

Business

**Need secure retirement income? Rising interest rates have juiced annuity payouts; Since you can’t unwind an annuities contract once you start receiving income, you should use an annuity for just part of your retirement income**

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Along with GICs, annuities demand a fresh look as interest rates soar.

Both are minimal-risk, conservative investments that were long avoided by many people because their returns reflected persistently low interest rates. Rising rates this year have improved returns for both dramatically.

Annuities are insurance contracts where you turn a lump sum of money over to an insurance company in exchange for a guaranteed stream of monthly income for as long as you live. In a world where a majority of workers do not have pensions, annuities address the fear of running out of money.

The improvements in monthly income from annuities over the past 12 months can be seen in the following examples of $100,000 annuities in a registered account, with payments guaranteed to last 10 years even if you die sooner (the money would go to your estate or beneficiaries). The data were supplied by Rino Racanelli, an insurance adviser who specializes in annuities.

\* A 65-year-old female: $550.88 a month, up 15 per cent from $478.90 12 months ago

\* A 65-year-old male: $589.75 a month, up 15.6 per cent from $510.10 12 months ago

Pushback against annuities starts with the fact that people don’t like giving up control of their money. You can’t unwind an annuities contract once you start receiving income. Solution: Use an annuity for just part of your retirement income.

The other criticism of annuities has been that low interest rates depress returns. Annuity payouts aren’t completely dependent on rates – they also incorporate factors like the age of the person buying the annuity and mortality credits, a term for money that is left behind when an annuity holder dies earlier than expected and then pooled for use by those who live longer than expected. But as the quotes above show clearly, rates do matter a lot for annuities.

Inflation is driving up interest rates – and living costs for everyone, including retirees with annuities. It’s possible to buy annuities that increase payments to offset inflation every year, but the monthly payments are much lower. An example from Mr. Racanelli showed a gap of $2,400 a year between a conventional registered $100,000 annuity and one with payments indexed to offset an inflation rate of 4 per cent.

“That’s a huge drop,” Mr. Racanelli said. “What I’ve usually found is it takes about 13 years to catch up to the payments you get without the inflation protection.”

His suggestion to clients who want inflation protection is to put some of their money in the stock market. Dividend growth stocks are a good place to start with inflation protection.

Mr. Racanelli said interest in annuities has increased lately, but some people are waiting for higher rates to lock money in. An alternative to trying to time the interest rate peak is to think about laddering, which means staggering your purchases into smaller annuities bought over time rather than make a lump-sum purchase. Example: Instead of a $100,000 annuity, you put $25,000 into four separate purchases made quarterly. Mr. Racanelli said that in most cases, there’s a $10,000 minimum on annuity purchases.

As of the end of June, guaranteed investment contract (GIC) rates were as high as 4.15 per cent for a one-year term and 5 per cent for five years. Annuity payouts are built on a combination of principal and interest, so they cannot be directly compared with the yield from the interest-only payments of a guaranteed investment certificate. But it’s still possible to calculate a rough return from the annualized monthly payouts from an annuity.

Using the example above of a 65-year-old female, payouts of $550.88 monthly produce an annual amount of $6,610.56 and a return of 6.6 per cent on a $100,000 annuity purchase. Your actual yield, or return, based on income separate from your principal, depends on how long you live. It would take about 15 years of payments totalling $6,610.56 annually to get your principal back. After that, you receive interest and mortality credits.

To increase your after-tax return from annuities, consider using non-registered money to buy one. Annuity payouts from a registered retirement income fund are considered regular income and taxed at your usual rate. With non-registered “prescribed annuities,” your payments are considered to be a level blend of taxable interest and a return of principal. As a result, your after-tax amount would be higher.

A final note on maximizing annuity returns: It’s essential to compare payouts from a variety of insurance companies. Mr. Racanelli’s figure for the 65-year-old male, the best available that day, was $26.02 a month higher than the low quote. Over 25 years, that works out to $7,806 before tax.

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