



The Advantages of Annuities

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Annuities are not the first thing that we, financial advisors, think of when sitting down with a client to address their needs. Stock market returns have been so good until recently that there has been little reason to consider this "pedestrian" approach to financial management. But recent events and demographic trends have served to highlight their value as a planning tool.

We all know how an annuity works, even if we don't know it by that name. A pension plan is a type of annuity. We contribute capital to our plan for many years and at retirement we collect a monthly income until death. A "single-premium immediate annuity" (SPIA) is much the same except that a person writes a cheque for a lump sum and that amount is paid back to them (starting immediately) with interest either over a fixed period of time or for life. SPIAs can have guaranteed payment periods and can often be indexed for inflation.

Two things that people have not liked about annuities is that they give up their capital in exchange for a guaranteed income stream, and that they are based on long-term interest rates, which are much lower than they were a decade ago. A series of long-term bonds or GICs or a systematic withdrawal plan (SWP) from an equity mutual fund can both provide income and preserve capital, so why bother with an annuity?

Peace of Mind

The major advantage of an annuity, as with a company pension, is security. A pension or annuity, particularly if it is indexed to some extent for inflation, is guaranteed to provide money until the annuitant's death and that of their spouse if it is a joint policy. As Jim Otar pointed out in his recent series of *MoneySaver* articles and his book *High Expectations and False Dreams* (Otar, 2001, page 114) concerning retirement fund depletion, annuitizing at least a portion of a RRIF goes a long way to ensuring that one's retirement standard of living will not be jeopardized.

Tax Efficiency

Annuities that were purchased with money that was not from a RRIF or RRSP will return both a person's capital and interest. This means that the gross monthly income that one receives from a non-registered annuity is largely non-taxable, whereas interest, dividends and capital gains income from bonds, GICs and mutual funds are fully taxable at their respective rates. To make things even better, the government allows for annuity interest to be prescribed, or evened out over the term of the annuity. A \$100,000, 5%-GIC will generate \$5,000 in taxable interest income annually, while an annuity with the annual interest portion of a non-registered annuity will be much less. (A form of this strategy employing life insurance was outlined by David Machry in the December 2001 *MoneySaver*.) And for those not able to take advantage of the pension income deduction, a small life annuity providing \$1,000 in annual income is entirely tax free.

In the words of Stephen Pollan, author of the popular book *Die Broke* (Harper, 1997, chapter 11), an SPIA is the "magic bullet". Its purchase, along with that of various living benefit insurance policies, allows for someone to live securely while maximizing their income and escaping unwanted taxation. I might add that for those wanting to be only partial "die-brokers" and still leave an estate for some purpose, the combination of annuities and permanent insurance may do the trick.

Estate Planning

It may occur that we think that someone to whom we want to leave money at our death will not be able to handle it. Perhaps they are just poor managers of money. Or they might be too young or too profligate. Instead of having a lawyer set up a testamentary trust for them and finding a willing trustee, it may be simpler just to specify in one's will that that person's share will be used to purchase an annuity for them. The annuity could be guaranteed to pay monthly for a certain number of years (even to some other named beneficiary) and run for a specific period

Annuities: Single life male, 10-year guarantee

Financial Institution	Age in Years					
	55	60	65	70	75	80
Canada Life	605.21	649.51	707.26	777.48	855.06	928.63
Clarica	587.63	628.82	683.82	751.34	823.40	895.38
Empire Life	605.00	659.51	729.28	800.72	868.06	-
Equitable Life	613.66	659.32	718.95	792.47	874.83	951.35
Great West Life	557.00	599.35	655.00	723.37	799.37	871.92
IA Pacific Life	593.08	641.24	703.83	779.47	861.38	935.75
Imperial Life	582.37	626.21	684.30	756.49	838.70	920.36
Industrial Alliance	593.08	641.24	703.83	779.47	861.38	935.75
Manulife Financial	614.38	654.55	708.44	775.71	848.77	914.61
Maritime Life	597.50	646.53	709.23	783.79	863.83	936.70
Standard Life	568.94	615.95	676.43	750.30	834.70	916.03
Sun Life Assurance Co	572.38	612.65	666.55	735.19	812.19	885.37
Transamerica Life Canada	603.99	649.82	710.70	785.58	867.92	944.67

Annuities: Single life female, 10-year guarantee

Financial Institution	Age in Years					
	55	60	65	70	75	80
Canada Life	565.28	599.78	646.52	708.81	788.09	876.16
Clarica	553.50	588.33	630.63	692.54	765.23	848.57
Empire Life	570.72	614.31	673.10	740.38	815.38	-
Equitable Life	579.88	617.07	666.84	732.62	815.79	906.73
Great West Life	525.61	559.86	606.01	667.11	743.93	827.91
IA Pacific Life	553.17	591.58	643.24	711.55	796.99	888.76
Imperial Life	548.80	584.28	632.73	697.79	781.52	876.19
Industrial Alliance	553.17	591.58	643.24	711.55	796.99	888.76
Manulife Financial	582.76	617.82	662.40	723.00	798.22	878.62
Maritime Life	557.70	598.35	652.00	721.56	807.12	897.39
Standard Life	539.20	578.68	631.81	702.44	791.46	886.71
Sun Life Assurance Co	537.07	569.09	611.90	667.90	739.02	820.25
Transamerica Life Canada	566.76	603.09	652.97	719.97	804.74	897.18

Annuities: Joint life, 10-year guarantee

Financial Institution	Age in Years					
	55	60	65	70	75	80
Canada Life	534.56	561.63	600.23	654.70	729.36	821.72
Clarica	522.44	548.13	588.76	640.45	707.55	794.07
Empire Life	532.11	565.81	614.31	674.05	746.73	-
Equitable Life	545.88	575.38	617.02	675.54	755.83	854.15
Great West Life	493.26	519.23	555.76	606.76	675.45	758.72
IA Pacific Life	520.48	551.31	594.77	655.60	737.78	836.47
Imperial Life	517.21	545.04	584.99	641.74	719.86	817.30
Industrial Alliance	520.48	551.31	594.77	655.60	737.78	836.47
Manulife Financial	545.01	569.63	606.14	659.35	731.31	818.66
Maritime Life	522.22	555.16	600.54	662.66	745.14	842.80
Standard Life	506.91	538.23	581.93	642.74	725.43	826.18
Sun Life Assurance Co	506.64	531.60	566.82	615.69	681.66	762.87
Transamerica Life Canada	545.70	573.75	614.57	673.01	753.14	851.06

Monthly incomes based on a premium of \$100,000 of non-registered funds. Payments will commence in one month. Annuities are investments that pay an income on a periodic (monthly, quarterly, semi-annual or annual) basis. Annuities can be purchased with registered funds from individual RRSPs, locked-in RRSPs, pension plans or deferred profit sharing plans (DPSP). Annuities can also be purchased with non-registered funds. There are generally two types of annuities. Term-certain annuities pay a periodic income for a specific predetermined period of time or number of payments. Life annuities pay a periodic income for as long as the annuitant or joint annuitants live.

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such as 20 years or until they reach age 65. The beneficiary receives all of their share of the legacy with interest and can invest it or spend it as they see fit, but they don't have the chance to spend it all at once.

If you are considering an annuity purchase, you should do some homework on the product. The time when you purchase them (preferably at market peaks, if you currently hold stocks), how often you buy them (you need not buy a single annuity all at once, purchases can be staggered to take advantage of interest rate movements over time), how much you buy in a single annuity (monthly payments of \$2,000 are guaranteed by an industry protection fund), from which company you buy them (monthly payouts for the same annuity vary widely!), and with what terms and guarantees they come should all be taken into account.

Free information on annuities can be found in pamphlets at trust companies or from life insurance brokers as well as on insurance company web sites (www.transamerica.ca, for example). The web site of the CANNEX service (sometimes mentioned in *MoneySaver's* member services section) provides consumers a rough estimate of what annuity payments would amount to for a number of companies (www.cannex.com). The new book by Moshe Milevsky and Aron Gottesman, *Insurance Logic* (Stoddart, 2002) features a detailed, informative chapter on annuities, which they call "longevity insurance".

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