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Changes within the immediate annuity industry may provide

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sick and disabled clients with attractive price breaks.

Until recently, sick or disabled clients who might qualify for actuarially fair immediate annuities didn't have many options. Although a client's condition may have reduced his life expectancy, the immediate annuity market didn't offer increased benefits to compensate for the shorter life span. But movement within the insurance industry has created an outlet for these impaired risk cases, resulting in additional benefits to those sick and disabled clients who are seeking a steady, constant income stream.

An impaired risk immediate annuity is nothing more than a regular immediate annuity that is actuarially priced to reflect the owner's life

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expectancy. Clients who might take advantage of impaired risk benefits suffer from significant illnesses or disabilities. They can be older and retired (over 65) or younger and unemployable or employment-limited, because of their condition. Using impaired risk immediate annuity products, these clients are assured an income source that cannot be forfeited and offers pricing benefits that consider their adjusted life expectancies.

Carriers offer impaired risk benefits to make their immediate annuity products more attractive. The immediate annuity market is competitive; companies use these benefits to stand out from the crowd.

Impaired risk annuity underwriting

is not new, but until 1995, it only was available in the structured settlement or litigation annuity market. Presently, there are about a dozen life insurance carriers (see Table 1) that offer this underwriting technique, up from two in 1995. Just as in life underwriting, this technique is referred to as "substandard" underwriting.

Because of movements within the insurance industry, the number of insurance carriers in the impaired risk annuity market is poised to expand even more. One of the current barriers to offering these annuities is a requirement that the insurance industry set aside reserves on a standard basis using the insured's chronological age. This is very costly because it strains reserves and carrier profitability.

On December 5, 2000, however, the National Association of Insurance Commissioners' (NAIC) life committee

approved a guideline which would lift this requirement and create new reserving rules based on the insured's rated age — the age that most closely resembles the true mortality risk. This is the last step before the proposed guideline is fully adopted, which is expected to happen when the general NAIC membership meets on March 25, 2001.

The proposal states, "The population is aging, and the need for fairly-priced single premium immediate annuity benefits is substantially increasing. Forcing companies to hold standard reserves results in many people being overcharged (for the extra cost of capital associated with the higher reserve) at a time in their life when they may have the greatest need." Carolyn Johnson, NAIC senior counsel and model laws coordinator says presently there is no opposition to the guidelines, and adoption is certain.

If this occurs, industry leaders estimate that the number of carriers in the impaired risk annuity market will double by this time next year. More insurance company competition means enhanced products, better consumer annuity pricing and higher consumer product awareness.

DETERMINING THE BENEFIT

The impaired risk annuity benefit is determined by the annuitant's adjusted life expectancy, not by his or her chronological age. Individual medical conditions also are considered. These conditions affect annuity "life contingent" benefit payments. A 65-year-old annuitant with impaired health due to a heart condition, cancer, diabetes or a stroke may be assigned a rated age of 75 by the underwriters of the annuity policy. At the same time, the insurance company will consider the client's shorter time

| CARRIER | WEB ADDRESS | NAME OF IMPAIRED RISK IMMEDIATE ANNUITY PRODUCT | AM BEST RATING | S&P RATING |
|---|--------------------------|---|--|------------|
| American Mayflower First Colony Life Insurance Co. GE Capital Assurance GE Capital Life Assurance Co. of New York • all members of the GE Financial Assurance family of companies | www.gefn.com | Rated Age Immediate Annuity | A++ for First Colony, A+ for the rest of the companies | AA |
| Canada Life Assurance Co. | www.canadalife.com | Substandard or Impaired Risk Annuity | A+ | AA+ |
| Fidelity & Guaranty Life Insurance Company | www.fglife.com | Guarantee Income Plan | A | AA |
| Golden Rule Insurance Co. | www.goldenrule.com | Immediate Care | A | AA- |
| Lincoln Benefit Life Insurance Co. | www.lbl.com | Single Premium Immediate Annuity | A+ | AA+ |
| Presidential Life Insurance Co. | www.presidentiallife.com | Single Premium Immediate Income | A- | Api |



horizon due to health circumstances, providing the insured with a pricing advantage. The age rating increases the monthly benefit for any given premium or, for any desired benefit, reduces the annuity purchase cost.

For example, a 68-year-old female might be quoted a "standard" monthly annuity benefit of \$1,176, or \$14,112 per year, with an installment refund of premium benefit election. The premium cost is \$150,000. However, another insurance company that offers impaired risk benefits reviews her medical condition and issues her an age rating of 75. This increases her monthly benefit to \$1,341, or \$16,092 per year — a 14.03 percent increase. Conversely, if she requires a \$1,176 monthly benefit, her standard premium cost of \$150,000 is reduced to \$131,544, which results in a 12.3 percent premium savings.

An impaired risk premium cost reflects the consumer pricing advan-

tage of using a fairly priced annuity. This consumer now has the advantage of using her "true" mortality circumstances to increase her annual spendable income. And this income is truly 100 percent spendable, because she does not have to worry about reinvesting money in the future to generate additional dividends or interest. The entire annual benefit can be spent without fear of eroding future income.

SELLING TO IMPAIRED RISK CANDIDATES

A good place to start selling impaired risk annuity products is among your substandard life or long term care clients or clients who have been denied this type of coverage due to health circumstances. It's also wise to consult with attorneys who specialize in special needs trusts or elder law who may have clients who could qualify as an impaired risk candidate. Another group to prospect is new retirees with unhealthy spouses, or second spouses who can't rely on the first wife's children to take care of "Dad's new wife."

The impaired risk discussion comes up after the immediate annuity concept is sold, when you can point out that impaired risk pricing becomes an added benefit. People are more willing

| MAX. ISSUE AGE | MIN. DEPOSIT | SPECIAL/UNIQUE FEATURES | PHONE NUMBER |
|--|--|--|----------------|
| 85 maximum rated age, no maximum issue age | \$5,000 | Flexible structuring of benefit payments. Can step down or step up benefits after a certain age to let the customer maximize the amount received from the annuity. Can step up to six percent annually for inflation. Can also defer compensation to a previous date. Offers a certain-only period, lifetime guarantees, installment refunds for certain period contracts and lifetime income with a certain period. | (888) 325-5433 |
| 90 | \$5,000 | Offers 24-hour turnaround for underwriting. No forms or questionnaires. Will use any medical information available to make an assessment. | (800) 829-7099 |
| 89 | \$100,000 | Accelerated benefit rider. | (800)-357-8734 |
| 99 | \$10,000 | Especially for people who are about to enter or who are already in a nursing home or are receiving care. Looks at mortality and morbidity; the more ill the person is, the higher the payout will be. | (800) 275-5101 |
| 99 | \$5,000 non-qualified, \$2,000 qualified | Can add up to five years on the person's age to improve annuity payouts. Can put a yearly increase for cost of living on the annuity. | (800) 525-9287 |
| 90 | Premium must generate a \$25 check or more | No life contingency, period certain | (800) 926-7599 |

OBJECTIONS TO FIXED RATE IMMEDIATE ANNUITIES

[and responses to them]

to discuss health impairments if they believe they will receive an economic benefit in doing so. This is the opposite of discussing pricing and death benefits through life insurance, which can be very difficult.

The largest obstacle facing advisors who are trying to sell an impaired risk immediate annuity policy is not the underwriting, but the positioning of the financial product itself.

POSITIONING THE IMMEDIATE ANNUITY

Because they provide identical benefits, immediate annuities are equivalent to defined benefit (DB) pension plans. Since less than 10 percent of the current work force has defined benefit pension plan coverage, there is a potentially large market for immediate annuities. Add the growing availability of impaired risk annuities, and you have a whole new market of individuals with access to fairly priced pension products. That's why I'm fond of saying, "The future of the life insurance business is the annuity business, and the future of the annuity business is the pension business."

I compare the immediate annuity to an employer-sponsored DB pension plan, as they both meet an insurance need. When you paint an immediate annuity as an insurance product that prevents asset dissipation, like a DB pension plan, its usefulness becomes very clear and compelling to your clients.

Explain to your clients that an immediate annuity, like a DB pension plan, is primarily a risk management tool, not an investment. Immediate annuities insure against the risk of inadequate lifetime income at retirement and capital loss. The risk management benefits of an immediate annuity policy, or any insurance policy for that matter, are difficult to quantify. Often, immediate annuities are compared and contrasted to mutual funds or other investments. This is an inappropriate characterization. Would you compare auto liability or fire insurance premiums with mutual

There are several common objections encountered when selling impaired risk immediate annuities. The objections usually regard the immediate annuity, rather than the impaired risk underwriting. Once you master responses to immediate annuity objections, emphasize the impaired risk benefits to close the sale.

The insurance company keeps my money when I die.

The immediate annuity is defined as an insurance policy, not an investment. There is no money to return to the insured's estate (assume a "straight life" benefit) because the money was spent on, as opposed to invested in, the annuity contract. This is similar to the way premiums are spent to purchase fire and auto liability insurance. Although the policyholders will never get their money back, they receive the economic benefit of their premium through the immediate annuity contract and the scheduled benefit payments.

What about the kids?

This is a two-part concern expressed by both clients and financial professionals. The first part deals with annuities with life contingent benefits. In this case, it's important to remember who you represent and who hired you. The elderly people spending the money are your clients; you represent their interests, not their children's interests. If the parents express an interest in estate property transfer issues, that should be addressed only after you and your clients are satisfied with their overall financial protection. They should understand the high opportunity

costs incurred by not using estate assets for their own support and enjoyment.

The second part deals with period/term certain annuities. You may discover that estate property transfer issues are your clients' paramount concern. If this is the case, probe deeper with family history questions. Many wealthy families purchase multi-million dollar policies, as parents want to be assured that some portion of their estate will provide a long-term economic benefit to their children or grandchildren. An 80- to 85-year-old parent may purchase a 40- or 50-year term/period certain immediate annuity and collect the income. At the parent's death, the income passes to the child or grandchild. The child or grandchild collects the annuity income along with other estate assets. However, because the beneficiary can't commute the policy benefits, parents maintain "dead hand" control over the annuity income. Simultaneously, parents avoid trustee and trust investment issues. In this case, there is no impaired risk underwriting as all annuity benefits are guaranteed.

But there's no liquidity!

That's the main reason for purchasing the policy in the first place, and where the anti-dissipation benefit comes into play. You want to have the policy in place before you need the benefits. Just as with other insurance issues, if you wait and attempt to purchase a policy when you are distressed and need the anti-dissipation benefit, chances are the purchase will not be timely. You don't want to over-

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funds and mutual fund investments? The immediate annuity, like insurance in general, serves a unique role in our society, and paid immediate annuity premiums should be considered an expense like auto and fire liability premiums.

THE THREE-LEGGED STOOL

Financial liquidity is highly prized and perhaps over-emphasized because of the perceived value of maintaining one's ability to efficiently adjust to financial changes. However, this same liquidity may become a detriment as large amounts of liquid financial assets can dissipate just as quickly and easily.

The non-liquidity of the DB pension plan and the immediate annuity is the insurance feature that protects the consumer's greatest asset: next year's income. With the expected decline in the quality of Social Security coverage, retirees will have to consider the purchase of immediate annuities if they want to maintain and protect their retirement incomes. Furthermore, impaired risk immediate annuities can help your clients avoid the massive pension deficit problem that studies show this country will be facing in the next 10 to 20 years.

The analogy of the three-legged stool often is used to describe the desired financial position necessary to support a well-balanced retirement. One stool leg represents Social Security benefits, another leg represents DB pension plan coverage and the third leg represents personal savings. Using this analogy, liquidity, non-liquidity, stable value and capital growth assets are well proportioned, providing retirees with a balanced and effective income source at retirement, which is sorely needed — retirees no longer have the luxury of time to recover from asset-draining financial hardships, especially if they're already sick or disabled.

Risk impaired immediate annuities can provide the saving grace that may determine a retiree's quality of life. An immediate annuity can be a powerful source of future income, and the impaired risk benefits further protect the ill and disabled members of society who can least afford financial loss. ■

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PREPARING THE CLIENT

Medical information helps underwriters determine the overall physiological condition of an annuitant. Insurance companies do not send health examiners or gather medical specimens from the annuitant, which is the practice in life insurance underwriting. As a result, this type of annuity underwriting is usually accomplished within a 48-hour timeframe.

Notify your clients, however, that the insurance company may request medical information to determine eligibility for impaired-risk benefits. Paperwork your client may have to submit includes:

- ▀ Physicians report at the time of diagnosis,
- ▀ Hospital discharge summaries,
- ▀ Recent medical examinations by a physician,
- ▀ Records of previous medical problems from physicians and hospitals.

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insure either. It's your job, as the insurance professional, to make an accurate assessment of insurance need. A balanced financial approach using the three-legged stool analogy is a good place to begin your client assessment.

There's no inflation protection.

No one financial product does it all. Employing the three-legged stool analogy, capital assets could be used to provide the inflation protection the annuity lacks. Meanwhile, the annuity provides the insurance benefits the capital assets lack. Another option is

buying an annuity with a cost of living adjustment (COLA) feature. However, because the annuity is actuarially sound, a COLA would require the client to initially accept lower benefits in exchange for increased future benefits.

What if the insurance company defaults?

Diversification will mitigate this risk. For example, a \$1 million premium might dictate the use of three to four carriers, while a \$500,000 premium might dictate the use of two to three carriers, depending on the client's

tolerance. It is highly unlikely any two carriers will view risk the same way. The more carriers you employ, the more pricing variation you are going to receive.

But I can make 15 percent in a mutual fund, unlike an immediate annuity.

This might be true; however, you don't purchase an immediate annuity to get rich, you purchase an immediate annuity to avoid poverty. Besides, do you know what mutual fund is going to give you a 15 percent return right now?