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### Boom Time for VAs

Give baby boomers the facts about the flexibility, security and potential returns of VAs and there's a chance they'll like what they hear

by *Terry Sawchuk*

You may be aware of the benefits of variable annuities for retirees, but what about for your baby boomer clients? In many cases, a variable annuity will allow the boomer generation to have their cake and eat it too. The era of company-provided pensions is over. Most boomers are going to be personally responsible for their own retirement income. In addition, the confidence of the average investor has been shaken due to the state of the stock market over the past five years and future global unrest.

Fortunately, there is an investment vehicle that can ease these boomer-specific worries. A variable annuity can give boomers a sense of security. In fact, if they are willing to pay a little extra for guarantees, they can actually insure their retirement income (see "Insight Into: Guaranteed Living Benefits" on page 44.) And, the nice thing about the variable annuity is that this insurance doesn't have to come at the expense of losing potentially high returns from the stock market. A 54-year-old investor has plenty of time between now and when he retires. He could live another 40 years, so he can't afford to become too conservative with his investments.

The variable annuity offers the best of both worlds. The investor can continue to invest as aggressively as he wants, using a highly diversified portfolio of investments. He can also gain extra protection such as a guaranteed death benefit or the ability to insure a certain portion of his

income by way of annuitization. Of course, he must understand what that means: if he annuitizes, the principal now belongs to the insurance company and in exchange, he is going to get an income for life. If he fully understands this process, then a variable annuity can be a powerful tool. With variable annuities, baby boomers can receive the growth that they'll need without sacrificing the safety they desire.

## **SELLING TO BOOMERS**

If you're used to working with retirees, the boomer generation can be challenging. In many cases, the age difference between retirees and boomers is very small. However, the difference in mind-set can be massive. Boomers come from the "show-me-and-I'll-do-it-myself" generation. They like to see details. They grew up in an environment where they were constantly questioning and challenging authority, whereas their parents treated authority with great respect. You have to talk differently with baby boomers when you meet them face-to-face. Show them concrete facts and figures as they are very cost conscious. When illustrating common pitfalls of the average investor, the baby boomer may say, "I haven't made those mistakes yet, and I certainly don't want to make them now that I know about them." Provide details, but don't overwhelm clients or you'll lose them. They don't want to be experts; they just want to know that what you are going to do will help them.

When working with boomers, there is a fine line between playing the role of advisor and playing the role of salesperson. As an advisor, you can have the best laid plans, the most incredible financial strategies and the best products and services. However, if you can't motivate the client to take action, all that effort is of no value. The biggest challenge is developing what you know is the best course of action for the client and combining that with what you think they are going to do in terms of your recommendations.

Marketing to baby boomers is easy once you understand how they think. Chisel away the walls they have built by asking them to come see you with an open mind. Tell them that you will share just the facts and allow them to draw their own conclusions. If they sense that you are trying to sell them something rather than help them solve their problems, you will lose all credibility.

Get them to look objectively at the solution. If they look at expenses, historical performance, the flexibility and features of variable annuities, there's a good chance they'll like what they see.

## **EXPENSES**

VAs have earned a reputation for being too costly, and it's likely that boomer prospects will come to you with this misconception. However, when you examine total costs and compare a properly established variable annuity with a mutual fund or wrap-fee account, you'll find that in many instances, the costs of a variable annuity are extremely competitive, sometimes even lower. It's important to constantly stay abreast of industry changes and make sure that you're dealing with reputable insurance companies whose products remain competitive.

Another point regarding cost effectiveness is that inside variable annuities, clients can choose traditional mutual funds, index funds, sector portfolios, mechanical strategies and fixed accounts. There is a diversified offering of products and services. If you were to build a portfolio combining these types of vehicles outside of the annuity, the transaction fees could be pretty expensive. Inside an annuity, there are no transaction fees. So once again, an annuity may be a more cost effective way of managing a client's assets.

If you keep the costs reasonable and you are fiduciarily responsible, variable annuities can be an excellent investment vehicle for boomers.

## **HISTORICAL PERFORMANCE**

Higher quality, lower cost VA contracts will stand up well in the performance arena. I happen to favor index-based sub-accounts that work with a more concentrated group of stocks, as these outperform most index averages. When reviewing the performance of a variable annuity, keep in mind that internal costs may eat into the gross return. A comparison to the major indices is fair, but also factor in the additional benefits that the client is paying for when you conduct your evaluation. If the VA's performance is close to the major indices, I think — when all is said and done — it has stacked up very well. Performance is important, but it is far from the final word when all aspects of a VA are considered. Between the guaranteed death benefit, potential living benefits, tax-deferred growth and the variety of other available benefits, the real measure of success is value. The only person who can ultimately determine the value is the client who chooses to pay for the benefits, and the fact that the benefits were chosen is an indication that there is value.

## **FLEXIBILITY AND FEATURES**

VAs offer myriad features that are attractive to boomer clients. Risk-adverse clients will appreciate knowing how the variety of a VAs' subaccounts (many VAs have upwards of 30 subaccounts to choose from) give them the means to diversify their accounts to reduce market risk. Also, most VAs now offer fixed subaccounts in addition to stock and bond funds, a feature that can further diversify a client's assets and reduce risk.

Remind boomer clients that VA subaccounts are managed by professional money managers. Consider offering some background information on the managers of the funds they are interested in (this information should be readily available from the carrier). Boomer clients will also likely appreciate the fact that VA contracts allow them to move money around subaccounts without causing a taxable event, in a sense, giving them the power to manage their own VA investments.

Another benefit of VAs is the fact that, unlike 401(k) plans, the IRS does not limit the annual amount that can be invested in a VA. The death benefit offered by VAs will be an attractive feature to boomer clients concerned about leaving assets to their heirs, and a growing number of guaranteed living benefits are attractive features for clients who want insurance on their VA investment.

You should educate clients about VAs by using language and anecdotes that they can relate to. The book "Investing with Variable Annuities: Fifty Reasons why Variable Annuities are better Long-Term Investments than Mutual Funds" by John Huggard, J.D., CFP, is a must-read for all registered representatives who sell variable annuities. It is the reference guide to understanding how annuities are supposed to work.

The book has a number of good examples using everyday terminology to help combat the same over-used, under-educated arguments for avoiding variable annuities. For example, Huggard eloquently diffuses the mindless argument that you should never put an annuity inside an IRA because it is already tax-deferred. Investors don't pay anything extra for the deferred nature of the vehicle; it's just built-in. There are many other reasons why a client would buy a variable annuity that have nothing to do with its tax-deferred status. Huggard concludes that if you're not paying extra for the tax-deferral, why is it even an issue?

## **NASD SCRUTINY COMING DOWN THE PIKE**

There are many rumors about what the National Association of Securities Dealers and Securities Exchange Commission are planning to do with variable annuities over the next several months. In my opinion, the NASD should focus on the sales practices of advisors selling variable annuities. Advisors need to fully disclose the sales costs, the surrender charges and other features of the annuity so that there are no surprises for the consumer. The biggest problem this industry faces with variable annuities is that in some cases, the products are being misrepresented. The variable annuity is a great concept, and the market does an efficient job of weeding out the lower-quality, less-competitive products. When people start to figure out that a product is not what it is supposed to be, they stop buying it.

Regulators also need to look at controlling costs. They should set standards for the maximum charges for mortality and expense risks or maximums for what a company could charge for a fund expense ratio. The better annuity companies already have reasonable costs, and such a move could bring other companies in line.

Rumor has it that regulators will require variable annuities to offer strictly Class A Shares. This will directly limit consumers' choices. Often, consumers like the fact that they don't have to pay an upfront sales charge. In the current market, most variable annuities are sold with deferred sales loads. Going to strictly Class A Shares (shares containing a front-end charge) would severely damage the consumer's right to choose what they think is in their own best interest. There are certain clients who will absolutely not pay an upfront charge. Requiring variable annuities to offer strictly Class A Shares would completely eliminate such potential variable annuity investors from the marketplace.

Because of the complex nature of the variable annuity — there are multiple inner workings and various optional bells and whistles — there aren't too many people who fully understand how this product works. But, I can't think of any other business that would self-regulate what consumers should and should not be willing and able to pay for. In the car business, consumers are given several options they can add to a vehicle, if they choose. Most of these options, like leather seats or sunroofs, provide neither safety nor efficiency, yet the auto manufacturers certainly do not restrict the dealers from offering these options to their patrons. The individual investor should be given the opportunity to determine what "options" they deem valuable in any investment vehicle and naturally, to purchase that option if they are willing and able.

## **ADVICE FOR SELLING VAs TO BOOMERS**

In order to be successful with the boomer demographic, you must do your homework. You need to fully understand how the variable annuity works; when it is and isn't appropriate. Because variable annuities are a complex product, they can be easily misunderstood. To protect yourself, the industry and your reputation, the fewer misunderstandings that happen, the better off we all will be. If you are trying to sell a variable annuity because it has a healthy commission, you will have a short career. If you approach the variable annuity as a solution to a baby boomer's problems or needs, rather than a product to be sold, you'll be successful. n

In practice for more than 14 years, Terry Sawchuk favors variable annuities as an investing tool for baby boomers and retirees. He is the founder and chairman of the advisory firm, The Michigan Senior Society. In addition to his advising practice, Terry hosts a weekly radio show, Easy Street, on 760 AM in Detroit.

### **Inside the mind of boomers**

Getting to know your boomer prospects will help you earn their trust and their business. Del Webb, a developer of communities for those age 55 and older, conducts extensive research on the baby boomer demographic each year. The company's 2004 report reveals that although the majority of baby boomers are emotionally prepared for retirement, their financial situations are not as rosy. In other words: they need your help, and in the right situations, variable annuities may assist them in reaching their retirement goals. Here are some additional findings from this year's study:

**75%** boomers who feel retirement will make them happier and more free to be themselves.

**24%** boomers who believe they'll be bored in retirement.

**12%** boomers who feel they'll be more worried once they retire.

**Baby boomers' top priority once they retire is their health, followed closely by traveling, relaxing and becoming debt free.**

**36%** boomers who think they have enough money to live comfortably once they retire.

**40%** boomers who are not sure if they will have enough money to live comfortably in retirement.

**25%** boomers who do not think they will have enough money in retirement.

**Boomer males (50 percent) are more likely to think they will have enough money to live comfortably in retirement than boomer females (34 percent).**

**10%** boomers who think \$50,000 to \$100,000 is necessary to live comfortably in retirement.

**21%** boomers who think \$500,000 to \$1 million is necessary to live comfortably in retirement.

**20%** boomers who think \$1 million to \$2 million is necessary to live comfortably in retirement.

**1%** boomers who think \$5 million or more is necessary to live comfortably in retirement.

**24%** boomers who don't know how much is necessary to live comfortably in retirement.

The majority (67 percent) of baby boomers who are empty nesters say their disposable income has increased since their children left home. Sixty percent of boomers plan to invest or save their additional disposable income. Boomers who are employed (63 percent) are more likely to save or invest their disposable income than boomers who are retired (43 percent).

Source: Del Webb

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