THE STAN CLARK FINANCIAL TEAM'S

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Financial & Estate Planning

ANNUITIES: IS NOW THE RIGHT TIME?

By Sylvia Ellis, Senior Estate Planning Advisor

With interest rates rising, we're seeing more and more articles written about annuities.

Annuities are designed for those seeking a low-risk, tax-efficient investment. Here's how they work. An individual invests a lump sum with an insurance company in exchange for a set monthly income, which can be for a specific period of time or for life. Payments can start immediately or be deferred to a later date. It is often recommended that, if you wish to have an annuity, it represent a portion of your overall investments.

There is a significant tax advantage with what is called a prescribed annuity, a non-indexed annuity purchased by an individual with non-registered funds. That is, funds outside of an Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF). The income payments are made up of a blend of capital and interest, with only the interest taxable. Qualifying for special tax treatment allows the taxable portion to be level over the life of the annuity, as opposed to starting out high and reducing over time.

This produces a higher after-tax return than a similar fixed-income investment, such as a guaranteed investment certificate (GIC). For example, if an individual in their mid-60s earned $1,000 per month, about 30% would be taxable (the taxable portion varies with age). Using a 30% marginal tax rate, the actual tax paid would only be $90, leaving a monthly net income of $910 for life.

Are the conditions now right for an annuity? A good time to buy is when interest rates are high and expected inflation is low. As noted, interest rates have indeed risen – however, past inflation has risen even more. The question becomes: How do interest rates compare to future forecasted inflation?

A good measure for this is to look at the yield on long-term real return bonds. These are bonds that pay an interest rate equal to the Consumer Price Index (CPI) inflation rate, plus a fixed percentage. Long-term real return bonds in Canada are currently yielding 1.64%.

This is the highest real return in over 10 years, and well above the negative real yields of the pandemic. But it is still well below the real returns offered in the "good old days" of annuities, 2010 and earlier.

Let's say the conditions now are right. However, you're concerned about what will be left over for beneficiaries. There are a few ways to preserve your investment. The first is to opt for a guarantee period.

Source: Bank of Canada

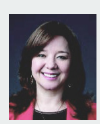
The income is guaranteed for the annuitant's lifetime. Or, for spouses, a Joint Life annuity is guaranteed for both lifetimes.

You could also purchase an additional guarantee for your beneficiaries. Examples are for five, 10, 15 and 20 years. If you choose an annuity with a 15-year guarantee, and you pass away in seven years, it means that you have eight years of payments remaining. One thing to remember, though: the higher the guarantee period, the lower the income.

Another option is to insure your annuity, that is, couple it with life insurance.

Annuities are not for everyone. Nevertheless, they are beneficial in many situations. When discussing annuities, again, you need to consider: the various types available; and inflation and interest rates at the time. If you wish to gauge what is being offered now or in the future, CANNEX.com regularly publishes annuity income reports. Generally, as a benchmark, CANNEX posts information for males aged 65 and single, with 10 years guaranteed.

If you would like more information on annuities, or wish to see a quotation based on your specific situation, we will be happy to provide it to you.



Sylvia Ellis is the Senior Estate Planning Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Sylvia provides support to the team in projecting and planning client financial affairs.