Annuities can ease retiree clients' concerns

Their major drawback is the inability to withdraw amounts beyond the income stream

By Jade Hemeon

With lifespans grow-ing longer, some of your clients will experience retirements that last longer than their working lives. A life annuity — which lasts as long as your client does — is one way to guarantee an income stream.

Having the money to finance a long life is a major concern of retirees and those approaching retirement. Even if they have sizable RRSPs, fluctuating financial markets can wreak havoc on portfolio values and interest rates can change dramatically over time. To combat these problems, a life annuity may make sense for at least a portion of a client's income stream.

An annuity is one of the tax-deferred options available when a client collapses an RRSP in the year in which he or she turns 71. However, the client does not have to purchase an annuity at that time. The client can choose to roll the RRSP into a RRIF, and then purchase an annuity at a later date.

"Clients can convert any portion of their RRIFs to a registered annuity at any time," says Mark Halpern, a certified financial planner and founder of Markham, Ont.-based financial planning and insurance firm **Illnessprotection.com**. "Conceivably, they may want to invest the RRIF in securities for a period of years, then convert a portion to an annuity down the road, or buy more than one annuity on a laddered basis over time."

Essentially, a life annuity is an insurance product that is purchased with a lump-sum payment. Annuities are designed to pay a fixed sum on a monthly, quarterly, semi-annual or annual basis until the annuitant's death.

Various special features are available at a cost, such as the ability to transfer benefits to a surviving spouse or to index the annuity income to inflation. There are also "term certain" annuities that allow the purchaser to designate a beneficiary to receive the annuity payments for a defined number of years if the client should die prematurely.

Annuities can be purchased with RRSP or RRIF money, or outside an RRSP with non-registered funds. If an annuity is bought with the proceeds of a registered plan, the client pays income taxes on every dollar of the monthly income that the annuity pays. If the annuity is purchased with money outside an RRSP, the monthly payments are a mix of capital and interest, and there are no taxes on the capital portion of the payments.

LIKE A REGULAR SALARY

"Many people who retire are accustomed to having a regular salary," says Diane McCurdy, president of Vancouver-based **McCurdy Financial Planning Inc.** "Annuities can be purchased to cover at least a portion of their expenses. With the bare minimum covered, people tend to feel less anxious about ending up with no money in their old age. They're also less worried about other money they have invested in more volatile assets, and can ride out the ups and downs with greater peace of mind."

The amount of income paid by an annuity depends on the amount invested, the age and gender of the annuitant and the type of annuity selected. Generally, the older your client is when a life annuity is purchased, the shorter the potential lifespan and the more generous the return on the annuity. The income is also influenced by market interest rates prevailing at the time.

The big drawback to annuities is the inability to cash out or to withdraw lump-sum amounts beyond the predetermined income stream. Clients have no access to capital as they do when a GIC matures. Once they invest in an annuity, the terms are fixed and they are locked in for life, no matter what happens to interest rates or inflation, or what financial emergencies crop up.

Still, arranging for a quarter to a third of a client's income to come from an annuity can be a satisfactory compromise for many retirees.

"Running out of money is one of the greatest dangers seniors face today, important consideration as we get older is that RRIFs require ongoing management decisions. Annuities require no decision-making."

Another downside: once the annuity has been purchased, the insurance company keeps any unused capital at the time of death, whether the client dies one week later or lives for another 40 years. With an annuity, the longer the client lives, the better the deal is for the client and the worse for the issuing insurance company.

"Life expectancy is an unknown risk," says Jim Yih, a retirement income specialist with **CORE Financial Advisors** in Edmonton. "My father is 75 and getting younger every day, while my mother died at 63. If you die young, you get shafted with an annuity; on the other hand, you won't outlive your money."

As a result, a regular life annuity is not a solution for people who are concerned about leaving an inheritance for their children, although the problem can be solved by purchasing a life insurance policy and paying the premiums out of the annuity's income.

NO MANAGEMENT NEEDED

Because interest rates are relatively low these days, annuities are not as attractive as they would be in a higher interest rate environment. Currently, a 70-year-old woman looking for $40,000 in annual income would need to invest about $525,000 in a regular life annuity, says Yih. Her investment would give her a yield of 7.6% for life, which beats five-year GIC rates of about 4%. A $525,000 GIC investment would pay the same woman $21,000 a year. But it would also give her the principal back at maturity, and if interest rates rose during the term of the GIC, the funds could be reinvested at higher rates.

"An annuity can be ideal for someone such as a widow who has never managed money and is intimidated by finances," says Yih. "No one has to manage a portfolio, roll over maturing GICs or worry about adjusting to a changing income.

"They can also be suitable for people who are single or married with no kids. These people may be less concerned about leaving an estate and, at the same time, will probably be solely responsible for looking after themselves in old age."

Bill Bell, president of **Bell Financial Inc.** in Aurora, Ont., agrees that annuities can make sense for single people or couples without children who are less concerned about eroding the value of their estate. Bell says that for clients who want the security of annuities and have children, he makes sure that the family knows about the decision so there are no surprises when the will is read.

"I make sure there has been a conversation with the family," he says, "and that family members are aware that we are taking money of the estate to create an income that will last till the end of their parents' lives, no matter how long that is."

For people who are facing the prospect of going into a nursing home, an annuity can be a good income solution. If clients are concerned about losing their mental faculties with age, an annuity protects them by automatically providing the income to take care of their living costs. As well, it makes it difficult for greedy relatives or investment charlatans to take advantage of them.

"Nursing homes typically cost a certain amount a month," says Bell. "But outside of buying some Christmas or birthday gifts, a person at this stage probably isn't spending another nickel."

And your client does not have to stick to just one annuity. He or she can put together a portfolio of several annuities. The portfolio can be spread among different issuing insurance companies, to take advantage of different yields and features. **IE**