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Investing in Annuities for your Retirement Needs

Early saving and prudent retirement planning would ensure that you can sustain your lifestyle during your retirement years. So should an annuity be considered in your retirement portfolio?

ANNUITIES ARE AMONG THE various investment instruments used for retirement purposes. Other instruments used include stocks, bonds, cash, property, unit trusts, as well as insurance products. The main function of these instruments is to generate streams of income and grow the capital in order to fund one's desired lifestyle upon retirement.

It is important to understand the purpose of each investment instrument and how it can meet your needs, before you decide whether it is appropriate for you. So what are some of the factors to consider before investing in an annuity?

WHAT IS AN ANNUITY?

An annuity is a long-term insurance product used to provide financial hedge against the risk of living too long and thus outliving your financial resources.

As an annuitant, you would pay a principal lump sum to an insurer who would in return provide a guaranteed stream of monthly payouts for the rest of your life. The monthly payout amount depends on the principal sum invested. The payout comprises partly the principal, and partly the interest income on the remaining principal.

These monthly payouts are made for as long as the annuitant is alive. In the event that the annuitant dies, the annuitant's estate will receive the remaining principal plus interest (which is determined by the insurer).

IMMEDIATE VS DEFERRED ANNUITIES

Annuities are usually classified as either immediate or deferred. Both are purchased with a single premium paid either by cash or with Central Provident Fund (CPF) savings, under the CPF Minimum Sum Scheme (currently mandated at S$94,600, from 1 July 2006).

With an Immediate Annuity, the first payout commences within a short time after the purchase. A Deferred Annuity is used to accumulate money for retirement during the "deferred period", and income payouts are only due sometime in the future (after the deferred period). For example, you may purchase a deferred annuity with your CPF Minimum Sum at age 55. The period between age 55 and 62 is a "deferred period" of 7 years during which your annuity plan is accumulating interest to generate an income stream from age 62, payable for the rest of one's life.

If the annuitant wishes to surrender the annuity plan during the deferred period, the single premium invested plus interest, will be refunded. If the annuitant surrenders the plan after the deferred period, the single premium plus interest (less the total monthly payouts) will be refunded.

PARTICIPATING VS NON-PARTICIPATING ANNUITIES

Participating annuities are plans that participate in the insurer's profits. These profits are payable in the form of annual bonuses which are usually declared at the end of the calendar year, and credited to your annuity plan. Bonuses are non-guaranteed, and the amounts may vary from year to year. In addition to these bonuses, participating annuities also provide guaranteed income in the form of fixed monthly payouts.

Non-Participating annuities (or Flat Annuities) only provide guaranteed income through fixed monthly payouts. There are no bonuses since they do not participate in the insurer's profits. Hence, in comparison, a participating annuity is a better hedge against inflation in the long run.

WHAT YOU CAN DO WITH YOUR CPF MINIMUM SUM

As of 1 July 2006, the CPF Minimum Sum is set at S$94,600. Upon reaching the retirement age of 55, you can use your CPF Minimum Sum for the following:

1. **Buy a life annuity from a participating insurance company.**
2. **When the CPF Minimum Sum is utilized to purchase a deferred annuity, the monthly payouts are exempted from income tax. On the other hand, if cash is used for the purchase, the monthly income payouts are subjected to income tax once your full principal sum has been exhausted.**
3. **Place it with a participating bank to earn a fixed interest. The bank will then pay you a monthly income until your Minimum Sum is exhausted. The participating banks are United Overseas Bank (UOB), Development Bank of Singapore (DBS) and Overseas Chinese Banking Corporation (OCBC).**
4. **Leave it with the CPF Board to earn interest at the prevailing rate (currently 4% p.a for Medisave, Special, and Retirement accounts). This interest rate is revised every quarter. You will get a monthly income from age 62 onwards, until the Minimum Sum is exhausted.**

Assuming that you have left a minimum sum of S$94,600 with the CPF Board, you will get an estimated monthly income of S$750 for 20 years.

BENEFITS OF ANNUITIES

Here are some features of an annuity:

1. **Security**
   An annuity is a highly secure investment instrument, if it is purchased from an insurance company with good financial strength.
2. **Risks**
   Annuities, especially participating plans, are a good hedge against inflation, as compared to non-participating or flat annuities.
3. **Capital Gains**
   Investment-linked annuities are likely to enjoy capital gains. However, this type of annuity is not common in Singapore.
4. **Income**
   Annuities provide a guaranteed stream of income for life and provides financial hedging against living too long and outliving our resources.
5. **Payout Amount**
   Monthly income payouts have been much lower in recent years due to a lower interest rate environment. Hence, it's worth comparing the monthly income payout offered by different insurers.
6. **Special Features**
   Look out for special features and benefits included in the annuity plans, such as Long-Term Care benefits, personal accident plans, or the option to buy additional benefits.
7. **Tax Status**
   Annuity income is non-taxable if it the annuity is purchased using your CPF Minimum Sum. But it is subject to taxation if you use cash.

PLANNING FOR YOUR GOLDEN YEARS

As our population ages rapidly and with the increased life expectancy, the need to plan for our retirement is obvious, and has been greatly encouraged by the government. Early saving and prudent retirement planning would ensure that you can sustain your lifestyle during your retirement years. So, should an annuity be considered in your retirement portfolio?

According to the Singapore Department of Statistics, "Population Trends 2006", the life expectancy of a female Singaporean in 2005 is 81.6 years old and 77.7 years old for a male Singaporean. The trend of Singapore's life expectancy since 1970 to 2005 has been rising. Living too long, and thus outliving one's income is one of the major concerns during our retirement years. We certainly cannot ignore these apparent trends.

Annuities should be considered in a well diversified retirement portfolio. The old adage of not putting all our eggs in one basket certainly holds true especially in the construction of your retirement portfolio. As we have no control of our life expectancy, it would be prudent to hedge against this risk and build a retirement plan based on proper planning. **iFAST**

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