

Life Annuities - Are They Right for You?

As a part of retirement planning annuity income can compliment other incomes you are receiving. There are two types of annuities – “life” and “term certain.” Both these types of annuities can be registered and non-registered. This article will outline the details of life annuities and suggest reasons why you may wish to consider them in your portfolio.

What is a life annuity?

Life annuities provide you with a regular income paid at selected intervals for the rest of your life, regardless of the age you live to. These payments will cease at your death and no value will be available to your beneficiaries unless you arrange for a joint annuity or a guaranteed minimum payment period (explained later.) These regular payments can be monthly, quarterly, semi-annually or annual. A life annuity can only be purchased from a life insurance company. The income payments can be level for the remainder of your life or can be indexed at a pre-selected rate. Several factors, including current interest rates, are considered when an annuity income is calculated, and as a result, once you buy a life annuity you are locking this interest rate in for the entire payment period.

Registered

Life annuities can be purchased with assets in any registered account. (These can include RRSP, RRIF, LIF, LRIF and DPSP funds.) You can also arrange for your company “Registered Pension Plan” to be converted to a life annuity. The entire amount of the income you receive will be taxable in the year you receive it.

Non-registered

Any money you have in an unregistered account may also be used to purchase a life annuity. The taxation of payments from a non-registered annuity can be quite favorable. Non-registered funds can be used to purchase a “prescribed” annuity. When you do this only the interest portion of the payments are taxable and this interest portion remains level throughout your lifetime. This results in a very favorable after tax income. A suggested strategy would be to consider using cash that is in an account and earning interest, which is taxable to you each year, to purchase a prescribed annuity. The resulting after tax cash flow will be substantially greater. If you wish to ensure that the original capital you put into the annuity is available to your beneficiaries (remember the annuity stops at your death) then you can life insure this capital. In most case, even after the cost of insurance is paid, the remaining after tax income is significantly greater.

Types of life annuities

“Single” life annuities

These will pay you an income at the selected intervals for as long as you live. As mentioned the income will cease at your death.



“Joint” life annuities

These will pay an income for as long as two people live, the income will stop at the second death. Typically you would select this type of annuity to be sure you and your spouse would receive income for life. As a note, current pension legislation requires that if you are married and are selecting an annuity income from any registered pension plan, you must select a joint annuity with your spouse. The only exception to this would be if your spouse “signs off” and allows the payments made for your life only. In most cases it would not be in the best interest of either spouse to sign off as this effectively “disinherits” the survivor. Joint life annuities can also be arranged to pay the original amount, or a percentage of the original amount, to your spouse after your death. Typically this would be 75, 60 or 50%.

Guarantees

Although all life annuities will pay an income to you for the remainder of your life, this income will cease at your (or the joint annuitants) death. In order to protect you against a substantial loss in the event you purchase an annuity and die within a short period of time, you can add a minimum guarantee to the payment period. This can usually be 5, 10, 15, or 20 years or until a specific age. The maximum guarantee period however cannot exceed your age of 90.

Example: If you add a 10 year guarantee to a single life annuity and die in the 5th year, the remaining 5 years of payments will be commuted to a discounted lump sum and paid to your beneficiary.

How do you decide?

The income received from a given amount of capital will reduce as you add additional guarantees and survivor benefits to an annuity. The highest income will result from a single life, no guarantee annuity. This income will reduce as you add features to the point where the least amount of income would result from a joint last-to-die annuity, with a maximum guarantee period, paying 100% of the original income to your spouse at your death. When you are considering which type of annuity is best in your situation you should review several quotes with these various alternatives. This will allow you to see the resulting incomes, and help you select the correct annuity, based on your income requirements, balanced with your desire to leave an estate for your beneficiaries.

Impaired annuities

Similar to the effect poor health will have on the purchase of life insurance, in that it will increase the premium you pay, the effect of poor health on life annuities will be to increase the income you receive.

When should you consider life annuities?

For most people a “base” income that is guaranteed to be paid for your and/or your spouse’s life can form the foundation of retirement income. Here are some factors you might consider in purchasing a life annuity.



- You want a fixed income guaranteed for life.
- You don't want to make investment decisions.
- You want to lock in your investments at current rates.
- You're not concerned about leaving an estate to your children or grandchildren.

Summary

The use of life annuities can bring several advantages to your income planning. As with any other decision, assistance from your Investment Executive in showing you how these can fit into your plan would be of benefit. In addition, rates from different insurance companies can vary significantly and we will be able to assist you by shopping various companies and reviewing the results with you.

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