42 Point Questionnaire

Questions You Need to Ask about Your Variable Annuity

Fees, penalties, and contractual limitations you may not know about that could cost you money

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FINANCIAL

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Variable annuities are my least favorite of the annuity types. They once served a good purpose, in the 1980s and 90s when the stock market was thriving. But now I consider them the least effective annuity, especially for retirement income planning. A variable annuity (VA) is an insurance product with an investment feature— in other words, the place where insurance meets securities, and their meeting point is ***fees***.

Why do I say that? Did you know there was a life insurance fee connected to your VA? Probably not, because it's a portion of what they usually call a mortality and expense fee (M&E). Typically this fee is about 1.5%. **Did you know that you were paying a fee of 1.5% for life insurance through your VA?** Maybe that would be okay if you were getting your benefits tax free, like you get from life insurance, but you're not. If you want life insurance, buy life insurance!

Next, you have the securities end of things. The securities arm of the VA seller will handle the investments within the annuity…for a fee or two or three.

- They have mutual funds, which require a fund manager. His job is to make you money, but he's not going to do this for free. He charges a fee—somewhere around 1.5%.
- And how does a fund manager make you money? He buys and sells. What fee comes with buying and selling stock? Transaction costs! Although it varies depending on the number of transactions, these can be around 1-2% as well.

So now the fees could be up to 4%. **Did you know you could be paying 4% on your variable annuity? And some fees are guaranteed by contract to increase every year.** That's the problem. The company doesn't always clearly disclose these fees. They give you a prospectus and you need to figure out these fees for yourself.

Oftentimes a client comes in and disagrees with me. He'll say, "No! I only pay 1.5% in fees. I double-checked with my broker!" I'll remind him that it may not be a great idea to get a second opinion from the same person who gave you the first opinion.

So we play a little game called, "Let's call the broker." We sit down together, turn on the speaker phone, and dial the broker's number. The VA company's service representative will ask for verification of the client's ID, and the client will give permission for the VA company to speak with me directly on his behalf. Then we ask these 42 questions (or as many as apply to his particular policy).

Basic Information

1. Is this a qualified or nonqualified account?
2. Is it a fixed or variable annuity?
3. What is the current account value?
4. What is the surrender value?
5. How many years are left until the policyholder can get out without a penalty?

6. Have there been any systematic income withdrawals to date? What total amount?
7. Is this policy subject to annuity premium tax (some states)?
8. Is this policy subject to long-term capital gains tax?
9. What have been the total withdrawals to date?
10. What options are available to reallocate into a fixed account if this one is losing money?
11. What is the current interest rate on the fixed account?

Fee Administration

12. Do the fees come out when the account is down?
13. Do the fees come out in the fixed account?
14. With low interest rates, does the principal actually go down when it's in the fixed account?
15. Are any of the fees guaranteed by contract to increase annually?

Fees

16. What is the contract maintenance fee?
17. What is the M&E (mortality and expense) fee?
18. What is the annual fund operating expense fee?
19. What is the administration fee?
20. Are there subaccount fees, and how much are they?
21. What is the turnover fee?
22. What is the surrender charge?
23. Is there a separate first-year surrender charge (and if so, what is it)?
24. Is there a mutual fund fee (and if so, what is it)?
25. What are the transactions fees, and how many has the account incurred in the last year?
26. Is there a long-term care fee (and if so, what is it)?

If there is a death benefit rider:

27. What are the fees for the death benefit rider?
28. What percentage is the rollup?
29. Is it simple or compound interest?
30. Does the rollup ever stop (at a certain age/after so many years of having the policy)?
31. What is the current minimum guaranteed death benefit?
32. Do withdrawals come out dollar-for-dollar or pro rata?
33. What is the minimum amount that has to be left in the account to keep the death benefit?

If there is a minimum guaranteed minimum withdrawal benefit (GMWB):

34. What percentage is the rollup on the GMWB?
35. Is it simple or compound interest?
36. Does the rollup ever stop (at a certain age/after so many years of having the policy)?
37. What is the income payout percentage?
38. Are the fees based on the income benefit base, or cash value? (If the answer to this is "cash value"): Do the fees go up each year even if it loses money in cash value?
39. Is income taken out dollar-for-dollar or pro rata?

Other Administration Questions

40. If the income account value is $200k and account value is $100k, does that mean if the client takes $1 out, the income account value goes down by $2?
41. What income payment does this client get today ($ amount)?
42. What percentage is the total surrender charge?

One Client's Story

Mr. Jones is a client who had a million-dollar variable annuity. We had the kind of discussion this report starts with, and he told me I was wrong and that his fees were only 1.5%. I told him that he didn't have to believe me—that he could believe the broker. We made the call. At first the customer service representative said that the annual fee was 1.5%. Then we asked our 42 questions.

In just a few minutes, we learned that Mr. Jones was paying:

- ✓ Insurance fee as part of the mortality and expenses: 1.65%
- ✓ Investments within the annuity (subaccounts): 1.5%
- ✓ Rider fees or options: 1%

Total fees on this annuity: Over 4%!!!

Mr. Jones is a retired teacher who had made less than $40k a year when he was working, and **this company was making that amount every year off of his account!**

This client had done his due diligence. He had double-checked with the broker and we double-checked with the customer service representative. But we didn't find out the truth until we dug deeper. Mr. Jones needed a coach—someone to help him ask the right questions.

Now what's the point? What do these costs really mean, and how does this variable annuity work? Well, in Mr. Jones' case, it worked like this:

- If the market went up 10%, he earned just 6%, because the company took their 4%.
- If the market went down 10%, he lost 14%—the 10% of the market loss plus the 4% that the company took.

So his returns went up less when they did go up, and down more when they fell. **How long could retirement funds last with this strategy?**

In addition, annuity companies, including those that issue VAs, offer annuity policies as a "long term" strategy. They want you to stay with this product. During the first years of the contract, it carries surrender charges; so if you want out, you could pay a sizable penalty.

How to Decide Whether You Should Keep Your VA

Perhaps this simplified illustration can help you decide whether or not to keep a VA.

Account Value (AV)	**$400K**
Income: (example, 5% per year) 5% x 400K for one year 5% x 400K x 5 for five years	 $20K income per year $100K over 5 years
Fees (example, 4%) 4% x 400K for one year 4% x 400K x 5 for five years	 -$16K fees per year -$80K over 5 years
Net gain: Income minus annual fees	 **$4K per year** **$20K over 5 years**
Surrender charge: AV x 5%	***Today you will pay $20K in surrender charges (saving the fees for the next 5 years)***
	Savings: $60K

What Should You Do?

People often see the results of the game and ask right away, "How do I get out of this contract?" **Please understand that we are not suggesting that you should immediately cash out of your policy. What we do suggest is that you allow us to do a full analysis of your contract(s) to see exactly how your strategy is structured and how it has performed.** Only then can we adequately recommend whether you should stay with your current arrangement or look at something that might work more to your benefit.

We will show you:

- ✓ A chart of fees specific to your policy.
- ✓ A summary of fees on your VA.
- ✓ Benefits vs. cost analysis.
- ✓ Items from your company's prospectus that you need to understand.
- ✓ A comparison of contracts.
- ✓ Strategies that might work better for your circumstances (if applicable).

Let us help you get the full picture of your variable annuity. We'll be happy to play "let's call the company" with you. Then, if you qualify, we'll help you employ a strategy that can actually enhance your retirement income.

** Annuities are contracts between you and an insurance company. Annuity product guarantees rely on the financial strength and claims-paying ability of the issuing insurer.*

*** Annuity riders may be available for an additional annual premium that may provide additional benefits and income guarantees.*

This article is meant to provide general information on issues that many people consider in making the decision as to whether or not they should buy annuities; and if they do decide to buy, which types of annuities and which annuity benefits and additional riders. This information is not designed to be a recommendation to buy any specific financial product or service.

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