Here’s Why This Popular Investment Is a Horrible Idea Right Now

Description

For some of us, 71 feels like a long ways away. For others, it feels like just yesterday that 71 felt, well — a long ways away. But no matter how near or far you are to your 71st birthday, if you’re planning for retirement you know what that pivotal age entails: converting the RRSP into a stream of income.

For most Canadians, that will mean deciding between converting the RRSP into an RRIF or an annuity (you could take out a lump sum if you want to pay all your taxes at once). While some Canadian financial experts (usually those who sell annuities) will tell you the latter is a great way to get lifetime income, I’ll be honest with you: in Canada’s current climate, annuities are a bad idea. Here’s why.

Why annuities are a bad idea right now

First off, let’s take a step back. Annuities are perhaps one of the most complicated financial products out there, which is why it’s all too easy to get locked into a bad deal. So let’s break them down as simply as possible.

An annuity is simply a pension that’s funded by you. You sign a contract with an annuity provider, agree to certain terms and conditions (such as how long your annuity will last, how your money will grow, and when you start receiving payouts), then you receive annuity payments over a specific period of time.

Annuities are often advertised as a stream of income you won’t outlive. And with nearly 20% of Canadian retirees living on only $25,000 in savings, that promise can be tempting.

But what many annuity providers don’t advertise are the restrictions. For most annuity products, when you sign the contract and hand over your money, that money is no longer under your control. You are restricted to the annuity payouts that you agreed to in the beginning. For instance, if you agreed to have $2,500 paid to you every month, you couldn’t receive $3,000. Break these conditions and you could face some penalties.

But restrictions aren’t even the worst part about annuities. No, the biggest drawback to an annuity, at least in today's financial climate, is the low-interest rate you'll receive.

If you choose a fixed rate annuity today, that is, an annuity whose interest rate is based on the prime rate, you'll lock into a terrible rate of return. Canada's interest rates are at a historic low right now, and if you were to convert an RRSP into an annuity at these rates, you'll earn far less than, say, an RRIF with conservative investments.

Are annuities *always* a bad idea?

I wouldn't say annuities are *always* a bad idea. Some annuities offer variable rates, which tie your rate of return to investments (these are usually *super* complicated, however). In fact, for Canadians who want the utmost security, an annuity can give you immense peace of mind. You know your money will come back to you in the form of annuity payouts, which can feel a bit like receiving a paycheque.

But if you want to optimize your rate of return in retirement, I'd say skip the annuity for now.

If you *do* choose an annuity, definitely add a beneficiary to your plan (this will most likely cost extra). Unlike an RRIF, which allows your spouse or kids to take over your investments if they pay taxes, an annuity without a beneficiary rider doesn't offer this benefit. With a single-life annuity, the insurance company takes over your retirement savings when you die. Sure, they don't keep this money. It's pooled and given out to other annuitants. But one thing's for sure: without the rider, your hard-earned retirement savings won't grow your family tree.

A better idea

In this climate, where interest rates are still extremely low, I'll pass on the annuity and convert my RRSP into an RRIF. Inside the RRIF, I'll invest in conservative securities (that is, *not* growth stocks, cryptocurrency, or IPOs), probably blue-chip stocks or a fund that follows the **TSX/S&P Composite Index**.

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Date
2025/06/30
Date Created
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