

# INCOME VALUE:

An industry solution to assessing the fair market value of Income Annuities

THE VIEW ACROSS THE SILOS



## Q&A

### Frequently Asked Questions and Answers

#### Section 1: What is it?

##### **What is INCOME VALUE?**

INCOME VALUE is the fair market value of an immediate income annuity, deferred income annuity, or the annuitized portion of a deferred annuity. The INCOME VALUE is equivalent to the present value of the remaining benefits using a standardized methodology and approach as of the date indicated. The INCOME VALUE is not a cash or surrender value, cannot be withdrawn, and does not represent a commuted value.

##### **What is the benefit of INCOME VALUE?**

INCOME VALUE helps remove some of the barriers that prevent financial advisors and clients alike to using Income Annuities as part of their retirement portfolio. It helps better align income annuities with the service models of advisors and bring them more into the mainstream of retirement planning.

##### **Why was Income Value created?**

There are several reasons why INCOME VALUE was created. First and foremost, once a purchase of an income annuity is made, those assets disappear from a client's consolidated statement, and from the AUM (Assets Under Management) report of the advisor and advisory firm. Making the income annuity holding more visible along with other investments and products within internal and external reports will help increase transparency and awareness of these products. It also makes it easier for financial advisors to account for these products as part of the financial planning process -

especially as it relates to product allocation methodologies in supporting cash flow needs in retirement.

##### **How is it used?**

INCOME VALUE can be used in a variety of ways:

- 1) Household Reporting / Consolidated Statements for a client
- 2) Assets Under Management (AUM) reporting for Financial Advisors
- 3) As a basis from which a Fee Based Advisor can charge their service fee against
- 4) As a basis for Advisor Trail Compensation
- 5) Financial Planning Tools
- 6) Tax Reporting for special circumstances

##### **Is this a Cash Value (Liquidity Value)?**

No. INCOME VALUE is not a cash value. It is merely a representation of the fair market value of an income annuity or annuitized contract. An annuity contract may have a commuted value that is available.

##### **Is INCOME VALUE the same as Mutual Fund or Variable Annuity account Values?**

No. Mutual fund and variable annuity account values are cash values that an investor has access to. Mutual funds are actively traded and an investor can buy and sell them in the open market. The account value of a variable annuity can be withdrawn (subject to surrender charges, if applicable). On the other hand, the INCOME

VALUE is not a cash value and there is no active or secondary market with an annuitized contract.

### **Is INCOME VALUE equivalent to a bond or fixed income holding?**

No. The INCOME VALUE represents the fair market value of an income annuity or annuitized contract. One of the benefits of the INCOME VALUE is that it can be accounted for as an asset under management holding next to a bond or other fixed income holding in a client's portfolio.

### **What product(s) is this value used for?**

INCOME VALUE can be used to provide a fair market valuation of an Immediate Income Annuity Contract (Fixed or Variable) otherwise known as a SPIA or IVA, a Deferred Income Annuity Contract otherwise known as a DIA or Longevity Insurance, or the fully or partially annuitized assets of a Deferred Annuity Contract (a Variable Annuity or Fixed Annuity).

### **How was the value created/designed?**

In December 2010, approximately 50 financial service organizations across the industry began to work together to define a common standard for a fair market valuation for annuitized contracts along with the necessary technological requirements to derive such a value. Research was conducted to identify preferences and current practices for valuation. Then individuals from the group of firms representing various functions including sales, marketing, actuarial, and operations worked together to define common methodology and standards.

### **What makes this value different than other income annuity values used today (e.g., Statutory Reserves, Initial Premium, Compensation Based Value, Commuted Value)?**

The industry felt strongly that a market value should be as representative of the current interest rate environment as possible, a factor not reflected in existing "income value" methodologies:

- Statutory Reserves: Is derived from an accounting practice that uses a conservative interest rate only set once a year and therefore lagging the market.
- Initial premium: Does not represent the state of benefits that would exist in a contract several years down the road
- Compensation Based Value: Is based on a proprietary formula that varies by product manufacturers.
- Commutation Value: Is also a proprietary calculation applied differently across product manufacturers.

Through the INCOME VALUE, the industry defined a common standard that is applied consistently across all products and incorporates common discount rates and mortality tables.

## **Section 2: How does INCOME VALUE work?**

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### **How is Income Value calculated?**

First, depending upon the mode of payment (e.g., monthly), each income payment is discounted back to the valuation date using a common industry benchmark called the Income Annuity Yield Curve which is somewhat similar to the U.S. Treasury Curve. Then, the probability of survivorship is calculated for each payment, based on a common mortality table used across the industry ( A 2000 Mortality Table). Finally, the discounted payments are combined with the survivorship calculations to derive a total INCOME VALUE.

### **What is the discount rate used?**

See "What is the Income Annuity Yield Curve?"

### **What is the "Income Annuity Yield Curve"?**

The Income Annuity Yield Curve is a set of discount rates that are derived from the actual income guarantees provided by a sample set of insurance companies on any given day. The Income Annuity Yield Curve is slightly different than the U.S. Treasury curve in that the rates are more reflective of the pricing and credit experience of the industry companies that provide guaranteed lifetime income. A comparison of the Income Annuity Yield Curve to the US Treasury Curve is available.

**Why is the INCOME VALUE different than the Initial Premium within the first month of an immediate payout contract?**

There are a few reasons for this difference. One is that most income annuities pay a commission to the distributor which is deducted from the premium the client pays the insurance company - the net difference is what ultimately funds the income guarantee that is quoted. This is similar to certain mutual funds (e.g., A Class Shares) where a load is deducted from the investment amount to pay the distributor before the funding of the shares takes place. Another reason is that each manufacturer has their own proprietary methodology on how they price their products. After purchase, the valuation follows an industry standard methodology, and thus, some minor variance between the two is expected.

**Why should there be a fluctuating value with the market?**

An income annuity (or annuitized contract) is typically one of many products and investments held in a client's portfolio. Virtually all other holdings are priced and fluctuate as a function of the market. INCOME VALUE allows annuitized contracts to align with all the other products for a more accurate view of an entire portfolio.

**Can INCOME VALUE be withdrawn?**

No. The INCOME VALUE does not represent a liquid value. It is a representation of the market value of the insurance benefit that is received from a contract.

**Is there a rate of return on the INCOME VALUE?**

No. INCOME VALUE is a present valuation of the benefits received from an income annuity contract. The set of rates used to discount the benefits is provided by the Income Annuity Yield Curve which is similar to the U.S. Treasury curve, but is more representative of the pricing and credit experience of the insurance companies that back these guarantees.

**How transparent is this formula? Would the Firm be able to validate?**

The formula is pretty straightforward. The set of rates associated with the Income Annuity Yield Curve are fully interpolated so that each insurance company can apply them consistently. The formula and related variable can also be made available on disclosures, if necessary.

**What processes are in place to ensure all product manufacturers calculate the value in the same manner?**

CANNEX Financial Exchanges has been asked to calculate and update the Income Annuity Yield Curve on a daily basis. A rate sheet of sample contract values will also be made available on a daily basis so that insurance companies can audit and validate that their formulas are accurate.

**How often is the value transmitted?**

The frequency of transmission of INCOME VALUE is generally between the insurance company and the distributor who would then make the value available in either internal and/or external reports. Even in cases where carriers are required to transmit insurance policy information on a daily basis, the INCOME VALUE may stay the same throughout the month until such time it is updated either at end of month or at some other time.

**How many insurers make this value available?**

The adoption of INCOME VALUE by insurance companies will occur over the course of time. It is assumed that the distributors who will want to make use of this value sooner will encourage their insurance partners to comply as needed.

**What are some additional Key Terms used in the calculation?**

- Economic Value: Calculating the present value of each payment against a common discount rate
- Discount Rate: The set of rates provided by the Income Annuity Yield Curve
- Probability of Survivorship: Calculated for each payment period based on common mortality tables and improvement scales.

## Section 3: Firm use of INCOME VALUE

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### **Is the use of INCOME VALUE approved by regulatory bodies like FINRA and the SEC?**

INCOME VALUE is just another measurement to assess the benefit or value of a contract, similar to Statutory Reserves, Compensation Based Value or Commuted Value. If a distributor wishes to communicate INCOME VALUE to a client, then they would need to provide their own compliance review and provide the appropriate disclosures. A sample disclosure statement for INCOME VALUE is available for distributors.

### **Are there regulatory standards or disclosures that apply to the use of this value?**

No. However, a sample disclosure statement for INCOME VALUE is available for distributors.

### **How does a firm receive the value?**

INCOME VALUE can be made available from the carrier to the distributor through the existing DTCC process via the Positions File (POV File) that is universally used across the industry. Enhancements have been made to accommodate INCOME VALUE.

### **Who does the distributing firm need to contact if interested in receiving the value from an insurer?**

The distributing firm should contact the relationship manager or product manager at each of the insurance

carriers they work with to request the addition of INCOME VALUE data in the Positions file they receive from the DTCC.

### **Is there a cost to use this value?**

The cost to receive this data is included in the existing service agreements established with the DTCC.

### **How can using INCOME VALUE benefit the Firm?**

There are a number of benefits that can be realized by employing INCOME VALUE. First and foremost, it can help provide a more complete view of the assets held under management supported by the organization. This would also help better align income products with incentive and support programs across the firm and ensure that an advisor is not penalized for offering a product that could be of value in supporting a retiree's cash flow portfolio.

### **What is the plan to expand access to this value?**

The availability of INCOME VALUE will depend on how various distributors choose to communicate it either internally within their organizations or externally to their clients. There will be training and awareness material available through the Retirement Income Industry Association (RIIA) and other industry organizations to help promote the use and adoption of INCOME VALUE.

## Section 4: Advisor use of INCOME VALUE

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### **Can a fee-based advisor use Income Value as part of their service charge?**

Some fee based advisors have adopted a practice where they charge a fee for their service against the value of an annuitized asset as well as other investments within a client's portfolio. The income annuity contract or annuitized asset is managed within a broader portfolio to support a financial plan. Any advisory fee charged using the INCOME VALUE as the basis for the fee should be determined based on the nature of the advisory service that has been established and be reasonably related to such services. Ultimately, any decision on a fee structure is the responsibility of the fee-based investment advisor.

### **Can advisors be paid ongoing trail compensation based on the INCOME VALUE?**

Some insurance companies provide a trail based compensation schedule based on values that are specific and proprietary to each insurer. It would be up to each insurer and subject to a firm selling agreement whether or not to apply INCOME VALUE to any trail-based schedule.

### **Other benefits for advisors**

Some retirement income strategies employ a mix of both investment and insurance products to support cash flow needs in retirement. A market based value for an income annuity can help the advisor provide a full view of the all the client's assets at work in supporting their financial plan. Also, a market based value applied to income contracts would provide a more accurate accounting of the assets under management (AUM) internally within their own firm

## Section 5: Client use of INCOME VALUE

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### **Will the Income Value be displayed on client statements or other communications?**

The decision to make INCOME VALUE available to clients via a statement or report is up to each individual distributor and advisor firm.

### **Does the client have access to withdraw this value?**

No. INCOME VALUE is meant to provide a market based view of the assets applied within an income contract. The Commuted Value or other liquidity values from which the client can cash in a portion or the entire contract is a separate and specific calculation that is determined by each insurance company providing the options.

### **Other benefits for Clients**

Applying an INCOME VALUE to an annuitized contract may provide a client a more accurate view of all of entire portfolio at work for them in supporting their financial plan. This value may also be of use by clients and their advisors in making future decisions about their portfolio as their needs change over time.

### **For more information:**



CANEX Financial Exchanges has been asked to calculate and update the Income Annuity Yield Curve on a daily basis and make this information available for download from its web site.

Additional INCOME VALUE technical and educational materials are also available on this site.

<http://www.cannex.com>

Information on INCOME VALUE may also be found through the following industry groups and associations:



<http://www.riia-usa.org/>