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Money for life: The hidden costs

A modest proposal: Make the sellers of variable annuities tell people how much they're really paying for their investment.

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Money

NEW YORK (Money Magazine) -- If you'd like to help thousands of people who are saving for retirement (and maybe even yourself), I have a suggestion. Tell the Securities and Exchange Commission to get off its duff and pass rules improving the disclosure investors get about variable-annuity fees.

The SEC has been mulling this issue for more than two years now. But when I called the agency for a status report recently, I got no hint as to when - or, for that matter, if - new rules might see the light of day. That's a shame. Because judging from the e-mails I get, only a tiny fraction of the investors who have some $1.4 trillion sitting in variable annuities know that they're paying more than they would to invest in regular mutual funds.

How much you're paying

A reader e-mailed me a few weeks ago telling me about a wonderful variable annuity he'd bought. It provided great investment choices and an option for guaranteed income, all for just 1.5 percent of his account's value a year. When I wrote back warning him that he was probably overlooking some fees, he replied that his adviser had assured him "a hundred percent" that he was paying 1.5 percent, tops.

Long story short, after several exchanges, I received a note saying that after getting both his adviser and the annuity department on a conference call, he found that he was actually paying 2.5 percent. It could have been worse. Variable-annuity expenses can approach or even exceed 3 percent a year.

Where the money goes

Annuities have four types of fees:

- There are "insurance charges" (also known as the mortality and expense fee, or the M&E fee), which insurers claim you pay for various insurance features but which in fact usually go mostly toward sales commissions and marketing costs.
- Next, you've got the fees for each of the investment options within the annuity.
- Then there's another set of fees for a panoply of optional riders that may sound good - promising future income or guaranteeing that your heirs will get back at least as much as you invested - but in my opinion are typically too pricey to be worthwhile.
- And, finally, there are surrender charges, the fee you may owe when you withdraw your money.

True, the prospectus discloses these charges. But that document can run several hundred pages long, and the various fees are laid out in prose that rivals Ambien in its sleep-inducing power.

Besides, the prospectus doesn't tell you what you would pay based on the specific investments and other options you've chosen. You practically need to be an actuary to come away with an accurate sense of what you're shelling out.

An easier way

I'd like to propose my own simplified disclosure checklist (at right). It's not perfect. It doesn't get at all the possible nuances of these complicated investments. But it will let you see how much you're spending each year for a variable annuity - and how much more you might have to pay to get out of it.

Copy my checklist and use it right now. Next time you're at the receiving end of a pitch - or if you already own a variable annuity and aren't sure what you're paying - have the adviser fill in the blanks. I think you'll be surprised at what this investment is really costing you. And I suspect you'll conclude it's not worth it. ■