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Insured annuities help mitigate market volatility

Complement other sources of income and enhance portfolios

Investors are growing weary of market volatility and, given the frequency of the gyrations over the past few years, it's no surprise. Unfortunately, the instability has caused many to panic; pulling out of the markets and sitting in cash. However, with inflation eroding the remaining value of the portfolio, it's unsustainable as a long-term solution.

Market volatility has been most tough to stomach for those nearing or in retirement. Returns on cash are simply not sufficient to meet retirement goals, but being fully invested in the markets is not always suitable. Older investors are at a crossroad, trying to decide how to protect their portfolios while generating a consistent income stream. Some estate planning can help.

Insured annuities complement other income sources by providing stability and enhancing conservative portfolios. They are a one-time investment that pays guaranteed income for life while achieving higher income, lowering taxes, preserving capital, and providing a tax-free transfer to beneficiaries. With guaranteed lifetime payments, an insured annuity addresses the worry of outliving one's retirement funds.

An insured annuity is comprised of a life annuity contract and a life insurance policy. They are bought simultaneously, with the annuitant as the life insured. The annuity generates the cash flow needed to pay both the life insurance premium and the income tax on the annuity.

The tax advantages are significant. Generally, the older the annuitant the larger the payment but, unlike a GIC, only a portion of the annuity payment received is taxable. When non-registered funds are used, the preferential tax treatment can bring advantages. Because a smaller portion of the income is deemed to be taxable, Old Age Security clawbacks also may be lowered or eliminated.

Let's look at the basics for a 70 year-old, non-smoker female who purchases a $500,000 insured annuity at current rates, and has a high marginal tax rate of 43.7%.

Her insured annuity pays out $38,625.72 per year at prescribed terms. She pays insurance premiums but, because her annuity payment includes return of capital, only a portion of it is taxable. The annual net cash flow after these deductions would be $18,015 per year or 3.60% after-tax and expense yield.

If our subject purchased a $500,000 GIC with a 4.0% rate of return, the results would not be nearly as good. Although she would only have taxes to pay, they are much higher. The annual net cash flow from the GIC would be $11,260 a year or 2.25% after-tax and expense yield.

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For this senior, the insured annuity has an annual net cash flow 60% higher than the GIC.

Her named beneficiary also receives advantages. In addition to being tax-free, the end of life insurance payment is not considered part of the estate. Therefore it is paid directly to the beneficiary, bypassing probate and avoiding costs and delays associated with administering the estate. It is also protected from creditors.

As straightforward as this process sounds, there will be some variables in the rules and annuity rates so investors should get qualified advice to ensure they fully understand the concept.

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