SINGER
WEALTH

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No-load variable annuities

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Now that so many advisors have become fiduciaries, insurance companies that traditionally offered commission-based products through brokers are now allowing fiduciary advisors to utilize no load variable annuity contracts.

This can be a suitable alternative to underperforming commission-based deferred or variable annuities. When an insurance company issues a product without commissions, they can issue them without surrender charges. That means most no-load variable annuities are just as liquid as stocks and bonds.

The annual expenses are typically as low as .25% per year. Many investors like variable annuities because they grow tax deferred and, unlike IRAs which can no longer be stretched, variable annuities can continue tax deferral over the life of a surviving spouse and children. The deferral could easily last 50 to 60 years.

What is also attractive is that most of the contracts offer a guarantee of principal at death for a small cost of 10 to 20 basis points. That means that the insurance company promises to refund any investment losses at the death of the annuitant.

In 2007, I had a client who was diagnosed with brain cancer. His life expectancy was uncertain, so I recommended a variable annuity with a guarantee of principal at death. Because he knew his principal was protected in the event of his death, he invested very aggressively.

In 2008, the stock market crashed, and his account value dropped from $1,000,000 to $750,000. Unfortunately, he died later that year and the insurance company, as required by the contract, put his $250,000 of investment losses back into his account. Although the contract only protects the original principal, there is nothing preventing the contract owner from periodically opening a new contract to transfer the funds and lock in gains, especially since there are no surrender charges.

We suggest that gains be locked in whenever the original contract appreciates by 10% or more. For any investments that will go to one's heirs, this could be a great low-cost strategy for capturing market returns while protecting principal and periodically locking in gains.