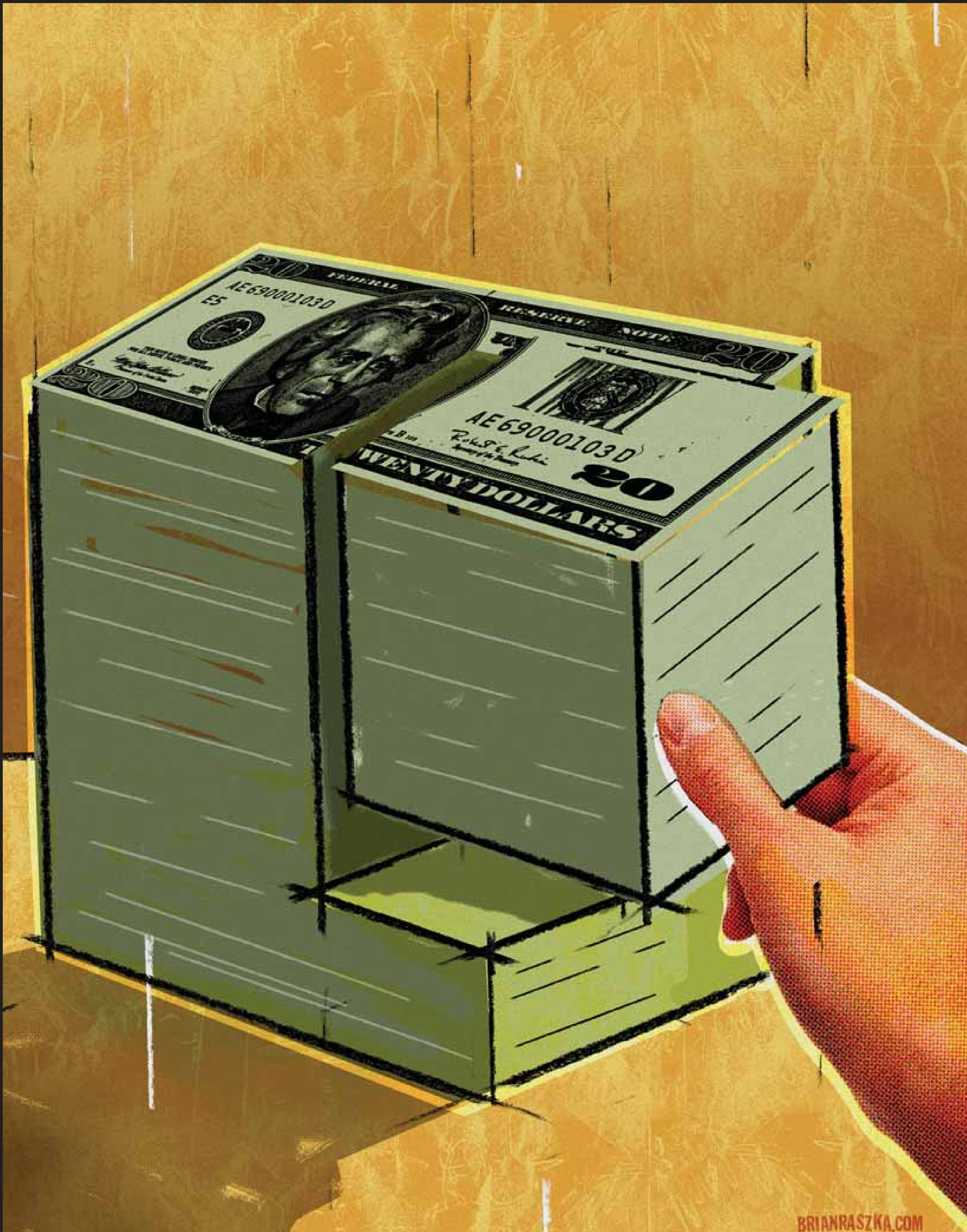
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By Michael Vaughan
Illustration by Brian Raszka

An emerging annuity alternative

THE SECONDARY ANNUITY MARKET SMOOTHES THE WAY FOR LIFE'S BIG, UNPLANNED CHANGES

The problem seemed insoluble. Jim needed some of the monthly retirement income his annuity provided but not all of it. And he needed a large sum of cash, fast. It wasn't poor financial planning; life changed for Jim in a way he could not anticipate. In this case it was Jim's son, Nathan, who had started a custom car shop. Business was booming, but Nathan needed some gray hair on the sales floor, someone he could absolutely trust, and a little bit of growth capital. »

Jim was perfect for the job but could not seem to get the numbers to work. Years earlier, before his wife died, his advisor, Susan, helped him select an annuity that would offer monthly payments of $7,865 guaranteed for 20 years or the rest of his life for a premium of $1.2 million. With the salary Nathan could offer him, Jim didn't need the full monthly payment. At the same time, the upfront annuity premium sapped almost all of his liquid investments, making it difficult to fund an equity investment in his son's business. Jim felt handcuffed by his annuity.

Susan crafted an alternative for her client in the emerging secondary market for annuities, and she deftly solved all of Jim's challenges. In the ensuing transaction, Jim sold five years worth of partial annuity payments — $2,713 of his $7,865 monthly payment — for a lump sum of $137,000, about what his son needed to finance new capital equipment purchases.

During this 60-month period, Jim would receive $5,152 a month from the annuity, and after the five-year period was up, Jim would again receive the full $7,865 monthly payment for the remainder of his life.

Jim hoped the new venture would work out and that he wouldn't need the full payment, but knowing it was there gave him enormous peace of mind.

He later told Susan, "You gave me so much more than access to cash. Knowing that the income I might need will be there in five years allows me to work smart instead of scared, and in the long run, that's going to make all the difference in the world."

And it made a big difference to Susan, too. The status she achieved in Jim's eyes as a result of the solution she developed resulted in a steady stream of referrals from Jim's friends who also had "annuity issues."

This real-life situation typifies the benefits individual investors, as well as the advisors who serve them, can realize from the emerging secondary market for annuities. While it's not the New York Stock Exchange, some specialty finance firms are fulfilling the role of a market specialist and buying annuity contracts from individuals through their agents, brokers and financial advisors.

A guiding principle in finance suggests that all market participants realize benefits when a secondary market emerges. As illustrated above and in countless other scenarios, a secondary market gives consumers more choices. Meanwhile, insurance companies will sell more annuities because liquidity increases the pool of investors for whom an annuity investment is appropriate.

But for advisors, a myriad of benefits exists, ranging from developing new commission streams to prospecting to cultivating stronger relationships within their existing book of business. Realizing these benefits in large measure depends on how this opportunity is positioned in consumers' minds and how it is marketed by insurance and financial advisors. James may have responded positively to an advertisement that addressed one of the central conflicts investors have with annuities: the lack of flexibility. An ad with the following copy could resonate with annuity owners: *Feeling handcuffed by your annuities? With an annuity purchase program, you can finally sell your annuities for cash.*

Other tactics are already helping advisors help clients find liquidity options for their annuities.

WEALTH TRANSFER MARKET

There comes a time in many clients' lives when their attention turns from generating investment income to transferring wealth to their children and grandchildren. The old saying, "You don't want to die with an annuity," is crass but nonetheless offers an impor-

> "Helping investors realize liquidity for their annuities is not a commoditized product at all."

tant point of view. The tax treatment of annuities upon death vis-à-vis the heirs is draconian compared to the alternatives of passing on stocks, bonds and mutual funds. Specifically, the former potentially results in an immediate tax bill due to the increase in the heirs' ordinary income. The latter approaches enable heirs to enjoy tax-deferred investing at a stepped-up cost basis across two generations with the prospect of generating substantial wealth from their inheritance.

By marketing alternatives for annuities, advisors can sell into the wealth transfer market in two ways. First, there are opportunities to prospect for new clients in the over-60 market. These are individuals for whom the thought of wealth transfer is just beginning to emerge.

These prospects also may be on the other side of financing higher education for their children, and they are close enough to retirement that the picture is becoming clearer about what assets they will need in their lifetime vs. assets that they can pass along to future generations. For prospects such as these, the following positioning will likely strike a chord: *You can't take your annuities with you. But you don't want to leave them behind either. Annuities are great investments for stable, secure income but not for passing wealth on to heirs and beneficiaries. With an annuity purchase program, you can sell your annuities for cash and consider alternatives to bridge the generation gap.*

Whether for prospects or existing clients, marketing a wealth transfer solution can have far reaching implications for your practice's success. This is because once a plan is set in motion to place assets into the hands of the next generation, the next most obvious need becomes competent financial advice for heirs. Advisors who position themselves as the architects of efficient wealth transfer are the most likely candidates for this new business. And the opportunity to generate substantial sums under management and increase product sales is more than likely.

CHERRY-PICK COMPETITORS

For better or for worse, many clients are creatures of habit. Therefore, investors are likely to revisit their trusted, or at least tried, financial advisors for most of their needs. How can you troll among these prospects successfully and break their habit? Providing liquidity for annuities represents one potentially successful avenue.

Remember, the annuity business has remained relatively unchanged for the last 25 years. Yes, there have been bells and whistles, but there is very little that's truly new. This presents a significant prospecting challenge for financial advisors; specifically, how does one develop a selling proposition that is unique and capable of grabbing the attention of the prospect? It's not that offering advice on buying annuities is irrelevant, it's just that it rarely breaks clients' habits. After so many years, the product is commoditized in prospects' minds, so there's little incentive to change habits or change the advisor that sells them.

By contrast, helping investors realize liquidity for their annuities is not a commoditized product at all. Rather, it offers advisors the opportunity to make a solutions-based, consultative sale to prospective clients. An ad with the following language typifies this positioning: *Imagine owning a car that could not go in reverse ... That's how annuities can feel sometimes. When the road of life requires a change of direction, an annuity purchase program can help.*

Such an approach does two good things for advisors. First, it creates an awareness in the prospect's mind of the shortcomings of the product their existing financial advisor sold them: It might be inflexible or illiquid. In short, within certain circumstances, this annuity can cause a real problem. Second, approaching prospects in this way suggests the new advisor is not going to sell them just another product; rather, he is going to help them find a solution.

Whether it's two-tiered annuities with an annuitization bonus, high surrender charges or long surrender periods, the advisor who brings flexibility and liquidity to these products will have a leg up in this marketplace.

In a world where all barriers between stock brokers, insurance agents, CFPs, CPAs, wealth advisors and wealth managers have gone gray, transaction-based sales are a curse to new business development. Solutions-based sales are in vogue, and not just among the sales and marketing intelligentsia; prospects love them, too.

YOUR BOOK OF BUSINESS

While pointing out the shortcomings of your competition's products works well when developing new clients, it does not work when developing new business within your existing client base. After all, if your pitch to a client is about a car that can't go in reverse, the response will likely be, "Then why did you sell it to me?"

Rather, within an existing book of business, the positioning to provide liquidity for annuities is much more emotional and human. Because the secondary market is available for annuities of all shapes and sizes — fixed, indexed or variable, immediate or deferred — and because the market allows advisors to customize options for clients through the sale of partial payments, partial terms or the entire annuity, the following message could hit home with annuity holders in an existing book of business: *Life changes. Why can't your annuities change with it? With an annuity purchase program, your annuities can finally be as flexible as your life demands.*

In this scenario, it's no one's fault per se. But at the same time, a life-changes theme is something that your clients can identify with. It's an opening that puts everyone at ease and on the same team. But how do you monetize this goodwill?

This is challenging because annuities' primary benefit is also their primary shortcoming from a financial advisor's business development perspective. Specifically, the long-term and largely hands-off nature of an annuity means that once the sale is made it can be difficult to keep the relationship warm. In fact, a carefully chosen annuity makes the advisor obsolete — thus the importance of a life-changes approach. Specifically, it gives advisors the perfect opportunity to reach out to their existing client base and present customized options and new ideas.

The fact is that the decision to purchase an annuity was made very carefully; as a result, the decision to sell one also should be made very carefully. It's this new interaction with clients to determine the best course of action that breathes new life into client relationships and delivers real value to advisors, because it's providing them a new platform to market other products and services.

In general, between 10 percent and 20 percent of an advisor's clients should or could consider selling their annuities in the secondary market as a result of changes in their life, or because of new or changed attitudes about investing, or perhaps because of evolving estate planning objectives. While it's not a majority of the advisor's overall book, these are high-margin commissions because there is little or no marketing expense associated with the sale.

It's also important to recognize that the sale of a portion or all of an annuity by an individual in the secondary market sometimes represents the thin end of the wedge. Specifically, liquidity often is needed to achieve other investment objectives; as a result, the advisors who can deliver liquidity are best positioned to help clients put the proceeds from the sale to work in other investment products.

The idea of selling annuities is a simple one. However, its power to transform the annuity market is clear. On a smaller, microeconomic scale, its transformative qualities are equally clear. For individual investors, liquidity adds an important product benefit, which can make a material contribution to an individual's well-being.

For financial advisors, it represents an opportunity to provide solutions, develop new revenue streams, strengthen client relationships and, for now, stake out a leadership position in an emerging and important market.

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