Is now the time for annuities?

Low rates are here for the foreseeable future, but guaranteed income can still work for certain clients

BY DWARKA LAKHAN

ANNUITIES CAN HELP CLIENTS SEEKing a guaranteed and predictable source of income for a defined period — or for life. Annuities also can play a useful role in estate planning.

"Annuities are one of the best ways to plan for retirement if you are worried about volatility in the market, feel you will run out of money before you die and do not want to manage the investments," says Ahilan Balachandran, founder and CEO of **LifePlan Investments Inc.** in Markham, Ont.

That said, interest in annuities has waned in recent years because interest rates have hovered around zero — a level at which they're expected to remain for a few more years. "Annuities are not that beneficial to clients in a low-interest environment because they are locked in with low interest for the rest of their lives," Balachandran says. "Annuities are very popular when interest rates are high, but less preferred in low-interest periods."

However, prevailing interest rates may not be the most important factor for clients who want to avoid investment risk while receiving a fixed retirement income.

"After 35 years of being in the business of selling annuities, I conclude that rates are not the primary consideration for a person to purchase an annuity," says John Beaton, annuity broker with **Beaton Annuity Services** in White Rock, B.C. "People are not as worried about interest rates as they are about establishing a lifetime stream of income."

Beaton adds that annuities often provide peace of mind: "Some people understand that a time will come when they will suffer from diminished capacity to handle their affairs. Not having to worry about how things will be paid is more important."

Jim Ruta, president at **Advisorcraft** in Burlington, Ont., says that now is a particularly good time to consider annuities because financial markets' performance is uncertain. "You can guarantee yourself a multiple of what interest rates are with an annuity," he says.

Balachandran suggests that clients concerned about locking in at low rates could consider laddering annuity purchases — buying annuities at different times to benefit from different interest rates.

ANNUITIES PRIMER

Beaton says there are two main types of annuities: life annuities, which provide guaranteed income payments for as long as the annuitant lives; and term-certain annuities, which provide guaranteed income for a defined period.

Variable annuities (a.k.a. segregated funds), yet another type, provide a combination of fixed and variable income that changes over the life of the annuity.

With life annuities, a client can choose to add a joint life annuity option, so the product continues to provide income payments to the client's spouse after the client dies. Balachandran cautions that if only the annuitant is named in the annuity and there is no guaranteed period of income payments, the benefit of the annuity will be lost if the person dies earlier than expected.

In the case of a term-certain annuity, the client's beneficiary receives the balance of the guaranteed income payments should the client die before the guarantee period runs out.

An inflation-protection rider added to a client's annuity will increase income from the annuity each year by a fixed percentage to help offset inflation. However, the percentage of the increase is not necessarily linked to the consumer price index.

Still, annuities aren't for everyone — particularly not "the very rich," says Beaton. That's because these people are unlikely to run out of money during retirement. Clients with employer-sponsored defined-benefit pension plans may not need annuities either, as such plans may provide pension payments for life.

PROS AND CONS

Annuities can be an effective estate-planning tool because the annuitant can name a beneficiary to receive all or a portion of the annuity's investments. Having a named beneficiary avoids the probate process and its associated fees.

Another major benefit: "The income qualifies for tax credits and pension income splitting," says Balachandran.

One disadvantage of buying annuities is the large upfront investment required, which usually is at least $50,000. Once the money is invested, the client can't access it and usually can't change or cancel the annuity contract except in certain circumstances — for a fee.

Furthermore, when investing in annuities at low rates, your clients forgo the potential for higher market returns — albeit by removing investment risk.

Annuities providers have a ready reply to that cost, says Ruta: "Those who bemoan the loss of liquidity or capital upon early demise can also [be] guarantee[d] a minimum payback on their life annuity [of] 10, 15 or 20 years. The longer the guarantee, [however], the lower the potential income paid out."

Ruta adds that deciding the optimal annuity terms "is a balancing act based on client needs and wants, but it can be done effectively." IE

Shrinking market

In spite of annuities' benefits, low rates have hurt demand for these products. As a result, some insurance companies have shifted from annuities to selling products such as segregated funds, which are not as sensitive to interest rates.

For example, Manulife Financial Corp., once Canada's largest provider of fixed annuities, left the business in June 2018. Other insurers, including Sun Life Assurance Co. of Canada, Canada Life Assurance Co. and Industrial Alliance Insurance and Financial Services Inc., still offer fixed annuities.

"It's not that insurance companies have taken certain annuities off their shelves, but some companies – for example, Standard Life [Assurance Co. of Canada] – have disappeared from the marketplace," says John Beaton, annuity broker with **Beaton Annuity Services** in White Rock, B.C.

"None of the Canadian insurance companies actively selling annuities offer exactly the same benefit for the same cost," Beaton adds.

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