Guaranteed Income Benefits
(income for life)
Variable Annuities
VS.
Fixed Indexed Annuities
White Paper

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Preface

I decided to write this "white paper" after publishing a brief newsletter through The Wealth Preservation Institute (http://www.thewpi.org) on the same subject. The feedback from the newsletter was so overwhelming that it was clear to me that a more detailed summary of my findings/conclusions was needed.

With the stock market crash of 2000-2002 and again in 2007-2009, millions of Americans have lost billions of dollars in the stock market. The consequences of investors not having some of or a decent amount of their money in wealth-building tools that would not go backwards or ones that would guarantee a rate of return with a lifetime income has been dire.

In 2009, millions of people who are in retirement now can no longer live the retirement they dreamed because they **lost up to 50% or more of their money in the market**. Millions of people are not able to retire now or even in the near future for the same reason.

One product that is being pitched heavily in the financial marketplace today is one that offers a "**guaranteed lifetime income stream that cannot be outlived**." It sounds great, but like any financial tool, the devil is the details.

The primary product that people used to look to provide this "lifetime" or "guaranteed income" was a **variable annuity** (VA).

More recently, **Fixed Indexed Annuity** (FIA) products have been redesigned to offer the same "lifetime" or "guaranteed income" stream for life as a VA.

I created this white paper as a mathematical look using certain real-world assumptions to determine whether a VA or FIA with a guaranteed income rider will create more income and/or pass more wealth to heirs at an insured's death.

To my knowledge, this is the only white paper of its kind in the industry. This paper is **Copyright protected**. If you are an advisor reading this paper, you have my authority to forward it to your **colleagues (NOT TO CLIENTS)**. If you are a non-advisor, you have my authority to forward it to your friends or loved ones. **If you are a marketing organization (IMO, FMO, GA) or an insurance company, you DO NOT have my permission to use this as an educational tool for your licensed agents**. To obtain my permission, please e-mail me at **roccy@thewpi.org**.

*In an effort to give full disclosure, I am not securities licensed; and this white paper is **NOT to be used for investment advice**. I am an attorney who has a knack for breaking down the math behind the expenses and real-world returns of annuity and life insurance products (as you will read in the following pages).*

What is an Annuity?

An annuity is a contract between a buyer, or contract owner (typically an individual), and the issuer (typically an insurance company) whereby the contract owner agrees to pay the issuer an initial premium or payment in a lump sum, or payments over a period of time, during which the issuer guarantees the owner a stated minimum rate of return or the opportunity to participate in the growth of an underlying group of assets in which the annuity premiums are invested. As with all contracts, there are numerous terms and conditions that influence the features and benefits that accrue to the owner.

The annuity contract is generally called a "Policy" because it is issued by an insurance company, and the owner is generally referred to as the "Policyholder". This terminology is in general use even though the annuity is technically not an "insurance policy" in the traditional sense; however, it may have some of the attributes of a life insurance policy, e.g., a death benefit.

There are generally three parties to an annuity: owner, annuitant, and beneficiary. The **owner** is the individual, or individuals, who own the cash benefits of the annuity. The owner is typically the only party who can redeem the annuity for its cash value, change beneficiaries, and make other changes allowed by the annuity contract. An annuity owner can be an individual, a trust, or a business entity.

The **annuitant** is generally the individual on whose life the death benefit is contingent. The annuitant may be, and oftentimes is, the same as the owner; but this is not required.

The **beneficiary** is the individual or entity that is named to receive the death benefit of the annuity.

There are many different kinds of annuities, but this white paper will focus on Variable Annuities and Fixed Indexed Annuities. Also, annuities can be tax-qualified or not. That is not important to the premise of this document which is to determine whether a VA or FIA with a guaranteed income rider creates the most income and has the largest account value at death.

What is a Variable Annuity (VA)?

Most non-advisors think of VAs as a way to invest in mutual funds in a tax-favorable manner. A variable annuity offers a range of investment options. The value of the investments inside a VA will vary depending on the performance of the investment options chosen. The investment options for a variable annuity are typically mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

I've heard them sold as "mutual funds with an insurance wrapper." Why in an insurance wrapper? Because money inside an insurance wrapper can **grow without capital gains and dividend tax**. With an annuity, the gain is income taxed when withdrawn (vs. a life insurance policy where the money can come out income tax-free via policy loans).

Therefore, insurance companies tout an all-in-one package with a VA by showing insureds how they can invest in mutual funds and avoid current taxation on the growth (short- and long-term capital gains taxed or taxes on dividends).

When an annuity is purchased, a premium is paid to the insurance company which then, in turn, funds the annuity per the direction of the owner (again, the investments chosen are typically mutual funds).

A variable annuity has two phases: an **accumulation phase** and a **payout phase**.

During the **accumulation phase**, you make purchase payments, which you can allocate to a number of investment options. For example, you could designate 40% of your purchase payments to a bond fund, 40% to a U.S. stock fund, and 20% to an international stock fund. The money allocated to each mutual fund investment option will increase or decrease over time depending on the fund's performance. In addition, variable annuities often allow you to allocate part of your purchase payments to a fixed account. A fixed account, unlike a mutual fund, pays a fixed rate of interest. The insurance company may reset this interest rate periodically, but it will usually provide a guaranteed minimum (*e.g.*, 3% per year).

Example: You purchase a variable annuity with an initial purchase payment of $10,000. You allocate 50% of that purchase payment ($5,000) to a bond fund, and 50% ($5,000) to a stock fund. Over the following year, the stock fund has a 10% return, and the bond fund has a 5% return. At the end of the year, your account has a value of $10,750 ($5,500 in the stock fund and $5,250 in the bond fund), **minus fees** and **charges** (discussed below).

The Good

Tax deferral of investment gains – like an IRA, taxes on the gains from an annuity are due when taking withdrawals.

Ease of changing investments – Inside a VA, there are sub-accounts with various mutual funds to select from. In most VAs, you can change these investments with relative ease and with little or even no transactional cost.

Income for life – This will be discussed in an upcoming section.

Asset protection – In many states, all annuities are protected from creditors.

The Bad

Lack of disclosure – Many times advisors who sell VAs do not fully disclose the fees and the fact that some VAs require annuitization to remove your money with some of the guaranteed income products.

The Ugly

Costs/Fees – While lack of disclosure of fees is "bad," the fees inside a VA annuity can be ugly and can reach in excess of **4.5%** a year.

Typical Costs/Fees Associated with a VA

To say that VAs are "loaded" with fees would be an understatement. Having said that, fees are a non-issue if you are getting value for your fees. Many times an annuity owner has no idea how high the fees actually are in their VA and what's worse have no idea how those fee negatively affect their "guaranteed" account value and income stream.

The following charges will reduce the value of a VA account and the return on its investments.

Annual Money Management Fees .9% -This is the fee charged for having a security licensed advisor help you invest and manage the assets in your VA. An average money management fee is approximately **.9% per year**.

Mortality and Expense Risk Charge – This charge is equal to a certain percentage of your account value, typically in the range of **1.25% per year** (although they can exceed 2.5%). This charge compensates the insurance company for insurance risks it assumes under the annuity contract. Profit from the mortality and expense risk charge is sometimes used to pay the insurer's costs of selling the variable annuity, such as a commission paid to a financial professional for selling the variable annuity.

Example: Assume a VA has a mortality and expense risk charge at an annual rate of 1.25% of the account value. If the average account value during the year is $200,000, a $2,500 fee is paid for mortality and expense risk that year.

Administrative Fees – The insurer may deduct charges to cover record keeping and other administrative expenses. This may be charged as a flat account maintenance fee (perhaps $25 or $30 per year) or as a percentage of the account value (typically in the range of **0.15% per year**).

Example: Assume a VA charges administrative fees at an annual rate of 0.15% of account value. If the average account value during the year is $200,000, a $300 administrative fee will be charged.

Trading Costs/Underlying Fund Expenses – VA owners also indirectly pay the fees and expenses imposed by the mutual funds that are the underlying investment options for their VA. These expenses typically cost about **.5% per year**.

Fees and Charges for Other Features – Special features offered by some variable annuities, such as a stepped-up death benefit, a guaranteed minimum income benefit, or long-term care insurance, often carry additional fees and charges.

The average annual expense for a VA vary depending on which study you read, but most studies put the fees between **2.2%-2.7% per year**. These fees can vary depending on whether A, B, or C-share mutual funds are purchased. These annual fees **DO NOT** include additional fees for riders such as guaranteed account value rider and guaranteed income rider (discussed in an upcoming section).

Surrender charges – Both VAs and Fixed Indexed Annuities (FIAs) have surrender charges. They vary somewhat, but a typical surrender charge period would be between 5-16 years. If money is withdrawn from an annuity within the surrender charge period, a penalty will be assessed from the insurance company. A typical surrender charge schedule for a five-year product would be: 5% in year one, 4% in year two, 3% in year three, 2% in year four, and 1% in year five.

Often, contracts will allow you to withdraw part of your account value each year – 10% or 15% of your account value, for example – without paying a surrender charge.

For those who are sold annuities with the proper surrender period, the charge should never come in play.

Fixed Index Annuities ("FIAs")

A FIA is just that. It is an annuity that when purchased will **not allow the owner's account value to decrease** no matter what happens in the stock or bond markets.* *The asterisk signifies that while the insurance company guarantees that the money will not go backwards, the company must remain solvent to keep the guarantees.

The “index” part of the name comes from how the growth in a FIA is calculated. The growth is pegged to a stock index (typically the S&P 500). Although the gains are linked to the S&P 500 stock index (minus dividends), the premium dollars paid by the insured are not actually invested in the S&P 500 index (which would be very risky). Additionally, the growth in a FIA is traditionally capped (caps vary per company, but a typical cap will vary on an annual point-to-point product from 5% - 12%+ depending on different variables).

The following is a simple explanation of how an insurance company can guarantee that money will not go backwards in a FIA and allow gains at market rates (up to a cap).

1) The insurance company receives an owner’s premium payment and invests the money in income-producing bonds.

2) Income from the bonds is then used to purchase options on the S&P 500 stock index.

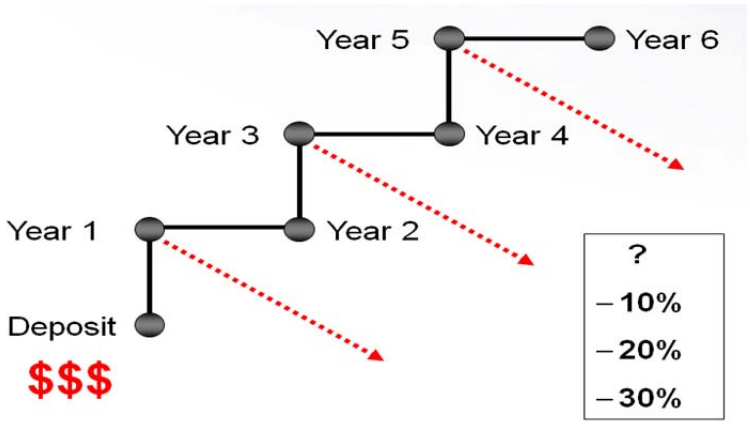
The return of the S&P 500 options drives the returns in the FIA. The higher the bond income, the more/better options can be purchased on the S&P 500 index. The lower the cost of the options, the better the returns.

It is because of the above variables that the “**caps**” in the products (explained in the next section) will have slight fluctuations.

Crediting Methods

One of the most popular crediting method is called the **annual point-to-point** method. It works as follows: At the time of the initial premium, the level of the measuring stock index is recorded as the starting point and compared to the level of the index at the first anniversary date of the initial premium 12 months later. The difference is measured and used to determine the amount of the earnings paid into the annuity for the first year. This movement in the index may be subject to a participation rate, a **cap**, and possibly a spread.

The insured’s account value will never go backwards, and most point-to-point annuities lock in the gains every year. See the following chart which should help illustrate the value of a product that will never go backwards due to losses in the measuring stock index and which also locks in the gains every year.



	$100,000 Invested in S&P	$100,000 Invested in EIA
Year	**A**	**B**
1	14.71%	12%
2	-22.09%	0
3	-11.88%	0
4	-9.10%	0
5	21.04%	9%
Total	**$86,648.64**	**$122,080**

For the above example, I assumed a $100,000 premium into a FIA on the right and $100,000 into the actual S&P 500 stock index on the left. In year one, you'll notice a **12% cap**. In that year, the S&P 500 stock index returned 14.71%; but the annuity return was capped at 12%. However, when the S&P 500 went negative the following three years in a row, the FIA account value did not go backwards. In year five, the S&P 500 returned 21.04%, and the FIA with the now lower **9% cap** returned 9%. These two charts show the simplicity and protection of a FIA.

Participation Rate

The participation rate is the amount of the movement in the index that the annuity owner is entitled to have credited to the annuity as earnings. The participation rate in many products today is generally 100%. Some of these products have an "average" or a "cumulative average" which in mathematical terms is less than a 100% participation rate in the change of the index "point-to-point." Care needs to be taken to understand how the participation rate works to make sure you are actually buying a point-to-point FIA with a 100% participation rate.

Some products literally have **no cap,** but the participation rate may be **50%-70%**.

The best way to understand FIAs is through examples.

> Assume the index used is the S&P 500 and this index increases 12% during the year, but the participation rate is stated as 80%. In this case, the annuity would be credited with an earning rate of 9.6% (80% of 12%). If the participation rate was 100% but had a 9% cap, then the amount credited would be 9% since that is the maximum permitted, or the cap. Sometimes both participation limits and caps are used to determine the earnings credited.

Also, some FIAs employ a fee, generally called the "spread," which is subtracted from the earnings rate before it is credited to the annuity. In the foregoing example, if the spread were 2%, the annuity would be credited with 7.6% (9.6% less the 2% spread) and 7% (9% less 2%) respectively. The participation rates, caps, and spreads may be fixed for a specified time or they may be guaranteed for the term of the annuity. Generally, if they are subject to being reset at the option of the issuer, they will also include minimum and maximum amounts that limit their variability.

FIA Fees

As you read in the VA section of this paper, there are significant annual fees charged against the annual returns or account value even if there is no return in any given year. FIAs technically have NO fees (although they do have surrender charges similar to VAs). The "fees" come into play in the form of caps and participation rates which can depress the returns in years with significant stock index returns.

Summary on Typical VAs and FIAs

What you need to understand is that there is no free lunch with annuity products. You should be buying VAs or FIAs because you like the benefits offered by the products not because they will outperform a classic stock portfolio in a robust market. You may choose to buy a VA so you can have tax-deferred growth and avoid current transaction costs typically associated with a stock or mutual fund portfolio (dividend or capital gains taxes). You may choose to buy a FIA because you want to make sure your money never goes backwards due to stock market losses and because you want your gains locked in every year with the understanding that the product will typically have an annual cap on the gains.

While there are many valid reasons to buy annuities, many people are buying them today for one simple reason: a "**guaranteed income for life**." The following material will discuss the guaranteed riders that can be added to a VA and a FIA and will demonstrate with real verifiable math whether a VA or FIA will perform better given certain real-world situations.

Annuity Riders

VA Riders

There are many different types of VA annuity riders. This paper will focus on a Guaranteed Death Benefit (GDB), Guaranteed Minimum Withdrawal Benefit (GMWB), Guaranteed Minimum Income Benefit (GMIB), Guaranteed Lifetime Withdrawal Benefit (GLWB), and Guaranteed Minimum Accumulation Benefit (GMAB).

Guaranteed Death Benefit – GDB

If an annuitant dies before the annuity begins paying out benefits, the beneficiary, as named in the contract, will receive a death benefit. With most VAs, the death benefit received by the beneficiaries is guaranteed to be at least the initial premium paid when purchasing the VA. If the actual net account value is higher than the premiums paid at the time of death, that will be the death benefit paid to the beneficiaries.

For example: If Dr. Smith paid a $100,000 VA premium and the three years following the funding of the VA the stock market declined by 50%, the account value will be less than $50,000 because of the VA fees. However, if Dr. Smith passed away, his heirs would receive a GDB of $100,000. If the stock market did well and if the net account value was in excess of $100,000, the beneficiary(s) would receive the higher value.

Additional cost of investment: 15-35 basis points (.15% - .35%) per year.

Guaranteed Minimum Withdrawal Benefit - GMWB

A GMWB is a rider that annuitants can purchase that gives them the ability to protect their retirement investments against downside market risk by allowing the annuitant the right to withdraw a maximum percentage of their entire investment each year until the initial investment amount has been recouped.

The best aspect of this guarantee is that it protects annuitants against any investment losses that have been incurred without losing the benefit of upside gain. **For example**, suppose that Dr. Smith's initial investment was $100,000; but due to downturns in the economy, the investment is now only worth $85,000. Since Dr. Smith had purchased a guaranteed minimum withdrawal benefit with a rate of 5%, he will be able to withdraw a certain percentage each year (in this case, $5,000) until the entire $100,000 is recovered.

The problem with this rider is that most annuitants will have to live a long time in order to get their principal back. In the example, Dr. Smith would have to live for 20 years in order to recoup the initial $100,000 investment (although many times a guaranteed death benefit rider is added in order to make sure that the initial principal is

paid in the form of a death benefit should the annuitant not withdraw $100,000 via the GMWB before death).

Annuitants must usually elect the GMWB when the contract is issued; and in some cases they are non-cancelable, which means their costs continue even if there is no chance they will ever pay off.

Additional cost of investment: 40-75 basis points (.40 -.75%) per year.

Guaranteed Minimum Income Benefit - GMIB

A GMIB is a rider that annuitants can purchase that gives them the ability to receive a "guaranteed income for life." An annuitant must "annuitize" (taking level systematic lifetime income payments) the annuity balance in order to receive the lifetime income stream. Once an annuity is annuitized, there is no ability to take lump sum distributions from the VA in times of need. Some VAs have a lengthy waiting period before being able to activate this rider (ten years for example).

This option may not be too attractive to annuitants who are older and who are in poor health because they are stuck with a lifetime income payment and cannot take advantage of the guarantees if they take withdrawals from the VA.

Receiving a GMIB ensures that an annuitant will receive a payment regardless of market conditions. The payment is based on the actual account value in the VA at the time the GMIB is activated **or** the guaranteed income base. Then the income stream is based on a specified percentage of the higher of the two.

For example: Assume Dr. Smith funds a VA with $500,000 and that the guaranteed rate of return on that investment is 5%. Assume the total expenses in the VA each year equaled 2.7%. After 10 years, the guaranteed account value/base would be $814,447. If the actual gross return of the annuity was 7%, the actual account value/base would be $761,751. Because the guaranteed account value is higher than the actual account value, the GMIB would be based on $814,447.

The account value/income base amount is only half of the equation. What also drives the GMIB for life is the percentage payment based on the account value used. That percentage will vary per company. If, **for example**, the GMIB is based on a 5% income benefit using the guaranteed account value of $814,447. Dr. Smith would receive a GMIB for life in the amount of $40,772. If the GMIB was based on a 7% income benefit, then Dr. Smith would receive $57,011 every year for rest of his life

There are a lot of moving parts to these riders, and it's important to understand that both the initial guaranteed return (roll-up percentage/rate) is important but so is the GMIB rate/percentage used to pay the income benefit for life (which is based on the higher of the two accumulated roll-up account values).

Additional cost of investment: 50-75 basis points (.50% - .75%) per year.

What then passes to your heirs upon death?

It will depend on the product used. For most, whatever the actual account value is will be passed to the heirs upon death. The actual account value is decreased by the payments made to the annuitant during the payment phase. The account value will still continue to grow at market rates which could slow the diminution of the actual account value. However, remember that the fees in the VA will still be charged which in flatter stock market periods could really eat away at that actual account value. This will become much clearer to you in a later section of this paper where I will go through a comparison of VA GMIB riders to FIAs riders.

Guaranteed Lifetime Withdrawal Benefit - GLWB

A GLWB is a rider that annuitants can purchase that gives them the ability to take minimum "withdrawals" throughout their lifetime from the invested amount **without having to annuitize** the investment. The amount that can be withdrawn is based on a percentage of the total amount invested in the annuity.

In most cases, if you were to access the funds in the annuity, you would have to either annuitize it (take level systematic annual lifetime payments) or face fee penalties. The GLWB allows access to the invested capital, regardless of the performance of the investments inside the VA, and continues to maintain and invest in the annuity. The guaranteed withdrawal amount is a set percentage that typically will increase the longer you wait to take withdrawals.

For example, the insurance company may agree to pay you 5.5% at age 60; but if you wait until age 70, you may receive 6%.

"IF" the VA performs well, the annuitant could receive more than the predetermined GLWB by having the account value of the VA recalculated over set intervals (such as every 5 years). This rider seems to be attractive to those who want to have their money actively invested in the stock market but who also want to hedge that risk while knowing that they have a guaranteed income option while NOT giving up access to the funds through annuitization as the only option of receiving a lifetime income payment.

Additional cost of investment: 50-60 basis points (.50% - .60%) per year.

Guaranteed Minimum Accumulation Benefit – GMAB

A GMAB is a rider that annuitants can purchase that guarantees a minimum amount of growth will be credited to the VA account value during a predetermined accumulation period (a term of years). If the net actual VA account value is higher than the guaranteed account value at the end of the term, then the rider in hindsight was not needed. However, if the investments of the VA do not perform well, the annuitant, after the term of years, will have a guaranteed account value (which is specified when purchasing the VA).

Additional cost of investment: 25-75 basis points (.25% - .75%) per year.

Summary of Total Potential Costs in a VA

In the early part of this paper, I outlined that the average costs of a typical VA is approximately 2.2%-2.7% per year WITHOUT riders.

As you've just read, there are many riders that can be added to a VA. Let me list them for you again and their potential annual fees.

Guaranteed Death Benefit (GDB)	.15% - .35%.
Guaranteed Minimum Withdrawal Benefit (GMWB)	.40% - .75%
Guaranteed Minimum Income Benefit (GMIB)	.50% - .75%
Guaranteed Lifetime Withdrawal Benefit (GLWB)	.50% - .60%
Guaranteed Minimum Accumulation Benefit (GMAB)	.25% - .75%
Totals:	**1.80% - 3.20%**

Therefore, if you take the average non-rider cost of a VA at 2.2%-2.7% and add in the riders, you could have an annuity with a total annual cost of between **3%-5.9%**.

Many in the industry think the fees of VAs are out of control. This white paper is not designed to give my opinion of what I think of fees in VAs. I am simply trying to explain how VAs work, list the typical VA fees, and the fees for each various rider.

One of the reasons that the average person will typically like FIAs better than VA is because they can understand the costs a little bit better. With VAs you have typical annual costs of money management fees, mortality and expense risk charges, and administrative fees. Then you have the many different riders that can be added to a VA.

With most FIAs, there are no "fees." The costs as most people will call them in a FIA come in the form of a cap on returns. With a VA, an annuitant knows the fees will be taken out of growth which will decrease the available account value. With a FIA, it is very likely that the caps in years when the stock market does well will limit what could have been the account value had there been no cap. The question is which product will accumulate more money over the next 5-10-20+ years. The answer is we have no idea because we do not know how the stock market will fair going forward.

What we do know and what this paper was designed to demonstrate is whether a VA or FIA with the guaranteed income benefit(s) riders will guarantee more income in retirement for retirees and which one will pass the most amount of wealth to the heirs upon the death of an annuitant.

Fixed Indexed Annuity Riders

There are few riders that can be added to a FIA. In fact, the only useful one I'm aware of is a guaranteed income benefit (GIB) for life rider. The FIA income rider functions slightly different from a VA and, therefore, needs to be explained.

The GIB for life rider is sort of a combination of riders offered by VAs. The rider 1) guarantees a **rate of return** on what I call an "accumulation account" on premiums paid and 2) guarantees an **income for life** based on a certain percentage rate of return which will be determined by the age of the annuitant at the time of activation.

The accumulation account value is NOT a walk-away account value. It is ONLY used for calculation purposes when determining the guaranteed income for life payment.

As stated, there are two different account values inside a FIA that has the GIB for life rider. The accumulation account (which is guaranteed to grow at a specified rate of return) and an actual account value (which will grow at whatever market rates the FIA would typically grow (limited by the caps or participation rates)).

Let me use an example, and I think you'll understand how the two different account values grow. In the following chart you will see an accumulation value account in the center column and the actual account value in the right hand column. This example product has a 7% guaranteed rate of return on the accumulation account.

	Accumulation Value	Account Value
Issue Age 55	$100,000	$100,000
Year 1 Age 56	$107,000	$103,600
Year 2 Age 57	$114,490	$107,329
Year 3 Age 58	$122,504	$111,193
Year 4 Age 59	$131,080	$115,196
Year 5 Age 60	$140,255	$119,343
Year 6 Age 61	$150,073	$123,639
Year 7 Age 62	$160,578	$128,090
Year 8 Age 63	$171,819	$132,702
Year 9 Age 64	$183,846	$137,479
Year 10 Age 65	**$196,715**	**$142,428**

As you can see, the center column grows at 7%. The right column is the actual account value, and I had it grow at a made up and more modest rate of return.

If the annuitant dies prior to activating the GIB for life rider, the beneficiaries of the FIA would receive what's in the right hand column in any given year.

If the annuitant wanted to withdraw money from the annuity, he/she would do so from the right hand column. For simplicity sake, I did not include the surrender charges which would decrease the account value in year one in an amount of 5%-16+% depending on the annuity used. As you read, surrender charges decrease just about every year until gone (which is usually between 5-16 years depending on the annuity purchased).

When the income benefit (discussed in an upcoming section) is activated, it is based on the accumulation account value not the actual account value. The only reason there is an accumulation account is so the insurance company has a value to use to base a lifetime income stream off of.

There is a significant difference between a guaranteed accumulation value of 5% and 7%. This should be one key factor for determining which FIA to use. For example, if an annuitant, age 50, positioned $500,000 into the new FIA with a 7% guaranteed accumulation value, that value at age 70 would be $1,934,843. If the client used a FIA with a guaranteed accumulation value of 5%, that value would be $1,326,649.

Accumulation Period

The previous example assumes an accumulation period of 20 years. Most products only roll up for 10-12 years. There is a big difference between a 10 and 20 year accumulation period.

Depending on the age of the annuitant, a 10-year accumulation period may be fine. However, if the annuitant is 50 years old, he/she is most likely going to wait more than 10 years to activate the rider and could wait an entire 20-year period before activating it.

Most VA riders have a 10-year maximum roll-up period. This is a significant point for many potential buyers.

Withdrawal vs. Annuitization

One of the unique features of a GIB for life rider with a FIA is that it does NOT require annuitization. An annuitant can activate an income stream for life; but if he/she needs a lump sum of money, the money in the actual account value will be available. Withdrawals will decrease future payment streams or will cause them to cease if all of the remaining actual account value is withdrawn.

Calculating the Lifetime Income Stream

Different insurance companies have different ways they calculate the GIB. Remember that the GIB is based off the guaranteed accumulation account (which grows typically at between 5-7%). Some companies use the following payment schedule:

-5% if the rider is activated before age 70
-6% before age 80
-7% over 80 years old

Most companies use the following schedule:

-5% if the rider is activated before age 65
-5.5% if activated at ages 65-69
-6% if activated at ages 70-74
-6.5% if activated at ages 75-79
-7% over 80 years old

The "fairest" payment schedule

At least one company in the marketplace has a payment schedule that is calculated by taking the annuitant's age at the time of activation and subtracting 10. It sounds simple enough.

-If a client is 60, the payout will be **5%**
-If a client is 63, the payout will be **5.3%**
-If a client is 77, the payout will be **6.7%**
-if a client is 84 when triggered, the payout will be **7.4%**
-if a client is age 90 when triggered, the payout will be **8%**

The maximum income varies per company but ranges from 7-8% typically.

As you will see, there is a significant difference between a typical payment schedule and the fairest payment schedule.

Example 1

Let's look at an example for a 79-year old with $500,000 in his FIA accumulation account with a GIB for life rider. With some products in the marketplace, the client is going to receive a GIB of **6%** a year for life.

The income for this annuitant using a normal FIA with a GLB rider would be $30,000 a year.

What about with the fairer GIB payout? The annuitant would receive a GIB of **6.9%** (79 (age) – 10 x .001).

The income for this annuitant using what I consider the best FIA with a GIB for life rider (6.9%) would be $34,500 a year. With the more client friendly product, the annuitant receives **$4,500 more** income every year for life. If the annuitant lived another 10 years, that's an additional $45,000 of income.

Example 2

This example will use the information from a previous example and will illustrate how important both the guaranteed rate of return on the accumulation account is as is the guaranteed rate of return on the income benefit.

There is a significant difference between a guaranteed accumulation value of 5% and 7%. For example, if a client, age 50, positioned $500,000 into the new FIA with a 7% guaranteed accumulation value, that value at age 70 would be $1,934,842. If the client used a FIA with a guaranteed accumulation value of 5%, that value would be 1,326,649.

There is also a significant difference when an annuitant can receive an income benefit of 5.9% vs. 5%.

If the annuitant is 69 when starting the GIB, using the more client friendly FIA, the GIB for life would be 5.9% x $1,934,842 (the accumulation value) = **$114,155** every year until death. Using a 5% income benefit the payment would be **$96,742**.

When I compare that to the typical payment schedule using a 5% guarantee on the accumulation account and a 5.9% GIB, look at the difference: 5.9% x $1,326,649 = **$78,272** every year until death. Using a 5% income benefit on the 5% guaranteed roll-up accumulation account, the payment each year would be **$66,332**.

The difference is staggering;

	5.9% Income	5% income
7% Guaranteed Return (accumulation account)	**$114,155**	**$96,742**
5% Guaranteed Return (accumulation account)	**$78,272**	**$66,332**
Difference in income for a 15 year payout for a 70 year old	**$538,245**	**$456,150**

The biggest difference is between a 5% guaranteed return with a 5% income benefit and a 7% return and a 5.9% income benefit (over 20 years the difference is **$956,460**).

The conclusion from the previous examples illustrates that it is vitally important to find the product with the highest guaranteed rate of return on the accumulation value as well as the highest guaranteed income rate of return.

Finally, most FIAs also have a reset feature in them. If over a time frame (typically five years) the actual FIA returns are greater than the guaranteed rate of return (on the accumulation account value), the accumulation account value will be reset to the higher value.

When is a 7% Guaranteed Rate of Return Better than an 8%?

To further illustrate the problems insureds may have when picking a product, I wanted to explain a classic marketing technique that some companies employ in the sales process.

If I asked you if you would rather have an 8% or 7% guaranteed rate of return on an accumulation value for a FIA, what would you say? Of course, you'd say 8%.

When is a 7% guaranteed return better than an 8% guarantee?

The simple answer is when the GIB from the 7% guaranteed return FIA is better than the 8% guaranteed return product. How can that be? You may have guessed the two ways by what you've already read.

1) The GIB rate of return for the 7% guaranteed return product (accumulation value) may be higher. For example, the income benefit may be 1% higher with the 7% product which, in turn, over a lifetime of the payments could overcome the fact that the accumulation account upon which the GIB is based is lower than the 8% product.

2) The accumulation period for the 7% guaranteed return product may be 5-10 years longer.

Let's look at an example where the roll-up period for the annuity is 10 years and one is 20 years. I'm also going to throw into the mix that the 7% product uses the fairer guaranteed income payment schedule. Assume the annuitant was 50-years old when funding both annuities.

Income at age	Fairer Payment Schedule	GIB w/ 7% Roll-up up to 20-years	Typical Payment Schedule	Income w/ 8% Roll-up up to 10-years
60	5%	**$9,835**	5%	**$10,794**
64	5.40%	**$13,924**	5%	**$10,794**
65	5.50%	**$15,174**	5.50%	**$11,874**
69	5.90%	**$21,337**	5.50%	**$11,874**

What do you notice about the previous chart?

Look at the percentage used to generate the guaranteed income at the various ages. At age 60, both companies have a 5% income benefit.

At age **64**, the fairer FIA has a **5.4%** income benefit and the other product still has a **5%** income benefit.

Therefore, unless the client activates his/her income stream right at age 60, the income from the FIA I prefer will be higher.

Now let's look at age **65** and **69**. There is a huge income difference in the two products. Why?

Because the 7% FIA has a **guaranteed 20-year accumulation roll-up**. The 8% FIA has a **10-year accumulation roll-up**. In year 11, there is no guarantee of 8% (I've assumed the worst case scenario that could happen which is no growth due to a low account value over the first 10 years).

Is the previous example a manipulate one? Absolutely. I intentionally manipulated it to drive home the point that is vitally important that annuity owners understand how these products work so they are not taken in by flashy sales techniques. With a good understanding of how these products work, potential annuity buyer can pick the one that best fits their situation.

Costs of the GIB inside a FIA

Like VA riders, the GIB for life rider for FIAs does have a cost. The cost varies per company but can be as low as .40% a year to as high as .85% a year.

As you know, the account balance in a FIA cannot go backwards due to market declines. However, it can go backwards if this rider is added and the FIA has a return of zero in any particular year (a return of zero happens when the S&P 500 has a negative return or if, by chance, the index actually returns zero).

The fee for the GIB for life rider is taken out of the account value every year regardless of the returns.

Time Frame for Activation

The GIB in a FIA can usually be activated anytime after owning the annuity for 12 months. However, the annuitant for most FIAs must be age 60 or older to activate it. Some VA riders also can be implemented shortly after purchasing the annuity and adding the rider.

Enhanced Income Benefit

Some FIAs will provide an increased income benefit that acts like a **long-term care benefi**t (LTC). LTC insurance policies typically activate and pay benefits when you can't perform two of your six ADLs (Activities of Daily Living: eating, bathing, dressing, toileting, transferring (walking), and continence).

The best enhanced benefit I know of in the marketplace adds 3% to the guaranteed income stream. Therefore, if an annuitant is 70 years old, the normal income stream would typically be 6%. If the annuitant can't perform two of six ADLs, that income stream would be increased to 9%. The maximum I've seen in the marketplace is an enhanced income payment with an 11% annual payout.

This enhanced benefit on some FIAs is FREE (see the next section for an explanation for how an insurance company can afford such a free benefit).

How can Insurance Companies Afford to Guarantee Payments for Life?

With a FIA, it's quite a bit easier than with a VA. Remember that with a FIA, the product is already designed to never have the account value go backwards due to negative market rates of return. Additionally, the gains are locked in annually.

When the insurance company starts paying the lifetime income stream, it is taking the money from the owner's own actual account value. In essence, the insurance company is giving the owner back his/her own money.

The actual account value will still grow in up years with those gains locking in which should reduce the speed at which the account value is diminished.

Additionally, the insurance company has priced the product with the additional rider fee (.04%-.85%) annually to help make sure the product is profitable.

When the annuitant can't perform two of six ADLs and the increased income benefit is activated, it seems like a risk that the company will actually have to pay out more than the actual account value. Annuitants who can't perform two of six ADLs are ones who have a much shorter life expectancy than those who are fully healthy. By using mortality underwriting tables, the insurance companies know that annuitants who can't perform two of six ADLs do not have a long life expectancy and, therefore, will most likely die before ever driving down the actual account value to zero.

Simple Interest

Be careful of products in the marketplace that give out a 10% or more guaranteed rate of return. It sounds great, but these products use a simple rate of return vs. a compounded rate of return to come up with their numbers. Due to the fact that I think everyone knows how big of a difference compound interest is vs. simple interest (just see your 30-year home loan that never seems to get paid off), I'll not put the actual numbers in this paper.

Comparing Guaranteed Income Rider
VAs vs. FIAs

Many readers of this paper will skip right to this section to see the outcome of my real- world comparisons between my favorite FIA and the best VA I could find.

Example 1 will use the following assumptions:

Annuitant age: 50
Amount Invested: $100,000
Income starting in year: 10
Guaranteed return VA: **6%**
Hypothetical VA return: **10% gross**
(net return = 6.84% M&E charge: 1.25%, administration fee .15%, portfolio expense 1.01%, MGIB .75%).
Guaranteed return FIA: **7%**
Hypothetical FIA return: **6% gross**
(net return = 5.6% in years 1-10 and 5.5% in years 11 and beyond).

Why the difference in returns (10% for the VA and 6% for the FIA)? The VA should return a higher amount in a robust market. That may or may not happen over the next 20 years. Also, with the first example, I'm intentionally giving the benefit of the doubt to the VA. Why? Because I want to illustrate the power of the FIA product which will become clear when you see the numbers of an illustration intentionally slanted in favor of VAs.

What about the difference in the guaranteed rate of return used for the accumulation account? The 6% VA return is the highest I can find in the market right now, and the 7% FIA return is with the product I prefer to use and is available in the market right now.

Guaranteed Income Comparison

		VA Income	FIA Income	VA Income	FIA Income
Year	Age	10% Gross	6% Gross	0% Gross	0% Gross
11	60	$9,274	**$10,131**	$8,276	**$10,131**
12	61	$10,175	**$11,056**	$9,120	**$11,056**
13	62	$11,171	**$12,062**	$10,057	**$12,062**
14	63	$12,271	**$13,155**	$11,097	**$13,155**
15	64	$13,487	**$14,341**	$11,879	**$14,341**
16	65	$14,831	**$15,629**	$12,265	**$15,629**
17	66	$16,316	**$17,028**	$12,669	**$17,028**
18	67	$17,955	**$18,545**	$13,092	**$18,545**
19	68	$19,765	**$20,191**	$13,534	**$20,191**
20	69	$21,761	**$21,977**	$13,994	**$21,977**

This is a very interesting chart. The VA, which used a 10% gross rate of return, had a guaranteed income of **less** than the FIA using a 6% rate of return. It's pretty close in most years, but the FIA wins in every single year.

You may be asking yourself why did I run an illustration at 0%? Because in the securities world, advisors are forced to run these illustrations for their clients; and that's the numbers that are on a typical VA illustration. The 0% rate of return is not a worthless number even though the likelihood of it happening itself is about 0%.

What we can learn from the 0% rate of return in the VA is that the FIA does much, much better and, therefore, we can deduce that the lower the return in the VA has under the 10% illustrated number, the better the FIA return is going to be by comparison because the FIA return is not contingent on such a high gross rate of return. Understand that the assumed rate of return in the FIA is less than the 7% guaranteed return which is why the income at the 6% assumed rate is the same as the 0% rate.

Guaranteed Account Value Comparison

The following chart will illustrate the cash surrender value of both the VA and FIA. This is the amount of money that is available for withdrawal and also the amount available at the death of the client. The account values are for a 10-year period. Each value assumes that the client waits until that year to start the withdrawal.

		VA Acct.	FIA Acct.	VA Acct.	FIA Acct.
Year	Age	Value 10%	Value 6% Gross	Value 0% Gross	0% Gross
11	60	**$193,602**	$186,904	$69,271	**$100,000**
12	61	**$206,843**	$197,127	$66,235	**$100,000**
13	62	**$220,989**	$207,910	$63,188	**$100,000**
14	63	**$236,102**	$219,283	$60,127	**$100,000**
15	64	**$252,249**	$231,278	$57,045	**$100,000**
16	65	**$269,500**	$243,929	$53,939	**$100,000**
17	66	**$287,931**	$257,272	$50,810	**$100,000**
18	67	**$307,622**	$271,244	$47,738	**$100,000**
19	68	**$328,660**	$286,187	$44,739	**$100,000**
20	69	**$351,137**	$301,841	$41,811	**$100,000**

Because we assumed a fairly high gross rate of return in the VA, the surrender value of the annuity is slightly higher than the FIA in every year. The 0% rate of return example is interesting because it illustrates how devastating the affects of the fees in the VA can be and the fact that the money in a FIA cannot go backwards due to zero or even negative years in the stock market.

This illustration makes complete sense because the VA at 10% sure should outperform a FIA with assumed growth of 6% (remember these numbers are not the guaranteed returns but instead are the assumed rate of return that drives the actual account value).

Logically, you'd think the VA would destroy the values of a FIA at 6%. But if you look at the numbers again, it's close. What does that mean? It means that, if the VA returns much less than an average gross rate of return of 10%, the FIA at a 6% rate of return will have a higher surrender value.

As for the death benefit, if the market does well with the VA and the FIA, the beneficiary of the annuities will receive the surrender value. If, however, the VA or the FIA returned zero (not likely but useful for an illustration), the FIA beneficiary would receive $100,000 and the VA beneficiary would receive less or much less. The VA can purchase (which I did assume for this illustration) a guaranteed DB rider; and so whenever the annuitant dies, the beneficiary will receive the $100,000 initial premium amount.

Example 2

Annuitant age: 50
Amount Invested: $100,000
Income starting in year: 10
Guaranteed return VA: **7%**
Hypothetical VA return: **8% gross**
(net return = 4.84% M&E charge: 1.25%, administration fee .15%, portfolio expense 1.01%, MGIB .75%).
Guaranteed return FIA: **7%**
Hypothetical FIA return: **6% gross**
(net return = 5.6% in years 1-10 and 5.5% in years 11 and beyond).

To give readers a little variety, I've increased the guaranteed rate on the VA to 7% but decreased the hypothetical rate of return down to a gross 8%. The FIA assumptions shall remain the same.

Guaranteed Income Comparison

		VA Income	FIA Income	VA Income	FIA Income
Year	Age	8% Gross	6% Gross	0% Gross	0% Gross
11	60	$8,276	**$10,131**	$8,276	**$10,131**
12	61	$9,120	**$11,056**	$9,120	**$11,056**
13	62	$10,057	**$12,062**	$10,057	**$12,062**
14	63	$11,097	**$13,155**	$11,097	**$13,155**
15	64	$11,879	**$14,341**	$11,879	**$14,341**
16	65	$12,265	**$15,629**	$12,265	**$15,629**
17	66	$12,669	**$17,028**	$12,669	**$17,028**
18	67	$13,092	**$18,545**	$13,092	**$18,545**
19	68	$13,710	**$20,191**	$13,534	**$20,191**
20	69	$14,803	**$21,977**	$13,994	**$21,977**

The main difference between this example and the previous example is that the FIA guaranteed income is significantly more than that of the VA illustrated at an 8% gross rate of return vs. a 10% gross rate of return.

What do these numbers tell us? The VA needs to have returns that are significant (in excess of 10% a year) in order to beat the guaranteed minimum income for life returned by the FIA.

You may be wondering why the GIB from the 8% gross return with the VA is virtually identical to the 0% gross rate of return. The simple answer is that the fees in the VA are so significant that it knocked down the returns so that the guaranteed

minimum income benefit from the VA is basically the same (except years 9 and 10 where the 8% gross return generated slightly more income).

Guaranteed Account Value Comparison

		VA Acct.	FIA Acct.	VA Acct.	FIA Acct.
Year	Age	Value 8%	Value 6% Gross	Value 0% Gross	0% Gross
11	60	$158,751	**$186,904**	$65,581	**$100,000**
12	61	$166,086	**$197,127**	$62,381	**$100,000**
13	62	$173,723	**$207,910**	$59,144	**$100,000**
14	63	$181,670	**$219,283**	$55,883	**$100,000**
15	64	$189,959	**$231,278**	$52,689	**$100,000**
16	65	$198,702	**$243,929**	$49,571	**$100,000**
17	66	$207,935	**$257,272**	$46,529	**$100,000**
18	67	$217,686	**$271,244**	$43,558	**$100,000**
19	68	$227,984	**$286,187**	$40,659	**$100,000**
20	69	$238,860	**$301,841**	$37,829	**$100,000**

What should jump out at you is how much higher the FIA at a 6% gross return surrender account values are vs. the 8% gross VA return values. Also, like Example 1 0% gross return column, the same column in this example has a decreasing account value due to the expenses in the VA.

Do remember that for these examples I added a VA death benefit rider that will pay a $100,000 death benefit no matter when the client dies and no matter what the gross rate is.

Let me throw in one last caveat to the FIA illustrations. In the FIA world, it is very common to have a bonus in the annuity to jump start the account value from day one. In the previous examples, I used a 3% bonus product. Why? Because when adding the bonus, the product still had a surrender charge similar to the VA that did not have a bonus. Therefore, my examples are “apples to apples” due to the fact that the surrender charge in both illustrated products was zero in year 11.

Summary of the above Illustrations

I want readers to understand that I used one of the best VAs in the industry for these examples at the lowest expenses possible. Again, I wanted to give the benefit of the doubt to the VAs in the examples. If I would have used a typical VA that had higher internal expenses, the numbers would have been further skewed in favor of FIAs.

I also used my favorite FIA which has a 7% guaranteed rate of return and the only 20-year roll-up time period in the industry.

One example I did not show was one where the annuitant started an income stream at age 64 or 69 or any other time period that ends with a 4 or 9. If you'll recall, most annuities (both VAs and FIAs) have a fairly rigid payment schedule (5% at ages 60-64 or even 5% from ages 60-69). The FIA I prefer to use would pay a 5.4% benefit at age 64 and a 5.9% benefit at age 69. If I would have had an example where I used a 64, 69, 74, 79, 84, or 89 age annuitant when the income stream is activated, the numbers would have been further skewed in favor of using a FIA.

What the examples should illustrate to readers is fairly clear. If the goal is to receive the maximum guaranteed income for life with the best chance of having a sizable actual account value that is available for a withdrawal or to be passed to the beneficiaries upon the death of the annuitant, a FIA is clearly a better option.

If it is your believe that the mutual funds will average in excess of 10% and more realistically 12%, then a VA is going to be a better option due to the fact that the caps on returns in a FIA will not allow it to keep up with the returns of a VA in a sustained robust market.

Does it really make Sense to use the GIB for Life Rider in the First Place?

Variable Annuities

This is a very interesting question and not an easy one to answer. If you review the **VA** illustrations I used to create the numbers for this paper about how the GIB is calculated, it doesn't give you a specific rate of return used during the income phase to create a guaranteed income for life. I'd put the language in this paper from the contract, but it would be nearly impossible for many readers to decipher it.

The Income Benefit

To make things simple, I decided to reverse engineer the numbers from the **VA** illustration to come to my own conclusion on the rate of return used for the income benefit. I built my own calculator that allows advisors to input ALL the needed variables to determine what the income benefit will be in ANY FIA product. I can manipulate that calculator to back into the numbers I'm looking for from the **VA** contract.

If we use the 8% gross return/7% guaranteed return VA illustration from earlier, we know that the guaranteed return of 7% provides a higher accumulation account value than actual account value using the 8% rate of return (due to the high internal expenses). The guaranteed accumulation account value in year 11 of the contract is $196,715 (created using the 7% guaranteed return). This will be the base account value used to determine the guaranteed income benefit for life.

The guaranteed income benefit in year 11 of the VA contract is $8,276. Therefore, I simply needed to determine the percentage rate of return on $196,715 to equal an $8,276 income benefit. That rate of return is approximately **4.21%**.

In case you don't recall from earlier in this paper, the guaranteed income benefit on the 7% guaranteed account value from the FIA is **5.0%** in year 11 of the contract. It is for this simple reason that the FIA guaranteed income benefit is significantly more than the 8% gross rate of return (hypothetical)/7% guaranteed return VA. Also, the 10% gross return VA only did slightly better than the FIA with its 7% guarantee.

While the previous is interesting and while you need to understand the above to understand the different nuances of the products, the question at hand is does buying the rider make financial sense?

The answer is it depends. It depends on the assumed rate of return in either a VA or FIA. If the return in either is high enough, in hindsight the rider would not be necessary and instead would simply cost you and/or your beneficiaries' money. For my conclusions below, I'm going to assume that the VA and FIA income benefits were activated at age 60.

1) VA with an 8% return/7% guarantee—you might think that the answer is that the guaranteed income benefit would have been worth buying because the fees of the VA will drive the actual account value far below the guaranteed account value which, in turn, will generate less income. That's not the case. Remember, I assumed an 8% gross rate of return. If I take off all the guaranteed riders, the internal gross rate of return of the VA will be **5.59%**.

If the VA actually returns **5.59%** net every year, then the GMIB rider will not be necessary if we are comparing the guaranteed income payments. The VA not only would not run out of money, it will have $158,823 as an account value when the annuitant turns age 100.

How can that be? The net return is less than the guaranteed return of 7% used to calculate the guaranteed base account value used to determine the GIB for life. Remember that I reversed engineered the percentage rate of return used to calculate the income benefit? If you do, then you'll recall that the rate of return on the accumulation account is 4.21%. Because the assumed gross rate of return of 5.59% is so much higher than the 4.21%, even though the actual account value is lower than the guaranteed account value used to calculate the GIB is higher, the VA without the rider can make the same income payments and have a sizable account value at death.

Was the rider needed?

If you read the pervious numbers, your conclusion may be no. However, with a VA, if you don't have the rider, there is no guarantee that there will be money in the VA. What if the gross rate of return in the VA mirrors how well the average mutual fund investor has done over the last 20 years (which is less than 3.5% (see Dalbar))? With a 3.5% gross rate of return with the VA illustrated, the net rate of return would have been .59%.

The VA would have run out of money in 12 years or at the annuitant's age of 71.

Was the rider needed?

Let me state one last time that it depends. For most annuitants over the age of 60 and certainly 65-75+, they should not be heavily invested in mutual funds. Look at what happened in 2000-2002 when the stock market went backwards over 45% and again at 2007-2009 when at one period of time the stock market went backwards 59%. How would their VA faired? Not too well.

GIB riders are useful for annuitants who want certainty in their lives. Even if there is a cost for them, if an annuitant's goal is to have an income benefit they can never outlive, then the rider is certainly useful from a mental point of view and, who knows, maybe it will or maybe it won't be useful from a financial point of view. It depends on what the market does over the next 20 years of the annuitant's life (a time frame we can't predict what the stock market will do).

In the sake of brevity for a white paper that didn't turn out too brief, I will not run the numbers for the 10% gross return VA. The better the gross return in the VA, the better the chances are that the rider will not be needed.

Also, remember that I used one particular VA for my white paper (the best one I could find). Results will vary per annuity as the fees could be higher or lower (although it would be tough to find one with lower expenses than the one I used). The guaranteed return on the accumulation account could be higher or lower, and the rate of return used to calculate the GIB could be higher or lower.

It is my recommendation that, if you are an advisor working with VAs and/or FIAs, you owe it to your clients to use a calculator like the one I created so you can run your own independent scenarios that will allow you to give the best and most accurate advice. If you are a non-advisor reading this and can't find an advisor you feel comfortable with because they do not know how to run real-world numbers on VAs and FIAs in order to give you the best advice, please e-mail info@thewpi.org; and I'd be happy to forward you to an advisor you can work with.

Is the GIB for Life Rider needed in a FIA?

This may be a more interesting question than if the rider is needed in a VA. Why? Because unlike a VA, FIAs lock in gains in up years and do not allow the account value to go backwards in down years. Yes, the returns are capped in up years, but the volatility in FIAs is much less than VAs; and the annual fees levied on the account balance each year is zero vs. fees that will typically be in excess of 3% per year the typical riders in a guaranteed income VA.

If you'll recall, the GIB from the FIA in the examples at the annuitant's age 60 was $10,131. Unlike the VA which does not state in the illustration what the rate of return when the GIB kicks in is, we know that the rate is for the FIA I used for this paper (annuitant's age 60 minus 10 x .001 = a 5.0% return).

The cost of the rider for the annuity I used was .4% for years 1-10 and .5% for years 11 and beyond. Did it make sense to have the rider? Again, it depends on what you think the annuity will return over the next 20+ years.

If I assumed a 5% gross rate of return in the FIA and a $10,131 annual lifetime withdrawal that started at age 60, without the expense of the GIB rider, the actual annuity account value would go to zero at age 91.

If I used an assumed rate of return of 5.5% and no GIB rider expense, the annuity would have an account balance of $29,168 after the annuitant turned age 100 (meaning it did not run out of money when paying the annual $10,131 GIB for the life of the annuitant).

Using the rider is about not knowing what the future will bring and giving annuitants certainty in their lives in what is an uncertain world. The risk, however, with a FIA that does not have the rider is much less than a VA with the same rider due to the locking feature with the gains. However, because a FIA has less upside, annuitants who really want action in the market at age 60+ are not going to receive it with a FIA. Instead they will simply receive a product that should have a better guaranteed lifetime income benefit and a better actual account value in what many will predict will be a modest market over the next many years.

As a side note: The above numbers drive home the point of how little risk the insurance companies are taking with a FIA. By the nature of the product, the insurance company doesn't have to worry about the stock market going down 59% in an 18-month period (which is why the expenses for the rider needed to obtain the same benefits as multiple VA riders is so much lower).

Summary Thoughts for This White Paper

When I sat down to create this white paper, I envisioned one that would be 8-10 pages long. I'm now on page 31 of the paper, and I could have easily made it another 5-7 pages longer with more illustrations.

People are clamoring for a safe way to build their wealth. They are clamoring for a "guaranteed" retirement income they cannot outlive.

The fact of the matter is that VAs were the only game in town for many years.

As you can read for yourself with the numbers from this paper, VAs can, in fact, provide a guaranteed income for life at a certain rate while still allowing the annuitant significant upside potential in the stock market in the event it does well or very well over time. The potential for growth coupled with the needed riders to guarantee an income and maintain at least the principal in the account with the ability to take withdrawal from the annuity (vs. annuitization) comes at a **very steep cost**.

Any one who can say with a straight face that VA contracts are not very expensive when all the needed riders are added is someone you want to stay away from. The fees are very high in my opinion for VAs, and the main reason I created this white paper was to determine them for myself and to put the information down on paper so others could also learn and see the real costs and benefits of these products.

FIAs will not bring us world peace; but now with their guaranteed income riders, they are a product that MUST be looked at by any advisor selling annuities to someone over the age of 50. Unfortunately, many broker dealers who rule the world of security licensed advisors have put forth a mentality that FIAs are evil or are bad for consumers and that VAs must be the annuity of choice if you hold a security license. That is too bad for our industry in general as well as the consumers they give advice to.

FIAs will probably never allow an annuitant to earn sustained returns in excess of 8%+ a year. However, FIAs as I've discussed them in this paper will never lose their principal balance, lock in the gains in up years, and are much less costly than VAs (given the assumption that the stock market doesn't average 12% or more a year over a sustained period of time with no losses right before an annuitant chooses to take his/her money out of the annuity).

As for the GIB of a FIA, the numbers are clear. Unless a VA earns a gross rate of return of 10% or more over a sustained period of time, the GIB from a FIA will either be superior or significantly superior.

For advisors who can think independently, I challenge you to run the numbers in an honest manner for your clients so you can help them determine the best product for their particular situations.

If you are a non-advisor reading this, I'm sorry to say that the vast majority of the advisors you will talk with will have no or little idea of the math that has been discussed in this paper. Most advisors do not have the capability to run the numbers discussed in this paper because they do not have the proper calculators and information to do so. It's a sad state that the financial industry is in, but it is what it is.

Getting Help

As stated earlier, if you are an advisor and you would like to be able to run the numbers as I've run them in this white paper so you can provide the best advice to your clients, please e-mail info@thewpi.org and request information about my online calculator that will do the math for you.

If you are a non-advisor looking for help and don't believe you know an advisor who can help you, please e-mail info@thewpi.org; and I'd be happy to forward you to an advisor who has access to my calculator and who can help you make the best decision to grow your wealth in the most secure manner possible.

Disclaimers

I've disclaimed a few items throughout this paper, but I wanted to reiterate them in summary form.

Remember, I used one particular VA for the illustrations in this paper. It was ranked as one of the three best in the industry by TheStreet.com.

This paper was not meant to give hyper-specific numbers that can be counted on 24-7. In order to do that, I'd have to run 20+ annuity illustrations from different companies; and I'd have to keep running them on a weekly or monthly basis to keep up with all the changes of the products. For example, as of the time this paper is being published, nearly all of the VA contracts with a GIB just lowered their guaranteed rate of return by 1%.

Guaranteed rates of return will go up and down, the income percentage when the rider is activated will go up and down, and the gross return in any illustration is a guess at best. This paper is meant to give you a look right now at the products in the marketplace and to illustrate today the pros and cons of VAs vs. FIAs.

This paper is meant to be thought provoking as much as it is to be a conclusionary paper.

Remember, I'm not securities licensed. I'm just an attorney who likes to break down the math of financial products to see which one(s) will do better or well given certain real-world assumptions. This paper has not been proofed or approved by FINRA or the SEC. It should not be used to give investment advice.

To my knowledge, this is the only white paper of its kind in the industry. This paper is **Copyright protected**. If you are an advisor reading this paper, you have my authority to forward it to your colleagues. If you are a non-advisor, you have my authority to forward it to your friends or loved ones. If you are a marketing organization (IMO, FMO, GA) or an insurance company, you **DO NOT** have my permission to use this as an educational tool for your licensed agents. To obtain my permission, please e-mail me at **roccy@thewpi.org**.

*I'd also like to give a special thanks to **Wayne L. Lew**, Wealth Preservation Specialist, Sagemark Consulting/Lincoln Financial Advisors, Mercer Island, WA 98040. Wayne helped me understand how VAs work and also provided the VA illustration used in this white paper*.

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