

Money Matters

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Skloff Financial Group Question of the Month

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Q: After contributing to our 403(b) retirement plans with the same investment provider for 10 years, my wife and I discovered our employers offer multiple investment providers. Can we switch to a different provider?

A: The Problem — Learning About Your 403(b) Investment Provider Choices

Many non-profit employers offer retirement plans that are similar to 401(k) plans, called 403(b) plans. Unlike most 401(k) plans that offer one investment provider, most 403(b) plans offer multiple investment providers. All too often employees are so overwhelmed when starting a new job that they postpone enrolling in their 403(b) plan.

The first time they are reminded about enrolling in a 403(b) is in their faculty cafeteria or lunchroom. The person reminding them is generally a representative of an insurance company that sells their insurance company's proprietary variable annuity.

Unfortunately, far less than 1% of the hundreds of 403(b) annuity contract owners I have interviewed over the last two decades were aware of the mortality and expenses (M&E) charges built into their annuity. An even smaller percentage of these contract holders were aware of the SEC's notice, titled "Variable Annuities: What You Should Know."

In the notice they "Caution!" about investing in a variable annuity through a tax-advantaged retirement plan. Many 403(b) participants will contribute for years before learning about or evaluating other investment providers offered by their employer.

The Solution — Know Your Choices and Evaluate Their Strengths and Weaknesses

Upon request, every employer must provide a list of investment providers. The majority of 403(b) plans are dominated by insurance companies that offer variable annuities. Mutual fund providers have been gaining market share at the expense of annuities ever since 1974, when Congress permitted mutual funds as a choice in 403(b) plans. We review two key strengths and weaknesses of each choice below.

Variable Annuity Providers. They have two key strengths: 1) your ability to annuitize, receive a lifetime stream of income guaranteed by the insurance company, upon transferring control of the annuity to the insurance company and 2) a guarantee by the insurance company of a death benefit (GDB), which ensures that in the event you die before annuitizing the variable annuity, your heirs will receive no less than the amount you invested.

They have two key weaknesses: 1) once you annuitize you transfer control to the insurance company. Unless you agree to slash your income stream so your spouse can continue to receive it when you die, the income stream seizes upon your death – even if it is the day after your annuitize. 2) the cost for the GDB does not appear on statements but usually cost 1%-2% per year. The annual cost, which is deducted from your annuity, is called a mortality and expense (M&E) charge and is usually buried deep in the annuity prospectus.

Mutual Fund Providers. They have two key strengths: 1) a larger number of mutual funds (versus sub-accounts in variable annuities) choices to design a well balanced portfolio based on your risk tolerance and 2) the lack of M&E charges means more of your money can work harder for you. They have two key weaknesses: 1) you cannot annuitize a mutual fund portfolio.

The concern for losing control of your money is so great that only 2% of annuity contract holders ever annuitize anyway. 2) you cannot buy a GDB. Putting aside the 1%-2% cost of the M&E charges assessed on variable annuities for a GDB, less than 1% of variable annuity policies actually paid a GDB. Based on the long term nature of retirement plans, the probability of your account declining below your principal and your dying at the same time is very low.

Switching Investment Providers. Fortunately, you can switch between investment providers on 403(b) plans. According to the IRS, "If you transfer all or part of your interest from a 403(b) contract to another 403(b) contract (held in the same plan), the transfer is tax free, and is referred to as a contract exchange." Work closely with your Registered Investment Adviser throughout the exchange process to assure a smooth transition.

Action Steps

It is never too early or late to switch investment providers in your 403(b) plan. The right investment provider can offer the right investments to reach your retirement goals. The right investment provider can circumvent unnecessary M&E charges. Have your account professionally managed by a private Registered Investment Advisory (RIA) firm that is obligated by law to act in your best interest before any other party, including shareholders of the RIA.

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