservative, moderately conservative or aggressive? How much risk is the customer willing to take?

12. Tax status: Which status has the customer chosen when filing taxes?

Brokers collect the results from the suitability analysis and use those results as a reasonable basis to believe that the following points are true. Reason and results also inform and help in determining suitability. The consumer has been reasonably informed of the various features of the annuity, such as the following:

• Surrender charge period and amounts

• Potential tax penalties associated with a sale, exchange, surrender or annuitization of the annuity

• Expenses and investment advisory fees

• Features of and potential charges for riders

• Limitations on interest returns

• Insurance and investment components

• Market risk

• The consumer would benefit from the annuity's features.

The annuity, as a whole, including any riders or product enhancements, is suitable for the consumer based on their suitability information. In the case of an exchange or replacement, the transaction, as a whole, is suitable.

An exchange or replacement (if applicable) is suitable taking into consideration the following, among other factors:

• Whether the consumer will incur a surrender charge or be subject to a new surrender period.

• Whether the consumer will lose existing contractual benefits.

• Whether the consumer will be subject to increased fees, investment advisory fees, or charges for riders and product enhancements.

• Whether the consumer will benefit from product enhancements and improvements.

• Whether the consumer has transacted another annuity exchange or replacement, and in particular, has had one within the preceding 36 months.

Now that brokers have the suitability process down, it is important to better understand each of the suitability areas. This article will dig deeper into these three areas:

1. Financial experience

2. Age

3. Liquid net worth

Determining a consumer’s financial experience sets the stage for the entire annuity planning process. If a consumer requires additional background and insight to make the right decision, a broker will know it up front. Additionally, the consumer’s age plays a key role in determining which type of annuity is most appropriate. Lastly, understanding the customer’s liquid net worth will provide a valuable understanding of a consumers entire financial picture.

Understanding The Customers Financial Background

Before any recommendations are given, one of the first pieces of information a broker must gather is the consumer’s financial experience. Financial experience is the knowledge that the consumer brings to the table to help determine, along with the broker, how specific financial instruments fit into an overall financial plan.

Clients with financial experience generally have a better understanding of investment basics. Those with less financial experience must rely more on the expertise of the broker and may need to take more time going over fundamental elements of annuities and financial planning.

Understanding the customer’s financial experience helps the broker know how much detail the customer will need in order to make an informed decision.

It will also identify the educational needs of the customer in order to make that informed decision.

A broker must also do their best to ensure that a customer makes an educated, informed decision. To do so, brokers must assess the financial experience of each customer and adjust their approach to making recommendations accordingly.

Applying Age and Stage Of Life

A customer's age and stage of life can greatly affect the annuity product that a broker recommends. In many ways, a customer's age contributes to their financial objectives and what they want and need from an annuity.

For example, individuals at retirement age generally have a lower risk tolerance. Often, these clients don't want their savings exposed to potential market value fluctuations. At this age, clients highly value the concept of a guaranteed income for life and often look for products that offer minimum guarantees. In addition, consumers in this age bracket often need access to funds for various living expenses.

A single premium immediate annuity is often a good option for those in this stage of life. An immediate annuity guarantees payments, which start right away, for a specified time period or for a lifetime. This type of annuity is generally used as a way to generate periodic income payments. It is often used to convert accumulated savings into an income stream during retirement. Guaranteed income is important because many retirees will rely on their savings during working years to last a lifetime.

Another option for retirees is a fixed deferred annuity. Fixed deferred annuities offer tax-deferred growth in addition to principal guarantees and surrender-charge-free access to funds when qualifying events occur, such as a terminal condition or nursing home confinement. Numerous fixed deferred annuities meet these criteria. One thing to keep in mind is that the surrender charge period should not exceed the persons life expectancy.

Younger clients, who are still within their working years, are typically focused on making sure that they have sufficient funds when it is time to retire. To optimize their retirement savings, those in this age group should take advantage of certain tax-deferred investment vehicles, such as their employers 401(k), especially when they are getting free money in the form of an employer match. Once these investments are made and excess savings are still available, a fixed deferred annuity can be a viable offering because it combines safety with tax-deferred growth. A fixed deferred annuity is used primarily as a vehicle for accumulating savings and eventually distributing the value either as a payment stream or as a one-time, lump-sum payment.

Consider Liquid Assets

Brokers, not to mention state regulatory agencies, have an increased focus on client's liquid net worth. Brokers must carry out due diligence to ensure a customer has enough liquid assets available after purchasing an annuity to cover long-term and short-term expenses. It is essential to learn if a customer has enough liquid funds to cover costs like daily living expenses or mortgage payments, as well as any money that might be needed for emergencies. Clients should not put all their liquid assets into an annuity.

State regulatory agencies are very interested in ensuring that a customer's percentage of liquid assets used to purchase an annuity will still leave the consumer with sufficient liquid funds to handle unforeseen financial circumstances.

Carriers have often established parameters regarding the percentage of liquid assets they will accept for the customers purchase of an annuity. These parameters often fall within 25% to 40% of the customer's liquid assets. These parameters are in place to help ensure a customer will not be left without funds should that customer lose their job or need to access emergency funds.

Find the Right Partner; Put the Wheels in Motion

With a provider's help, an annuity broker can work through the 12 areas of suitability to help keep the financial planning focus on the customer. A provider will have the necessary tools and knowledge to help annuity brokers navigate and understand individual state regulations and therefore help determine suitability for clients. To help ensure that an annuity recommendation is compatible with the state's suitability regulations, review the information with individual clients in mind and the state in which they do business.

Also, the right annuity provider will embody the following other qualities that help annuity brokers reach product suitability for their clients and offer support in other important areas:

• **Financial stability:** A provider must have financial stability. If the company goes under, the individual could lose their funds.

• **Product mix:** A provider should offer a variety of products so that annuity brokers can meet the needs of their clients.

• **Crediting rates:** It is important for an annuity broker to know the provider's current interest crediting rates, which is equally as important as knowing the companys renewal rate history.

• **Customer focus:** A customer-centric provider is the key to a strong provider/broker relationship. Determine how easy it is to do business with the provider and what kind of information the provider will offer the annuity broker, including questions about its annuity products and how quickly clients can access funds.

With the support of a provider, annuity brokers can help clients embark on goal-oriented financial planning and better understand the types of annuities available to them including the one that suits them best. q

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