Investments

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The Critical 10

Fourth year of retirement

Is my capital base okay, or am I eroding it with my annual withdrawals?

A 2010 Mindscape study funded by Ameriprise Financial created 6 stages of retirement. If you are in your fourth year of retirement you are, according to Ameriprise, experiencing the Reorientation phase of retirement.

After the initial excitement of the first year of retirement, many retirees begin to establish a new routine and establish different spending patterns. Periodically reviewing your financial blueprint is one way to ensure that early retirement years spending do not put you at risk in later life. Volatile equity markets and low interest rates increase retired investor anxiety and increased taxes complicated the issue even further.

In an age when a number of retirees have no corporate funded defined benefit pension plan, many are looking for ways to create their own pension. Many are including annuities as part of their investment asset mix. Income from an annuity may provide increased peace of mind and help offset longevity risk.

Annuities come in a variety of different forms, but the basic description is that they are an insurance product that provides a fixed payment and predictable returns. Once the annuity is purchased the terms and payments do not change, there is no potential for further growth as in equity investing. Factors contributing to the size of your annual payment include your age, your sex, when you purchase the annuity, interest rates and whether you wish to add some guaranteed payment options.

A Basic Annuity pays a fixed amount until time of death. The annuity and the payments end at that point. Insurance companies consult actuaries to estimate average life expectancy and make payment schedule based on that. Females generally receive less annual payment than males of the same age since life expectancy for women is higher. You can add a guarantee payment schedule to your annuity for periods between 5 and 20 years. If you should die before the guaranteed period expires, the annuity payments transfer to your beneficiaries. If you are funding an annuity purchase from RRIF money, it is important to note that the guarantee period cannot last beyond age 90.

A Joint & Last Survivor annuity makes payments until the death of the second spouse. The payments can continue in full to the surviving spouse or may be reduced in at death of the first spouse. Annual payments for continued in full option are lower than if payments are reduced at first death. This sort of annuity also provides for a guaranteed payment option. If death of the second spouse occurs before the guaranteed period, the beneficiaries of the estate receive payment.

Annuity Certain annuities continue payments at death to a designated beneficiary if death occurs before the end of the guaranteed period. This is an annuity taken against one life with a designated beneficiary assigned.

At the time of writing, a single life annuity on a 65 year old male living in Alberta would pay out about $557 per month for every $100,000 deposited. During periods of low interest rates a big portion of that payment would be return of principal with only about 7% of that amount taxable. (It is important to note that if you purchase an annuity with funds from a RRSP or RRIF that the entire amount would be taxable as earned income.) Adding a 20 year guaranteed payment period would decrease the amount received monthly, for example, to about $472.

Annuities have not been widely considered in recent years because of the low interest environment. Uncertain and volatile equity markets can have the effect of making investors re-evaluating their risk/reward trade off and annuities become somewhat more attractive as you enter retirement years. One downside of money invested in annuities is that, while there may be some guaranteed payment periods incorporated to your beneficiaries, there is no return of principal at death. Those wishing to leave an estate may find this feature a negative.

Using annuities can be a compliment, not a wholesale replacement to your investment portfolio. One strategy would be to consider purchasing an annuity with nonregistered money as a way to earn low tax obligation cash flow. Income from a nonregistered annuity, combined with CPP can be directed toward fixed monthly, nondiscretionary expenses. If you know that all the bills will be paid monthly it may allow you the luxury of having a more volatile, higher growth asset allocation in the early years of retirement. It can also simply give you peace of mind that your basic needs will be covered and that your other investments can be used toward discretionary expenses or toward creating a legacy.