Scotia Wealth Management™
Scotia Wealth Insurance Services Inc.

The Insured Annuity Strategy

Perhaps the biggest retirement question we face is, “Will I have enough?” Most of us want to know that we’ll have a steady base level of retirement income that won’t run out too soon. Traditional investment vehicles such as bonds, T-bills, and term deposits are often popular choices to achieve the retirement goals of income generation, safety and preservation of capital. However, the after-tax rate of return of these options may not be enough income to meet your needs.

There is an alternative strategy that provides income that is guaranteed for life and upon death, pays your originally invested capital to your beneficiaries directly, without the usual estate-related hassles and costs. The Insured Annuity strategy can preserve the value of your estate, minimize income taxes and most importantly, guarantee an income stream for the rest of your life.

Enhance Your Retirement Income

The Insured Annuity strategy involves the purchase of two contracts: a permanent life insurance policy and a prescribed Life Annuity. You designate a portion of your non-registered capital to be used to generate a guaranteed income with which you purchase a Life annuity. This usually produces a higher income than typical fixed income investments and ensures a guaranteed income that you and/or your spouse cannot outlive. With a Life Annuity, each payment is actually a blend of interest and your original capital, where only the interest portion is taxable. As a result, there is no residual value for your estate when you die.

Leave a Legacy

To solve this, part of the annuity payment is used to pay the life insurance premium. At death, the annuity income ceases and the life insurance death benefit is paid to your beneficiaries to replace the capital originally invested in the annuity. Because of the special tax treatment afforded by the annuity and the life insurance policy, the after-tax return on the Insured Annuity concept may be significantly greater than can be found on conventional interest-bearing investments.

An Example

The following example shows how a 65-year-old couple can benefit the Insured Annuity strategy compared to a GIC. They are generous grandparents of three who are looking to maximize their income now that they are retired. They also wish to fund their grandchildren’s education. The Insured Annuity strategy allows the couple to increase their monthly cash flow and still maintain the size of their estate.

As illustrated, the couple would apply for $500,000 of Term-to-100 insurance and once the insurance is in place, they would buy a $500,000 life annuity to generate income. They would then receive the difference between the monthly cash flow from the annuity and the monthly premiums being withdrawn for the insurance, while still maintaining the full value of their estate. Upon the death of the last surviving spouse, the annuity income ceases and the life insurance proceeds are paid out to the couple’s beneficiaries without passing through probate.

GIC at 3.0%	Annual Income	Insured Annuity
$500,000	Total Investment*	$500,000
$15,000	Gross Income	$26,268
$15,000	Taxable Income (interest component)	$5,076
$6,900	Taxes Payable at 46% Rate	$2,340
N/A	Insurance Cost (Premiums)	$9,588
$8,100	Net Income	$14,352

Rate of Return GIC would have to achieve each year to match the insured annuities income: 5.31%

* Annuity payments will not cover initial premium requirements. Assumes 65-year-old couple, non-smoking.
Rates will vary. January 2016.

Example:

Table of returns: Annual return a GIC would have to achieve to match the insured annuity income base on different ages and genders.

Age/Sex	Male	Female	Joint
60	5.69%	5.34%	5.26%
65	5.89%	5.31%	5.31%
70	5.99%	5.37%	6.09%
75	5.18%	5.33%	6.72%
80	1.11%	3.74%	6.10%

Things to Consider

This strategy is suitable for those who are between the ages of 60 and 85, risk-adverse, dissatisfied with currently low interest rates, and in good health (to qualify for life insurance).

Once the annuity is purchased you cannot cancel the contract – it is locked in for life. This may represent a significant commitment, depending on your age. It also means that you should not consider moving all of your investment assets into the annuity just in case something unexpected should occur that requires some of your investment capital. As well, annuity income is fixed so although interest rate levels may go up, the annuity income remains the same. However, the accumulated cash flow over the lifetime of the Life Annuity may be more than that of a GIC, even with increasing interest rates.

Summary

The Insured Annuity strategy can generate a guaranteed, lifetime net income that is typically much higher than what you can achieve with other fixed income vehicles. As well, by directing the capital to named beneficiaries, you can avoid unnecessary estate costs and delays.