Retirement planning

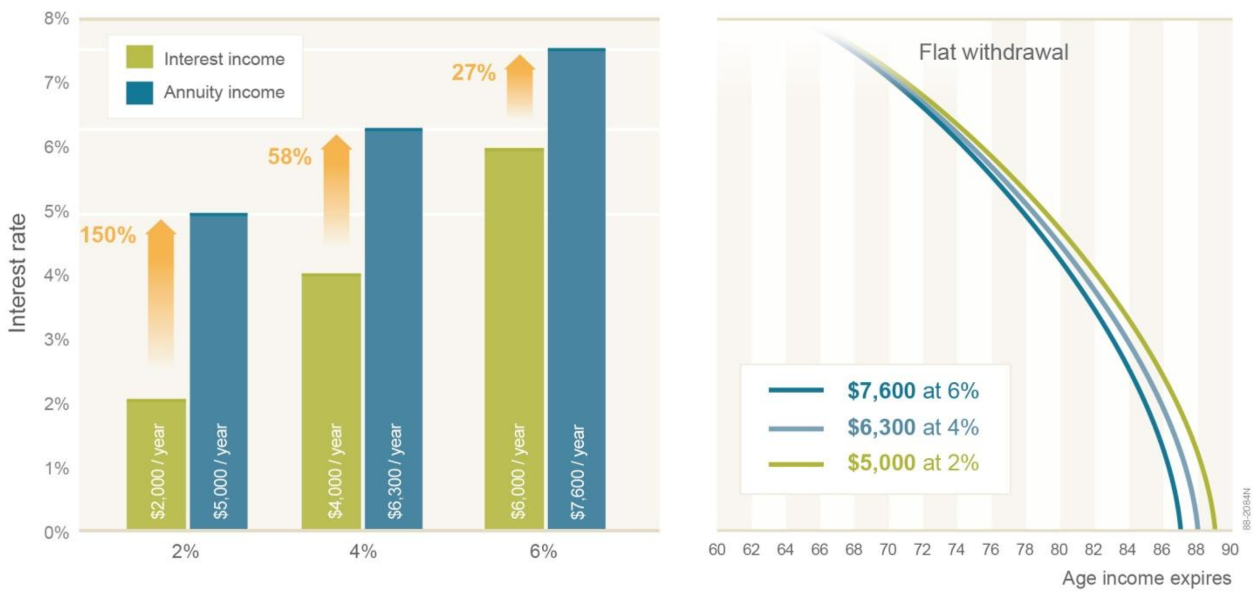
Why not buy an income annuity in a low interest rate environment?

Did you know that the value of an income annuity is actually amplified in a low interest rate environment, when compared to GICs?

In the previous article, we discussed how top financial security advisors who sell income annuities say the topic of interest rates rarely comes into retirement income planning conversations. A client in retirement may be looking for certainty, predictability and simplicity and you, as their advisor, need to find the most suitable option for them.

Here's an example of how an income annuity provides excellent value as opposed to a GIC.

$100,000 premium, male 60 year old, guaranteed 10 years, non registered
Great-West Life GIO rate for 11-20 years. April 2015.



In April 2015, the long-term interest rate for a $100,000 GIC was two per cent. If, at that time, Deborah, a 60-year-old client, at decided to purchase an income annuity, she would have received five per cent, or $5,000 a year.

If Deborah chose to receive the two per cent payout from the $100,000 GIC, she would have received $2,000 a year. At the end of the term, Deborah will have access to her initial $100,000.

The advantage of the income annuity income of $5,000 a year over the interest-only income of $2,000 was 150 per cent (see left chart). With a life income annuity, this $100,000 will provide Deborah income for life.

Alternatively, Deborah could have received an income of $5,000 a year from a systematic withdrawal plan (SWP). By doing so (based on the two per cent), she would run out of money at age 89 (see right chart).

But does the income annuity still have an advantage if interest rates were at four per cent? Yes. The advantage is still on the side of the income annuity – by 58 per cent. The GIC alternative would generate an income of $4,000 a year, or four per cent. The income from the annuity would increase to 6.3 per cent on $100,000 and provide an income of $6,300. If a SWP was chosen, with $6,300 a month earning at four per cent, the money would run out at age 88.

Finally, if interest rates were at six per cent, the advantage of the income annuity over the interest rate option is still better – by 27 per cent. The GIC would provide an annual income of $6,000. The income from the annuity would increase to $7,600. If Deborah chose the SWP and withdrew $7,600 annually based on six per cent, she would exhaust her funds by age 88.

What does it all mean?

Many clients would be surprised by the previous example but income annuities do provide good value in a low interest rate environment. As a financial security advisor, you have the opportunity to dispel myths and provide education and transparency around available income products. Our consumer research from the last three years has told us people are looking for predictable income for life and easy-to-understand income products. You're in the best position to help clients understand the value of income annuities. You have the opportunity to secure a higher guaranteed income from a portion of your client's retirement nest egg to help them support their retirement expenses.

Stay tuned for our next article, which addresses another common question around purchasing an income annuity: "Could I do better in a GIC, bond or balanced fund as opposed to purchasing my income annuity now?"

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