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Report on RRSPs / ANNUITIES

Seeking peace of mind in a low-interest-rate era

Retirees who have only modest savings and who risk running out of cash are prime candidates for an annuity

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When Rudy Halmo sold his business and retired about 20 years ago, he didn't want to gamble his savings in the stock market. Instead, he took the conservative route and spent about $100,000 for an annuity that would pay him a fixed income for the rest of his life.

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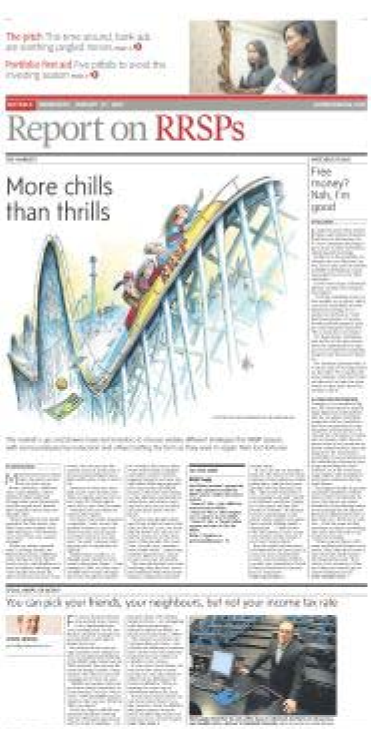

Report on RRSPs

More chills than thrills

Free money? Nah, I'm good

You can pick your friends, your neighbours, but not your income tax rate

Opting for the security and predictability of an annuity turned out to be a smart move for the Simcoe, Ont., resident. Having locked in a hefty interest rate of more than 10 per cent at the time, his annuity delivers a monthly income of $1,300.

"It's terrific. I have nothing to be concerned about," says Mr. Halmo, 88.

But even though he has no regrets about his decision, if he were retiring today he says he would give annuities a pass. The reason? With interest rates at historic lows, the monthly payments would be too small. A 65-year-old male buying a $100,000 life annuity today, with payments guaranteed for a minimum of 10 years, would receive monthly income of about $700, according to Cannex, which gathers information about financial products and services.

For all the peace of mind annuities offer, they can be a tough sell these days. Not only are interest rates nearly invisible to the naked eye, but the number of competing investment products is always growing, giving retirees an ever-increasing array of options to choose from.

What's more, now that markets have recovered, many retirees have rediscovered their appetite for risk and want to keep a chunk of their retirement money in stocks or mutual funds in the hope of generating higher returns.

"My guess is that sales of annuities probably went up a bit when the market was doing horribly, because people were looking for an investment that was safe," says William Bernstein, author of *The Investor's Manifesto: Preparing for Prosperity, Armageddon and Everything in Between*.

"Now that people have embraced - probably temporarily - risk, suddenly annuities aren't that interesting."

The low returns aren't the only drawback. Many seniors also don't like the irreversible nature of an annuity, or the fact that the money spent on a life annuity with no guarantees is gone once the person dies, leaving nothing for the heirs.

"Most people don't like putting their money someplace where they lose control and can't change their mind if they decide they made a bad choice," says Malcolm Hamilton, a pension consultant with Mercer (Canada) Ltd. "For the most part the annuity is a one-way decision. You put the money in and you can't change your mind, and I think that makes people reluctant to do it."

Despite such drawbacks, annuities still deserve a place in the retirement plans of some people, experts say. Retirees who have only modest savings and who risk running out of cash if they live a long time are prime candidates for an annuity, which guarantees that they will have a certain level income whether they live to 85, 95 or 105. An annuity is in effect a bet on how long a person will live, so retirees who are in good health - and whose parents and grandparents lived to a ripe old age - will usually get the greatest bang for their annuity buck compared with those who are in poor health and who have shorter life expectancy.

Bear in mind, however, that annuity buyers tend to be a healthy group for that very reason, and this is reflected in the mortality tables that insurance companies use to calculate payouts.

Another thing to keep in mind is inflation. Unless you buy an inflation-indexed annuity, the purchasing power of your monthly income will erode over time.

Who should not buy an annuity? People who have ample savings and are at no risk of running out of cash don't need to consider an annuity. The same goes for retirees who have rock-solid pensions that more than cover their retirement spending needs.

An annuity doesn't have to be an all-or-none financial decision, however.

"Often what we'll suggest is to look at what your fixed costs are and annuitize sufficient money so we know we've locked in all your fixed costs, and let's keep a significant portion of money available for discretionary things - travel, grandchildren and those kinds of things," says Ted Warburton, partner at First York Insurance Agency. "It's a foundation that adds some peace of mind and comfort."

One of the most popular choices is a joint and last annuity, which continues paying income after the first spouse dies, often at a reduced rate, but stops after the second spouse passes away. Some people combine an annuity with a joint life insurance policy, so that after the second spouse dies the insurance proceeds can be passed along to the heirs.

"There's a place for safe, secure, sleep-at-night, not-to-worry, hands-off types of investments," adds Mark Halpern, a certified financial planner and president of illnessProtection.com.

FIVE ANNUITY OPTIONS

Annuities come in an array of flavours and can be purchased with registered or non-registered funds. Here is a look at some options: Term annuity

A contract to pay a fixed monthly income for a specified number of years. If the annuitant dies, the payments continue to a designated beneficiary.

Single life annuity

Payments continue until death, regardless of how long the annuitant lives.

Life annuity with guaranteed term

Income is guaranteed for a period of five to 25 years, so that if the annuitant dies early, the payments continue for the duration of the specified term.

Joint and last survivor annuity

Payable to two people, usually a husband and wife. Payments continue after the death of the first spouse, sometimes at a reduced rate, and cease after the death of the second spouse.

Indexed annuity

Payments rise by a fixed percentage each year, or by an amount linked to the consumer price index.

John Heinzl