

1

Introduction to Annuities

Overview and Learning Objectives

This chapter examines what an annuity is and the various ways annuities are classified. It also describes the age-old problems that annuities attempt to solve and explains how annuities have been used over the years. Finally, the chapter discusses how important annuities are to our society today. By reading this chapter and answering the questions, you should be able to

- 1-1. Identify several definitions for the word “annuity.”
- 1-2. Explain how annuities have been used throughout history.
- 1-3. Explain the reasons why people purchase annuities today.
- 1-4. Describe the difference between nonqualified and qualified annuities.
- 1-5. Identify the three parties in an annuity contract.
- 1-6. Identify the various classifications of annuity contracts.
- 1-7. Explain why immediate annuities help clients feel financially secure.
- 1-8. Identify the eight steps in client-focused planning.
- 1-9. List and describe six sources of annuity prospects.
- 1-10. Identify the three age-based market segments.

Chapter Outline

| | |
|---|------|
| Introduction | 1-3 |
| History of Annuities | 1-4 |
| Why Individuals Purchase Annuities | 1-5 |
| Primary Objective of an Annuity Contract | 1-6 |
| Parties to an Annuity | 1-7 |
| Types of Annuities | 1-9 |
| Licensing Qualifications to Sell Annuities | 1-13 |
| Client-Focused Planning | 1-15 |
| Eight Steps in the Selling/Planning Process | 1-15 |
| Summary | 1-19 |
| Prospecting in the Annuities Marketplace | 1-21 |
| Introduction | 1-21 |
| The Increasing Opportunity for Annuities | 1-21 |
| Annuities in Retirement Planning | 1-22 |
| A Prospecting Overview | 1-32 |
| Qualified Prospects | 1-33 |
| Markets | 1-41 |
| Conclusion | 1-45 |
| Case History: A Lifetime of Annuities | 1-47 |
| Chapter One Review | 1-51 |

Introduction

The American Heritage Dictionary and *Webster's Third New International Dictionary* define the word *annuity* as follows:

- the annual payment of an allowance or income
- the right to receive this payment or the obligation to make this payment
- an investment on which a person receives fixed payments for a lifetime or a specified number of years. Derivation: Latin; annus, year¹
- a contract or agreement under which one or more persons receive periodic payments in return for prior set payments made by themselves or another (as an employer)²

These definitions focus on how money is paid from an annuity contract. Annuities that provide current payments to an annuitant are commonly called “immediate annuities” or “payout annuities.” Normally, immediate annuities are purchased with a single deposit and income payments begin within one year; the insurance and financial services industry commonly refers to these annuities as single-premium immediate annuities or SPIAs.

The above definitions do not focus on the more common type of annuity, which is one where the income payments are not paid until some time well in the future. These contracts are referred to as deferred annuities because the income payments are deferred until an indefinite time. Today, purchasers of deferred annuity contracts generally focus on the accumulating values of their annuities, not the future income.

This textbook will concentrate on both types of annuity contracts—immediate annuities for paying income and deferred annuities for accumulation and growth. Annuities will be referred to throughout this textbook as annuity contracts or annuity policies. Either term is correct. The owner of the annuity will be referred to interchangeably as the annuity owner, the policyowner, or the contract owner.

History of Annuities

Among the first things to learn about annuities are the needs that annuities fill, not just now but throughout history. This section will help describe how annuities have met societal needs over many centuries.

Financial professionals may tend to think that the annuity is a rather modern tax-driven financial tool. Annuities, however, were in use long before the Internal Revenue Code was enacted. The creation of annuities was not tax driven; it was driven by our need for security in an uncertain world. It was, and is, driven by our need for the insurance features that the annuity contract provides.

Annuities existed as early as 2500 BC in Babylon. The Roman Empire issued “annua,” which were lifetime payments made once a year to the citizens of Rome. In the Middle Ages in Europe, individuals paid a lump sum of money to a hospital or church in exchange for lifetime payments to secure their futures.

In 1653, France developed a system of annuities in which the benefits passed to the surviving members of a pool until only one member was left. Called a *tontine* because it was developed by Neapolitan banker Lorenzo Tonti, each of its members paid a sum into the fund and, in return, received dividends from the fund. As each person

died, his share of the income was divided among the surviving members until only one member was left who received all the income. When the last member died, the fund reverted to the state.

France, Britain, and the United States adopted similar systems to fund buildings and other public works. Later, there were private schemes in which the last survivor received the fund principal as well as the dividends. The schemes were eventually banned because there was too much incentive for members to kill each other to increase their share of the fund.

In the United States, the plans to fund a life income were not confined to tontines. In 1776, the National Pension Program for Soldiers was signed, and by 1894, 37 percent of the federal budget was devoted to military

$$500 \times 12 \times 32 = \$192,000$$

On August 4, 1997, Jeanne Calment died at age 122. For the last 12 years of her life, she lived in a nursing home in Arles in southern France. It is reported that in 1965, Calment was concerned that she might live too long and exhaust her resources trying to support herself. She made an agreement with her attorney that he could have her apartment at her death in exchange for \$500 every month for the rest of her life.

Obviously, the arrangement worked well for Mrs. Calment, but it was a little tough on her attorney. He died prior to Mrs. Calment. She ended up getting the apartment back, and she also received \$500-per-month income for 32 years until she died.³

pensions. In 1875, American Express established the first private pension plan for its employees.³

In 1889, 74-year-old Chancellor Otto Von Bismarck introduced the concept of Social Security in Germany by providing a social insurance program for retirees at age 70, which was funded by employers, employees, and the government.

Following the Civil War in this country, there were hundreds of thousands of widows, orphans, and disabled veterans. This led to the development of a generous pension program, with interesting similarities to later developments in Social Security. It was with the creation of Civil War pensions that a full-fledged pension system developed in America for the first time.

Finally, in our brief history of annuities, Franklin D. Roosevelt signed the Social Security Act into law on August 14, 1935. The first payment was made to Ida May Fuller on January 31, 1940. She continued to receive payments for 35 years. Ida May died in 1975 at age 100, having paid \$22.54 into the Social Security system and receiving \$22,888.92 in benefits.⁴

Why Individuals Purchase Annuities

One of the most prevalent reasons individuals purchase annuity contracts is to accumulate funds for retirement and then, once in retirement, to manage distributions of those funds. Annuities compete for investment funds that would otherwise be in currently taxable investments. Fixed deferred annuities, which guarantee principal and some level of interest earnings, compete for money that would otherwise be in vehicles like savings accounts or certificates of deposit. Variable annuities compete for money that might otherwise be in taxable mutual funds. Investments in which earnings are subject to income taxes each year may be placed in nonqualified annuities and enjoy tax-deferred growth until withdrawal.

This brings up the distinction between qualified and nonqualified annuities. Nonqualified annuities are annuity contracts into which investors put their after-tax funds. For example, an individual takes \$1,000 from his or her savings account at the local bank and deposits it into an annuity contract. Because the \$1,000 had already been taxed to the individual (we will assume it was money from his or her employer's paycheck), it is considered nonqualified money. For that reason, nonqualified annuities are also referred to as after-tax annuities.

Qualified annuities are funded with pretax (or before-tax) funds. To illustrate, an annuity purchaser who recently changed employment decides to use funds from his or her previous employer's 401(k) account to purchase a rollover IRA annuity. Because the employee has never paid income tax on the funds inside the 401(k) account, it is considered funded with pretax or qualified money.

This distinction between a qualified and nonqualified annuity is important because regulators, the popular press, and ill-informed financial advisors have been under the mistaken impression that registered representatives have been misleading clients into believing that the "annuity wrapper" is necessary for qualified money to maintain its tax-deferred nature. This, of course, is not true. Some also have been under the impression that insurance companies charge for the tax-deferral feature, which would mean that qualified annuities carry unnecessary fees. This also is not the case. The tax-deferred character of annuities is a result of the Internal Revenue Code. The Code stipulates when and how annuities will be taxed. Tax deferral inside the contract is a part of the generic nature of annuities; it is not a feature that carries an added cost.

Primary Objective of an Annuity Contract

The primary objective of an annuity contract is to pay financial benefits to the persons who receive the annuity payments during their lifetimes. Its primary objective is not to pay a death benefit, like its cousin, the life insurance contract.

There are three important distinctions between an annuity contract and a life insurance contract:

- An annuity contract has no significant mortality charges. In other words, the insurance company does not have to build a cost into the annuity to protect itself against the early death of the annuitant. No medical underwriting is required. The insurance company is not insuring against early death.
- An annuity has no net amount at risk, whereas life insurance does. The death benefit that is payable is nothing more than the value of the annuity. The insurance company does not suffer a financial loss at the death of the annuitant.
- An annuity contract is not tax efficient in paying benefits at the annuitant's death. The beneficiary of an annuity will have to pay

income taxes on any gain in the value of the annuity over the principal paid by the annuity owner. Life insurance, on the other hand, is almost always 100 percent income tax free to the beneficiary.

The deferred-annuity contract is used to accumulate money for some future date. It is most efficiently used to accumulate money to be used in the future either as a lump sum or as a stream of payments. Annuitization is the surest way to provide systematic payments from a specific sum of money over a specified period, or for the duration of a single life or the lives of two people; this is because the payments are guaranteed by the insurance company.

Three Differences between an Annuity and an Insurance Contract

- An annuity has no significant mortality charges.
- An annuity has no net amount at risk.
- An annuity is not tax efficient at paying benefits at the annuitant's death.

Parties to an Annuity

The parties to the annuity include the insurance company that issues the annuity, the owner of the annuity, the annuitant, and the beneficiary. Each of the parties has a different set of obligations, rights, and responsibilities.

Within the annuity contract itself, the person who purchases the annuity must name the owner of the contract, the annuitant, and the beneficiary. Often, the same person may assume the role of both owner and annuitant, but this is not always the case.

Owner

The annuity contract *owner* is a person, or legal entity, who enters into the contract with the insurance company to purchase the annuity. The owner of the contract is the person or entity with all the legal rights to the contract. This is an important distinction from the annuitant. The owner is the person who pays the premiums, chooses which optional policy features or riders are to be included in the contract, and has the right to withdraw or surrender the annuity.

Furthermore, the policyowner is the person with the authority to communicate with the insurance company about the annuity's values and to determine who will receive the annual or quarterly statements from the company.

Annuitant

The *annuitant* is the person whose life is the measuring life for the annuity. The annuitant must be a living person. It cannot be a legal entity because a legal entity has no measuring life. For example, a corporation cannot be an annuitant because a corporation has no age and has no death. The annuitant has no legal rights in the contract. Therefore, the annuitant has no right to surrender or withdraw funds from the annuity or to change the beneficiary.

Beneficiary

The *beneficiary* is the person, or legal entity, who normally inherits the annuity proceeds at the death of the annuitant. The annuitant and the beneficiary should not be the same person because the beneficiary is to receive the funds at the annuitant's death. It would not be sensible to name the beneficiary as the same person whose death triggers the distribution.

The beneficiary, like the annuitant, has no legal right in the contract before the annuitant's death. Once the annuitant has died, the beneficiary does have a legal right to receive the death proceeds. However, the owner may generally change the beneficiary at any time prior to the death of the annuitant—even right up until the time of the annuitant's death. This is why the beneficiary is presumed to have only an “expectancy” in the annuity, but no legal rights arise until the annuitant's death.

EXAMPLE: Jerry Jones purchases a \$100,000 deferred annuity on the life of his wife, Janine. Jerry names himself as the beneficiary. Jerry is the annuity owner and the annuity beneficiary. Janine is the annuitant. Janine has no legal rights in the annuity contract. She serves as the measuring life only. If Janine wants to change the beneficiary to her son, she will not be able to do so. Jerry, as the owner of the annuity, is the only one with the legal right to change the beneficiary.

Upon Janine's death, Jerry is now entitled to receive the proceeds of the annuity as the beneficiary. Jerry has a legal right to receive those funds once the annuitant has died. Prior to Janine's death, Jerry as the beneficiary did not have any legal rights.

Chapter 7, “Taxation, Plan Implementation, and Servicing Annuity Products,” will cover in more detail some of the tax traps that annuity owners can get themselves into, depending on whom they name as the owner, annuitant, and beneficiary of an annuity.

Types of Annuities

Annuities may be classified in several different categories. Table 1-1 shows the various classifications of annuities based on the following:

- single-premium or flexible-premium annuities
- immediate or deferred-payment annuities
- qualified or nonqualified annuities
- fixed-interest, indexed, or variable deferred annuities

| TABLE 1-1 Annuity Classifications | | | |
|--|---|---|---|
| | Single-Premium Deferred Annuity | Flexible-Premium Deferred Annuity | Single-Premium Immediate Annuity |
| Qualified Annuity | Fixed-interest annuities Indexed annuities Variable annuities | Fixed-interest annuities Indexed annuities Variable annuities | Fixed payments Variable payments |
| Nonqualified Annuity | Fixed-interest annuities Indexed annuities Variable annuities | Fixed-interest annuities Indexed annuities Variable annuities | Fixed payments Variable payments |

Single-Premium or Flexible-Premium Annuities

First, annuities can be classified by how many deposits the consumer pays into the annuity. For example, annuities are classified as either single-premium or flexible-premium annuities. A *single-premium annuity* is structured to allow only one contribution in the contract. Subsequent contributions are usually not allowed into these types of policies. If the policyowner envisions making additional contributions into an annuity contract, the policyowner should consider purchasing a flexible-premium annuity. A *flexible-premium annuity* allows additional contributions at any time from the policyowner.

Note that immediate annuities generally fall only under the category of single-premium annuities. This is due to the nature of the contract in which a policyowner will give one deposit into the immediate annuity in return for a fixed amount of income. Immediate annuities, by their very nature, do not accept additional deposits. To purchase a second income stream, the policyowner will need to buy a second immediate-annuity contract. Whether the policyowner foresees making additional

contributions later into a deferred annuity is a question both the financial advisor and the policyowner should discuss prior to the purchase of the annuity to make sure that the proper annuity is chosen.

Immediate or Deferred Annuities

An annuity is a contract between a purchaser and an insurance company in which the insurance company promises to make periodic payments to the purchaser starting immediately or at some time in the future. This definition gives us our next classification of annuities, immediate or deferred, regardless of whether they contain qualified or nonqualified money. An *immediate annuity* is a contract with an immediate payment or one with payments that begin within one year of the contract date. A *deferred annuity* is a future-pay contract with payments to begin at some later date beyond the first contract year.

Chapter 6, “Immediate Income Annuities; Plan Presentation Techniques,” will cover immediate annuities in more detail.

Qualified or Nonqualified Annuities

Annuities are also classified based on the type of money placed in the annuity contract. The annuity may be funded with monies accumulated within employer-provided qualified retirement plans such as pensions, profit-sharing plans, 401(k)s, 403(b)s, Keogh or HR-10 plans, SEP IRAs, and SIMPLE IRAs, or other plans that allow the investor to put pretax money into the plan such as a traditional IRA. Because each of these plans is designed to meet regulatory qualifications in order to allow pretax investments and tax deferral on earnings, the plans are referred to as qualified plans. An annuity that accepts these types of funds is referred to as a *qualified annuity*.

Obviously, the tax-deferral feature that is a part of all annuity contracts is redundant when dealing with qualified money that already enjoys the advantage of tax deferral. As a result, when the decision is made to invest qualified money into annuities, it should be because of the features that annuity contracts offer, rather than for the redundant tax deferral.

If the money placed in the annuity has already been subject to income tax, the annuity is classified as a *nonqualified annuity*. The benefit of tax deferral in nonqualified annuities can be a great value for nonqualified money that does not enjoy tax deferral in the vehicle in which it is currently invested. Tax deferral allows money that would otherwise be paid out in income taxes to remain invested in the annuity

contract and to continue to earn a return. This increases the size of the annuity that one day will be used to generate income.

The issue of accumulating money over the long term can be approached by addressing the question of how long it will take money to double or triple. Taxation reduces part of an investor's return. For example, note in table 1-2, if money is earning 4 percent but the investor has to pay 25 percent of those earnings in income taxes, instead of doubling in 18 years, it will take 24 years. (The 4 percent return is reduced by 25 percent from the income taxes owed on the interest earned. This equals a net return of 3 percent. The table indicates that a 4 percent return will take 18 years to double, and a 3 percent return will take 24 years to double.) This shows one-third more time for the money to double as a result of netting, after taxes, just 3 percent instead of 4 percent.

Moreover, if an 8 percent return is subject to a 25 percent tax, the time to double is not 9 but 12 years—once more, one-third again as long. The deferral of income taxes on money available in qualified plans and nonqualified plans gives people time to accumulate more money for retirement.

The decision to use annuities for qualified money is quite different from the decision to use annuities for nonqualified money. The taxation of distributions differs also. Accordingly, we will explore the taxation of both qualified and nonqualified annuities in chapter 7, "Taxation, Plan Implementation, and Servicing Annuity Products," and examine qualified and nonqualified annuities in chapter 2, "Annuity Markets."

| TABLE 1-2 Time Required for Money to Double or Triple | | |
|--|---|--|
| Growth Rate | Approximate Years to Double (Divide Growth Rate into 72) | Approximate Years to Triple (Divide Growth Rate into 115) |
| 3% | 24.0 | 38.3 |
| 4% | 18.0 | 28.8 |
| 5% | 14.4 | 23.0 |
| 6% | 12.0 | 19.2 |
| 7% | 10.3 | 16.4 |
| 8% | 9.0 | 14.3 |
| 9% | 8.0 | 12.7 |
| 10% | 7.2 | 11.5 |

However, because annuity contracts, whether for qualified or for nonqualified money, are virtually identical in contract language, classifications, features, and associated costs and regulation, the chapters that deal with those issues, such as this one on annuity classifications, will not generally distinguish between qualified and nonqualified annuities.

Fixed-Interest, Indexed, and Variable Deferred Annuities

Deferred annuities are classified by the method the insurance company uses to determine how interest is credited to the annuity contract (that is, fixed-interest-rate, indexed annuity, or variable annuity).

A *fixed-interest annuity* is the simplest type of deferred annuity. They generally offer the annuity owner a guaranteed interest rate for a certain period of time. That time frame may be one year or 5 to 7 years, depending on the annuity contract. Once the initial guarantee period for the interest rate is over, companies generally set renewal interest rates in conjunction with the interest rate environment at the time of the renewal. Therefore, annuity purchasers will have no idea when they buy the annuity what level of interest the annuity will earn once the guarantee period is over.

However, fixed annuities do have a guaranteed minimum interest rate by which the company must abide. This guaranteed minimum serves to provide some level of comfort to the annuity purchaser. Fixed-interest deferred annuities are covered in detail in chapter 3, “Fixed-Interest Deferred Annuities; Effective Interviewing Techniques.”

Indexed annuities, which are rather new to the industry and generally became popular in the 1990s, are another type of deferred annuity. They were developed as a response to the rising equity markets and the need for insurance advisors who were not licensed to sell variable annuities to have a product to offer their clients that could generate higher returns than a traditional fixed annuity.

An *indexed annuity* ties the earnings in the annuity contract to an outside index. Therefore, the true earnings of the insurance company are not an indicator of the earnings for the annuity contract. The most popular type of indexed annuity is one tied to the Standard and Poor’s (S&P) 500 Index. This type of annuity is meant to assist clients who want more growth potential than a fixed annuity can offer but who may not be ready for the full risk of a variable annuity. Chapter 4, “Indexed

Annuities; Fact-Finding,” will cover these types of deferred annuities in detail.

A *variable annuity* is a deferred annuity that allows the annuity purchaser to participate in the investment of the annuity funds by determining how much of the contribution will be invested in a series of accounts. These accounts range from a general account to a series of subaccounts tied to various financial markets.

Variable annuities are the most complex and most regulated of the three types of deferred annuities. Variable deferred annuities are covered in detail in chapter 5, “Variable Annuities; Developing Product Recommendations.”

Licensing Qualifications to Sell Annuities

Annuities are insurance products. Therefore, the sale of these products comes under the jurisdiction of the various state insurance departments. Each state has its own set of rules, regulations, and licensing requirements designed to protect its citizens. Anyone who sells annuities must be licensed and must maintain the qualifications required by each of the states in which he or she does business. In some states, just giving advice about annuities requires licensing. The objective of state licensing is to ensure that only those people of good character who are knowledgeable about annuities can sell in the state.

Generally, before an advisor can sell annuities to the public, he or she must pass a state licensing exam. In most states, after the exam is successfully completed, the advisor must apply to various insurance companies to sell their products. Once all the paperwork has been submitted, each company will perform a background check on the person. If everything is in order, the advisor will be appointed as an agent by each of these companies to sell fixed annuities and many types of equity-indexed annuities.

To sell variable annuities, the licensed agent must also be a registered representative. A registered representative must register with the National Association of Securities Dealers (NASD), submit the required background information, and pass an NASD examination. The NASD examination is either the Series 6 or the Series 7. The Series 6 examination limits a representative to selling mutual funds, unit investment trusts, and variable annuities. The Series 7 is more extensive and qualifies the individual to sell stocks and bonds as well as mutual funds and variable annuities.

An Advisor . . .

Gives advice,
informs, offers
opinions, and
provides counsel.

Agents who sell registered products, such as variable annuities, are also accountable to the various state securities departments. A broker-dealer is responsible for the representative's registration process and his or her compliance with the Securities and Exchange Commission (SEC) and NASD rules and regulations.

Another aspect of the sales process and the qualifications needed for selling annuities involves the advisor's capacity for dealing with clients. Is the salesperson an agent or an advisor? The latest trend in the financial services community is for companies to change the names of its salespeople from agent to advisor. Clients expect agents to have allegiance to their companies and products, while the same clients expect their "advisors" to hold allegiance to them. Regulators favor allegiance to clients, as do companies that recognize that satisfied clients are their most profitable customers.

This brings a new level of responsibility to the advisor. An advisor is one who gives advice, who informs, who offers opinions, and who provides counsel. This requires a broader base of knowledge than is needed just to sell annuities. Consequently, the overall objective of this book is to help you become competent in advising your clients about annuities and how they fit into their financial plans. This requires the advisor to explain the selling/planning process to the client, as discussed in the next section of this chapter.

Client-Focused Planning

Because of the nature of the client-advisor relationship, it is both ethically required and financially wise for the financial advisor to thoroughly understand the client's needs and act to fulfill those needs as much as possible. There must be what is known as *consultative (client-focused) planning or selling*. Such an approach requires the advisor to gather as much information as possible from the client about the client's needs, goals, interests, and assets in order to put together an investment or insurance package that will best meet the client's needs. Consultative planning or selling is a sound approach to building good relationships with clients.

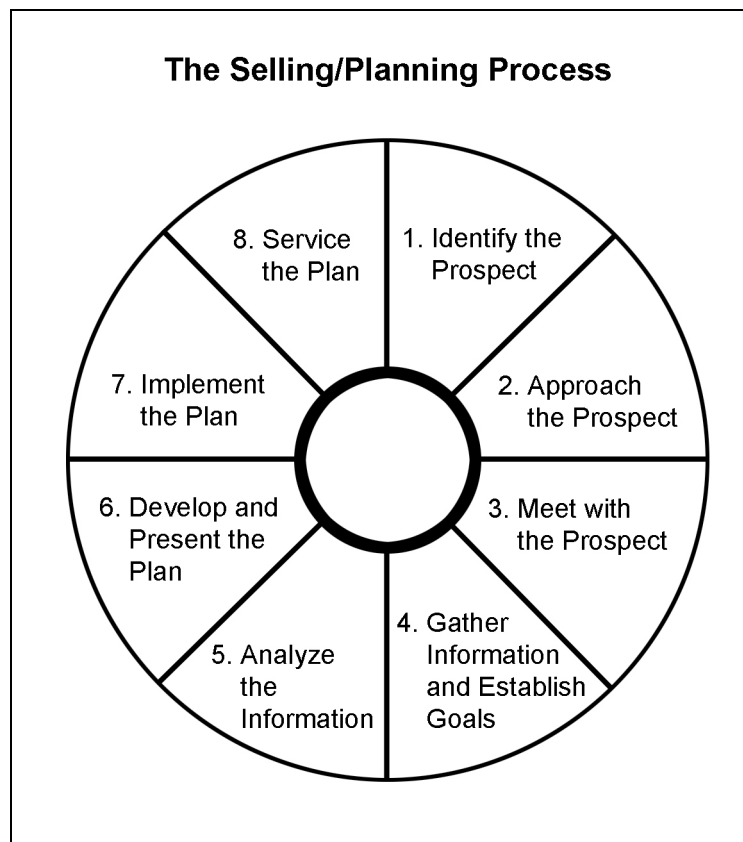
The sale of products is essentially client-driven. Advisors must approach clients with a willingness to listen carefully. Clients can best provide the information regarding their own needs and goals. Clients may also think that they know which product best fits those goals, but advisors should keep the client focused on articulating needs and goals so they can find the best product or service to match those goals.

Marketing annuities requires the same step-by-step procedure that is necessary for financial advisors to be successful in marketing any other personal financial product. Identifying and selecting prospects for individual planning is the first step in a chronological procedure that you need to identify, adhere to, and understand in order to enhance your competency in all financial services endeavors. In this regard, it would seem appropriate to provide an overview (perhaps for some of you a review) of the universally recognized components of what is generically referred to as the "selling process" or "planning process."

Eight Steps in the Selling/Planning Process

The selling/planning process is based on a planning philosophy. Over the years, many authors have written about selling and planning the "right" way. In doing so, they have used many terms to describe the right way: relationship, client-centered, counselor, consultative, needs-based, values-based; the list goes on and on. We do not recommend any one method. Instead, we attempt to examine those principles and concepts involved in cultivating a long-term, mutually beneficial relationship with a client.

We have divided the selling/planning process into eight steps. The selling process encompasses the (financial) planning process. Within each sale, the advisor should conduct some type of planning. The first two steps are preliminary marketing steps you must complete prior to actual planning. Steps 3 through 8 are the (financial) planning process. These next six steps involve interaction between you and your client. They will be repeated many times because they are the basis for your ongoing working relationship. Knowing what you also want to accomplish and why you want to accomplish it will guide your actions in each step of the process. We will briefly explore the necessary actions in the successful completion of the selling/planning process from the financial advisor's perspective.



1. Identify the Prospect

Effective planning begins with getting in front of the right prospect. Not only do you want to identify prospects who have a high probability of

needing, wanting, and affording your products, but you also want to find people who will value you and become a source for repeat business and, more important, referrals. A systematic approach to prospecting that utilizes various pre-approach methods can help you find target markets of potential clients and enable you to market efficiently and effectively.

2. Approach the Prospect

This step involves getting appointments. You can do this either on the telephone or face-to-face through seminars. If you are successfully cultivating relationships, you will generate more referral-based business. With the negative feelings people have toward telemarketers, cold calling becomes more difficult, and referrals become that much more critical.

3. Meet with the Prospect

This is where you establish rapport, explain your business purpose, ask some thought-provoking questions, and listen, listen, listen. The importance of listening cannot be overstated; it is essential when building any relationship. You need to gain prospects' trust and agreement to gather pertinent information about them. You must also let prospects know what you can do for them (in general terms) and help them to see your value. You must answer the prospect's question: Why should I do business with you? Your final objective in meeting with the prospect is to gain acceptance to proceed to the information-gathering step.

4. Gather Information and Establish Goals

When you think of the word *interview*, you think of someone asking someone else questions. That is exactly what you want to do with your prospect. Questions help you uncover the prospect's current planning needs, goals, desires, values, and attitudes. It is helpful to discover as much about the prospect's financial priorities as you can. For example, long-term care insurance may be important to the prospect, but just how important is it? Is it more important than deferring a summer vacation? If it is not and you do not know that, you could be wasting your time.

The key skills in the fact-finding interviewing process are as follows:

- questioning. Ask open-ended questions to probe for individual needs, goals, attitudes, and values. Ask confirming questions to clarify.
- listening. Actively listen, rephrase and reflect to ensure that you and the prospect are on the same page.

- uncovering. Provide information or ask open-ended questions designed to help the prospect see the reality of the situation. Be fair and honest, not manipulative.
- taking notes. Jot down numbers, goals, needs, priorities, and feelings.
- summarizing. Review what the prospect has told you and confirm that you have clearly understood him or her.
- acting. Gain acceptance to work together to achieve goals.

5. Analyze the Information

Once you have a good idea of the prospect's needs, goals, priorities, and attitudes, analyze his or her current financial situation. Consider the weakness(es) in the client's current plan. Then begin to formulate concepts and products that might best enhance that situation, and organize these into a potential plan, no matter how basic or sophisticated it is.

If your products do not fit the situation correctly, send the prospect where the prospect can get what he or she needs. For example, if the person has the money to systematically invest but is not doing so, advise him or her about the benefits of such a course of action. Because of your focus on the long-term relationship, even though the prospect may not do business with you today, he or she will remember that you had his or her best interest at heart. People want to do business with those they trust!

6. Develop and Present the Plan

Develop your product recommendations based on the information that you gathered in the fact-finding interview. Explain the applicability of as many relevant products' features and benefits as you can that address the individual prospect's financial goals. Confirm throughout the presentation that the prospect is in agreement with you so that you can handle any questions or concerns that arise. Clarify any miscommunications or misunderstandings thoroughly. Obtain the prospect's agreement to proceed toward implementing the plan.

7. Implement the Plan

Guide and assist the prospect in acquiring the financial products and services to put the plan into action. Complete the necessary paperwork and applications, and submit them to your company. Advise the prospect of the time frame and any responsibility he or she may have (such as taking a medical exam when applying for life insurance). Use this

opportunity to proactively discuss any additional questions or concerns that the prospect may have.

Once the prospect is a policyowner or account holder, your goal is to convert him or her into a client. That process begins with delivery of any planning documents or policies. Delivery can also be accompanied by an explanation of the financial strategy and recommendations that you have assembled for your client. At delivery, review the benefits you are providing and how they address the applicant's financial needs. Reinforce the concept of comprehensive planning and the necessity to periodically monitor the applicant's situation to ensure that changes that may occur as time passes and lives evolve are addressed. You can do this by offering a periodic review—annually or some other agreed upon time frame.

8. Service the Plan

This is the step in which you convert policyowners into lifetime clients. Ongoing service cements your relationship with each new policyowner, which gives you the opportunity to make additional sales and obtain referrals. Even in the course of performing minor service transactions such as a beneficiary change, you should render excellent service. What differentiates one financial advisor from another is the proactive element of his or her service strategy. Many clients purchase products and never hear from their advisors again. Proactive servicing strategies, such as monitoring the plan through periodic reviews and sending regularly scheduled newsletters to clients, allow you to stay in touch with them. It is this high-contact service that helps you to build lasting client-advisor relationships. It will also lead to cross-selling opportunities and future referrals.

Summary

Practicing and perfecting the skills necessary to execute each of the eight steps in the selling/planning process is an evolutionary work in progress. It is something that you will do over and over again throughout your financial services career. Making the client the focus of your efforts greatly improves your chances of success.

Prospecting in the Annuities Marketplace

Introduction

This section discusses the application of conventional prospecting concepts to identify prospects for annuities. It begins with a look at the overall potential for earnings in the annuities marketplace. We will then discuss opportunities to sell annuities as they relate to changing demographics, longevity, and retirement planning readiness. Then we will proceed to a prospecting overview, which defines the objective and means for successful prospecting. Finally, we will examine the characteristics of a qualified prospect for annuities, identify some issues related to prospect needs, and review some age-based market segments. The information discussed here will help you get started in identifying prospects. Marketing and prospecting topics are explored further in chapter 2.

The Increasing Opportunity for Annuities

The annuities marketplace offers the potential for bountiful earnings and sales opportunities for today's financial advisors. A look at some of the statistics regarding the volume of premiums deposited into annuities in 2002, and the numbers of people who own these products, makes it evident that the annuities marketplace is strong and growing.

Consider some of the following figures from LIMRA International's study, "The 2002 Individual Annuity Market: Sales and Assets": Total annuity sales in 2002 amounted to \$219.9 billion, which represents an increase from 2001 of nearly 19 percent, when sales totaled \$185.3 billion. The volume of variable annuity sales even increased slightly from \$111 billion in 2001 to \$116.6 billion in 2002, despite the downturn in the stock market during those years. Fixed annuity sales increased by \$29 billion, which accounts for the overall increase in total fixed annuity sales from \$74.3 billion in 2001 to \$103.3 billion in 2002.⁵ Table 1-3 summarizes these findings.

| TABLE 1-3 Individual Annuity Sales | | | | |
|---|-----------------|-----------------|------------------------|----------------------------|
| | 2001 | 2002 | Volume Increase | Percentage Increase |
| Total Annuity Sales | \$185.3 billion | \$219.9 billion | \$34.6 billion | 19% |
| Variable Annuities | \$111 billion | \$116.6 billion | \$5.6 billion | 5% |
| Fixed Annuities | \$74.3 billion | \$103.3 billion | \$29 billion | 41% |

The total assets under management within all annuities products totaled an amazing \$1,288 billion in 2002. This consisted of \$804 billion in variable annuity products and \$484 billion in fixed annuity products. Furthermore, at the end of 2002, there were more than 42 million deferred-annuity contracts in force. The average contract value of all in-force contracts was just over \$30,000. Approximately 15 million of them were fixed annuities and 27 million were variable annuities. Also, at the end of 2002, there were more than 2.2 million immediate annuities in force.⁶

While it is interesting to look at the numbers that account for the current size of the annuities marketplace, it is even more important to focus on the people who will be potential purchasers in the future and to understand why they will buy annuity products.

Annuities in Retirement Planning

By 2011, the leading edge of the baby boomer generation of 77 million individuals will turn 65. This unique group of people characterized by their self-reliance, independence, and indulgence, will undoubtedly reflect these traits in their retirement-related choices and lifestyles. But will they have adequate savings to fund their desired lifestyle during retirement? Will they acquire a state of financial independence where decisions are made based on choice and not on economic necessity? Will this generation, which hopes to retire earlier and will probably live longer in an environment of reduced Social Security benefits and diminished pension plan guarantees, be able to live comfortably in a retirement that may last another 20 to 30 years?⁷

Let us examine the most prominent factors that contribute to the need for annuities: (1) the relationship between retirement income and aging, and (2) the changing demographics.

The Relationship between Retirement Income and Aging

Regardless of the fact that people of all ages purchase annuities, the greatest single factor that motivates people to buy either deferred or immediate annuities is their need for retirement income. For preretirees, there is a genuine incentive to accumulate funds for retirement; for postretirees, there is a psychological need to guarantee that those accumulated funds will outlast their lifespans.

There is a direct correlation between aging and the amount of money needed to fund retirement. As we will see later in this chapter, the longer a person lives, the more acute the need to accumulate and conserve financial resources for retirement becomes. The history of annuities discussed previously demonstrates

that annuities are not about taxes; they are about a universal, history-spanning concern about running out of money before we run out of breath. As the saying goes, “The good news is that we are living longer. And the bad news is that we are living longer.”

Correlation between Retirement Income and Aging

- Preretirees have an incentive to accumulate funds for their retirement.
- Postretirees need a guarantee that the funds they have accumulated will not run out during their lifetime.

Changing Demographics

In light of the correlation between aging and the need for retirement income, consider the following demographic changes.

Increased Longevity—People are living longer because advances in medicine, nutrition, and so forth have developed preventions, cures, and treatments for diseases and conditions that were once fatal. Consider that the average life expectancy in 1900 was 47 years; in 2000 it reached 76.9 years. That is a 29.6-year increase in the average life expectancy. Perhaps more significantly, people who survive to age 65 can expect to live to age 83; in 1900 they could expect to live only to age 68.

Unfortunately, while medical advances mean people will live longer, such advances have compounded the problem of funding retirement income. As lifespan increases, the length of time people will need financial resources during retirement certainly increases as well.

Consequently, the amount of money needed to fund a secure retirement will present unprecedented challenges to future retirees.

Many individuals fear they may run out of money, and with good reason. Medical advancements have increased life expectancy. But life expectancy is just one-half of the story. Life expectancy means that statistically one-half of men will die by age 74 and one-half of women by age 79. The other half will still be alive and more concerned than ever about outliving their money. We all tend to focus on life expectancy, but we would be wise to focus also on the potentially devastating financial impact of 50 percent of the people who live longer than life expectancy.

Psychologist and gerontologist Ken Dychtwald put it this way: “We have completed a century of incredible improvements in healthcare, which has dramatically elevated our life expectancy. While we have managed to increase our life spans by almost 30 years since 1900, we haven’t yet focused properly on our health spans.”⁸

As we enter a new age of biology, experts say the most profound effect may ultimately be a stunning ability to slow the aging process, perhaps allowing the healthiest and strongest among us to live 125 years or more. Even the most cautious scientists now believe that, in the coming decades, many people may be biologically capable of surpassing what is, as this book is being written, the oldest person’s age of 122. Some say that a very select few may even reach age 150. For others, seeing 95, even 100, may become routine.

One piece of the picture is already clear: As table 1-4 shows, there is tremendous growth in the number of people reaching age 100. The Census Bureau estimates that as of 2000, there were 75,000 Americans older than 100. That is about 23 times the number in 1960, and their ranks are growing every year. The Bureau projects that there will be 214,000 centenarians by 2020 and 834,000 by 2050.

It seems apparent that the need to accumulate enough money to provide lifetime income has never been greater. The increase in the number of centenarians from 1990 to 2000 was 38,000. The increase in centenarians from 2000 to 2010 is projected to be 95,000.

Baby Boomers—The baby boom generation with retirement years between 2011 and 2030 will significantly swell the population in the postretirement age categories, which are 65–84 and over age 85, within the next few decades. A few statistics using the population projections in Figure 1-1 make the case dramatically.

| TABLE 1-4 Centenarians in the United States | |
|--|------------------------|
| Year | Number of Centenarians |
| 1960 | 3,300 |
| 1970 | 4,800 |
| 1980 | 15,000 |
| 1990 | 37,000 |
| 2000 | 75,000 |
| 2010 | 170,000* |
| 2020 | 214,000* |
| 2050 | 834,000* |

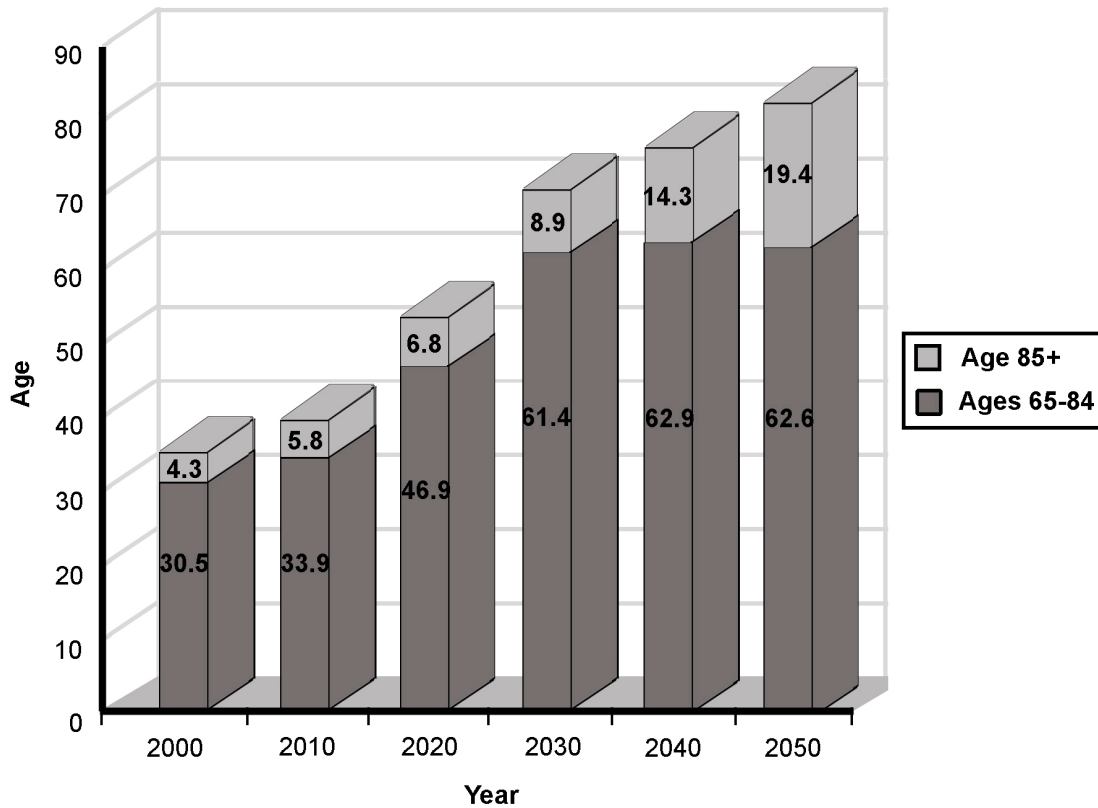
* Projected
Data provided by the U.S. Bureau of the Census.

- In the year 2000, there were approximately 35 million people over age 65, constituting 13 percent of the country's population of 275.3 million; by 2030, when the last of the baby boom generation (those born between 1946 and 1964) turns age 65, there will be 70 million seniors, constituting 20 percent of the population (351.1 million).
- Individuals aged 85 and older are the fastest-growing segment of the senior population and are expected to increase from 4.3 million, or 1.6 percent of the population in 2000, to almost 9 million by 2030, when they will represent over 2.5 percent of the population.
- By 2050, when the full effect of the baby boom retirees is felt, the age-85-and-over category will exceed 19 million and comprise almost 5 percent of the population (403.7 million).

Increased longevity already means that more people will reach ages that will require comprehensive retirement planning strategies. The baby boom phenomenon will further accentuate this due to the sheer numbers of those associated with this demographic group. Today's baby boomers can expect to live longer, healthier lives than any generation before them. The bottom line is that more people will require larger retirement funding resources in the not-so-distant future, and they will require them for a longer period of time.

Today's baby boomers can expect to live longer, healthier lives than any generation before them. The bottom line: More people will need larger retirement funding resources in the not-so distant future, and they will need them for a longer time period.

FIGURE 1-1
Projected Growth in U.S. Elderly Population (in millions)



Source: Projections of Total Population by Age Groups, Population Projections, Population Division, U.S. Census Bureau, Washington, DC, December 1999–January 2000, NP-T3A-F.

Earlier Retirement

The median age at which people expect to retire is 62.⁹ However, recent surveys indicate that the expected age of retirement decreases as the age of those questioned gets younger. According to the National Retirement Planning Coalition 2002 Survey of Prospective Retirees, about half (48 percent) of those surveyed believe they will live to be 75–84 years old. Another 27 percent believe they will live longer than that. Ironically, those who think they will live to an advanced age are not more inclined to postpone the age at which they expect to retire. Thus, the fact that Americans both expect to retire earlier and live longer places additional

strain on the need for them to plan more carefully to adequately fund their retirement.¹⁰

The Three-legged Stool of Retirement Income

A generation ago, Social Security and pensions took care of most people's needs during retirement, which lasted an average of only 12 years. With people retiring earlier and living longer, many may spend as much time in retirement as they did in the work force. Traditionally, the American retirement savings system has rested on three legs: Social Security, employer pensions, and personal savings. But with Social Security and conventional defined-benefit pension plans predicted to play a considerably smaller role in furnishing retirement income in the future, it is clear that individuals must take a more active role in providing for their own retirement security.

Social Security—According to the Social Security Administration, Social Security currently protects 150 million workers, with over 44 million people receiving retirement, survivor, and disability benefits. Social Security today replaces about 40 percent of the average worker's preretirement earnings. For two-thirds of the elderly, it is a major source of income; for one-third, it is virtually their only income. When Social Security began in 1935, a 65-year-old had an average life expectancy of just over 12 years; today life expectancy is nearly 18 years and rising. Also, the number of workers paying into the system per beneficiary will decline from 3.3 today to 2.0 by the year 2030. Many people think that Social Security tax contributions are held in an interest-bearing account earmarked for payments to future retirees. In reality, however, Social Security taxes paid by today's workers mostly go to fund benefits for today's retirees. Social Security is now taking in more taxes than it pays out in benefits, with excess funds credited to the Social Security trust fund. If no changes are made, the increase in benefit expenditures due to aging baby boomers will eliminate the surplus by 2017 and exhaust the trust fund and the trust fund's accumulated reserves by 2041.¹¹ It is quite clear that preretirees will need to look beyond Social Security income if they are to live comfortably.

Pensions—Along with Social Security, generations in the past have relied on company pensions,¹² also known as defined-benefit (DB) plans, to support them financially in retirement. With these plans, employers typically bear both the investment risk and longevity risk of retirement

**Three-legged Stool
of Retirement
Income**

- Social Security
- Pensions
- Savings

benefits, promising a stream of lifetime income to retirees based on their cumulative earnings, years of service, and age at retirement. This is also changing.

Over the past 25 years, defined-contribution (DC) plans have radically changed the American pension plan system by shifting responsibility for the financing and investment of retirement benefits from employers to employees. Since their introduction, 401(k) plans have dominated the DC portion of the private pension system. As participation in 401(k) plans has grown, coverage in DB plans has declined. Few new DB plans are being formed, small- and medium-sized plans are being terminated, and there is little growth in employment among large unionized manufacturing firms that maintain DB plans.

Consider the following:

- Eighty million workers participated in private-sector retirement plans in 2001, of which approximately 70 percent were in DC plans, and approximately 30 percent were in DB plans.
- In 1998, 47 percent of all contributions to pension plans were made by employees, compared to only 11 percent in 1978.
- In real dollars, employer contributions to all types of pension plans were 18 percent lower in 1998 than in 1978, while employee contributions were 480 percent higher.

As with Social Security, the decrease in company pension plans greatly increases the burden on individuals to take charge of their own retirement income needs.

Savings—With so much of the responsibility for saving for retirement now shifted to the employee, how well are workers doing in both calculating their retirement needs and actually putting aside the funds required?

Less than half of all American workers were covered by employer retirement plans at the end of 2001.¹³ But even those who do participate in retirement plans, according to a *Washington Post* article, have saved very little. Of all the workers with 401(k) plans in 2000, 44 percent had balances of less than \$10,000; 14 percent had only \$10,000–\$20,000.¹⁴

The big picture is no better. According to the 2002 Employee Benefit Research Institute (EBRI) Retirement Confidence Survey, the amounts workers as a whole have accumulated for retirement are generally small. Almost half (46 percent) have saved less than \$50,000; 15 percent say they have saved nothing. Fewer than 2 in 10 (17 percent) say they have

\$100,000 or more saved for retirement. While the amount accumulated generally increases with age, less than one-quarter (23 percent) of those ages 40–59 report having saved \$100,000 or more. The majority of workers expect to spend at least 20 years in retirement, so even with \$100,000 saved, excluding interest, they would have only \$5,000 per year to spend.

Although 67 percent of those surveyed had saved for retirement, only 32 percent had actually calculated how much money they would need to have saved by the time they retired. Nevertheless, 34 percent considered themselves on track when it comes to retirement.

Retirement Readiness

Many financial experts suggest that today's retirees will need between 66 percent and 75 percent of their preretirement income to maintain their current standard of living in retirement. This is based on the assumption that spending on such items as commuting, clothing, and other costs associated with working will decline when they retire. However, although some costs, such as shelter, traditionally decline in retirement, others, such as healthcare, often dramatically increase. There is also evidence to indicate that a dichotomy exists between the expected increase in spending during retirement and a decrease in the savings rate as a percentage of income among preretired workers. This has many current and prospective retirees fearing, especially in light of the recent performance of financial markets, whether an accelerated depletion of retirement resources will reduce their standard of living, or perhaps cause them to exhaust their money entirely. This has to do with the simple fact that many people underestimate the amount of money they will need to retire securely.

Financial preparation for retirement presents a challenge to workers, plan sponsors, and the federal government. The future financial well-being of a large and growing segment of our population rests on finding a way to close the gap between the current level of inadequate retirement readiness and what will be necessary for the millions of individuals who will be retiring over the next 20 years.

The information, guidance, and financial advice provided by professionals within the financial services industry will be a key factor in assisting future retirees to both accumulate sufficient wealth during their working years and to move those funds into retirement income that will last as long or longer than they live.

Annuities can play a vital role in helping investors achieve financial security during retirement. There are exciting marketing opportunities for those who are willing to pursue the financial rewards that exist within this lucrative market, and it simultaneously provides a valuable financial product to retirees both today and tomorrow.

Financial and Emotional Retirement Needs

For your clients to achieve financial success in retirement, it has to be planned. The decision to retire does not mean that people should stop planning. Retirement planning is a continual process that can be facilitated by the use of annuities. While the planning strategies after retirement may differ from those that you suggest to your prospects and clients who are planning and saving for retirement, they are no less important. However, an individual's planning perspective usually changes in the years before and after retirement occurs. Nevertheless, the older a person gets, the greater the probability that he or she will need annuities as a financial vehicle either to accumulate tax-deferred dollars for future use in retirement or as a source of guaranteed income that provides unique financial security features during retirement. In retirement planning, there are not only financial considerations but also dynamic psychosocial factors involved.

Preretirement—When preretirees in their 20s and 30s are just starting out in their careers, they tend to see retirement as a far-off, elusive concept that they will probably have to deal with someday. These workers are too busy climbing corporate ladders, establishing their own businesses, and starting their families to give the illusory concept of retirement too much thought or too many financial resources.

However, as people enter their 40s and 50s, retirement takes on a much higher priority. The picture of retirement begins to crystallize in their minds as the possibility of living to old age becomes an increasing reality to them. It is during these decades of life (usually ages 45–64) that workers are demographically classified as “preretirees.” They develop a growing concern about their well-being beyond their working years. Many people become obsessed with the need to accumulate enough money to maintain and enjoy their lifestyle during their golden years. Accordingly, they begin to allot greater resources into their qualified and nonqualified retirement plans, despite their contemporary financial obligations concerning education funding for their children, long-term care for their parents, and their own personal living expenses. Their

sense of urgency regarding retirement funding is typically at its peak during their middle years.

This “preretirement mentality” is evidenced by anxiety about ensuring a comfortable retirement. Financial planning goals are geared toward amassing a large sum of money. The objective is to save as much money as possible to fill (metaphorically) a large bag of money. Preretirement mentality is greatly focused on building and accumulating money in an effort to allay the increasing fear of financial destitution in old age.

Deferred annuities that are inherently tax deferred are ideal to help accomplish this financial goal of the preretiree. This is because deferred annuities offer flexibility in making contributions into them, and nonqualified deferred annuities allow virtually unlimited deposits. Furthermore, there is a choice of three types of deferred products (fixed-interest, equity-indexed, and variable) that accommodate any individual’s risk tolerance and investment objectives.

Postretirement—Not all of your prospects will be emotionally comfortable with their financial outlook during retirement. As a matter of fact, there is some concern on the part of retirees that no matter how much money they have accumulated over their lifetimes for use in retirement, they cannot properly enjoy its use because they fear that they may exhaust it before they die. This concept can be referred to as the “postretirement mentality.” The main focus in postretirement is not how full the retirement bag of money has become but, rather, that the bag never becomes empty. This paradigm shift often evidences itself in behavior that results from the natural insecurity associated with becoming poor. This fear, like many others, may have little rational basis. Nonetheless, after 40 working years of conditioning themselves to be thrifty and put something away for tomorrow, retirees often never

Reasons to Buy Immediate Annuities

- Guarantee income in retirement
- Cover specific fixed expenses in retirement
- Avoid placing a financial burden on children
- Pass estate to heirs and/or reduce estate taxes
- Pay long-term care/life insurance premiums
- Comply with IRS required minimum distributions
- Generate temporary income until Social Security begins
- Shelter assets from Medicaid
- Take advantage of other tax advantages
- Spend down an estate
- Fulfill legal/financial obligations

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abandon this tendency. They may deprive themselves of modest luxuries and reasonable indulgences, even if they truly can afford them. This, in part, accounts for some retirees whom we might consider well-to-do taking part-time jobs to bolster their incomes. Although we as advisors can attempt to alleviate their feeling of financial insecurity during retirement, we also need to be sensitive to its reality.

This is where immediate annuities can help. Immediate-annuity buyers generally purchase for one obvious financial reason: to provide guaranteed income in retirement. However, the reasons for purchasing annuities are not strictly financial. For instance, some of the more common reasons for purchase other than income are to cover specific expenses, to avoid becoming a financial burden on their children, to benefit from a variety of income and estate tax reasons, and to ensure the payment of life and long-term insurance premiums.¹⁵ Thus, the motivation to purchase immediate annuities depends on how the prospects perceive both the financial and the emotional aspects of what the product can do for them.

Once you have an understanding of why and when people will need annuities, it makes sense to identify prospects for annuities and to determine where these prospects can be found. In the next section, we will discuss prospecting factors and age-based markets for annuities products.

A Prospecting Overview

The objective of annuities prospecting is the same as prospecting in any personal market, which is to continually find potential clients. Reaching that goal calls for the same type of organized, day-to-day action as you have used in your personal markets.

Successful *prospecting* requires that you establish organized and systematic procedures to achieve specific and definable activity goals. It means following these procedures methodically, thoroughly, and regularly. It entails disciplining yourself well enough and consistently enough so that the procedures become habitual for you.

Successful prospecting is a continual process that you should integrate into all of your sales and service activities. Being alert to prospecting opportunities at every phase of the sales process will help you maintain a consistent inventory of high-quality prospects.

Once you establish the habit of prospecting, you should be able to spend less time on poorer quality prospects. As you move toward

working with wealthier and more qualified prospects (described below), you will find that your financial rewards will be simultaneously larger and easier to achieve. The result is that you will earn more money in proportion to the work and time you expend.

Qualified Prospects

The process of selling any insurance or financial product begins with creating a profile of the typical person who will believe in you and buy your products and services. In other words, you need to define the characteristics of qualified prospects.

Generically, *qualified prospects* are people who

- need and value your products and services
- can afford to pay for your products and services
- are insurable or financially suitable
- can be approached on a favorable basis

Let us apply this definition to create a profile of a qualified annuity prospect.

Need and Value Your Products and Services

Who needs annuities? Although people in their 50s and 60s have a greater probability of needing annuities than people in their 20s do, poor planning can seriously jeopardize the financial well-being of many individuals during their retirement years. Furthermore, if a person runs out of money during retirement due to inadequate wealth accumulation, he or she will most likely experience a reduction in the quality of life during those golden years.

However, no matter how logical the financial reason for buying annuities, prospects must have a strong emotional reason to buy. They must value the future financial security and peace of mind that come from adequate retirement funding involving annuities more than they value other competing wants, needs, and desires. In other words, does the prospect *feel* that it is worth the price he or she must pay for annuities?

Annuities: Never Too Early to Start

Here is one advisor's counsel about marketing and prospecting for annuities: "Talk to everyone. I talk to anyone between the ages of 30 and 80. If they are not interested, I ask if they would mind referring me to their parents or other relatives. For younger prospects, I tell them that it is never too early to start to accumulate future wealth on a tax-favored basis."

Emotional needs are not easily observable. However, there are some characteristics that may indicate that a prospect will value annuities. We suggest you compile your own list of characteristics, starting with these few examples. Look for people who

- are implementing a retirement plan or seriously considering one. People who have bought annuities believe that they are a major component of their retirement plan.
- own other insurance products such as life, disability, or long-term care insurance. People who own these types of insurance products demonstrate that they value the concept of risk transfer.
- work for an employer that offers contributory qualified plans such as SEPs, SIMPLE IRAs, or 403(b) plans that may involve annuities. In general, people who work for employers who offer such plans involving annuities are more familiar with the roles they play in retirement planning than the general public is.

Can Afford to Pay for Your Products and Services

One of the biggest obstacles to the annuities sale is cost and commitment. Note that cost and value are interrelated. For example, a middle-aged couple may say that they cannot afford annuities because they cost too much. You may discover, however, that they own a vacation home. What this couple is really saying is that they value the commitment of funds to annuities as an important component in a comprehensive retirement plan less than they value committing funds to their other current needs, wants, and desires.

If you have not done so already, identify the income and net worth ranges you will target in order to avoid affordability issues. Describe any characteristics you will look for that may indicate a prospect's ability to pay annuity premiums. For example, you might look for the prospect who

- owns a home
- owns a business
- has supplemental policies in place, such as a personal articles floater policy on fine jewelry
- has high liability limits on property and casualty insurance
- owns a personal liability umbrella policy

Are Insurable or Financially Suitable

There are many people who want annuities and can afford to pay for them but are unsuitable for one or both of the following reasons:

- They have a greater need for asset and/or income protection products.
- The particular annuity product you are marketing does not match their risk tolerance and investment objectives.

For example, if you encounter a married annuity prospect who wants to purchase a deferred annuity but has insufficient life or disability income insurance coverage, you may be risking financial catastrophe for that prospect or family. Many advisors would also argue that long-term care insurance should be in place before annuities are purchased. Of course, these higher priority needs present an opportunity to cross-sell the asset or income coverage that is lacking.

On the other hand, you may encounter an annuity prospect who is unsuitable for a variable deferred annuity because he or she has a low risk tolerance and very conservative investment objectives. It would be equally unsuitable to sell a variable annuity to such a prospect as it would be to sell any deferred annuity to someone who needs insurance coverage first. The best defense against making this mistake is to use the proper risk tolerance and investment objective assessment tool as part of the fact-finding process. Fact-finding techniques will be discussed in chapter 4.

The worst thing for everyone involved is for a prospect to purchase an annuity product that is detrimental to his or her future financial security and your business relationship with the prospect. As a proactive step to prevent this from happening, many successful advisors recommend prequalifying the prospect over the phone. This may avoid an embarrassing situation or at least better prepare you for your interview with the prospect. We will discuss prequalifying in chapter 2 when we cover the topic of approaching the prospect.

Can Be Approached on a Favorable Basis

The first three aspects of qualified prospects are helpful in categorizing a prospect's readiness to purchase annuities. It is best to work on the assumption that all prospects see the need and value, can afford to buy, and are suitable until proven otherwise. In fact, by the time you are ready

The most critical factor in deciding if a prospect is qualified or not is whether you can meet with this person on a favorable basis.

to meet with a prospect, you will have usually discovered this is true. Age is seldom a critical factor either.

Perhaps, however, the most significant factor in deciding whether someone is a qualified prospect is whether you can meet with this person on a favorable basis. Just what is involved in this concept?

The concept is easier to explain by example than by definition, but in general terms, *favorable* basis means a situation where the advisor is perceived as appropriate (or competent) in the prospect's eyes. It is largely a matter of acceptance and usually implies a good measure of respect, trust, and confidence in the advisor's professionalism. It often evidences itself by the prospect's being at ease with the advisor. It is certainly characterized by a willingness to grant you sufficient and exclusive time to meet him or her in an environment that is free of distractions.

Rapport with prospects is important even before your face-to-face meetings with them. For example, if you are making calls on the telephone, you need to be able to project a warm and professional image. If a good reputation precedes you in your target markets, prospects will be more responsive to your request to meet with them.

Once you have established a positive atmosphere and a comfortable working environment with mutual respect for each other's time, the stage is then properly set for the initial interview.

Prospecting Sources

There are many different *prospecting sources*. We will provide a brief overview of some of the more popular ones that successful advisors have used to sell annuities.

Existing Clients—Most of your existing clients who are in their late 50s and 60s are good candidates for retirement planning. Senior clients who are about to retire or have been retired for a while are good potential clients for annuities as retirement fund distribution vehicles. If these people are your clients, you already have a professional relationship with them, so it stands to reason that most will be receptive to working with you to further explore their planning needs as they move toward or into their retirement.

Almost every outstanding producer has a systematic procedure for contacting existing clients to find out if anything in their financial situation has changed, to follow up on previously discussed cross-selling opportunities, or to discuss additional needs. Turn these periodic reviews

into opportunities to explore retirement planning issues for seniors who are still working—update the facts on their current retirement plans, do an analysis, and offer annuities if they fit a need you uncover.

Referrals from Clients/Prospects—It is advisable to pave the way for referrals early on in the selling/planning process, preferably during the initial meeting. Create the expectation of receiving referrals if the prospect appreciates what you do for him or her.

EXAMPLE: “Mr. and Ms. Prospect, as we work together, if you find what we are talking about to be important and valuable, then give me the opportunity to meet with people you know and care about so that I may help them, too.”

Then, when you ask for referrals it will not surprise the prospect. The best time to ask is when the prospect indicates an appreciation for you and/or annuities. It could be as simple as, “I’m so glad you showed me that. I always thought paying taxes on my Social Security retirement benefits was unavoidable.” Obviously, if the prospects purchase annuities from you, they have demonstrated an appreciation for the product. However, even if prospects do not buy an annuity, ask them about the value of the process. If they have a favorable opinion of you and the process, ask for referrals.

EXAMPLE: “Ms. Prospect, I know you have decided that you do not need annuities. May I ask what, if anything, in this process you found to be of value? [Wait for a response.] “That’s great. I am glad I could help you clarify some of the income and healthcare concern issues of retirement planning. May I ask who you know who might also benefit from this type of advice?”

Of course, if your prospects have parents who may be in the market for annuities, you can specifically ask for their names.

EXAMPLE: “Mr. Prospect, although I disagree with your waiting to buy an annuity at this time, I respect your decision. I am glad, however, that you see the need for retirement planning. I was wondering, do you think your parents may benefit from owning annuities to either defer their taxes or guarantee a lifetime income? Do they live in this state? Would it be okay if I met with them?”

As always, remember to follow up on referrals by providing an update to the referrer to let him or her know how the meeting went.

Satisfied clients can also be an excellent, yet often overlooked, source of referrals. Be sure to put a system in place to regularly ask existing clients for the names of people who may be interested in using annuity products in their retirement planning as well.

Centers of Influence (COI)—By definition, a *center of influence* is an influential person who knows you, has a favorable opinion of you, and agrees to introduce or recommend you to others. A client may become an effective center for you, just as a center may become a client, but this is not necessary to the relationship you need to establish. In general, you will find that COIs

- are active in a community or sphere of influence
- are sought out for advice by those within their sphere of influence
- seek to communicate with others
- are givers, not takers

Good COIs know the people in your target markets regardless of their occupation or profession. However, some occupations and professions deal directly with your target markets, and finding COIs in these occupations and professions could prove very profitable. Examples include the following:

- elder law attorneys
- CPAs
- fee-based financial planners
- advisors who sell noncompeting lines of financial products (for example, a property and casualty agent)
- healthcare providers
- clergy
- members of a volunteer organization

Also keep in mind that sometimes your best COI is simply a friend or close relative who comes into contact with a lot of people on a regular basis and is personally interested in helping you to succeed in the financial services business.

Once you have identified some possible COIs, you will need to set up meetings with them. Write and practice a script if you do not know them very well.

One strategy for you is to approach the COI by explaining how the meeting will benefit him or her. For example, you might approach a noncompeting advisor as follows.

EXAMPLE: “Pat, you have a great reputation in the community, and I would feel comfortable referring clients to you. I would like to get together with you to brainstorm ways we can help each other build successful practices. Would breakfast sometime next week work for you, or would a lunch be better? My treat.”

Your meeting with a COI is as important as a sales appointment. Therefore, plan your presentation. Keep it brief and consistent with your approach. For example, if you are meeting with a community leader, the goal of your presentation is to show the COI just how he or she can help others by referring them to you. Your approach to accomplish this objective may include the following steps:

- Share the impact that poor retirement planning will have on people needing it and upon society in general.
- Illustrate the impact with any personal stories.
- Demonstrate how annuities can help prevent this for many people by providing tax-deferred cash accumulation and guaranteed income.
- Give the COI some practical actions that he or she can take to help.

You will probably want to ask the COI for names of qualified prospects. If so, have a brief written description of how to identify qualified prospects. Although referrals are important, you may find other ways the COI can help you. For example, if the COI is a leader for a senior community service organization, you can approach him or her about doing an educational presentation for the rest of the organization. Be creative.

Prospecting Sources

- Existing clients
- Referrals from clients/prospects
- Centers of Influence
- Networking
- Seminars
- Lists

Networking—*Networking* is the process of continual communication and sharing ideas and prospects with others whose work does not compete with yours. In turn, their clients might also be shared with you and become your clients.

Most networking groups have the same general rules. Membership is limited to one person from each type of sales background, whether insurance, real estate, mortgage brokerage, or some other sales profession. Each person who attends the meeting is required to bring a prescribed number of names. For example, the real estate agent member of the group just sold a house located in an over-age-55 community that she represents exclusively. She gives you the name of that person as a prospect who may be interested in annuities for retirement planning. On the other hand, your client may have expressed a desire to live in an independent-living or retirement community and thus would be a good prospect to share with the real estate agent.

If you can find an existing networking group in your community, it might be worthwhile to investigate joining it to provide you with a steady stream of prospects.

Seminars—Some advisors have found that seminars are an extremely effective way to prospect, especially in the senior market. Seminars enable advisors to accomplish two key objectives. First, seminars are a means to present annuities in the context of retirement planning to several prospects at one time, resulting in less time needed to conduct one-on-one interviews. Second, seminars cast advisors as the experts, especially if they play a significant role in the presentation.

Seminars are not only a source of prospects but also a method for prospecting and marketing annuities. Many successful advisors in the annuities market use seminars as their main prospecting tool. Therefore, we will comprehensively discuss the use of seminars as both a prospecting and marketing tool in the next chapter.

Lists—Many experienced advisors use this prospecting tool with excellent results. Advisors who have had success with lists note that the key is to select lists that will contain prospects who would likely have an interest in annuities. For example, a list of American Association of Retired Persons (AARP) members would certainly contain people who are age 50 or older. Some companies provide lists to their advisors through market segmentation programs; check with your company to see

if one is available. Otherwise, you will want to buy a list from a reputable list vendor.

When dealing with a vendor, exercise caution. Here are some points to keep in mind:

- Select lists that reflect your target markets.
- Check to see how recently the data were collected.
- Make sure that the list has current phone numbers.
- Verify the source of the leads.
- Make sure that the list has been “scrubbed.” This means that any “do not call” and undeliverable names have been eliminated.
- Check to see if duplicate entries or incomplete names have been deleted.

One final thought on lists: Keep good records so you can evaluate the quality of the leads and compare different vendors until you find the one that gives you the best return on your investment.

Markets

You have probably been in the financial services industry long enough to know that success in the business comes from finding groups of prospects with common needs and characteristics, a process known as *segmenting*. The ultimate goal is to find a segment that is large enough so you do not run out of prospects and one that has a communication system that will facilitate the process of identifying prospects. Such a segment is known as a *target market*. Target marketing will be discussed further in chapter 2.

Nevertheless, because of the relationship between aging and the need for retirement income, we will first segment the markets for annuities in terms of product type—deferred and immediate—and then by age. The age groups for deferred annuities we will explore are under age 45, ages 45 to 64, and age 65 and older. For immediate annuities, the age groups are under age 65 and age 65 and older. To assist you in the process of segmenting your current clientele and/or prospects according to both their age and their annuity product need, we will provide a brief overview of these market segments.

Age Distribution of Deferred Annuity Owners

| | |
|-----------------|-----|
| Under 35–44 | 26% |
| Age 45–64 | 46% |
| Age 65 or older | 28% |

Source: Deferred Annuity Owner Study: Profiles, A 2003 Report. © 2003 LIMRA International, Inc.®

Deferred Annuities

Under Age 45 (Providers)—People under age 45 typically do not feel the need for buying annuities or retirement planning as keenly as those who are older than age 45. This segment is a little more resistant because there are many other needs that have more immediate importance to them. For example, many are still worried about saving enough for their children's education and protecting their incomes from the risks of death and disability. Nonetheless, you will find several distinct opportunities in this market for selling annuities. The first opportunity is that you can sell these people a qualified deferred annuity contract through such vehicles as 403(b) plans offered through their employers. The second opportunity for you is to motivate this under-age-45 group to begin an individual retirement annuity (IRA) or a nonqualified annuity in order to take advantage of compound interest over the longer period of time that they have until their retirement.

Ages 45 to 64 (Preretirees)—While many in this market segment who are parents may still have other financial concerns (such as saving for children's education and the life and disability insurance mentioned in the under-age-45 segment), a greater emphasis is now being placed on their retirement needs. According to a 2003 LIMRA study, 46 percent of all deferred-annuity owners fall within the ages of 45 and 64. Retirement for these people is no longer an abstract far-away concept but is, instead, one that is very real and that they are approaching quickly. This is the bread-and-butter market segment and will be for several years to come because baby boomers (born 1946–1964) comprise a growing percentage of this market.

Age 65 and Older (Retirees)—This market segment is formidable in size in terms of total owners (28 percent), and it will continue to grow due to the aging and increased longevity of the baby boomer generation. Indeed, the average age of single-premium deferred annuity buyers is 65 overall; the average age of nonqualified annuity buyers is 66. The average age of annuity owners is 67.¹⁶ While people in this age bracket represent a large cohort of prospects for deferred annuities, they are also the most prolific buyers of immediate annuities, as discussed below. This naturally leads to the conclusion that people in this age group own both types of annuities. There is no shortage of evidence to support this conclusion. A majority of all annuity owners (54 percent) state that their household owns at least one

other annuity. On average, owners of multiple annuities own 2.7 contracts. The average combined balance held in all annuities is \$133,000.¹⁷

Immediate Annuities

Under Age 65 (Preretirees)—People under age 65, which was the traditional Social Security retirement age, largely do not see the need to purchase immediate annuities. Only about 1 in 5 (22 percent) of all immediate-annuity buyers fall into this age bracket. Of these, nearly half (10 percent) are between the ages of 60 and 64.¹⁸ A person's decision to purchase an immediate annuity has also traditionally meant that the liquidation of a single sum of money in exchange for a periodic income stream that is usually guaranteed for life irreversibly excluded access of those premiums in any other format. Recently, however, as discussed in chapter 6, some companies now offer limited access to lump sums of cash from within immediate annuities after payments have commenced; this may increase future sales potential within this age group. Nonetheless, the likelihood of prospects in this age segment is small because the vast majority of these people are still working and preoccupied with the accumulation of wealth, not the liquidation of it. In fact, only 20 percent of immediate-annuity owners are either employed or not unemployed, while 80 percent of them are retired.

Age 65 and Older (Postretirees)—This age group, by far, represents the biggest potential source of prospects for immediate-annuity products. Seventy-eight percent of all immediate-annuity buyers are 65 or older. Among them, 61 percent are over age 70; the average immediate-annuity buyer is 70 1/2 years old, and age 70 is the most common age at purchase for male and female buyers and qualified market buyers.¹⁹ Those people in retirement are extremely concerned about conserving financial resources and maintaining the lifestyle they enjoyed while working. Retired immediate-annuity buyers receive income from a variety of sources, on average more than 3.4 sources.²⁰²⁰ Annuities rank second, behind Social Security. This suggests that many retirees who purchase immediate annuities view them as an important source of income.

Getting Started

The following is one advisor's guidance to others who are getting started in the annuities markets:

- Buy one—you can't sell something you do not own yourself.
- Know your annuity products—educate yourself on how they work and what they do for clients.
- Talk to everyone you can about annuities.
- Always do a complete fact-finder.
- Make sure the client understands the features of the annuity he or she buys—crediting methods, death benefits, taxation, bonuses, and so forth.
- Be careful.

Conclusion

There is a tremendous opportunity for financial advisors to shape millions of Americans' retirement security through the annuity products discussed in this book. The need for both deferred and immediate annuities is evident, based on these products' current statistics regarding buyer and ownership trends. Because of the increased longevity of the American population in general, and the baby boom generation in particular, the annuities marketplace will continue to grow steadily over the next 25 to 30 years.

Now you have a basic idea of what annuities are, what they do, who the prospects for them are, and why people buy them. In the next chapter, we will examine additional markets for annuities, along with various methods for approaching prospects within each of those markets.

Case History

A Lifetime of Annuities

Harold and Betty were saving money for their retirement in a certificate of deposit, and they were paying taxes on the interest earnings each year. As their income tax bill became larger and larger every year, they began to pay attention to annuity advertisements.

They wondered which type of annuity might be suitable for them. They knew they did not need an immediate annuity because their retirement was 20 years down the road. They agreed to investigate the deferred annuity, designed for people who want to accumulate money for retirement.

After reviewing all of the details of the annuity contract, they decided to invest some of their retirement money in a deferred annuity. They wanted an annuity that guaranteed the interest rate for some time into the future, similar to a bank's certificate of deposit.

Their choice was a single-premium annuity with a 5-year interest rate guarantee that met their interest expectations and provided a level of comfort, even though they would be tying up their money due to the annuity's surrender charges. This money was for their retirement, and they would not access it prior to age 59 1/2 (so as not to incur the federal 10 percent penalty tax on money withdrawn before that age). They understood that they would always need to keep the money inside an annuity contract either by renewal or an Internal Revenue Code Sec. 1035 tax-free exchange in order to maintain the income tax deferral on the interest earned. They were assured that they could buy another single-premium annuity when they wanted to invest more but that the new annuity would be based on the then current interest rates.

Over the years, they accumulated a number of these single-premium, deferred, fixed annuities that guaranteed their principal and interest. As time went on, Betty began to learn about investments and started to worry that the interest they were earning in their annuities was insufficient to keep up with the increased cost of living by the time they would reach retirement. Their financial advisor, upon hearing their

concern, suggested that they consider moving the money as it matured from single-premium, fixed annuities into either an indexed annuity or a variable deferred annuity.

Two things concerned Harold and Betty. First, they did not want to pay taxes on the earnings they had accumulated within their existing annuities. They were assured that if they exchanged their old annuities for a new annuity in the proper fashion, the IRS would allow them to continue the tax deferral. Second, they did not want to put what they already had accumulated at risk in the stock market.

The result was that they exchanged one of their maturing fixed annuities into an indexed annuity linked to the Standard & Poor's (S & P) 500 index. This contract guaranteed that 100 percent of their principal would earn a minimum of 3 percent if they left the money in the contract for a minimum of 5 years. If the S & P 500 Index increased more than 3 percent during that period, their annuity would be credited with the higher amount.

When another of their fixed annuities matured, they used the same procedure to move the money into a variable deferred annuity. In this variable contract, because conservation of principal was important to them, they placed all the money into the guaranteed-principal, guaranteed-interest-rate general account. Then they directed the insurance company to move the interest earnings on their guaranteed account each month into a diversified selection of the various stock subaccounts available within the separate account.

As time went on, Harold and Betty became more comfortable with the ups and downs of the stock accounts. They set up a system whereby their bank account set a percentage of their income into the annuity, and they directed the insurance company to place those funds each month into a diversified selection of stock subaccounts. One day, their account report arrived, and it showed a seven-figure balance, something neither of them had ever expected. They were approaching retirement with much more confidence than they had 20 years ago.

Years later, it was time for Harold and Betty to retire. It was also time to find a way to have income from their qualified plans and their nonqualified annuities replace their paychecks. Harold and Betty were in excellent health and doing more to have fun in their retirement years. They decided to purchase a joint and survivor fixed immediate annuity to ensure continued income no matter which one of them lived longer. This provided Harold and Betty with an extra \$16,000 per year of joint and 100 percent to the survivor income, using \$250,000 from their deferred

variable annuity that would, combined with their Social Security income, bring them up to \$40,000 per year of lifetime income. This should be enough so that they can let the rest of the nest egg in their deferred annuity and qualified plan grow undisturbed.

Five years later, Harold and Betty must begin to take their required minimum distributions from their qualified plans. So at age 70 1/2, they choose to use \$1 million of their qualified plan money to buy an immediate annuity to assure them a joint and survivor income of an additional \$62,000 per year, rather than taking the minimum required distribution of about one-half that amount. Their income now is expected to be, in total, more than \$100,000 per year.

Ten years pass quickly, and they arrive at age 80. Both Harold and Betty are in an assisted-living facility, and have received \$800,000 in immediate-annuity income from the qualified plan over the last 10 years.

Mulling over all they have been able to do in their retirement years, they conclude that the income from the life annuities has empowered them to spend and give with confidence. They have had the fulfilling experience of knowing that whatever they spend or give away today will be replaced next month, as long as they live. Life annuities are said to cause people to live longer, and Harold and Betty think they have discovered the reason why. People who buy life annuities do not worry about income. It is remarkable, Harold and Betty conclude, they have had a long and happy retirement without financial worry.

Chapter One Review

Key Terms and Concepts are explained in the Glossary. Answers to the Review Questions and Self-Test Questions are found in the back of the book in the Answers to Questions section.

Key Terms and Concepts

| | |
|--------------------------|------------------------|
| annuity | nonqualified annuity |
| owner | fixed-interest annuity |
| annuitant | indexed annuity |
| beneficiary | variable annuity |
| single-premium annuity | prospecting |
| flexible-premium annuity | qualified prospects |
| immediate annuity | prospecting sources |
| deferred annuity | segmenting |
| qualified annuity | target market |

Review Questions

- 1-1. What is the definition of an annuity?
- 1-2. Summarize two ways annuities have been used throughout history.
- 1-3. Describe the difference between qualified funds and nonqualified funds.
- 1-4. Explain how annuity payments can provide security to a consumer.
- 1-5. Identify the four classifications of annuities.
- 1-6. Explain the difference between an immediate annuity and a deferred annuity.
- 1-7. Describe why tax deferral is a redundant feature for qualified annuities.
- 1-8. List the eight steps in the selling/planning process.
- 1-9. Identify the trend in life expectancy since the early 1900s.

- 1-10. List six sources for obtaining annuity prospects.
- 1-11. Identify the three age-based market segments

Self-Test Questions

Instructions: Read chapter one first, then answer the following questions to test your knowledge. There are 10 questions. Circle the correct answer, then check your answers with the answer key in the back of the book.

- 1-1. Which of the following features distinguishes an annuity contract from a life insurance contract?
- (A) Annuity contracts have no significant mortality charges.
 - (B) Annuities have no net amount at risk.
 - (C) Annuities are not as tax efficient to beneficiaries as life insurance.
 - (D) All of the above distinguish an annuity contract from a life insurance contract.
- 1-2. A client has money in his 401(k) plan with his employer. He is retiring and would like to place this money in an annuity contract. The best contract would be a
- (A) single-premium nonqualified annuity
 - (B) single-premium qualified annuity
 - (C) flexible-premium qualified annuity
 - (D) flexible-premium nonqualified annuity
- 1-3. What is the surest way to provide systematic payments from a specified sum of money over a specified period?
- (A) death of annuitant
 - (B) annuitization
 - (C) withdrawals
 - (D) full annuity surrender
- 1-4. The greatest single factor that motivates people of all ages to purchase either deferred or immediate annuities is which of the following?
- (A) desire to save income taxes
 - (B) need for retirement income
 - (C) need for investment diversification
 - (D) quest for guaranteed interest rates

- 1-5. Which of the following party or parties to the annuity contract serves as the measuring life?
- I. owner
 - II. annuitant
- (A) I only
(B) II only
(C) Both I and II
(D) Neither nor II
- 1-6. An advisor is already licensed to sell fixed annuities but now wants also to sell variable annuities. The advisor must pass which additional exam?
- I. NASD Series 6 exam
 - II. NASD broker-dealer exam
- (A) I only
(B) II only
(C) Both I and II
(D) Neither nor II
- 1-7. A client purchases an annuity with after-tax dollars and wishes payments to begin in 8 months. The client is purchasing which type of annuity?
- I. immediate annuity
 - II. nonqualified annuity
- (A) I only
(B) II only
(C) Both I and II
(D) Neither nor II
- 1-8. Each of the following is an age-based market segment for annuities identified in the text EXCEPT
- (A) under age 50
 - (B) ages 50 to 64
 - (C) ages 55 to 65
 - (D) ages 65 and older

1-9. Each of the following is a classification of annuities EXCEPT

- (A) multiple-premium annuities
- (B) immediate annuities
- (C) qualified annuities
- (D) fixed-interest annuities

1-10. All of the following are acceptable definitions of the term “annuity” EXCEPT

- (A) the single payment of an allowance or income
- (B) the right to receive this payment or the obligation to make this payment
- (C) an investment on which a person receives fixed payments for a lifetime or a specified number of years.
- (D) a contract or agreement under which one or more persons receive periodic payments in return for prior set payments made by themselves or another

Notes

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20. Ibid, Immediate Annuity Buyer Study: Profiles and Attitudes

Answers to Questions

Chapter 1

Answers to Review Questions

- 1-1. *The American Heritage Dictionary* and *Webster's Third New International Dictionary* define *annuity* as follows:
- the annual payment of an allowance or income
 - the right to receive this payment or the obligation to make this payment
 - an investment on which a person receives fixed payments for a lifetime or a specified number of years
 - a contract or agreement under which one or more persons receive periodic payments in return for prior set payments made by themselves or another (as an employer)
- 1-2. The creation of annuities was driven by our need for security in an uncertain world and our need for the insurance features that annuity contracts provide. Throughout history, annuities have been used to provide an immediate stream of income in exchange for a lump-sum payment into a common fund, such as a tontine, in which the benefits passed to the surviving members of a pool until only one member was left living. Following the Civil War in the United States, there was the development of a generous pension program, with interesting similarities to later developments in Social Security. It was with the creation of Civil War pensions that a full-fledged pension system emerged in America for the first time.
- 1-3. The distinction between qualified and nonqualified funds within annuities is as follows:
- Nonqualified annuities are annuity contracts into which investors put their after-tax funds.
 - Qualified annuities are funded with pretax (or before-tax) funds.
- 1-4. The primary objective of an annuity contract is to pay financial benefits to the persons who receive the annuity payments during their lifetimes. Annuitization is the surest way to provide systematic payments from a specific sum of money over a specified period, or for the duration of a single life or the lives of two people; this is because the payments are guaranteed by the insurance company.
- 1-5. The four classifications of annuities are
- single-premium or flexible-premium annuities
 - immediate or deferred annuities
 - qualified or nonqualified annuities
 - fixed-interest, indexed, or variable deferred annuities

- 1-6. Immediate annuities are contracts with immediate payments or those with payments that begin within one year of the contract date. Deferred annuities are future-pay contracts with payments that begin at some later date beyond the first contract year.
- 1-7. The tax-deferral feature that is a part of all annuity contracts is redundant when dealing with qualified money that already enjoys that advantage. As a result, when the decision is made to invest qualified money in annuities, it should be because of the features that annuity contracts offer, rather than for tax deferral.
- 1-8. The eight steps in the selling/planning process are as follows:
- Identify the prospect.
 - Approach the prospect.
 - Meet with the prospect.
 - Gather information and establish goals.
 - Analyze the information.
 - Develop and present the plan.
 - Implement the plan.
 - Service the plan.
- 1-9. Medical advancements have increased life expectancy. Based on data for 10 states, life expectancy was 46 years for men and 48 years for women in 1900. It increased to 74 years for men and 79 years for women in 1997, a 28-year increase for men and a 31-year increase for women.
- 1-10. Six sources for obtaining annuity prospects are
- existing clients
 - referrals from clients/prospects
 - centers of influence (COI)
 - networking
 - seminars
 - lists
- 1-11. The three age-based market segments are
- under age 45 (providers)
 - ages 45 to 64 (preretirees)
 - ages 65 and older (retirees)

Answers to Self-Test Questions

- 1-1. D
1-2. B
1-3. B
1-4. B
1-5. B
1-6. A
1-7. C

- 1-8. C
- 1-9. A
- 1-10. A

Chapter 2

Answers to Review Questions

- 2-1. As retirement planning tools, annuities offer clients these important features:
- income tax deferral
 - probate avoidance
 - guaranteed lifetime income at annuitization
 - limited liquidity using free-corridor amounts
 - the ability to take partial surrenders without having to surrender the entire annuity
 - flexibility in making contributions as needed
 - no limits on the amount of premiums that can be invested
 - surrender charges that discourage clients from withdrawing funds prior to retirement age
 - low cost (typically annuities do not charge an annual fee, but if they do, it is a relatively modest fee)
- 2-2. The stretch IRA is a marketing concept that allows beneficiaries of IRAs to avoid taking a lump-sum death benefit by instead taking only the required minimum distribution and correspondingly avoid a huge income tax liability. Instead, the beneficiary can stretch out the required distributions from the death benefit over a long period of time, usually over the life expectancy of the beneficiary.
- Stretching out the proceeds simultaneously stretches out the income tax liability. At the same time, it allows the remaining balance to continue to grow on a tax-deferred basis. The end result is that, over time, the beneficiary ends up with a much larger inheritance than he or she would have had if the IRA were taken as a lump-sum distribution at the time of death.
- 2-3. The most beneficial aspect of the Roth IRA is that if certain conditions are met, all the funds withdrawn from the Roth IRA by the participant or the surviving spouse are completely income tax free. Unlike their traditional IRA counterpart for which distributions are almost always 100 percent taxable, Roth IRA distributions can provide tax-free retirement income.
- Furthermore, “qualified distributions” from Roth IRAs are not included in the recipient’s gross income for federal income tax purposes, regardless of whether or not the recipient is the participant or a beneficiary.
- 2-4. Even though a charitable gift annuity is not an annuity available from an insurance company, there is a market for the sale of an immediate annuity with a charitable gift annuity. A charitable organization may “reinsure” its financial obligation to the donor