Episode #284: Is it Time to Upgrade your Variable Annuity Policy?

Welcome back. My name is Kyle. We're going to hop right into it today and talk about is it time to upgrade your variable annuity policy? Now, when I say upgrade, I mean to maximize this asset on your retirement portfolio balance sheet. And when we think of variable annuities, we look at the good, the bad, and unfortunately the ugly.

Of course, the good is when the market's performing, we're seeing our account values rise, life is good. Then there's the bad, where we're having a hard time earning a rate of return more than the fees being charged, where we're starting to see some erosion take place inside our account value. And then there's the ugly, the worst case scenario, when the market's not performing, creating pressure to your account value. On top of that, you have those excessive fees coming out. So, what are variable annuity owners to do?

The landscape has changed, the last 10 years has been great, so what are they to do? We look at what's called the flight to safety approach, where we're exchanging tax-free your variable annuity policy for a fixed indexed annuity policy, which will provide you the same level of security, same level of lifetime income needs, but at no risk to your capital.

Let's look on over to the board and look at the advantages of exchanging that policy and the disadvantages and some criteria that we have to look at before we can recommend making this transaction possible. If we look on over to my right hand side, we have lower cost.

Gone are the days of you paying any administrative fees, income rider fees, sub-account fees, which average out about 3% to 4%. If you look at the cumulative variable annuity policies out there today. Indexed annuities provide a low fee or no fee most of the time. So, we're going to give you a pay raise right off the bat by eliminating any form of drag associated with your contract. No principal risk, as I mentioned earlier. We're not invested directly inside the stock market. Variable annuity owners have done great, as I mentioned before, they're taking their winnings, they're leaving the casino, and they're capturing all that upside that they've experienced. So, now they want to protect it and the index annuity will provide them a shield against any negative stock market volatility.

Cumulative income, I should put in parentheses, “more” cumulative income. When we look at life expectancy, these indexed annuities are prioritizing the income stream or that private pension you're able to generate from the asset more than that variable annuity can provide. Maybe less initially, but more long term on a cumulative basis. Why? Because they have payout increases each year. They step up as long as the index is performing positive, providing that form of cost of living adjustment, to offset any of that inflationary risk, of which those VAs don't have in place.

And then lastly, enhanced death benefit. By making this transaction, this exchange, you're going to get a day one death benefit higher than the premium you've contributed towards the policy. A cool feature that most index annuities have. But let's look at the cons of making this replacement.

There, of course, are some cons. The first one is lower income. As I mentioned before, on the right-hand side, we're going to have more cumulative income inside index annuities, but we have to start off with a little bit less. But over time, with that increasing income, we can receive far more income extracted from that asset long term. Growth is limited, our upside is capped for that principal protection I mentioned earlier, we have to be willing to give up that upside. And that's fine, right? As we're approaching retirement, our focus has to shift from accumulation to distribution. So, we're okay with giving up some upside.

Surrender schedule, while this isn't an additional fee, this new contract would be on a new surrender period, meaning if you were to walk away and surrender the contract outright, you will pay significant charges, but of course, not something of concern for doing this for distribution and prioritizing the income stream from this asset.

Additional paperwork, unfortunately, there would be a new application, a new transfer process, getting those funds from one institution to another. Now, just because you can replace or exchange a policy doesn't mean you should. If we look over the criteria here below, the first thing we look at is, is the policy at least three years old? If it's not, we can't touch it. It's something that, you know, we keep an eye out and we want to be able to govern, and if it's sold within the last three years, a lot of times you're going to have these surrender charges. And when we look at surrender charges, there's ways we can overcome them. But if there's a hurdle rate more than 3%, a lot of times, again, that's a deal breaker, we can't make this transaction occur. Even if you love the company or even if you hate the company, you're going to have to stay put for a little more time.

Lastly, income rider values. We wanna make sure if the variable annuity has an income rider value that the new contract can provide a higher income value day one. And if not, there may be some explanation around that. But a couple of ideas or criteria that we look at on an average case basis.

So, let's wrap a bow around this episode. What did we talk about? The flight to safety approach, capturing locking in those gains, funneling those dollars tax free into an index annuity policy for that principal protection, for the cumulative higher income we can generate. But understanding there's downside, understanding we're taking a lower income stream to begin with, but it has to make sense, right? As I mentioned earlier, just because you can doesn't mean you should. Let's stick in between these sets of criteria here. And when we do that, work with the advisor who shared this video with you.

A lot of these exchanges will take a very close eye to compare, to run fee analysis, to run investment analysis, product comparisons. Let's spreadsheet it out and make sure it aligns with you and your goals for your retirement. That's all I have today. Again, we look forward to having you and seeing you next week on "Money Script Monday."