Six Annuities for the Wealthy

By Editor Test *Wed, Mar 7, 2012*

Contrary to conventional wisdom, high net worth individuals can benefit from owning annuities. It just has to be the right kind of annuity.

Reviewing my 2012 editorial calendar recently, I saw that someone had penciled in “The Needs of the High Net Worth Investor” as the theme for March. But what can be said on the topic, with regard to annuities? The conventional wisdom is that the rich don’t need annuities.

I guess it depends in part on how you define “rich.” Warren Buffett and Michael Bloomberg may not need annuities. But if people earning $250,000 or more are rich and people with at least $100,000 in securities are “affluent,” the annuity market might be bigger than we thought.

The trouble here is with the careless use of the word “annuities,” a term so general that it merely creates confusion. If you ask more specifically, *Are there certain types of annuities that can help the wealthy use their money more efficiently?* then the answer has to be yes.

Certainly, rich people do buy annuities or should buy them or should at least know more about them.

An 80-something retiree who sold his cardboard box factory for several million dollars recently put $2 million in a B-share variable annuity, on the supposition that he could get guaranteed growth. Months later, at a holiday gathering, he asked me if I thought he did the right thing. ‘That depends,’ I said. ‘Did your broker buy you a Mercedes?’

Another wealthy relative, a ‘millionaire next door,’ prefers to clip coupons in retirement rather than tour Bali or Machu Picchu because he’s hoarding his fortune against the possibility of huge nursing home expenses. There are annuities that could help him.

But more to the point: there are at least six kinds of annuities that so-called HNW investors should know more about as they contemplate or enter retirement. Starting with today’s story on Jackson National Life’s new Elite Access variable annuity, we’ll be writing about these products this month.

Longevity insurance. Rich people tend to live longer and therefore have greater longevity risk. The cheapest way for them to mitigate longevity risk (and have more fun with their money in the meantime) is to buy longevity insurance, aka an advanced life deferred annuity.

Fixed annuity/Long-term care insurance hybrids. The open-ended cost of long-term care insurance is one of the biggest threats to the value of bequests. As noted above, many wealthy people self-insure against these costs rather than buy expensive LTCI. Thanks to a provision of the Pension Protection Act of 2006, a deferred fixed annuity/long-term care insurance hybrid can help the wealthy avoid that trap. Part of the interest earned by the fixed annuity funds the LTCI, which is relatively cheap because the annuity assets (acting as a big deductible) cover the first year or two of expenses.

Low-cost variable annuities with alternative investment options. Although many of the wealthy know little about alternative investments and avoid them, these relatively exotic investments are emerging as popular diversification tools because of their low correlation with stocks and bonds. But alternatives, such as actively managed tactical asset allocation funds, can be tax-efficient because of high portfolio turnover. Therefore it makes sense to own them inside a variable annuity.

SPIAs—for tax-efficient income or to finance a tax-free bequest. In *Wealth Secrets of the Affluent* (Wiley, 2008), Christopher R. Jarvis and David B. Mandell urge the rich to explore the purchase of life annuities, either with after-tax money (to reap the tax benefit of the exclusive ratio) or with qualified money (to fund a life insurance policy for heirs).

Charitable gift annuities. This type of annuity allows a philanthropic HNW retiree to generate retirement income, save on taxes, and fund a charitable cause. In essence, the contract owner gives money to a charity, which pays the owner (and spouse, optionally) a lifetime income. The owner receives an immediate partial tax deduction for the amount that the charity is statistically likely to have left when the annuitants have died. According to a recent *New York Times* ad, the effective annual rate of return on such a contract, including tax savings, ranges from 6.3% for a 65-year-old single-life purchaser to 11.5% for a 90-year-old single-life purchaser.

Secondary-market annuities. Everyone, including the wealthy, is looking for better returns from low-risk investments today, and some secondary-market period certain deferred payout annuities offer an effective rate of return of seven percent or more. Sure, it’s a walk on the wild side, but some HNW investors are ready to take that risk. Just make sure that you’re working with a trustworthy intermediary who can demonstrate that you will have unequivocal rights to the income.

*　　*　　*

It’s likely that many HNW investors never even hear about these tools because they get their financial guidance from fee-based investment advisors who know nothing about annuities or regard them as “terrible investments.” Few advisors understand both investment and insurance products well and, more importantly, know how to combine them to generate maximum savings, utility and risk-reduction for their retired clients. As more financial advisors learn that a grasp of annuities can help them compete for HNW retired clients, that situation may change.