



Guaranteed Income— For Life: What You Should Know About Life Annuities

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The traditional old-fashioned pension plan—the one where employers rewarded decades of employee loyalty with an income for the worker and his or her family for life after retirement—is hard to come by anymore. As the economy globalized, more and more private employers, both in the United States and Canada, were forced to reduce or eliminate traditional defined benefit pension plans. They were just too expensive for employers to maintain while still remaining competitive with leaner companies that did not have to support so many retired workers out of their own revenues.

The decline of the traditional pension plan is too bad, though, because ordinary working families loved them. Together with Old Age Security Benefits, pension plans benefited Canadians because they represented guaranteed income for life.

If you're in or approaching retirement, and are not fortunate enough to be covered by a traditional pension plan, you need to be very careful. The average Canadian is living decades into retirement—and the catastrophic risk is that you could eventually outlive your savings, even if you use all the tax advantages of registered plans. That's a risk nobody can afford to take.

So what can you do? *The answer is to create your own pension.*

Generate Income For Life

Generating income for life is the objective of any responsible retirement plan. The combination of your personal savings, company pension plans, Old Age Security Payments and home equity must, ultimately, generate an actual income you can use to live on.

All these assets have an important place. But there is only one financial instrument on the market that is specifically designed to generate an income stream for you to live on, month in, month out, regardless of what

happens to the stock market, regardless of real estate values, and regardless of what happens to interest rates. That instrument is the **life annuity**.

The Basics

A life annuity isn't a stock or bond or direct ownership of shares in a mutual fund. Instead, it is simply a contract between you and a life insurance company. Here's the arrangement: You contribute a sum of money, called the *premium*, to the insurance company. In exchange, you receive the contractual guarantee of a certain amount of money each month, each quarter or each year—whichever you select—for the rest of your life.

- If you live much longer than you expected, the income will continue.
- If the insurance company's investment officers make some bad investments, that is not your problem. Your monthly or annual income will continue.
- If real estate prices collapse, or interest rates are slashed in half, your promised income will continue.
- If the stock market crashes, your promised income will continue.

Because of the unique guarantees that a life annuity provides—guarantees that no other financial product on the market can match—the life annuity is a critical ingredient in nearly every Canadian family's retirement security plan. Because the income is guaranteed, no matter what, the life annuity can essentially take *longevity risk*—the terrifying risk that you or your spouse will outlive your income—and make it practically disappear.

As such, the life annuity is an essential tool from both the income-planning and risk-reduction perspective.

Joint Life Annuities – Because You Love Your Family

If you're married, you will naturally want to take care of your spouse or partner—even long after you are gone. With a joint life annuity, you can ensure that if one of you dies, the income payments will continue to the survivor, as promised, as long as he or she lives.

This is true even if your survivor is much younger than you are.

You just have to make sure you purchase the correct type of joint annuity.

How Much Income Will You Receive?

The precise amount of income you will get from a life annuity is very individual and depends on a variety of factors:

- o Your sex;
- o Your age;
- o Your spouse's or partners' sex and age (for joint annuities, see below);
- o Your health (Regular life annuities work best for those in good health. However, if you have health challenges, call us and we will get you a special quote that may get you a higher income based on your potentially reduced life expectancy);
- o Prevailing interest and bond rates at the time of purchase;
- o The insurance company;
- o Inflation protection desired;
- o Any other riders you want.

Tax Considerations

In Canada, annuity income receives very favourable tax consideration. Depending on whether you fund your annuity using registered funds, or with outside money, your after-tax income from an annuity may well be much higher than you would otherwise get with comparable lower-risk investments—investments that don't come with any kind of lifetime guarantee.

If you buy the annuity using registered or before-tax dollars, then the payments withdrawn will be fully taxable.

If you purchase your annuity with non-registered dollars, the annuitant gets back benefits equal to the contributions paid in on a tax-free basis since those funds have already been taxed. So your payment can be virtually tax free.

At more advanced ages, your annuity income may be completely tax-free. This can also help lower your reportable income overall, reducing your income tax rate on your other sources of income, as well. Furthermore, to the extent annuity income is tax-free, and it does not count against you when calculating eligibility for Old Age Benefits, which the government would otherwise begin to claw back because the taxable portion of your income is too high.

Uses Of Life Annuities

The most basic use of annuities is to secure a basic standard of living, no matter what. Many of our clients calculate their minimum acceptable income, and then lock that in with an annuity sufficient to pay their rent or mortgage, groceries, medical and transportation expenses, and basic living expenses. That way, no matter what happens to the stock markets, they know their basic expenses will be taken care of.

Often we build an inflation hedge right into the contract. That means that the scheduled payments will increase each year as inflation does its work. You would accept a slightly lower initial payout, but with the guarantee that your income will keep pace with general inflation.

Some of our customers opt for a guaranteed life certain feature. This means that even if both joint annuitants have passed away, income will continue for a specific number of years. This can be long enough to see a grandchild through college, for example, or to take care of a financial promise or obligation.

The Guarantee

The promises of any annuity or life insurance contract are as strong as the insurance company's extremely conservative investments.

If a problem should occur, a not-for-profit organization called Assuris designated by the federal government will pay promised benefits, up to \$2000 per month in income, or 85 percent of promised benefits.

The life insurance and annuity industry has a long track record of keeping their promises to annuitants, widows and orphans, a record that is unmatched by any other industry.

Ivon T. Hughes is a leading expert on life annuities. His website, lifeannuities.com, launched in 1999, provides advice and online quotes across Canada.

His latest worry is what happens to his clients if our banks go to negative interest rates as Japan did on January 29th this year.