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What is a self-directed IRA?

“Stay committed to your decisions, but flexible in your approach.”– Tony Robbins

One of the most significant pieces of financial legislation enacted in the last 50 years was The Employee Retirement Income Security Act of 1974.

ERISA directly responded to the realization that most Americans did not have enough saved for retirement. ERISA provided the incentive of deferred taxation, allowing Americans to grow their savings more quickly using what came to be known as Individual Retirement Accounts.

A specific provision in ERISA required that a custodian must hold an IRA to provide more tax accountability and oversight.

The problem with using the custodial format was that most custodians were banks and brokerage firms.

For various reasons, these institutions failed to provide many investment options, usually offering just a handful of stocks or mutual funds. Many times the only products offered were those that earned the most profits for the institutions, regardless of how they impacted plan participants.

Employees with qualified plans, particularly seasoned and experienced investors, became frustrated with the limited choices and lack of control inherent in IRAs. They wanted and needed more options and control.

In response to these needs, a few custodians provided new IRA platforms. These self-directed plans allowed participants to dedicate retirement funds that could be invested in nearly any asset.

“Self-directed” IRAs were a significant improvement over traditional IRAs in terms of investment diversity. These early SDIRSs were cumbersome and costly to administer since they relied on an inefficient custodial model. However, investors saw the potential for self-directed IRAs and pushed to perfect a new model.

SDIRAS ARE NOT FOR THE FAINT OF HEART

Despite the great diversity and control offered by SDIRAs, most financial advisors don’t recommend them to their clients.

That’s because SDIRAs come with a lot of baggage, including the need to continually monitor your investments, numerous regulatory pitfalls, and tax consequences.

Since you, as the account holder, are ultimately responsible for ensuring your SDIRA is compliant, you will probably need to hire at least one SDIRA advisor. You might also need a dedicated tax specialist on your team. Another consideration is that many investments inside an SDIRA are difficult to value properly.

Navigating the regulatory landmines of an SDIRA is likely to increase your investment costs and create frustration. Unless you are an experienced, wealthier investor, this type of IRA could be more trouble than it's worth. Additionally, SDIRAs often carry more risk than regular IRAs.

If considering using an SDIRA for retirement, you should always consult a financial advisor who is licensed and authorized and who understands these vehicles. An advisor specializing in SDIRAs can help you discover if they will help you achieve your retirement objectives.

Al Martinez is a member of Syndicated Columnists, a national organization committed to a fully transparent approach to money management.

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