GWMBs – On Further Reflection

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Guaranteed Minimum Withdrawal Benefit (GMWB) plans have been available in Canada for several years now. They offer protection against premature depletion of one's retirement savings before death by guaranteeing a certain amount of money will be paid for life, at the same time permitting the policyholder to own equity (stock market) investments. A life annuity, while also guaranteeing payments for life, requires a person to give up their stock market investments in return for that guarantee. *Canadian MoneySaver's* editor, Dale Ennis, asked if I would update my views on GMWBs and alternatives.

Common criticisms of GMWBs is that they have high fees and they are complex. Moreover, they are structured in such a way that those leaving them could forego what are termed "notional" increases in their balances and benefits. This virtually locks a person into the plan if they do not want to lose out on the accrued benefits. But other things concern me as well.

First, I don't understand how they can be viable if they are heavily invested in equities. If the market goes down a lot or stays down for a long time, I can't see how the providers would not be stuck with huge liabilities to meet. Recent GMWB changes (in June 2009) have confirmed my suspicion that equity-based plans are not sustainable. One large provider has just increased significantly the fixed-income holdings in its GMWB plans to address this problem. That is prudent on their part, but it exacerbates the problem of high fees by requiring clients to pay equity-like costs for fixed-income returns. It also vitiates the claim that the plans offer both complete security of income and stock market returns. People could buy similar fixed income/equity balanced mutual or segregated funds or various exchanged-traded funds (ETFs) with lower fees and not take on much more risk of the premature depletion of their savings.

(Advisors who have sold these GMWBs have been angered by the fact that some companies are making these fixed-income adjustments to existing plans as well as new ones, although apparently the option to unilaterally alter the asset mix was contained in the wording of the contract. Did I mention that this product is complex?)

Second, I am concerned that the insurance industry's bankruptcy protection fund Assuris has not to this point specifically mentioned GMWBs on its website. My calls to them and to insurers did not reasssure me, although an Assuris official recently told advisors that the various constituent parts of the plans do indeed individually qualify for coverage. I hope that they clarify the coverage guarantee by listing this product by name in their literature.

Personally, I am much more comfortable with traditional retirement income options. Annuities, for example, take our savings and invest them in long-term bonds, then pay us out the interest and capital for life. It's a pooling of the savings of many people so that those who live a long time are "subsidized" by those who expire early. That's a concept that I can readily understand and believe in.

Segregated funds, which offer guarantees of capital (often 75% at the end of 10 years and at death) are, in my opinion, a fairly secure product to employ for retirement income in order to take advantage of stock market returns. In combination with an annuity, a segregated fund portfolio should be able to provide both secure income and growth for the two or three decades that they will be needed. Segregated or "seg" funds (so called because the investments in the fund are segregated for safety from the other assets of the insurer that offers them) can also provide the security of a minimum 75% guarantee security in the years leading up to retirement – the period that has been termed by some the "accumulation phase".

As with other financial products, there is a wide range of seg funds available for purchase. But some have poor or expensive guarantees, some have high management fees, and some have poor performance. Competent and independent advice on which are suitable for each person's situation would be helpful.

The company that I think leads the pack for seg funds at the moment is Standard Life (SLI). I hope that other firms will follow their lead in terms of features and benefits. Their own company brand's basic Ideal segregated funds have good performance, management fees that are about the same as those of comparable mutual funds, guarantees on capital invested of 75% after 10 years or 100% at death, and a lower-fee Platinum no-load option for accounts of $250,000 or more. While some other fund companies and insurers are reducing their guarantee options, SLI has maintained theirs. I hope they continue to do so.

What makes SLI even more attractive, particularly for those needing secure retirement income, is that at least 75% of 10 years of RRIF and LIF payments are guaranteed to be paid out, in addition to the 75% guarantee on the invested capital less withdrawals. (The value of the withdrawals is deducted from the initial investment on a dollar-for-dollar basis at SLI rather than the riskier proportional basis employed by most companies.) That guarantee to me means that the retiree can avoid utter disaster in their portfolio while the insurer can offer a promise that appears to be sustainable over the long term. It's not as good as a 100% guarantee, but it's some protection against premature portfolio depletion due to severe market declines.

In terms of flexibility, SLI's and other firms' seg funds allow for switches among equities, bond and cash, for monthly or lump sum withdrawals anytime desired, and for transfers to funds offered by other companies or even to a second or third annuity if interest rates rise to the point that annuities become irresistible. In addition, being insurance products, investors can avoid probate fees upon death and gain creditor protection if the proper beneficiary designations are made.

In summary, I don't see much advantage in GMWB plans. A combination of annuities and segregated funds can do the same thing with more flexibility and lower costs, while still providing a substantial 75% capital guarantee (or higher if you pay for it). Given that the insurance companies themselves do not counsel anyone to put all of their retirement savings into a GMWB, the combination of an annuity and a conservative segregated fund portfolio should not involve more paperwork or attention than a GMWB and an annuity.

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