

MINDING YOUR BUSINESS

The Insured Annuity Income for Life

By Gordon B. Clarke, CFP, CIM, OLS (Retired)



Have you seen the ad with the picture of an elderly man dressed as a fast food employee? It is designed to play on our fears. Older people worry about running out of money in their retirement, being a burden to their children, stuck in a grungy retirement home or as the ad indicates, trudging off to work at age 75 because of necessity, not by choice. So as we age, we quite naturally do not want to take chances with our retirement savings. Who wants to spend the “golden years” flipping burgers?

A very popular financial instrument

for this no-risk segment of society is the guaranteed investment certificate (GIC). The income and the capital are both safe and secure. Unfortunately safety and security are all GIC's have to offer. In today's low interest rate environment, rates of return are low, barely in the 3% to 4% range. To add insult to injury, the interest is fully taxed on an annual basis. In real dollars, after you factor in the inflation, GIC's are most often a money losing proposition.

There is an alternative strategy that older people can employ to significantly increase their income without addi-

tional risk. It is known as an Insured Annuity. It is a two part strategy utilizing life insurance and an annuity.

The annuity portion of the strategy is an insurance product and the basic version works like this. You give a lump sum to an insurance company in exchange for a guaranteed income. There are options and features but in its simplest form, the insurance company will pay you a predetermined income as long as you are alive. Upon death, any residual funds are retained by the insurance company.

This is where the life insurance part

of the strategy comes into play. Term insurance is coverage that is purchased for a specific period of years, usually 10 or 20 years. But a Term 100 policy is also available. In other words, you can buy term coverage for life. So if you were to purchase a \$100,000 annuity with no guarantees and then die early, you would have received income for as long as you lived but your estate would be without the original capital investment. However, if the annuity purchase was combined with a Term 100 life policy, the \$100,000 would be received by the beneficiaries, no matter when the annuitant died.

Insurance for the elderly is very expensive. After all, the risk of a 75 year old dying prematurely is much higher than a 30 year old. But there are two countering financial issues at work. The shorter anticipated life span of an older person also means the annuity payout will be relatively high. The second reason is in the taxation of the income. One type of annuity, called a "prescribed annuity", generates income that is not

fully taxed. Without going into all the details, only a small portion will be subject to income taxes. This creates huge savings.

It is generally better suited for older people, but the only way to be sure is by doing an analysis. But even if it does not work for you, consider it for your parents. After all it is the inheritance, not just the income that is being protected. Note that anyone can be named as the beneficiary including a charity such as the A.O.L.S. Educational Foundation, in which case, the estate will benefit from the large tax credit.

Here are the numbers for a 73 year old female. She can roll over her money into a GIC as would be her normal practice or she can use the Insured Annuity strategy. Let us assume she has \$100,000 available with a marginal tax rate of just 25% and compare it to a typical 5 yr GIC with a major bank. It has a rate of 3.30%.

	Insured Annuity	GIC
Investment	\$100,000	\$100,000
Annual income	\$8,900	\$3,300
Taxes	\$320	\$825
Insurance premium	\$4,000	\$0
Net Income	\$4,580	\$2,475

The results are amazing. For every \$100,000 of savings, she will have \$2,105 more to spend or save. The insured annuity strategy has created an income for the rest of her life equivalent to a 6.1% GIC. Then upon her death, her children will receive the \$100,000 insurance benefit.

You will not be seeing her flipping burgers anytime soon.



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