CHARTING RETIREMENT

How the cost of annuities changes over time

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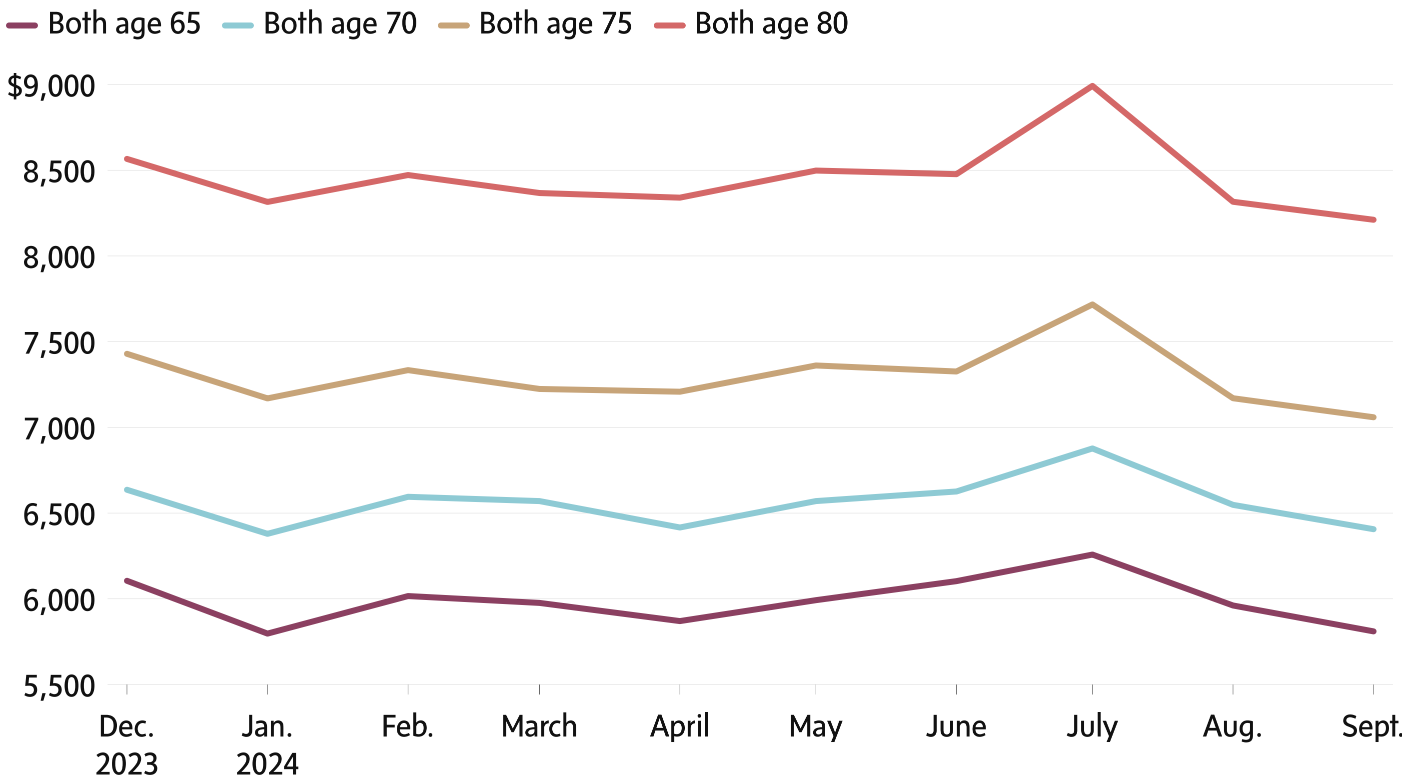
Retirement risk comes in many forms. There is longevity risk, which is the risk of outliving your money. There is also investment risk, which is the risk of losses on your investments.

To eliminate virtually all longevity risk and investment risk, you can purchase a life annuity from an insurance company. The chart shows how much annual income a couple – both the same age – could have purchased by paying $100,000 to an insurance company. Note the annuity payments continue as long as at least one spouse is alive and are payable for a minimum of 10 years, even if both die early.

What a couple receives from a $100,000 annuity

Amount of annual income based on date of purchase



THE GLOBE AND MAIL, SOURCE: RINO RACANELLI, ANNUITY BROKER

Two aspects of the chart are noteworthy. First, the amount of annuity is significantly more if you purchase the annuity at a later age. In early September, 2024, it would have been $8,211 a year starting at 80 versus $5,810 starting at 65.

Second, the cost of the annuity fluctuates month by month and even day by day. The main reason for the fluctuations is changes in long-term interest rates (higher interest rates translate into more annuity income). Another reason is that insurance companies are keener to sell annuities at certain times than at other times.

While annuities eliminate longevity and investment risk, they don't help with inflation risk. In other words, the purchasing power of the annuity income will decline with inflation. This was seen as a manageable problem when inflation was low but that changed in 2022 when pandemic spending caused inflation rates to spike. While inflation has since subsided, it is anyone's guess whether and when it will resurface. Some new investment products try to address this by minimizing investment risk while still providing some potential for increasing income over the long term.

Frederick Vettese is former chief actuary of Morneau Shepell and author of the PERC retirement calculator (perc-pro.ca)

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