ADVISOR PERSPECTIVES

Annuities Do Not Belong In 401(k) Plans

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by Rick Kahler

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Several weeks ago I wrote about the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which will reform various aspects of US retirement laws. The Act was passed by the House in May and is currently stalled in the Senate.

One of the most troubling of the SECURE Act's 29 provisions is that it will ease regulations to make it easier for financial salespeople to sell annuities to 401(k) plan participants. I am speaking primarily of variable annuities (VAs) and fixed-index annuities (also known as equity-indexed annuities).[1]

This is alarming, as the Act creates a safe harbor for annuities inside 401(k) plans. That means companies choosing to offer annuities would be shielded from liability – no matter how terrible an investment the annuity products may be. This provision has great potential for harm.

Annuities seem always to be a hot financial product in the market place. It's rare when I interview a new client that they don't have at least one in their portfolio. Often, it's the only investment they own. Annuities are not hot because consumers are clamoring to buy them, but rather because annuity salespeople love to sell them.

While I rarely recommend them, there are some good things about annuities, especially that earnings grow tax-deferred until distributed. They can be useful in this regard in special situations – when stripped of their high fees and commissions. Therein lies the problem.

Most annuities sold by salespeople inherently contain high fees, big commissions and high penalties to consumers for taking money out early. What that means for the investor is low returns. For those reasons, the negative aspects of annuities far outweigh any good.

Even worse, annuities have no place being owned by an IRA or, as the SECURE Act would allow, a 401(k) plan. Regardless of fees or commissions, no annuity belongs in a retirement plan. One of my top pet peeves as a financial planner is so-called "financial advisors" who sell people fixed and variable annuities for a retirement account. This makes no sense.

An annuity is a tax-deferred container to put investments in, not an investment itself. It's what investments are inside it that matters. The same is true of IRAs and 401(k) retirement plans. Since a retirement plan is already a tax-deferred investment container, it makes no sense to put an annuity – another tax-deferred investment container – inside of it. The silliness of this is obvious to even the most casual observer, unless your livelihood depends on selling these products.

Agents and their companies spare no expense in developing convincing storylines, half-truths and sleight-of-hand explanations of why it makes perfect sense for a retirement plan to own an annuity.

Annuities are sold, not bought. The only reason annuities are purchased in someone's retirement account is because the salesperson receives a much higher commission from the transaction than selling a mutual fund, individual stocks or CDs.

So why did our House vote 417-3 to open up investors' 401(k) plans to these high-cost, high-commissioned, financially disastrous products? I can only surmise that most of them didn't fully understand what they were voting on and that the insurance lobby did their normal amazing job of selling the alleged benefits of annuities. Oh, and maybe there was a campaign contribution or two.

Most annuities are expensive investment vehicles that benefit the salesperson and the company far more than they benefit you. If you are thinking of buying one, or in the future your 401(k) offers the option of buying an annuity, do some digging

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before you buy one. Make sure you get advice first from someone other than the annuity salesperson – someone with no vested interest in selling you this product.

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[1] One type of annuity, the deferred-income annuity (DIA), can be purchased in a tax-sheltered account through a QLAC. This article does not apply to QLACs.

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