Corbett Road

In The Media

Should An Investor Stay Away From a Variable Annuity? – 5 Experts Weigh In

— By Sarah Bauder | September 26, 2019

Disclosure: Our content isn't financial advice. Do your due diligence and speak to your financial advisor before making any investment decision. We may earn money from products reviewed.

A variable annuity is an annuity contract which allows for the allocation of money held in "subaccounts". Although tax-deferred, variable annuities do not guarantee a return on the principal. In this article, 5 experts discuss whether or not an investor should stay away from a variable annuity.

Most Investors Should Not Avoid Variable Annuities, The Downside Is Cost

"Pros – Most investors should not avoid variable annuities. You can guarantee income for life and enhance death benefits. Additionally, they're guaranteed growth. They're absolutely an option worth considering for the long run.

Cons – The downside to variable annuities is cost. They're relatively expensive compared to other options. Another is time since they require a commitment of five to seven years where you won't have access to all of the money without a penalty."

Chane Steiner, CEO, Crediful

Most Investors Are Much Better Off Simply Opening An IRA Or Contributing To A 401k

"With over 15 years of financial services experience, I often get asked about annuities. In the past, annuities were attractive because their longer terms paid higher rates than shorter-term savings like CDs. However, with the inversion of the yield curve, short-term interest rates are very close to longer-term ones, with the advantage of liquidity if access to those funds is needed. A variable annuity is even worse of an investment than a fixed annuity because the actual return is not even guaranteed (it's determined by the performance of the underlying investment selections).

Most investors are much better off simply opening an IRA or contributing to a 401k, and then investing in index funds or sector funds. The benefit of this is that by investing in the underlying holdings of the annuity, you will save fees and overhead, yet still have all the same tax deferment benefits. For example, an annuity that tracks a basket of stocks may return 4%

annually, whereas investing in that basket directly through a retirement account would have returned 6%. That is a significant difference that eats into your returns. While some variable annuities tout downside protection, that can very simply be replicated in a retirement portfolio as well (either through options or hedging trades). One should not be surprised to learn that annuities are some of the highest paying commission products a financial advisor can sell, which is usually a good indication that they don't add as much value as they claim. Bottom line: Investors should SKIP annuities altogether, learn about basic investment strategies and allocations and if any variable annuity has an attractive risk/reward profile, they should simply replicate it in a retirement account to have all the same benefits but at a lower cost."

Edgar Radjabli, CEO, Loan Doctor

Variable Annuities Are Not A One-Size-Fits-All Investment

"Contrary to the beliefs of your local insurance salesperson, variable annuities are not a one-size-fits-all investment. In many cases, they're not a good fit at all. Annuities are like ice cream at Baskin Robbins. It's all referred to as ice cream, but there are 31 different flavors. While, using a variable annuity may very well be a good solution as part of a portfolio, many times the investor could be just as well served (if not better) by taking a different route at a lower cost. At the very least, make sure you are speaking with a true Financial Planner that has the designations/credentials to back up their opinion.

For example, if an investor is 45 years old (and likely won't retire for 20 years), there is little to no reason for that individual to purchase a variable annuity with a guaranteed minimum withdrawal benefit (the solution that many insurance representatives or "advisors" sell and, coincidentally, comes with one of the highest commission rates). First, at age 45, the average person has little knowledge of the extent that they will need guaranteed income in retirement to cover their essential expenses. Second, you will be hard-pressed to find a rolling 20-year period in the market that produced a negative return. In this example, as the investor, you've essentially paid for additional insurance on your portfolio that you would highly likely never need. The juice is worth far less than the squeeze. In this example, I would compare this to insuring your South Florida home against the potential damage of a brutal snowstorm; highly unlikely you would ever have to file a claim."

Matthew E. Gaffey, CFP(r), ChFC(r), Senior Wealth Manager, Corbett Road Wealth Management

A Variable Annuity Is Often Suggested In Situations That May Or May Not Make Them The Best Choice

"Because so many 'financial advisors' earn their living through the sale of variable annuities, VAs are often suggested in situations that may or may not make them the best choice.

One selling point is that they provide tax-deferred investment growth, but retirement accounts already include that feature at no extra cost. Many school plans have an annuity as their primary option, even though there are much less expensive ways to invest.

Typically, the investment selections within a VA contract are limited to those mutual funds which have paid for the privilege of being one of the choices. This extra cost (known as paying to play) is passed on to purchasers through higher internal fees (aka expense ratios), adding to costs.

There is often a guarantee that no money will be lost but insurance fees continue even when the account value exceeds the amount deposited; the account itself would make the guarantee work.

I'd say the 'state of the art' in asset management would be to locate a service that cost no more than 1% of asset values yearly, all in. We often see variable annuity contracts with total fees in the 3.5% range, meaning the first 3.5% the investments earn is absorbed by fees. I've heard of an insurance agent describing contract costs as 'pennies on the dollar'. That, of course, is what most people who buy annuities pay and is way more than necessary

When we encounter a situation in which an investor is contributing the maximum to retirement accounts and is doing reasonable 'after-tax' investing, we do consider VAs but we then suggest one of the 'no load' products, say from Vanguard or Jefferson National's 'Monument' product. Both offer sensible investment choices at very low cost."

Warren Ward, CFP(r), Sr. Planner, WWA Planning & Investments

Put Your Money Into An Index Fund, You Probably Will Do Better In The End

"Annuities provide stability of your financial future. However, they are generally very expensive as they would assume the risk for you. If you are not able to manage your financial portfolio, you may consider buying annuities. If you are able to handle the market fluctuations in the short term, you may consider buying variable annuities. However, I suspect that if you put your money into an index fund and withdraw the same amount money automatically as an annuity offered, you probably will do better in the end."

Dr. Tenpao Lee, Professor of Economics, Niagara University

There is debate as to whether or not an investor should stay away from variable annuities. In certain situations, they are not a good choice of investment and are not recommended. If you are interested in variable annuities, factor in what these experts have discussed, consult a financial professional, and always do your due diligence.

Sarah Bauder is a financial writer with over a decade of experience at numerous online publications, writing about alternative investments, retirement, US politics, world economy and more.