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## **Annuity Suitability Guidelines**

Annuities are generally structured as either fixed, indexed, or variable instruments. Fixed and variable annuities may provide regular periodic payments to the annuitant and are often used in retirement planning and typically offer tax deferral. Variable annuities invest in sub accounts, which mirror mutual funds and allow the owner to receive larger future payments if investments of the annuity fund do well and smaller payments if its investments do poorly. This provides for less stable cash flow than a fixed annuity but allows the annuitant to reap the benefits of strong returns from their fund's investments. Annuities allow for additional features, called riders, that may provide enhanced death benefits or enhanced withdrawal or income benefits.

Due to complexity of these products, PCS has developed this document to aid the advisor and managing principal to align on suitability of an annuity investment. Please work with your MP to ensure proper documentation on an annuity submission.

**FINRA Rule 2330** applies to recommended purchases and exchanges of variable annuities and the initial sub account allocations. This Rule does not apply to reallocations among sub accounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This rule requires a registered Principal of PCS to review and determine approval within 7 business days of receiving the completed application.

The PCS registered principal must also provide approval prior to transmitting a customer's application for a variable annuity to the issuing insurance company for processing.

Additional details regarding FINRA 2330 – <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2330>

- 1. Annuity Concentration** – Generally, annuities are considered to be illiquid products, therefore concentration in the products should be monitored closely. PCS will generally use the sliding scale below as a guideline for annuity concentration as a percent of total investment assets held by the client (always exclude personal residence). These are guidelines and instances exist where it makes sense for an advisor/client to go beyond these guidelines. In these situations, it is expected that the advisor will provide additional detailed notes and insights which clearly substantiate why their client's purchase will fall outside of these guidelines and benefit the client. The additional or enhanced documentation should include details on emergency funds, values of other security types as well as current debt where applicable. Generally, investment real estate should not be included in the client's calculation as that is not an asset that can be readily converted to cash in an emergency.

<u>Investable Assets</u>	<u>% of Assets in Annuities</u>
\$0-\$50,000	0%
\$50,001-\$100,000	0%
\$100,001-\$250,000	30%
\$250,001-\$500,000	50%
\$500,001-\$750,000	55%
\$750,001-\$1,000,000	60%
\$1,000,001-\$5,000,000	65%
>\$5,000,000	70%

- 2. Client Income/Debt** - While income is a critical component of a client's financial success, it is only 1 of many factors that goes into determining suitability. Documentation around client need, subsidizing criteria, emergency funds, etc. should all be documented when submitting an annuity ticket outside of the income guidance. Clients' debt must also be discussed and disclosed to ensure their income exceeds their expenses when the annuity funding source of "income" is chosen. The client should not consider "charge free withdrawal amounts" as part of their potential income or liquid assets; example - the ability to withdraw 10% of the purchase amount each year without penalty.
  
- 3. Source of Funds** – There are multiple ways to fund annuity purchases. Income, savings, liquidation of other investment products, rollover of an employee sponsored plan, 1035 exchange (more information in below section), inheritance, etc. Advisors should provide comprehensive notes detailing how the annuity will be funded, rationale for using these funds for this purchase, etc.
  
- 4. Intent of Taking Income Withdrawals** – When a client/advisor has chosen to add an income/withdrawal rider to an annuity contract, the client must have a clear intention to use the income/withdrawal benefit. The client should also have a clear intention of when they anticipate turning the income/withdrawal benefit on. The addition of GMIBs or GMWBs to contracts for "if needed" withdrawals or as an indirect way to add a guarantee for is not suitable.
  
- 5. Maximum Withdrawal Utilization** - Clients who are purchasing lifetime GMWBs must also intend on taking the maximum withdrawal allowable at any age band. Taking the maximum allowable withdrawal maximizes the client's value under the withdrawal rider. This is not necessarily applicable to non-lifetime GMWBs and GMIBs, there are circumstances under which the client could take less than the maximum allowable withdrawal under these riders.

**6. Required Minimum Distributions** – GMIB and GMWB riders that are “RMD Friendly” don’t play a factor when determining suitability. There is no need to guarantee required minimum distributions because when a client's qualified account value falls to zero, the point at which the client begins to benefit under a GMIB or GMWB, the required minimum distribution is zero. Therefore, a client who is adding a lifetime GMWB but only intends on taking required minimum distributions does not meet the maximum withdrawal utilization requirement. While a client's required minimum distribution percentage will increase as they get older, that percentage will generally be applied to a decreasing account value. The circumstances under which a client's required minimum distribution is most likely to exceed the maximum allowable withdrawal under a GMIB or GMWB is when the account value is above, at or near the guaranteed minimum benefit base, i.e., the point at which the client is least likely to benefit under the rider and the carrier has the least amount at risk.

## **7. The Age 95 Income/Withdrawal Guideline**

### **a. Age 95 Guideline for GMIBs**

- i. The Basic Guideline for GMIBs - Client should be able to receive a minimum of 10 years of annuity payments by age 95 under the terms of the rider.
- ii. The Guaranteed Step-Up Credit for GMIBS - Withdrawals made prior to annuitization under GMIBs that contain a guaranteed step up to the benefit base with a dollar-for-dollar reduction in the benefit base for those withdrawals may be considered as "annuity payments" for purposes of meeting the age 95 guideline for GMIBs.

### **b. Age 95 Guideline for GMWBs**

- i. The Basic Guideline for GMWBs - Client should be able to achieve a return of premium by age 95 under the terms of the rider.
- ii. The Spousal Continuation Credit for GMWBs - If the GMWB allows for spousal continuation, or in the case of a joint rider, the age of the younger spouse may be used for purposes of meeting the age 95 guideline for GMWBs.
- iii. The Immediate Income Credit for GMWBs - If the client intends on taking income immediately, riders with a guaranteed withdrawal rate of 5% may be used through the client's age 77 and riders with a guaranteed withdrawal rate of 6% may be used through a client's age 80. However, at age 81 and beyond, the age 95 guideline for GMWBs must be met.

<u>Withdrawal Rate</u> <u>(Simple Interest)</u>	<u>Years to Return of</u> <u>Premium</u>
4.0%	25.0
4.5%	22.2
5.0%	20.0
5.5%	18.2
6.0%	16.7
6.5%	15.4
7.0%	14.3

- iv. The Guaranteed Step-Up Credit for GMWBs - The guaranteed step up to the benefit base may be taken into account for purposes of meeting the age 95 guideline for GMWBs

**Example 1:** Client is 79 years old and doesn't intend on taking withdrawals until age 85. Client wants to add the Lifeguard Freedom 6 to a new Jackson National Perspective II contract and has \$100,000 to invest. Interest rate is 6% and withdrawal rate at age 85 is 7%. In the below example, the client **WILL NOT** have their premium paid out BY age 95.

$$\$100,000 \times (1.06 \times 6) = \$141,852$$

$$\$141,852 \times .07 = \$9,930$$

$$\$100,000 / \$9,930 = 10.07$$

$$85 + 10.07 = 95.07$$

**Example 2:** Client is 78 years old and doesn't intend on taking withdrawals until age 85. Client wants to add the Lifeguard Freedom 6 to a new Jackson National Perspective II contract and has \$100,000 to invest. The interest rate is 6% and withdrawal rate at age 85 is 7%. In the below example, the client **WILL** have their premium paid out BY age 95.

$$\$100,000 \times (1.06 \times 7) = \$150,363$$

$$\$150,363 \times .07 = \$10,525$$

$$\$100,000 / \$10,525 = 9.5$$

$$85 + 9.5 = 94.5$$

**8. Enhanced Death Benefit** - These benefits come in the form of a rider and offer an annual step-up in value depending on the terms of the annuity contract. Enhanced death benefits come in a variety of forms, so it is important

the client has a clear understanding of each rider. Adding riders to your annuity contract comes with costs. It is always important to think carefully about the costs of any riders added to an annuity contract and to be clear about the amount of all fees and additional costs as these may affect the account's return.

**9. Costs (M&E, Admin, Riders, CDSC where applicable)** - Annuity products can be expensive especially when the client is paying for a benefit they do not intend to use or do not fully understand. All expenses, riders and CDSC fees must be fully disclosed to each client and client understanding should be documented. If there are ***CDSC fees associated with an exchange, proper documentation must be obtained as to why this exchange is necessary and how the client will benefit from the new product.***

a. If the client is paying more than 2% CDSC on the transaction both regulators and PCS deem this unsuitable.

b. CDSC schedule cannot exceed 8 years

**10. Age (85 or older or younger than 45)** - In rare situations will annuities be suitable for clients younger than 45 or older than 85. Clients in these age demographics may have financial goals not in line with annuity products.

**11. Suitability (Investment Objective, Liquidity Needs, Experience, Time Horizon, Tax Bracket)-**

**a. Investment Objective** - Annuity investments are suitable for the following investment objectives: Income, Balanced Growth and Growth of Capital. Instances exist where an Aggressive Growth investment objective is suitable for an annuity and should have additional documentation explaining the rationale. The Preservation of Capital investment should be reserved for cash and cash equivalents and not an annuity or other investment vehicles.

**b. Liquidity Needs** - annuity investments generally are illiquid unless an immediate annuity is used, or income rider is selected and turned on shortly after investment. Detailed notes explaining the annuity purchase when a client has high liquidity needs are required.

**c. Investment experience** - The expectation for a client purchasing an annuity would be a minimum of one year of investment experience.

**d. Time Horizon** - Annuity products are long term investments, and the account time horizon should reflect a long-term time horizon unless an immediate annuity is being purchased.

**e. Net Worth** - Minimum \$100,000.00 household net worth.

- 12. Sub Account Selection** - The sub accounts selected must be in line with the client's suitability profile.
- a. Fee based annuities should have a sub account selection that avoids any concentration thresholds.
  - b. Sub accounts will add costs beyond the M&E, admin and rider fees. These fees will vary across the sub accounts and discussed and understood by the client
  - c. In general, investments 1 standard deviation outside of a clients stated investment objective are allowable with detailed notes explaining the deviation.
- 13. 1035 Exchanges** - Annuity products are long term investments and should be sold with that understanding. CDSC schedules expiration does not require the client to exchange and this should be explained and completely understood by the client. A replacement should have a **clear and well documented** benefit for the client for the duration of the annuity, not just when purchased. Not every policy exchange will be in the best interest of the client. The replacement of one policy with another must be considered carefully.
- a. Several factors should be considered before suggesting an exchange such as, but not limited to the following.
    - i. There should be no surrender penalty for the exchange
    - ii. There should be no significant guaranteed benefit loss for the exchange
    - iii. No exchanges in the previous 7 years
    - iv. Must be properly documented and only recommended if in best interest of client
- 14. Reg BI** - With the adoption of Regulation Best Interest, financial professionals are required to document why a particular investment is in the best interest of the client and why a particular investment is in the client best interest compared to other products. The Recommendation Documentation Supplement is used to document the thought process involved in making an investment recommendation.
- a. Representatives are required to consider multiple annuity products when making an annuity purchase/exchange recommendation per the Care Obligation of Regulation Best Interest.
  - b. **These alternative considerations must be documented on the Recommendation Documentation Supplement (RDS)**
  - c. Recommendation Documentation Supplement (RDS) must include a summary statement documenting the specifics of how the selected annuity is better for an individual client than other considered annuities.

**15. Registered Index Linked Annuities Considerations** –Typically variable annuities are an expensive investment choice and become cost prohibitive for younger clients, however, consideration will be given to the use of no fee indexed linked annuities for younger clients.

- a. Age** – Client is no younger than 35 years old.
- b. Net Worth** –a minimum of \$100,000.00 in investable assets.
- c. Concentration** - Maximum concentration of 25% of investable assets.  
Also, provide details on cash equivalents and emergency funds for younger clients.
- d. No riders**
- e. No sub account, M&E or Admin costs**

**16. Additional considerations regarding Indexed Linked Annuities**

- a. Cap rates and the possibility of changes should be disclosed to all clients and documented.
- b. Complexity and derivatives of product should be completely explained and documented.
- c. Explain the recommendation of selected terms (Example: Why the 1yr over the 3yr and why index or indexes are selected)
- d. When giving up benefits and riders of an existing contract is the rationale logical and in the client best interest?
- e. For younger clients, consider the impact of taxes if the money is needed for another situation. Consult with a tax advisor.

**17. L Share Annuity Purchases and Additions**

- a. L share annuities typically have a shorter surrender period than other share classes. They also typically have a higher M&E charge than B share annuities.
- b. In very rare circumstances will PCS approve the new purchase of an L share annuity or additional contributions to an existing L share annuity.
- c. If considering an L share annuity recommendation, please first discuss with your PCS Managing Principal.