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SMART INSIGHTS FROM PROFESSIONAL ADVISERS

Should No-Load Variable Annuities Have a Place in Your Portfolio?

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Should No-Load Variable Annuities Have a Place in Your Portfolio?

Certain examples of this type of annuity can help you steer clear of some sky-high fees and scary surrender charges. However, make sure you understand exactly what you're getting into.

If you're close to or in retirement, two of your top priorities should be maximizing your income streams and minimizing your income taxes.

One often-overlooked investment vehicle that can accomplish both goals is a no-load variable annuity.

Wait! Don't close the page.

I know variable annuities get a bad rap — and in some cases, it's understandable. Buyers frequently pay fees that are so high, they erase any tax benefits they may bestow on the investor.

• There's the **"mortality and expense"** fee charged by the insurance company to cover the cost of death benefits and the expenses of other insured income guarantees that might be included with the annuity contract.

• Then there's the **"administrative expense"** fee that's meant to cover the cost of things like mailings and ongoing services.

• Don't forget to add up the **"investment expense ratio,"** which is a management fee for the sub-accounts inside the annuity.

• And finally, there are extra features, **called riders**, that add to your benefits — and to your cost.

It doesn't take a mathematician to figure out that if you're paying 3.5% or more in fees each year, your annuity must earn all that back before you start seeing a return. In years when the markets fall, your account value will be faced with a double dip, the first from market losses and the second from fees and expenses.

Buyers also often get themselves entangled in complicated contracts with long durations and high surrender charges. If you withdraw money within the first few years of your contract, for example, you might be required to pay a surrender charge that is typically between 5% and 7%.

I understand that all these issues factor into the general fear of variable annuities — but as a former tax attorney, I love to introduce our clients to them, because they offer an opportunity to defer taxes and, therefore, our clients will benefit from tax-deferred compounding growth.

THE APPEAL OF NO-LOAD OPTIONS

The solution to all those downsides? Try checking out some of the newer no-load variable annuities that are low in cost and have low-cost funds built into their model. The companies that offer them (Vanguard, Fidelity, Nationwide and a few others) don't pay a commission to a selling agent, so the fees are lower. And you can manage the investments inside your account yourself, or you can have your financial adviser (to whom you're already paying a fee) manage it for you.

You also can decide for yourself if it's worth adding the cost of an income rider. These guaranteed lifetime withdrawal benefits are what appeal to many annuity buyers, but they vary by insurer and the riders can be confusing. It's important to note that typically income rider values aren't real money and, therefore, they can't be cashed in. Thus, if your income rider value is growing at 6% or 7%, that does not mean you are making 6% or 7%. Rather, these values and growth rates merely function as formulas to provide income that can be paid over a term of years or a lifetime. Income rider calculations are usually complex, so you should seek the recommendation of an unrelated third party (such as your accountant or a third-party adviser) to ascertain the true value of the income payouts.

You also can avoid those scary surrender - charge issues with a no-load annuity, so it's a better option if you're worried about having access to your money should your financial situation change.

DO YOUR HOMEWORK

Of course, no investment product is perfect — and you should be especially vigilant when purchasing anything that's unfamiliar. It's important that you understand the purpose behind every single investment in your portfolio.

Financial professionals who sell variable annuities have a duty to advise you as to whether the product is a good fit for your retirement needs. Don't be afraid to ask questions. (The U.S. Securities and Exchange Commission has a list of recommended questions on its website.) https://www.sec.gov/reportspubs/investor-publications/investorpubsvaranntyhtm.html

It's a complex topic — and there's a lot of misinformation out there. But if your goal is tax deferral with compounding growth, you really should take a look at the role a no-load variable annuity could play in your retirement plan.

Kim Franke-Folstad contributed to this article.

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