InvestmentNews

A first: VAs with option for ETFs

By Gary S. Mogel

February 14, 2005

NEW YORK - Integrity Life Insurance Co. of Louisville, Ky., is offering the first variable annuities that include the option of investing in exchange traded funds. Other variable annuity providers may follow suit.

ETF-based variable annuities may offer lower costs than those using actively managed funds.

All of the ETFs offered by Integrity are fund-of-funds portfolios comprising iShares from Barclays Global Investors of San Francisco and distributed by Cincinnati-based Touchstone Securities Inc.

Representatives from large variable annuities writers Hartford Life Inc. in Simsbury, Conn., Jackson National Life Insurance Co. in Lansing, Mich., and Lincoln Financial Group in Philadelphia said that their companies are considering an ETF option for their variable annuity investments.

"We wanted to provide our clients with a low-cost, high-quality strategy that gives them a simple way to index the market or sectors and diversify," said Barry Meyers, Integrity's vice president of business development.

Integrity's variable annuity ETF option was developed in November and December 2004, and a marketing campaign, including presentations to the company's sales force and advisers, is under way.

Portfolios are available for conservative, moderate and aggressive investing strategies. The funds have a $10,000 minimum initial contribution, a $30 annual maintenance fee if the account value is under $50,000, and a 0.6% annual expense fee. A variable annuity without ETFs requires a $20,000 minimum contribution and carries a 2.5% annual expense fee, said Mr. Meyers. There is no annual maintenance fee.

"ETFs bring the characteristics of transparency and low cost into variable annuities," said James Parsons, managing director of Barclays. He added that it is too early to call ETFs offered in variable annuities a trend, but other variable annuity providers have made inquiries about offering Barclays ETFs. Mr. Parsons said he could not name the providers, as discussions are in progress.

Advisers welcome option

Representatives from Integrity recently made a presentation about their variable annuity with the ETF option, said Paul Winter, principal of Five Seasons Financial Planning in Holladay, Utah. "I don't recommend annuities that often, but anything that lowers fees or expenses within the variable annuity shell is good because the cost to the client will be less," he said.

"I am a big proponent of ETFs and use them for a majority of my clients," said John Gay, principal of Frisco (Texas) Financial Planning. ETFs are an appropriate strategy for variable annuity clients who want a core, cost-effective, passive type of investment approach, he added.

Mr. Gay said that many insurers are taking a "wait and see" approach toward ETFs, letting them develop more of a track record before making them available in variable annuities. He added that he would consider using ETFs in a variable annuity and has a favorable opinion of iShares, which he called "one of the top established players."

Dave Moran, senior vice president of Evensky & Katz Wealth Management in Coral Gables, Fla., which has $450 million under management, said that his firm has been very proactive in discussing ETFs with clients, and including them in variable annuities can be a good idea.

However, he pointed out that ETFs sometimes make more sense outside of the annuity, as they are geared to those seeking low-cost investments, and there may be less concern about deferring taxes.

Michael Schulitz, second vice president and managing director of Lincoln's Elite Series of funds, said: "ETFs can often be purchased for [0.1 to 0.3 percentage] points, and the tax advantages depend on the specific ETF used and are hard to predict."

Mr. Meyers of Integrity noted that the tax considerations can be secondary to the advantage of getting into a desired asset class or sector at low cost.

"Even if, from a tax standpoint, it may not help as much to have an ETF within a variable annuity, it doesn't hurt," said Barclays' Mr. Parsons.

Mr. Moran of Evensky & Katz said that ETFs have probably not made major inroads into variable annuities, because many of the insurance companies that own fund managers that don't offer ETFs didn't want to go to an outside manager and give up the revenue and control.

There may also be commission considerations. Mr. Gay, a fee-only adviser who does not accept commissions, said that the success of ETFs in variable annuities will hinge partially on whether the commissioned salespeople will be adequately compensated, given that the lower costs of passively managed ETFs might generate less income for the insurer.

As for Integrity, Mr. Meyers said, while the lower-cost ETFs may have "revenue implications" for the company, management has chosen not to reduce the compensation of its commission-based representatives.

"If this product is successful, other variable annuity writers will probably have to offer ETF options to stay competitive," Mr. Moran said.

"We do not have ETFs in our lineup now, but we are evaluating whether they are appropriate in variable annuities, and have had conversations with several prospective partners," said Lincoln's Mr. Schulitz.

He added that Lincoln already offers passively managed index funds in its variable annuities.

http://www.investmentnews.com/article.cms?articleId=51962