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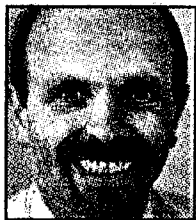
Annuities probably not a good idea for most investors

The financial-service industry is always coming up with great ideas about how to get rich and avoid taxes. Unfortunately, the order in which this enrichment happens usually has consumers last in line.

Annuities are a common investment vehicle proposed to people with large sums of money available because of their retirement, sale of a business or inheritance. They're probably not a good idea for most investors, created more to improve insurance companies' bottom lines than to benefit consumers.

With a more informed and skeptical

ROB RIKOON



Real Money

bank CDs.

The right kind of insurance might be

audience, old-fashioned life insurance sales are much harder to make these days. The general public now realizes that making a monthly or annual payment for "whole" life policies often turns out to be a bad investment, maybe even worse than

an appropriate part of your overall family financial plan, but some very bright insurance salespeople started promoting annuities in the late 1980s because selling their more traditional insurance didn't compare well with stock returns of the 1990s.

First, though, annuities had to have a tax break, so one of the strongest lobbying presences in Washington moved into high gear. The result was that earnings inside annuities were declared "tax-deferred." This sounds good but is only so on the surface. Then, because the real estate/oil and

gas partnerships sold in the 1980s had gone sour, annuity accounts were packaged and sold as one of the last "tax dodges" left.

In one way, it is true. Interest income, dividends and capital gains are not taxed inside annuities until withdrawal or death (the ultimate withdrawal). Some salespeople began to get their customers to put annuities into IRAs. Buying an annuity in an IRA is a bit like taking a shower while wearing a raincoat; the raincoat is simply "in the

way." IRAs are already tax-deferred, so using an annuity for this purpose just doesn't make sense.

Since the main advantage of an annuity is income-tax deferral and since an IRA already has these features, buying an annuity doesn't make sense for an IRA or any other retirement plan.

Annuities, however, have other, more serious disadvantages:

■ **Expenses:** The upfront and ongoing expenses of an annuity can be relatively high. It is estimated that the average annual expenses for an annuity equal 2.1 percent. Some companies offer annuities with much lower expenses (Vanguard and Charles Schwab), but you will also find companies that have expenses that are much higher. Remember, having higher expenses reduces the growth potential of your investments.

■ **Limited choices:** When you are buying an annuity, you select either fixed or variable. With a fixed annuity, the insurance company pays you a fixed rate of interest that will change every year or every few years. It's similar to buying a certificate of deposit from a bank. Once you have purchased the annuity, you are no longer free to "shop" for the best rate until your surrender-charge period has expired (see below). Also, you do not receive FDIC insurance. With a variable annuity, you can choose among a dozen or so mutual funds. Again, you are faced with limited choices that may underperform compared to the market. If you put your IRA with a discount broker as an alternative to annuities, you will have access to thousands of mutual funds. More choices create an opportunity to achieve better returns.

■ **Surrender charges:** Most annuities charge a penalty if you take your money out during the first several years. The surrender period can range from five to 10 years, and the surrender charges will typically equal 5 percent to 7 percent or more. Usually, these surrender charges decline each year you own your policy.

■ **The tax bill:** The growth in annuities is eventually taxed at

regular income-tax rates. None of the lower capital-gains rates ever apply to annuities. This means there is often a substantial increase in one's tax bill when money is withdrawn from the annuity or the annuity owner dies. If you are a frequent trader, annuities can assist in jumping from one investment to another without tax consequences. Like IRAs, annuities allow investors to buy and sell without incurring an immediately payable long- or short-term capital-gains bill. Remember, though, the point is that all the growth and income is taxed at higher income-tax rates in the end. This aspect of "tax deferral" is rarely discussed.

What should you do if you already have an IRA annuity? First, check to see if the surrender-charge period has expired. If so, you can simply "roll over" your IRA annuity to a regular IRA, thus eliminating all the baggage associated with owning an annuity. If you incur surrender charges to roll over your IRA annuity, see how much you will save by keeping your annuity until the surrender period ends. Then, check the potential underperformance of the annuity vs. other available investments such as the Standard & Poors 500.

If the annuity is not in an IRA, 401k or 403b, rolling it over is not an option. Finding the lowest-cost custodian for your annuity then becomes all the more important. Like traditional life insurance, once you have been sold a product, you end up continually paying for the privilege of having a temporary tax break. You are probably constantly being confused about how well your investment is doing as well. Given all the complexity in the rest of our busy lives, why bother?

Rob Rikoon is the president of Rikoon Investment Advisors, New Mexico's largest independently owned investment management firm. A question-and-answer session on financial markets and products will be held at Rikoon Investment Advisors' offices, 204-A North Guadalupe, on Feb. 17 at 3 p.m. There is no charge and the public is invited. Rikoon can be reached via email at rrikoon@aol.com or at 989-3581.