

They're not sexy, but they get the job done

Term or life annuities provide dependable payments, SUE BOWNESS writes.

But the payout isn't the only thing to consider

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Investors looking for a reliable, steady stream of income -- whether for themselves in retirement or for their children or other dependents -- can often find what they need in an annuity.

"It's almost the reverse of a life insurance policy," explains James Kraemer, a certified financial planner with TFI Financial Services in Winnipeg.

"With a life insurance policy you make premium payments and receive a lump sum when you die. With an annuity, you get back intermittent instalment payments."

When you invest in an annuity, you give a lump sum to a financial institution, usually an insurance company.

The company then turns that lump sum into an income stream, paying back the money to you in regular instalments, usually monthly or quarterly, which are a blend of interest and principal.

The income stream depends on a variety of factors, including the amount of your money you invest, your age and gender, and the time frame specified.

For example, a 60-year-old male would generally receive higher payments than a 50-year-old because his life expectancy is shorter.

Many options

Annuities come in several formats, including term annuities, which issue payments for a specified period, such as 10 or 20 years; and life annuities, which pay regular instalments until your death. A basic life annuity, known as a "zero guarantee," means that no matter when you die, the payments stop. You can also add a guarantee period to a life annuity, say 10 or 20 years, which ensures that it will pay out for at least that period, even if you die during that time.

Annuities appeal to risk-averse investors and retirees because they guarantee a regular payment of a specific amount of money -- a comfort in long-term financial planning if you don't want to worry about market fluctuations or losing money to inflation.

There are downsides, however, including low rates of return and the fact that once you buy an annuity, you're locked in; there is no flexibility to change the term or payment schedule.

And with some annuities, your estate may get little or nothing if you die prematurely.

Mr. Kraemer said he hesitates to recommend annuities because of the current low interest rates, but notes that many of his clients are looking for safe, steady investments.

"A lot of boomers are still living through the sticker shock of the earlier part of the [decade] when the markets went through significant decline and don't want to see their money go through that again," he says.

Estate planning

Mr. Kraemer said annuities can be useful in particular circumstances. He offered the example of a man who has three sons from a first marriage and who wants to provide for them after his death, but doesn't want to leave them a lump sum. Nor does the father want to burden anyone with the responsibility of being a trustee for his surviving children. The answer would be to instruct the executor of his estate to purchase separate annuities for each son.

"The investment decisions are taken away from the trustee, he doesn't have to worry about outliving the boys and passing along his duties to somebody else, and he doesn't have to worry about dealing with requests from the boys for additional money from a trust account or anything like that -- they will simply get a payment every month for the rest of their lives. So it fits very well with that situation," Mr. Kraemer says.

Another example would be if a parent wanted to provide an income stream for a disabled child; an annuity would probably fit the bill.

Not everyone is a fan of annuities. David McGruer, a certified financial planner with Dundee Private Investors Inc. in Ottawa, says he has not yet signed up a client for an annuity product, and he thinks investors often fall prey to misconceptions surrounding the investment vehicle.

"One of the common misperceptions about annuities comes from the fact that [investors] think the payment from the annuity is income and it isn't. It's income plus principal," says Mr. McGruer.

"So if someone says the income from your annuity is 8 per cent, 8 per cent is not the yield, it's the cash flow that you will get. A big part of that is your own money."

Mr. McGruer said there are simpler alternatives to consider if you're looking for steady income. "If you want a guarantee, buy guaranteed investments -- buy a bond or something like it -- and have another part of your investment that is clearly and distinctly an equity-type investment," he said.

With people living longer, investors are looking for ways to stretch their savings through retirement and still play it safe, said Bob Tillmann, vice-president of marketing and business development for Toronto-based Manulife Investments.

"You've got a combination of an aging population, with a large percentage of boomers who are approaching retirement; volatile markets, with people looking for investments that will protect

them from volatility; and relatively low interest rates, where people need to look for alternatives to the traditional GICs to plan their retirements," Mr. Tillmann noted.

Last fall, Manulife Investments introduced a **new annuity hybrid called Income Plus**, which Mr. Tillmann believes **will appeal to investors and retirees looking to get away from the volatility of the market yet still benefit from it.**

The Income Plus vehicle, which requires a \$50,000 minimum investment, guarantees your investment while also offering the returns of a segregated fund.

Every three years, it locks in market gains and guarantees bonuses, meaning your investment will increase over time. (It also offers a 5-per-cent bonus for each year you do not make withdrawals, meaning that if it were purchased 10 years before retirement, you could add at least 50 per cent to your initial investment.)

"It's an alternative that's very good for an investor who watches the market go up and down and isn't comfortable with having a good proportion of their savings exposed," Mr. Tillmann said.

"It's hard for a low-risk investment like a GIC to last long enough, so this gives investors the opportunity to participate [in the market] without the risk of losing money."

Annuity examples

The monthly payments an investor receives from an annuity depends on factors such as age, gender, type of annuity (life or term) and amount invested.

Certified financial planner James Kraemer of Winnipeg offers these examples of what the monthly income could be for a prescribed annuity, based on an investment of \$100,000 of non-registered money (money not derived from pension or RRSP funds).

50-year-old man

Life-zero guarantee: \$456.81

Life-10 yr. guarantee: \$454.09

Life-20 yr. guarantee: \$444.93

60-year-old man

Life-zero guarantee: \$543.25

Life-10 yr. guarantee: \$534.64

Life-20 yr. guarantee: \$503.94

50-year-old woman

Life-zero guarantee: \$432.91

Life-10 yr. guarantee: \$431.90

Life-20 yr. guarantee: \$427.50

60-year-old woman

Life-zero guarantee: \$503.29

Life-10 yr. guarantee: \$499.74

Life-20 yr. guarantee: \$483.90

Term-certain annuities

(Age and gender do not matter)

20-year term: \$585.94

30-year term: \$462.78

STAFF