CAPSTONE
ASSET MANAGEMENT™

ANNUITIES: READING THE FINE PRINT

The other day I met with a couple who told me about a product they saw advertised at their local bank. In their words, the amount of capital invested would provide a guaranteed rate of return of 8% for life. Upon further research, it became apparent that what they were actually referring to was an annuity. Given that this was not the first time I had heard clients speak about annuities this way, I thought it might be worthwhile to uncover aspects of this sometimes complex offering.

An annuity is actually an insurance policy where one contributes capital to an annuity and, in the case of a single premium immediate annuity, an income stream begins thereafter. The income stream is based on various factors including interest rates and life expectancy. In its simplest form, payments will cease upon death. As with most insurance products, however, there are varying levels of complexity. For example, with a deferred annuity the receipt of income is delayed. Additionally, one may choose to attach riders to a policy that may include the return of the initially contributed capital to a beneficiary upon death or one may elect for a spouse to continue to receive income upon one's passing.

Although an annuity does guarantee a series of payments for life, the return is in reality composed of capital, insured capital and interest. This means that although one may be receiving payments based on 8% of contributed capital, for example, one is likely not actually earning an investment return of 8%.

Being a specialized product, annuities do not come cheap. As expected, there is a cost for the management of the invested capital. Over and above this there is the administration cost of dealing with thousands of annuitants. Any additional rider benefits, such as an expanded income or death benefit come at an additional cost as well. Lastly, because it is an insurance contract, there are penalties or surrender charges if you withdraw funds early or otherwise break the contract.

Annuities can be appealing to those fearing they could outlive their capital because there is a guaranteed income stream for life. So some people may be willing to pay for that peace of mind. If you are worried about longevity risk, it is worth having a conversation with your Portfolio Manager. At Capstone, we offer basic complimentary retirement planning which can be helpful in testing different scenarios and while we do not sell insurance products, we are happy to provide counsel. Reading the fine print can be an arduous task, especially if you do not have a base level of knowledge. So, when in doubt, we encourage our readers to seek the advice of a trusted and qualified advisor.

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