



INVESTOR'S BUSINESS DAILY*

March 20, 2008

Annuities: Plus Or Too Many Minuses?

By TRANG HO

The basic idea of an annuity is simple: You give an insurance or investment firm a wad of money. In return, it promises to pay you a set amount of money, every year, for the rest of your life.

The fear of running out of money in old age grows as traditional pensions dwindle and Social Security leads to insecurity.

Americans reacted to that concern by pouring \$134.4 billion into variable annuities in the first nine months of 2007, says the Association of Insured Retirement Solutions. That was a 15% increase in sales over the year-before period.

Assets invested in variable annuities total \$1.5 trillion.

"It's all about protection," said Robert DeChellis, president and CEO of Allianz Life Financial Services. "No one has control over the market the day they're retiring."

But that guarantee comes at a steep cost in the form of much lower returns, higher fees and tax consequences compared with traditional investments in stocks, bonds and money markets.

Annuity policies, fees, charges, investment options and tax treatments are complex. Tony Bahu, a former independent insurance agent who sold annuities, says agents don't really know what they're selling or don't fully disclose all the costs.

"They made these things sound like they're a cure for cancer," said Bahu. "The agent goes out and maybe doesn't do his research and just believes what the insurance company is stating (and sells) this thing without proper knowledge or with bad information."

The Costs

So what are the charges that can eat away at your returns?

Start with mortality and expense, or M&E. According to the Securities and Exchange Commission, M&E typically costs 1.25% of the total account every year. This is for taking on the insurance risk of the annuity contract. It helps cover the company's costs, such as paying the insurance agent's commission.

Administrative fees cover such items as record keeping. This can be a flat fee of \$40 a year or 0.15% of the total account, the SEC says.

Surrender or withdrawal fees are the penalty for taking money out early or canceling contracts. Fees start at 8% for as long as the first 10 years of contracts, then decrease.

Variable annuities, which hold mutual funds, bonds or money markets, also charge sales loads and management fees for the underlying investments. And switching investment options can bring a transfer-fee bill.

Guess what else? A fee exists for each additional perk such as a stepped-up death benefit, long-term care insurance or protection against market declines. Some states and cities levy a premium tax — sometimes as high as 3.5% — on an annuity's value when it's sold.

Over the course of 20 or 30 years while you're saving for retirement, the stock market will generally trend higher, as will other investments. Instead of paying an insurance company to give you annual installments, why not do it yourself?

Is It Worth It?

Providers tout equity index annuities — typically invested in the S&P 500 — as offering market returns or a minimum interest rate while protecting against loss of principal should the market go down.

"We have yet to see a single contract that comes close to delivering that," said Steven Roth, president of Wealth Management International. "Typically the client is getting a rate of return that might be better than a fixed annuity or a CD, but often only between 40% to 65% of what the market will earn over a sustained period of time."

Roth's consulting firm specializes in analyzing financial products through models. It has helped two dozen victims defrauded in buying annuities. His clients ranged from the typical senior citizen of modest means to a self-made businessman worth \$42 million.

"I would like to think that people who are smarter are dodging bullets, but they don't," Roth said.

Commissions of 3% to as much as 12% encourage agents to promote annuities over other options, investment advisers complain. "They're sold to people. They're not bought," said Mike Glowacki of the Glowacki Group, which manages \$300 million in private assets. "I don't think you'll find any fee-only adviser that would recommend it to anyone."

Insurance companies, including Allianz and Citizens Financial Group, have paid millions to settle lawsuits alleging they misled senior citizens or sold unsuitable plans.

Because people are living longer than ever, some retirees might figure the annuity fees justify the comfort of having a defined monthly income stream. "Variable annuities based on stock market investments allow annuitants to hedge their longevity risk without giving up exposure to the investment risks and returns of the stock market," said John Ameriks, an economist at the TIAA-CREF Institute.

Allianz's DeChellis defends annuities, arguing that record annuity sales show that Americans put a high premium on steady and secure retirement payments.

"While some of them (investment advisers) may not like us, there are many more raving fans today than there were five years ago," he said.



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