VARIABLE ANNUITY REPLACEMENTS:
Should I Replace My Client's Variable Annuity with an FIA?

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You've had your initial consultation with a new client and in the discovery process you've learned they own a variable annuity (VA). As part of your review, you'll evaluate the VA policy to ensure that it's properly meeting the client's objectives. A suitable replacement can be an uphill battle, and an unsuitable replacement will be a flat-out waste of time and will frustrate your client. Having a useful resource and a process for evaluating how to proceed is invaluable.

A good FMO partner should be honest with you and set realistic expectations—just because one can argue that a VA replacement is suitable, there's no guarantee that an insurance carrier will want the business. Knowing ahead of time what you're up against will help you determine where your efforts are best appropriated and will help you set proper expectations with your client.

The Replacement Process

First and foremost, get the current, most recent statement. Without one, it'll be all but impossible to evaluate the policy. From there, follow these steps:

1. **Determine what the client's current and future objectives are for the policy.** In many cases, the policy was appropriate when they purchased it but may no longer be the best fit. Do they need it for income? If so, when? Is there a spouse, and if so, is joint lifetime income required? (Most VAs are set up at issue for single or joint income and can't be changed.)

   Is the death benefit a concern or priority? (If the policy is set for single income and there's a spouse, then there's a good chance the death benefit is important.)

2. **Have a Morningstar Report ran on the policy.** A Morningstar review will break down the fees and provide a clear definition of any living or death benefits. These are essential pieces to the policy puzzle.

3. **Run comparisons.** If the client's objectives have significantly changed, the choice to replace a policy can be obvious and pretty cut and dry. When the goals are the same, things get tricky, and a powerful case must be made for how the new policy will better meet these objectives.

   For these cases, the numbers will play an important factor. The more supporting documentation, the better. Demonstrating a clear advantage to replacing will be required. A strong client letter will also likely be needed.

Possible Reasons to Replace

Here are some of the most apparent reasons a VA may need replacing:

1. High policy fees. (This is typically the first complaint we hear from our agents and policyholders.)
2. The VA no longer meets their objectives. Here are some common examples:
   - The VA policy was for income guarantees no longer needed due to other investments' strong performance.
   - The VA was purchased for accumulation, but now the client wishes to preserve the death benefit.
   - The policy was acquired for accumulation but now wish to generate lifetime income.
   - Purchased for single income but now wish to generate joint income.
3. The client or agent is looking for principal protection.
4. More income can be provided on a guaranteed basis.

However, there are some hurdles to overcome, too:

1. *Any surrender charges that may incur.*
2. *The policy has been in force for less than two years.*
3. *Same selling agent. If the agent recommending the replacement is the same agent that sold the existing policy, the new carrier will question the objective. Circumstances change, so the sale may still be suitable, but the new carrier will likely more closely scrutinize the replacement.*
4. *High-income base or guaranteed income. Suppose the objective is income, and you see a substantially higher income value than the current market value. In that case, it's improbable that a new policy will be able to provide equal or greater income guarantees.*
5. *High death benefit guarantee.*

VA Replacement Case Study

Who: Mrs. Jones, age 72

Reason for replacement: Change in Objective

The basics:

- Nine-year-old VA purchased in 2011
- Account value = $170,445
- Lifetime income base = $235,144
- Current income guarantee if triggered = $11,757 per year
- Death Benefit = $170,445
- Surrender Value = $167,187

We were provided with a statement. We then ran a Morningstar report to discover the following fees:

- M&E = 1.70%
- Net Sub Account Fee Range = 0.31% - 1.54%
- Living Benefit Fee = 0.95%
- Total fee range = 2.96% - 4.19%

The Backstory

The client no longer needed income. Her primary concern was the death benefit. We identified a fixed indexed annuity that would better address her current objectives. The following narrative was submitted to the proposed carrier along with the most recent statement, product illustrations, the Morningstar report, and a letter from the client acknowledging the benefits she would be giving up by surrendering the existing variable annuity contract:

> *This email is in regard to Mrs. Jones, the use of the proposed (unnamed FIA) and it being funded by the replacement of an (unnamed variable annuity). The client Mrs. Jones has sufficient other assets and income and doesn't need these particular qualified funds for income. The primary objective is to minimize fees, eliminate losses, and protect and grow the death benefit as much as possible. Should the client need these funds to supplement her income, it would be ten or more years down the road. In that event, she may elect to take free withdrawals or turn on lifetime income depending on her health at that time and if the income need is determined to be permanent. Should the client's health begin to fail and she cannot perform 2/6 ADLs, she may elect to take advantage of the 2/6 ADL enhanced income feature.*
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> *The death benefit of the existing VA is currently $170,445.*
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> *The surrender value is $167,187.*
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> *After applying the 10% bonus of $16,718 to the surrender value, the day one five-year payout death benefit of the (unnamed FIA) will be $183,905 and will grow at 250% of the indexed interest performance with zero fee drag. The existing (unnamed VA) has total fees in the range of 3.11% to 4.34%. The (unnamed VA) policy doesn't have a fixed account option and must average a gross annual return of 3.873% to 5.103% over the next ten years in order to match the day one five-year payout death benefit of the (unnamed FIA). It has no principal protection, so there are no guarantees that the client will not actually end up with a lower death benefit down the road than what they have today. The client lost $38,819 in the last year alone.*

The policy was issued 40 days after the application was signed.

When it comes to VA replacements, leverage your resources, be thorough, follow a process, and set proper expectations. Even if the answer is "Hold onto this policy, we can't do better at this time," your clients will thank you.

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