PACIFIC LIFE | ADVISORY

Advisory Annuities and the Role of Fiduciary Duty

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About This White Paper

SEC and CFP® Board Guidelines May Help Fiduciaries Rethink Their Stance on These Products

Fiduciary financial professionals should be excited to have another solution to address clients' financial planning needs now that advisory annuities are easily accessible, and an IRS private letter ruling (PLR) allows for advisory fees to be taken directly out of nonqualified annuities. However, misconceptions about these viable products still abound. In fact, most of the barriers to incorporating annuities within the practices of RIAs no longer exist. This paper aims to show how many fiduciary financial professionals' objections to these products are incompatible with the current commentary on fiduciary duty published by the SEC, the courts, and well-respected industry designation organizations. Modern fiduciary financial professionals who add advisory annuities to their overall planning considerations can provide clients with a more comprehensive, well-rounded planning review.

About the Author

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2019 saw some seismic activity come from the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS) that should have made many more headlines in the Registered Investment Advisor (RIA) community than it did. Notably, the SEC issued an interpretation of the Investment Advisers Act of 1940's Standard of Conduct for Investment Advisers, and the IRS issued a private letter ruling (PLR) that allowed for advisory fees to be taken out of nonqualified annuities without causing a taxable event.[1]

On paper, these two publications should have opened the doors for RIAs to finally consider annuities as a part of clients' financial plans. However, the bigger news of the introduction of Regulation Best Interest and, of course, COVID-19 appear to have drowned out both announcements. How is it that outside of retirement plans, a financial product with more than $2.5 trillion in U.S. household assets at the end of 2020[2] is still met with resistance by RIAs? The simple answers, in my opinion: misinformation and misunderstanding.

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Annuities Set Off a Firestorm of Opinions

RIAs in their capacities as fiduciaries have some very firm opinions about annuities. Many are happy to tell me why they will not recommend annuities or why they are reluctant to assist their clients with these products, despite now having the ability to access advisory annuities through multiple avenues. However, opinions usually change when I'm able to show that their objections are often incompatible with the commentary on fiduciary duty published by the SEC, the courts, and industry designation organizations that numerous investment adviser representatives (IARs) respect and are members of. And they're usually happy about it; having another solution to address clients' financial planning needs is a good thing, right?

Diving Into a Taboo Topic

I'm often told that this is a sensitive topic, but I think it's time we had an honest discussion about annuities and fiduciary duty. To be clear, my goal isn't to admonish fiduciary financial professionals for not considering annuities or for not knowing how these products have been modernized to such a degree that they've become a viable solution for many clients. My goal is to present insights from the SEC and CFP® Board that may help fiduciary financial professionals overcome their common objections to these products.

- **Objection #1:** Our Clients Don't or Won't Own Annuities, and We'll Never Discuss Them
- **Objection #2:** I Can Only Use the Most Economical Solutions and Annuities Are Too Expensive
- **Objection #3:** Annuities Are a Conflict of Interest
- **Objection #4:** Annuities Are Too Complicated

But first, let's begin by examining the elements and roots of the fiduciary duty, the legal precedence, and the landscape that applies fiduciary duty to RIAs and IARs at the federal level.

[1]Internal Revenue Service. "PLR-101288-19." Department of the Treasury, November 15, 2019.

[2]"2021 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry." Investment Company Institute, March 15, 2021.

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The Responsibilities of Fiduciary Duty

Fiduciary duty is the legal code of conduct that says the fiduciary is obligated to act in the best interest of the client. There are a growing number of investment professionals who volunteer to have the standard applied to them by passing licensing exams and certifications.

While I don't act as a fiduciary in my current role as a managing director for Pacific Life, I was a fiduciary in the past when I was admitted into the Louisiana Bar more than 15 years ago. I've since earned many financial services certifications, and I always had one question whenever it came to the portions of course materials that required legal analysis instead of quantitative analysis; is it realistic for a profession made up of mostly non-attorneys to suddenly become experts on fiduciary duty when it's a decades-long career area of practice for attorneys?

Things get pretty complicated when applying a legal standard that requires qualitative and ethical considerations to a profession driven by primarily product recommendations and quantitative goals. Furthermore, it's a standard that requires humans, who naturally bring personal feelings into practice, to turn off bias. Being a fiduciary is just plain hard, but the goal here is to peel back the layers and hopefully provide a bit more clarity.

Under federal law, the fiduciary duty consists of a duty of care and a duty of loyalty.

- "The duty of care requires that an investment adviser provide investment advice that's in the best interest of the client, based on the client's objectives."[1]
- "The duty of loyalty requires investment advisers to eliminate all conflicts of interest or make full and fair disclosure of those conflicts, which might lead an adviser to give advice that is self-serving so that the client can give informed consent to those conflicts."[1]

We'll look deeper into the duties of care and loyalty later.

Court Precedence

The seminal Supreme Court case of *SEC vs Capital Gains Research Bureau, Inc.*[2] cemented that fiduciary duty was the standard under the Investment Advisers Act of 1940 (Advisers Act). Former SEC chairman, Jay Clayton, is on record saying the SEC has used this case for decades when applying and enforcing fiduciary duty as the standard of conduct for investment advisers.[3]

The Securities and Exchange Commission (SEC)

The SEC has regulatory authority over investment advisers pursuant to the Advisers Act and provides guidance of the law. The SEC published an interpretation of the standard of conduct that became effective July 12, 2019. This was meant to give final interpretation of the aspects of fiduciary duty for investment advisers, whose fiduciary duty under the Advisers Act is comprised of the duties of care and loyalty.[1]

[1]SEC, 17 CFR Part 276 [Release No. IA-5248; File No. S7-07-18], "Commission Interpretation Regarding Standard of Conduct for Investment Advisers" June 5, 2019.

[2]SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963), accessed February 9, 2023.

[3]SEC, Chairman Clayton, Jay, "Regulation Best Interest and the Investment Adviser Fiduciary Duty: Two Strong Standards that Protect and Provide Choice for Main Street Investors," July 8, 2019.

CFP® Board's Code of Ethics and Standards of Conduct

The CERTIFIED FINANCIAL PLANNER™ certification requires high standards in financial planning. The fiduciary duty always applies to CFP® professionals when giving financial advice. The CFP® Board's Code of Ethics and Standards of Conduct are meant to "reflect the commitment that all CFP® professionals make to high standards of competency and ethics."[1]

The (Big) Annuity Opportunity

The annuity marketplace is big and provides the opportunity to add value. Because gathering qualitative and quantitative information is the first step of the CFP® Board's Seven-Step Financial Planning Practice Standards[1], let's look at some findings.

- The Investment Company Institute reported that there was nearly $2.5 trillion in annuities (outside of retirement plans) in the U.S. at the end of 2020.[2]
- Two trillion dollars of those assets were in mutual funds offered through variable annuities and variable life insurance contracts.[2] That's more than the $1.4 trillion U.S. investors put into private equity investments[3] and more than the $1.8 trillion in stimulus that the Coronavirus Aid, Relief, and Economic Security (CARES) Act the government put into our economy in 2020.[4]

> *Most barriers to incorporating annuities within the practices of RIAs no longer exist.*

I've written about how some forward-thinking annuity carriers now provide advisory annuities that do not pay commissions, offer cost-conscious and transparent institutional pricing of investment options, and allow RIAs to bill directly on the annuity without creating a taxable event or reducing the clients' benefits.

IARs can access these annuities through custodians, outside insurance desks, and dedicated advisory teams at the annuity carriers themselves. All these avenues employ licensed professionals who are responsible for suitability due diligence, contract reviews, evaluation of annuity options, and function as Agents of Record, while still allowing IARs the ability to perform advice functions on behalf of the client. In light of these available services, most barriers to incorporating annuities within the practices of RIAs no longer exist.

And what about the annuities clients already own? It's not uncommon for RIAs to find millions of annuity assets already in their clients' portfolios. This presents a tremendous opportunity to review those insurance products with clients to see if they still meet their needs. Not to mention that those assets can be brought under the RIA's assets under management if modernizing the annuity is deemed appropriate.

[1] CFP® Board. "Practice Standards Reference Guide." Certified Financial Planner Board of Standards, Inc., November 4, 2020.
[2] "2021 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry." Investment Company Institute, March 15, 2021.
[3] "Portfolio for the Future™: A practitioner's guide to the five essential marks of effective capital allocation." CAIA Association, March 24, 2022.
[4] Boccia, Romina, "This Is How Big the COVID-19 CARES Act Relief Bill Is," The Heritage Foundation, April 20, 2020.

So, Why Aren't RIAs Using Advisory Annuities?

Let's look at the common objections given by IARs and then review the SEC and CFP® Board's standards in relation to annuities. We've removed the objection that most IARs are not licensed to sell annuities, since we've already discussed that licensed professionals can be accessed to evaluate and complete the sale.

Objection #1: Our Clients Don't or Won't Own Annuities and We'll Never Discuss Them

This objection falls under the duty of care. This includes, among other things, the duty to provide advice that is in the best interest of the client.

I've heard this objection from RIA owners, IARs, chief investment officers at RIAs, and compliance officers working with RIAs. To understand how this objection falls under the duty of care, we'll let the SEC provide the guidance. Then, we'll let the research provide the quantitative data and utility of annuities.

The Guidance and Planning Approach from the SEC and CFP® Board

The duty to provide advice that is in the best interest of the client based on a reasonable understanding of the client's objectives is a critical component of the duty of care. An investment adviser formulating a comprehensive financial plan for a retail client would generally need to obtain a range of personal and financial information about the client, such as current income, investments, assets and debts, marital status, tax status, insurance policies, and financial goals as part of a reasonable understanding of the client's objectives and goals.[1]

The SEC does not endorse financial products; however, it does provide consumers with information on products. The SEC runs Investor.Gov to educate consumers on investment products to help them make sound investment decisions, avoid fraud, and research investment professionals. This is a source for unbiased information about investment products from an authority.

There is even a comprehensive section of the site dedicated to annuities. It explains, "An annuity is a contract between you and an insurance company that requires the insurer to make payments to you, either immediately or in the future." The site goes on to explain that annuities are bought to provide income in retirement and that they provide periodic payments for a specific period, death benefits, and tax-deferred growth potential. Consumers can read about the types of annuities, benefits and risks, fees, how to buy and sell annuities, and required disclosures.[2]

Obtaining qualitative and quantitative information and identifying and selecting client goals are part of the CFP® Board's Financial Planning Practice Standards. Here are some questions to consider as part of your information gathering:

- Do you have clients who already own annuities?
- Do you have clients who need a source of guaranteed retirement income?
- Do you have clients who need tax deferral to accumulate retirement money or wealth because they've maxed out their qualified plan options?
- Do you have clients who want to provide a legacy?

[1]SEC, 17 CFR Part 276 [Release No. IA-5248; File No. S7-07-18], "Commission Interpretation Regarding Standard of Conduct for Investment Advisers," July, 2019.
[2]Investor.gov. "Annuities." *Investment Products*. U.S. Securities and Exchange Commission, accessed February 9, 2023.

How It Plays Out in Practice

The 2021 Cerulli Report on the U.S. RIA Marketplace[1] revealed that 88% of RIAs offered retirement income planning and 84% offered retirement accumulation planning as services. However, the Cerulli Report showed that around 22% of independent RIAs incorporated insurance products and annuities into their product mix. In comparison, 70% of hybrid RIAs used annuities. Cerulli suggested that the massive gap might be due to lack of availability, but a study from the previous year gives a different reason.

A 2020 research study conducted by Kitces Research, distributed by industry-respected thought-leader Michael Kitces, sought to learn how financial advisors go about financial planning, and there were some very eye-opening revelations. Eight hundred financial advisors participated in the study. Seventy-three percent held the CFP® designation, and 61% described themselves as an "Independent RIA." Surprisingly, the three areas of planning that RIAs reported they were least likely to cover in a comprehensive plan were life insurance, long-term care, and decumulation planning.[2] I find that surprising. These planning areas are ripe with opportunity, and all have specific products that can be used to help meet clients' needs—including annuities for strategic decumulation planning. So, does it make sense that some financial advisors never bring up decumulation and have objections to the viable solution that could be used to address this critical planning topic?

Of course, it is possible that a firm doesn't have any clients who own annuities or have heard the "fish" stories about them and don't want to discuss them as a solution. But sheer scale of assets in annuities, the results of the Cerulli Report, and a Kitces Research study suggest there is a large disconnect between fiduciaries and clients. The disconnect appears to be that fiduciary financial professionals assume, and possibly project their own biases, that their clients don't want annuities and think it's simple math when it comes to asset decumulation. However, studies have shown many investors want the psychological comfort of guaranteed retirement income.[3] That desire isn't limited to investors with lower incomes. There are high-income and wealthy clients who desire guaranteed retirement income also.[4] The gap could potentially close if fiduciaries dug deeper into the goals of clients and understood how to utilize modern advisory annuities. Processes and educational opportunities now exist to assist fiduciary financial professionals when evaluating annuities.

Objection #2: I Can Only Use the Most Economical Solutions and Annuities Are Too Expensive

When it comes to fiduciary financial professionals, this aspect of the duty of care is one of the most contentious—and for good reason. There is published commentary that says fiduciary duty requires IARs to put clients into the most economical solutions available.[5] However, this is not something that regulatory authority, courts, or certification organizations have mandated.

Honestly, what would it look like if that was the mandate in other fiduciary professions? Would you go through with surgery if the anesthesiologists told you their duty was to put you under with the lowest-cost anesthetic they could find? Or if the estate-planning attorney you recommended to your client copied and pasted from a cookie-cutter financial website because it was the lowest-cost option for the client? Yet, this discussion comes up from contributors at financial industry online publications, advocacy groups, and even heated discussions on social media platforms.

[1]"The Cerulli Report: U.S. RIA Marketplace 2021." Cerulli Associates, March 1, 2022.
[2]"Tharp, Derek. "How Financial Planners Actually Do Financial Planning (2020)." The Kitces Report Volume 1. Kitces Research, 2020.
[3]"Mseka, Ayo. "Americans Want Guaranteed Income in Retirement, Survey Confirms." Insurance Newsnet, November 10, 2021.
[4]"Shaw, DJ. "The Appeal of Guaranteed Lifetime Income Option Is Growing Among Participants." *Data & Research*. Plan adviser, October 19, 2022.
[5]Tretina, Kat. "How Fiduciary Duty Impacts Financial Advisors." Forbes Advisor, July 15, 2022

The Guidance and Planning Approach from the SEC and CFP® Board

So, what does the SEC say about cost and the duty of care in the latest "Interpretation Regarding Standard of Conduct for Investment Advisers"?

"The cost (including fees and compensation) associated with investment advice would generally be ***one of many important factors***—such as an investment product's or strategy's investment objectives, characteristics (including any ***special or unusual*** features), liquidity, risks and potential benefits, volatility, likely performance in a variety of market and economic conditions, time horizon, and cost of exit—to consider when determining whether a security or investment strategy involving a security is in the best interest of the client."

The interpretation states, "when considering similar investment products or strategies, the fiduciary duty does not necessarily require an adviser to recommend the lowest-cost investment product or strategy. Moreover, an adviser **would *not* satisfy the fiduciary duty** to provide advice that is in the client's best interest by simply advising the client to invest in the lowest-cost or least lucrative (to the investment adviser) investment product or strategy without any further analysis of other factors. Rather, the adviser could recommend a higher-cost investment or strategy if it's reasonably concluded that there are other factors about the investment or strategy that outweigh cost and make the investment or strategy in the best interest of the client, in light of that client's objectives."

> *"An adviser would not satisfy the fiduciary duty to provide advice that is in the client's best interest by simply advising the client to invest in the lowest-cost or least lucrative (to the investment adviser) investment product or strategy without any further analysis of other factors."*

Cost would also fall under the duty of care according to the CFP® Board's Code of Standards. A CFP® professional must act with the care, skill, prudence, and diligence that a prudent professional would exercise considering the client's goals, risk tolerance, objectives, and financial and personal circumstances. The planning process requires a CFP® professional to use reasonable assumptions about a client's life expectancy, inflation rates, tax rates, investment performance, and other material assumptions and estimates when identifying a client's goal.

Finally, recommending and then implementing a course of action requires the CFP® professional to analyze products and identify the advantages or disadvantages relative to ***reasonably available alternatives***. While it is implicit that cost will be considered in recommending a product as part of a course of action, there is no language that concludes that product with the lowest cost must be chosen. The questions are: does the product maximize the potential for the client to reach his or her financial goals, and is there a reasonable alternative available?

How It Plays Out in Practice

Some fiduciary financial professionals might say that the cost of annuities is higher, and the value is lower than other strategies. They may generally refer to variable annuities when they are referring to annuity cost since fixed annuities do not generally have expenses. Variable annuities have been considered securities under federal law and subject to the requirements of the SEC since 1959.[1] The costs associated with variable annuities include mortality and expense fees, administrative fee, annual contract fee, costs for the death benefit and any optional riders, and the fund expenses of the underlying investment options that are managed by asset managers.

Breaking Down Annuity Costs

- Mortality and expense fees are the insurance costs that give contract owners or their beneficiaries the ability to convert contracts into guaranteed lifetime income at any point in time via the insurance company's ability to pool the risk with other contract owners—a feature no other financial product can provide.
- Administrative fees cover the operational costs of the insurance company.
- Optional riders can provide enhanced lifetime income or death benefits, but these riders are voluntarily added by owners for an additional cost.
- The investment options within variable annuities are subaccounts that are managed similar to retail mutual funds, and the costs pay the asset management companies to manage them.[2]
- The transfer of risk from the client to the annuity company is what the client potentially pays the most for.

We've pointed out that annuities can provide lifetime income, death benefits, and tax deferral. Are there any reasonable alternatives to a product that can utilize pooled risk to guarantee lifetime income, provide tax-deferred growth potential, and a legacy transfer within the same vehicle? Those are special features, right? I would be remiss not to mention that innovation has led to the creation of advisory variable annuities that have transparent pricing, no surrender charges, and a robust lineup of institutionally priced investment options managed by well-known asset managers. Those advisory variable annuities are specifically designed for RIAs and their clients. Many well-known and respected advisory annuity carriers offer institutionally priced investment options. My experience is that fiduciary financial professionals who state cost as an objection have not been made aware of changes that have taken place in advisory annuities; I hope this paper helps to change that.

Objection #3: Annuities Are a Conflict of Interest

I don't think I've seen a more divisive debate than the fee versus commissions debate. The arguments on both sides are fierce. Fee-only advisors believe that commissions incentivize sales and thus put the fiduciary financial professional's interest ahead of their client's, which is a conflict of interest, and falls under the duty of loyalty. Brokers and insurance agents argue that charging a fee based on AUM is just repackaging commissions and not economically feasible for all clients.

[1] *SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65 (1959). Variable annuities are also subject to FINRA requirements. However, the SEC approved the creation of and oversees FINRA.

[2] *Although some funds may have names or investment goals that resemble retail mutual funds managed by the same money manager, these funds may not have the same underlying holdings or performance as the retail mutual funds. Investment results may be higher or lower.*

The Guidance and Planning Approach from the SEC and CFP® Board

The SEC and the CFP® Board both require fiduciaries to eliminate conflicts of interest or at least give disclosure so that the client can give informed consent.[1] The many arguments and opinions that have sprung up around disclosure and consent are beyond the scope of this article. We'll only focus on how the SEC and CFP® Board have addressed compensation. In fact, former SEC Chairman, Jay Clayton, addressed this very matter when he gave his speech on Regulation Best Interest and the Investment Adviser Fiduciary Duty.

Clayton stated that while he believed the asset-based fee or flat fee model was a good model, there is no "one size fits all" approach that works for Main Street investors seeking financial advice. Some investors may find paying a commission to be more cost-effective than an ongoing advisory fee, and adopting a one-size-fits-all approach could reduce access and/or increase costs to the detriment of Main Street investors with relatively smaller accounts.

The CFP® Board's Standard of Conduct requires that compensation methods be disclosed to clients. CFP® professionals have explicit rules about identifying as fee-only or fee-based. Fee-only advisors and their related parties cannot accept sales-related compensation. Fee-based advisors can receive commission or sales-related compensation, but it must be clearly stated to clients.[2]

How It Plays Out in Practice

So, how do fiduciary duty, conflicts of interest, and compensation apply to annuities? I've had fiduciary financial professionals ask me if there are "conflict-free annuities." The answer is yes. Financial products by themselves aren't conflicts of interest; the motivation behind a fiduciary financial professional recommending the product is where the potential for conflict comes in. This speaks to understanding the difference between product sellers and financial-advice givers.

Today's annuities allow for either compensation method. Fee-only fiduciaries now have access to advisory annuities that do not pay a commission and allow for the option of advisory fees to be withdrawn from the annuity. The option for commissionable annuities exists for fee-based or hybrid fiduciaries who are licensed. It all boils down to the financial advisors themselves determining which compensation method works for their practices, and the disclosure they provide to their clients.

Objection #4: Annuities Are Too Complicated

This is the last objection that falls under the duty of care. It is an objection that I have found is generally a result of outdated information. When fiduciary financial professionals call annuities complex, they are generally either referring to the tax rules listed under IRC Section 72, the broad spectrum of types of annuities, or the many optional riders offered by annuity carriers. The good news is that advisory annuities and many of the companies that sell them are making great strides to make these products as transparent and uncomplicated as possible. It does fall on IARs to keep their knowledge current as clients depend on their guidance. In addition, clients now have greater access to information and may go to their financial professionals with questions about annuities, which are getting more exposure thanks to organizations like the Alliance for Lifetime Income.

[1]Under the SEC's Final Interpretation of the Standard of Conduct Regarding the Adviser's Act, an advisor must eliminate or at least expose through full and fair disclosure all conflicts of interest which that incline an investment adviser—consciously or unconsciously—to render advice that was not disinterested.

[2]CFP® Board. "Code of Ethics and Standards of Conduct." Certified Financial Planner Board of Standards, Inc., October 1, 2019.

The Guidance and Planning Approach from the SEC and CFP® Board

The SEC's Interpretation of the Standard of Conduct points out that investment advisers using the duty of care may find complex instruments to be in the client's best interest. The CFP® Board's Standard of Conduct does not address complexity of products, but it does require CFP® professionals to understand what they are recommending, get the assistance of a professional who does understand, or limit/terminate the engagement when not sufficiently competent in a particular area under the duty of competence.[1]

How It Plays Out in Practice

Let's be honest, there are many complex/complicated products and strategies out there. IARs wanting to provide financial advice about annuities for a fee must complete the required coursework and pass an exam. This is the case with many industry certifications and their members are required to act as fiduciaries. I'll say that I've noticed the relatively small focus given to annuities in the educational materials for these industry examinations. Testing weight is given to many of the other products and strategies. It's my opinion that people tend to focus on the topics they'll be tested on the most and don't apply themselves in areas that will only show up in a few questions.

Many of the conversations that I've had with fiduciary advisors who call annuities complex were a result of the many years when annuities weren't available to RIAs that were fee-only, and thus they forgot the knowledge they obtained while getting certifications. As mentioned previously, availability of annuities to the RIA community is no longer an issue. There are plenty of ways to brush up on the knowledge necessary to recommend annuities.

Financial professionals can find annuity information on regulators' websites, in industry groups, and directly from annuity carriers themselves. The SEC even publishes Investor Bulletins. Specifically, the SEC has created bulletins about variable annuities that include an important fact many opinion articles on annuities fail to mention. The SEC points out that variable annuities and insurance companies are highly regulated.[2] Variable annuities are regulated by the SEC and by state insurance commissions. FINRA and the National Association of Insurance Commissioners are other regulatory bodies that are also sources for researching annuities. There are industry groups such as the Alliance for Lifetime Income providing education on a nonprofit basis. Finally, many insurance companies offer hundreds of field training seminars and webinars by their representatives, have an advanced planning department that can be tapped into, host webinars, and continuously publish materials. I have personally conducted training seminars on annuity basics all over the country.

There's a difference between *true complexity* due to a lack of information available and *perceived complexity* due to nonexposure of the latest information. I'll point out that complexity has not stopped fiduciary financial professionals from recommending option strategies, alternative strategies, leveraged strategies, structured strategies, and even crypto currencies. Ultimately, it is incumbent on the fiduciary professional to have both the knowledge and reasonable belief that the recommendation is in the best interest of the client.

[1]CFP® Board. "Code of Ethics and Standards of Conduct." Certified Financial Planner Board of Standards, Inc., October 1, 2019.

[2]The Office of Investor Education and Advocacy. "Updated Investor Bulletin: Variable Annuities." *Investor Alerts and Bulletins*. Investor.gov, October 30, 2018.

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It’s Time to Put the Special Features of Annuities to Work for Clients

Annuities have special features that can help a variety of clients address tax, income, and legacy needs. In some cases, annuities may, in fact, be the soundest solution for some clients. So, if not evaluated, it would be difficult to say that one has done their complete financial fiduciary duty for a client.

My hope is that this paper has helped clarify the regulations interpreting fiduciary standards so that fiduciary financial professionals can make informed decisions about annuities in their financial-planning process.

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All guarantees, including optional benefits, are subject to the claims-paying ability and financial strength of the issuing insurance company and do not protect the value of the variable investment options, which are subject to market risk.

Investors should carefully consider a variable annuity’s risks, charges, limitations, and expenses, as well as the risks, charges, expenses, and investment goals of the underlying investment options. This and other information about variable annuities are provided in the product and underlying fund prospectuses. These prospectuses should be read carefully before investing.

Annuity withdrawals are taxable as ordinary income when distributed and may be subject to an additional 10% federal income tax if withdrawn before age 59½. For nonqualified contracts, an additional 3.8% federal tax may apply on net investment income. Withdrawals will reduce the contract value and the value of the death benefits, and also may reduce the value of any optional benefits.

Under current law, a nonqualified annuity that is owned by an individual is generally entitled to tax deferral. IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax-deferred. Therefore, a deferred annuity should be used only to fund an IRA or qualified plan to benefit from the annuity’s features other than tax deferral. These include lifetime income, death benefit options, and the ability to transfer among investment options without incurring additional charges.

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