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# **TAKING CARE OF YOU**

**ISSUE#:** *Special Issue*

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## **1. WHY THIS SPECIAL ISSUE ABOUT ANNUITIES**

Since the Great Recession of 2008+, insurance companies have been capitalizing on the resulting, engrossing fear that many are experiencing, by mass marketing marvelous “guarantees” of: **automatic growth**, irregardless of performance; **capturing every upswing but never decreasing** during down swings; **life time income** and even increasing lifetime income; etc. It is almost like a “shark feeding frenzy” – for example, one insurance company that is only the 16<sup>th</sup> largest insurance company in the country, is now the fourth largest seller of annuities in the country.

This “feeding frenzy” is something like the huge sale of Long Term Care policies of a few years ago. Most of those companies have now made huge increases (e.g., 40%!) in their clients’ premiums because the insurance companies grossly under-priced the policies when they were sold, and must make these increases or go out of business! However, with annuities, there are no premiums for insurance companies to increase, and by contract the insurance companies cannot increase charges or reduce benefits – especially guarantees. So, the only alternative for under-pricing annuities will be to go out of business, because the government’s attitude is now “no company is too large to fail”. Are our memories so short that we forget that during the Great Recession of 2008+: AIG (the United State’s largest insurance company) was bailed out; Aegon (the world’s largest insurance company) was bailed out; Merrill Lynch (the US’s largest financial company) was saved from bankruptcy because Bank of America (the US’s largest bank) bought out Merrill Lynch; Bank of America then was saved because it was bailed out; and, that Lehman Brother’s failure (one of the US’s oldest financial companies) started the Great Recession of 2008+?

During the past two weeks or so, R.O.I. has had multiple clients talk to us about annuities. Their situations are listed in part **3. List Of Client Situations** – we encourage you to review those situations, and see if one or more sound familiar to you. R.O.I. is concerned that clients will make bad, very expensive and difficult to get out of decisions, promulgated by skilled and highly compensated agents’ hammering on fears that can “best be solved” by insurance company guarantees – guarantees that clients have little or no correct understanding thereof, nor of how they can possibly be fulfilled, and too often guarantees by insurance companies that have regrettable histories for honestly taking care of their clients (see **4. List of One Insurance Company's Recent Legal Problems**). **This is why R.O.I. is providing this special issue about annuities.** We hope that every client will study this issue thoroughly, talk to friends and relatives about what they learn from this issue, and **both clients, friends and relatives will contact R.O.I.** if they have any exposure to annuity sales efforts.

## **2. ANNUITY PROJECTIONS**

R.O.I. spent over 15 hours reviewing a client’s actual Variable Annuity contract and its accompanying 1 ¼ inch prospectus – **ALWAYS** remember, **the devil is in the details!** After doing our best to digest all of this information and figuring out how all the provisions worked together, we developed a spread sheet to project multiple real life scenarios. To empathize with the daunting challenges faced in creating the spread sheet, we encourage you to review **5. LIST OF ONE ANNUITY’S TERMS**, and then appreciate our trying to sufficiently understand the terms and how they work together. We wonder if any agent or broker has ever done this, and explained to their clients what might happen in different scenarios. We doubt that, because agents and brokers are not paid to provide such service – they are paid upfront, 7-9 years worth of R.O.I.’s compensation, to sell, sell, sell!

In each spread sheet, the annuitant is age 72 and the amount invested in the annuity is \$150,000. We assumed the best scenario for the annuity owner and the insurance company, i.e.,

- No withdrawals for 10 years – This allows: the owner to receive the greater of the 6%/year bonuses or any step-ups, and to receive the 200% adjustment; and, for the insurance company to pocket 10 years of excess fees and invest them to build up their “claims paying ability”; and,
- The annuitant lives and lives, all the way to age 101, so he receives 20 years of payments.

The spread sheet compares:

1. The **Benefits to The Annuitant**; with,
2. The **Claims Paying Ability** of the insurance company (every contract and prospectus has exculpatory language warning insurance owners that all guarantees are limited to the insurance company’s ability to pay claims at the time they come due); with,
3. A **R.O.I. Account** managed for 10 years (with net returns only 2%/year higher than the annuity investment account), and then using the 10 year value to buy a 20 year certain fixed annuity (without all the bells and whistles and corresponding extra fees).

Relative to Claims Paying Ability, we assumed that \$1,000/year of each year’s contract charges, inflating at 3%/year, is spent on insurance company operating expenses (e.g., trail commissions and over-head allowances for brokers and agents, accounting-legal-settlement costs, building purchase-rent-maintenance, actuary and statistician costs, client service personnel, advertising, portfolio management, etc.) – we do not know the accuracy of this assumption. The balance of each year’s contract charges is assumed to be invested to provide future Claims Paying Ability at a net 5%/year (insurance companies have to keep large amounts in cash to pay immediate and short term claims – cash generates almost no return - and the balance is invested in laddered bond portfolios to protect principle and generate profits. The assumed 5% return is for the combined cash and bond portfolio.).

We ran four projections relative to returns in the annuitant’s separate account (i.e., annuity mutual fund portfolio):

1. A **0%/year return** – this represents the client’s most feared scenario, and his greatest need for insurance company guarantees, i.e., **no investment growth and living a long, long time**;
2. A **4.35%/year return** – *assuming* the insurance company continues to have the ability to pay the claims (you will see that this is not a mild assumption), this represents the point where the **benefits to the annuitant are equal to the benefits in the R.O.I. account**;
3. A **6.90%/year return** - this represents the minimum return for the insurance company to have a **positive**

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amount in the assumed Claims Paying Ability Account when the annuitant dies at age 101; and,

4. An **8.82%/year return** – this represents the minimum return for the insurance company to be **able to pay a death benefit** at age 101.

Below are summaries of the projections, with some questions.

<b>RETURN % = 0%, No Investment Growth &amp; Living A Long, Long, Time</b>								
		<b>BENEFIT TO ANNUITANT</b>			<b>INS. CO.</b>	<b>R.O.I. ACCOUNT</b>		
Age	Year	Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Guaranteed Death Benefit To Heirs	Year End Claims Paying Account	Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Lump-Sum or Sum of Future Guaranteed Annual Withdrawals To Heirs
72	1	\$133,800	N/A	\$150,000	\$ 3,360	\$152,939	N/A	\$152,939
<b>81</b>	<b>10</b>	<b>\$ 99,115</b>	N/A	\$150,000	\$ 50,761	<b>\$182,122</b>	N/A	\$182,122
<b>82</b>	<b>11</b>	\$ 0	\$ 21,000	<b>\$150,000</b>	\$ 58,528	\$ 0	\$ 13,900	<b>\$264,100</b>
<b>86</b>	<b>15</b>	\$ 0	\$ 21,000	<b>\$ 0</b>	<b>\$ 0</b>	\$ 0	\$ 13,900	<b>\$180,700</b>
<b>101</b>	<b>30</b>	\$ 0	\$ 21,000	\$ 0	<b>\$ 0</b>	\$ 0	\$ 13,900	\$ 0
Total Benefit to Client =			\$420,000				\$277,990	
Total Benefit to Heirs =			\$ 0				\$ 0	
Total Benefits =			\$420,000				\$277,990	

**Questions To Help Evaluate Chart**

- At age 81 (10 years), what if client needs or wants to withdraw his money? Annuity = \$99,115; R.O.I. Account = \$182,122;
- At age 82 (11 years), what if client dies? Annuity = \$150,000 to heirs; R.O.I. Account = \$264,100 to heirs;
- At age 86 (15 years), what if client dies? Annuity = \$0 to heirs; R.O.I. Account = \$180,700 to heirs.
- During ages 86 to 101 (years 15-30), will the insurance company be able to pay Guaranteed Annual Withdrawal Amounts when its Claims Paying Account is ZERO! Remember, this is the fear motivated scenario that almost coerced the annuitant to buy the annuity in the first place, but this is when the insurance company’s ability to meet its guarantee is **most likely to fail**, especially as billions upon billions of claims are being made as the “baby boomer generation” moves through retirement.

<b>RETURN % = 4.35%, Benefits to Annuitant and In R.O.I. Account Are Equal @ 101</b>								
		<b>BENEFIT TO ANNUITANT</b>			<b>INS. CO.</b>	<b>R.O.I. ACCOUNT</b>		
Age	Year	Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Guaranteed Death Benefit To Heirs	Year End Claims Paying Account	Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Lump-Sum or Sum of Future Guaranteed Annual Withdrawals To Heirs

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Age	Year	Value	Amount	To Heirs	Account	Value	Amount	To Heirs
72	1	\$140,243	N/A	\$150,000	\$ 3,446	\$159,383	N/A	\$159,383
<b>81</b>	<b>10</b>	<b>\$163,106</b>	N/A	\$169,025	\$ 56,779	<b>\$275,264</b>	N/A	\$275,264
<b>82</b>	<b>11</b>	\$ 0	<b>\$ 21,000</b>	<b>\$169,025</b>	\$ 65,900	\$ 0	\$ 21,008	<b>\$399,152</b>
<b>90</b>	<b>19</b>	\$ 0	\$ 21,000	<b>\$ 0</b>	\$ 67,826	\$ 0	\$ 21,008	<b>\$231,088</b>
<b>94</b>	<b>23</b>	\$ 0	\$ 21,000	\$ 0	<b>\$ 0</b>	\$ 0	\$ 21,008	\$147,056
<b>101</b>	<b>30</b>	\$ 0	\$ 21,000	\$ 0	<b>\$ 0</b>	\$ 0	\$ 21,008	\$ 0

Total Benefit to Client =	\$420,000				\$420,161
Total Benefit to Heirs =	\$ 0				\$ 0
Total Benefits =	\$420,000				\$420,161

**Questions To Help Evaluate Chart**

- At age 81 (10 years), what if client needs or wants to withdraw his money? Annuity = \$163,106; R.O.I. Account = \$275,264;
- At age 82 (11 years), when the annuity’s Guaranteed Annual Withdrawals begin, note that the amount is still \$21,000/year even though the return assumption is significantly higher (4.35% vs. 0%). Effectively, the annuitant has given the insurance company \$150,000 for a Fixed Annuity that won’t start for 10 years;
- At age 82 (11 years), what if client dies? Annuity = \$169,025 to heirs; R.O.I. Account = \$399,152 to heirs;
- At age 90 (19 years), what if client dies? Annuity = \$0 to heirs; R.O.I. Account = \$231,088 to heirs;
- During ages 94 to 101 (years 23-30), will the insurance company be able to pay Guaranteed Annual Withdrawal Amounts when its Claims Paying Account is ZERO!

**RETURN % = 6.90%, Positive Insurance Company Claims Paying Ability Account @ 101**

Age	Year	<b><u>BENEFIT TO ANNUITANT</u></b>			<b><u>INS. CO.</u></b>	<b><u>R.O.I. ACCOUNT</u></b>		
		Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Guaranteed Death Benefit To Heirs		Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Lump-Sum or Sum of Future Guaranteed Annual Withdrawals To Heirs
72	1	\$144,021	N/A	\$150,000	\$ 3,496	\$163,160	N/A	\$163,160
<b>81</b>	<b>10</b>	<b>\$212,370</b>	N/A	\$201,423	\$ 62,737	<b>\$348,463</b>	N/A	\$348,463
<b>82</b>	<b>11</b>	\$ 0	<b>\$ 21,000</b>	<b>\$201,423</b>	\$ 73,106	\$ 0	\$ 26,595	<b>\$505,305</b>
<b>94</b>	<b>23</b>	\$ 0	\$ 21,000	<b>\$ 0</b>	\$140,878	\$ 0	\$ 26,595	<b>\$186,165</b>
<b>101</b>	<b>30</b>	\$ 0	\$ 21,000	\$ 0	<b>\$ 462</b>	\$ 0	\$ 26,595	\$ 0

Total Benefit to Client =	\$420,000				\$531,892
Total Benefit to Heirs =	\$ 0				\$ 0
Total Benefits =	\$420,000				\$531,892

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**Questions To Help Evaluate Chart**

- At age 81 (10 years), what if client needs or wants to withdraw his money? Annuity = \$212,370; R.O.I. Account = \$348,463;
- At age 82 (11 years), when the annuity’s Guaranteed Annual Withdrawals begin, note that the amount is still \$21,000/year even though the return assumption is **much** higher (6.9% vs. 0%). Effectively, the annuitant has given the insurance company \$150,000 for a Fixed Annuity that won’t start for 10 years;
- At age 82 (11 years), what if client dies? Annuity = \$201,423 to heirs; R.O.I. Account = \$505,305 to heirs;
- At age 94 (23 years), what if client dies? Annuity = \$0 to heirs; R.O.I. Account = \$186,165 to heirs;
- Notice the large difference in the Total Benefit To Client. Annuity = \$420,000; R.O.I. Account = \$531,892.

**RETURN % = 8.82%, Insurance Company Able To Pay Death Benefit @ 101**

		<b><u>BENEFIT TO ANNUITANT</u></b>			<b><u>INS. CO.</u></b>	<b><u>R.O.I. ACCOUNT</u></b>		
Age	Year	Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Guaranteed Death Benefit To Heirs	Year End Claims Paying Account	Year End Lump-Sum Withdrawal Value	Guaranteed Annual Withdrawal Amount	Lump-Sum or Sum of Future Guaranteed Annual Withdrawals To Heirs
72	1	\$146,865	N/A	\$150,000	\$ 3,534	\$166,004	N/A	\$166,004
<b>81</b>	<b>10</b>	<b>\$257,391</b>	N/A	\$229,136	\$ 67,742	<b>\$414,766</b>	N/A	\$414,766
<b>82</b>	<b>11</b>	\$ 0	<b>\$ 21,000</b>	\$229,136	\$ 79,232	\$ 0	\$ 31,655	\$601,445
<b>101</b>	<b>30</b>	\$ 0	\$ 21,000	<b>\$229,136</b>	\$ 81,701	\$ 0	\$ 31,655	\$ 0
Total Benefit to Client =		<b>\$420,000</b>					<b>\$633,097</b>	
Total Benefit to Heirs =		\$229,136					\$ 0	
Total Benefits =		\$649,136					\$633,097	

**Questions To Help Evaluate Chart**

- At age 81 (10 years), what if client needs or wants to withdraw his money? Annuity = \$257,391; R.O.I. Account = \$414,766;
- At age 82 (11 years), when the annuity’s Guaranteed Annual Withdrawals begin, note that the amount is still \$21,000/year even though the return assumption is **much, much** higher (8.82% vs. 0%). Effectively, the annuitant has given the insurance company \$150,000 for a Fixed Annuity that won’t start for 10 years;
- At age 101 (30 years), note that the annuity’s Total Benefit to Client is **still \$420,000 – the same as when the return % = 0!** Yet, the R.O.I. Account’s Total Benefit to Client is \$633,097. True, the annuity would pay a \$229,136 to heirs, but the primary reason for the annuity is to benefit the annuitant – not the heirs – and, the Total Benefits to the annuitant **and** the heirs is about the same as the R.O.I. Account’s benefit to the client.

### **3. LIST OF CLIENT SITUATIONS**

**Do any of these situations sound familiar to you?**

- Worried about long term economic troubles and corresponding market downswings, a client sought the security of “wonderful” insurance company guarantees. By the time R.O.I. reviewed the contract, the 10 day “free look” period was over. The client is now trapped in outrageous withdrawal charges if he gets out, ever-growing huge fees if he stays in, and very questionable guarantees if the worried about long term economic troubles and corresponding downswings materialize;
- A long term acquaintance who now works as an advisor at a bank wants a client to buy a fantastic annuity – “It captures all the upswings, and never goes down in value!”
- A friend touts the wonderful “6% guaranteed growth” in the annuity he just purchased, and thinks a client is “nuts” not to also buy one;
- A client has been pressured for a long time to buy an annuity that is so good the insurance company will no longer offer it after tomorrow.

**What would you do if you were faced with one or more of these situations?**

### **4. LIST OF ONE INSURANCE COMPANY’S RECENT LEGAL PROBLEMS**

1997 – Four states refuse joining a nationwide settlement against the insurance company, about deceptive sales practices involving 10.7 million clients between 1982 and 1995 – the declining states receive a \$25 million separate settlement. Total 49 state settlement = more than \$1 billion;

2006 – Settled 1996 class action suit, also involving employee dissension about slipshod and dishonest practices in reviewing claims. Total settlement = over \$2 billion.

2006 – Admitted to criminal wrongdoing in a scheme dating back to 1999 involving market timing in trading of mutual funds. Total settlement = \$675 million;

This kind of history – and there is more – makes one wonder what improper things this insurance company is **NOW** involved in, but has not yet come to the surface. **This insurance company now claims to be the nation’s leader in annuity sales – how comforting!**

### **5. LIST OF ONE ANNUITY’S TERMS**

Following is a list of **important** terms from just **ONE** annuity R.O.I. examined (other annuities would have somewhat different terms that would work together in somewhat different ways). It is **NECESSARY** for an individual to **UNDERSTAND** these terms, **and, HOW** they work together **in real life scenarios**, in order for the individual to evaluate:

- The **appropriateness** of the annuity for that individual; and,
- The real **value** of the guarantees.

If an individual does not **UNDERSTAND** these terms and **HOW** they work together **in real life scenarios**, the individual is **relying in blind faith on the agent** who is being paid huge commissions to sell his insurance company’s products.

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We will not bother to define these terms here, because almost all individuals who have annuities are too overwhelmed to try to understand them, and if they do try, almost all do not understand them. Insurance companies do not try to confuse purchasers of annuities, but the contracts and relationships are so intertwined and complicated, the result is an impossible contract to understand for the client and most agents. A wise “general rule” to follow is: “If you don’t understand something, don’t do it!” Does R.O.I. **CORRECTLY** understand **ALL** of these terms and how the work together? Probably not, but on behalf of our clients, **we have made a sincere and heroic effort to do so:**

Administration Charge  
Benefit Determination Baseline (the BDB)  
Bonus Period  
Contract Anniversary  
Contract Value  
Contract Value Reduces to Zero  
For Life Guarantee  
For Life Guaranteed Minimum Withdrawal Benefit  
Guaranteed Annual Withdrawal Amount (the GAWA)  
Guaranteed Annual Withdrawal Amount Percentage (the GAWA%)  
Guaranteed Minimum Withdrawal Benefit (the GMWB)  
Guaranteed Minimum Withdrawal Benefit Charge (the GMWBC);  
Guaranteed Minimum Withdrawal Benefit Death Benefit (the GMWBDB)  
Guaranteed Withdrawal Balance (the GWB)  
Guaranteed Withdrawal Balance Adjustment (the GWBA)  
Guaranteed Withdrawal Balance Adjustment Date (the GWBAD)  
Guaranteed Withdrawal Balance Bonus (the GWBB)  
Guaranteed Withdrawal Balance Step-Up (the GWBS-U)  
Income Date  
Latest Income Date  
Life Annuity with 120 Monthly Periods Guaranteed With Additional Death Benefit  
Life Income Of the Guaranteed Annual Withdrawal Amount  
Life Income With Additional Death Benefit  
Mortality and Expense Charge  
Separate Account  
Separate Account Contract Value  
Termination of the Guaranteed Minimum Withdrawal Benefit  
Total Asset Based Charges  
Withdrawal Charge  
Withdrawal Value

### **6. R.O.I.’S CONFLICT OF INTEREST**

R.O.I. has a conflict of interest relative to evaluating annuities for clients and prospective clients. Generally, if a client or prospective client is contemplating or has purchased an annuity, for example, \$100,000 in an annuity, R.O.I. might have managed that \$100,000 and be **paid by the client** a maximum of **\$1,250 (1.25%) over an**

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entire year. Over an entire ten years, R.O.I. could be **paid by the client** a maximum of **\$12,250** – **that sounds like a lot of money**. However, keep in mind that:

1. In order for R.O.I. to be paid that much money, R.O.I. would have to provide **at least satisfactory services** to the client for those ten years (e.g., active investment management, personally reviewed quarterly reports, monthly personally drafted newsletters, special communications like this one, annual reviews, individualized comprehensive financial plans, active retirement planning, etc.); and,

2. **R.O.I.’s relationship with clients is a “fiduciary” relationship**, meaning R.O.I. must always put the interests of clients before its own. Part of our NAPFA “Fiduciary Oath” (see [www.roionweb.com](http://www.roionweb.com) NAPFA Advisor Values) is to:

- Always act in good faith and with candor.
- Be proactive in disclosing any conflicts of interest that may impact clients.

R.O.I.’s conflict of interest should be contrasted with that of an advisor who sells a client an annuity. On the same \$100,000, the advisor and broker would be paid, **within 30 days**, 7-9% - let’s assume 8% - or **\$8,000 by the insurance company**. Because **it is not in the advisor’s financial interest** to provide similar services as R.O.I. (such services would interfere with his financial interest to sell more annuities), if the advisor pursues his financial interest and sells 10 such annuities/year (less than one/month), he and the broker would be paid **by the insurance company**, over the entire 10 years, **\$800,000** (\$8,000 x 10/year x 10 years) – **that IS a lot of money**. Keep in mind, that such an advisor **DOES NOT have a “fiduciary” relationship with clients**, and therefore has no legal or contractual responsibility to always act in good faith and with candor, and to disclose any conflicts of interest.

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