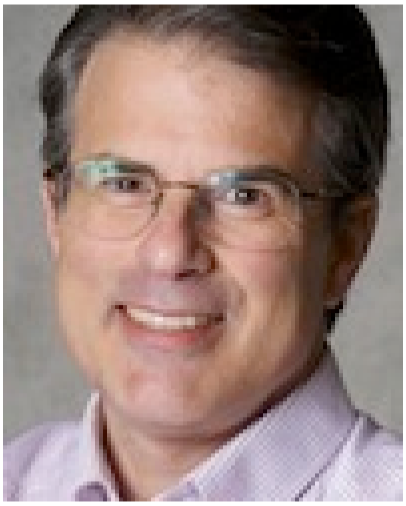
How Not to Sell an Indexed Annuity

By Kerry Pechter *Thu, May 10, 2018*

Five financial professionals commented on our April 5 story about my neighbor's encounter with an advisor who recommended an indexed annuity for lifetime income. She should 'run like hell,' one of them wrote.



"Run like hell."

When *RIJ* invited comments on our April 5 **article**, "Should My Neighbor Buy That Indexed Annuity?" which described a woman's real-life experience with an advisor she met at a free retirement planning seminar, we didn't expect to hear much praise for the advisor's assertive approach.

And we didn't. We received five responses, all of them more or less shaming the advisor. Two of the responders asked that we not reveal their names. They were not speaking in their official industry capacities. The others were Curtis Cloke, creator of the Retirement NextGen planning software, Bryan Anderson, of Annuity Straight Talk in Kalispell, Mont., and Phil Lubinski, creator of the IncomeConductor time-segmentation planning.

If you didn't see the article, here's a synopsis: My neighbor, who is 60 and would like to retire in seven years, has about $313,000 in savings. Most of it is in qualified accounts. She attended a advisor speak at a free retirement planning seminar held at a community college, and accepted his offer of a free consultation.

At their next and final meeting, he advised her to put $188,000 in a fixed indexed annuity (FIA) with a lifetime income benefit with a premium bonus and a roll-up. At age 70, after a 10-year deferral, it would pay her about $21,000 a year for life. With Social Security, she would have an income of $4,000 in retirement, which was her self-estimated need. He suggested she put the rest of her money in a managed account at his broker-dealer.

The blunt advice in the quote at the top of this story came from one of the anonymous sources, who likes indexed annuities as products but who didn't like the advisor's practices.

Phil Lubinski

Lubinski condemned the advisor for trying to commit my neighbor to a long-term investment when she still faces several unknown factors, such as her own health status and her potential for an inheritance. "How dare he present the numbers to support this sale and force her to work three years longer than she wants?" he wrote in an email.

"Maybe there wouldn't be enough assets to inflation-proof the equivalent of $4,000 per month in today's dollars at her age 67 retirement date. But, at the very least, he should have shown her how long she could support that income and then dig deeper into the possibility of an inheritance as the continuation of her income.

"After all the smoke and mirrors and "bonuses", the $188,000 growing to a benefit base of $269,000 after 10 years implies about a 3.65% return," he added. "I wonder what the actual surrender value was after 10 years. I dare say she should be able to earn 3.65% in a conservatively managed account and have 100% liquidity."

Cloke, a subject matter expert for The American College's Retirement Income Certified Professional designation program, didn't like the fact that the advisor in our story seemed to be rushing my neighbor into a product sale.

Curtis Cloke

Cloke told RIJ that opposes any advice product that leads with a product and with any proposal that fails to include many hours of careful consideration, an inventory and assessment of the entire household balance sheet, and at least three meetings with a prospective client. (My neighbor had two meetings, in addition to attending the free seminar.)

When meeting with prospects or clients, he prefers to let the plan arise from a client's own choices and decisions. Otherwise the client will not feel ownership of the plan, and the negotiations will collapse. Which is exactly what happened in my neighbor's case. She felt that a solution had been imposed on her, and she recoiled.

She was, in fact, put off by the penetrating look in the advisor's eyes when he tried to close the annuity sale. "I didn't get be 60 years old without recognizing that look," she said. She ignored the advisor's follow-up calls and eventually blocked him from her Facebook page.

Writing from northwest Montana, Anderson recommended that my neighbor, instead of buying an indexed annuity with a living benefit, should invest in an riderless indexed annuity and take annual penalty-free withdrawals up to the 10% limit, or as needed.

Bryan Anderson

"Your neighbor should not pursue this strategy, for two reasons. First, the income rider would lock up 60% of her available funds. Second, the management fees and rider fee would erode her principal over time, so she'd have no real flexibility or control. The windfall from downsizing her home will put her in a stronger position. So would the inheritance she's likely to receive," he said.

"She should simply re-position her assets with an allocation model that fits her risk tolerance and that gives her enough liquidity to cover her income gaps on a discretionary basis for short periods of time," Anderson added.

"Long-term decisions can wait until she's closer to retirement. If she wants to buy an annuity now, then she should buy one without an income rider and without fees so she can have maximum yield, liquidity and control over the assets with the option to re-position those assets when she's nearer to retirement."

One of our anonymous critics, however, suggested that the advisor offered her tough-love, in a sense. He wrote:

"Her real problem is that she doesn't have enough money to retire at 67. Therefore, in a sense, the advice she received not to retire until age 70 was good advice. The advice may have been designed to get her to the 10-year mark of the annuity rather than to encourage her to work longer, however.

"If you're asking if she should buy the indexed annuity or the deferred income annuity (DIA), I would recommend the indexed annuity. It will cost about the same as the FIA, but she can liquidate the FIA if necessary. This is one of those strange annuity pricing quirks. Since FIA issuers can assume much higher lapse rates than DIA issuers, they can guarantee the same amount of income but still offer a cash value."

"An annuity will give more income per dollar of investment than any other option. To get the same payout on a regular investment portfolio, she is going to have to do 7% systematic withdrawals. At the end of the day, we're back to the fact that she doesn't have enough money to retire at 67 and take $4,000 per month," he wrote.

Would this type of sale have been prevented by the Department of Labor's 2017 fiduciary rule, as drafted by the Obama Administration? Our advisors disagreed.

Anderson didn't think so. "I have no confidence that the DOL rule would have changed anything," he wrote. "The sale would have gone forward regardless. The investment advisor's team, if unable to sign the Best Interest Contract themselves, would have easily have found an institution do so. In any case, 'best interests' are a matter of opinion. An advisor's abilities only go so far as his knowledge of available products and strategies."

But Lubinski thought this transaction would have failed the Best Interest Contract Exemption (BICE) test of the fiduciary rule. "What compliance department would allow a rep to take 60% of a 60-year-old's assets and cram them into an indexed annuity with a 10-year surrender schedule?" he wrote.

"This is exactly the type of situation that the DOL was trying to oversee. It's why, at the last minute, they didn't give indexed annuities a prohibited transaction exemption and forced them to be part of a BICE."