Basics of annuities

Wealth Management

Financial freedom doesn't come without a cost. Most financial professionals say that you will need between 60% and 80% of your final working year's salary for each year you live in retirement. However, that school of thought has changed, as many in early retirement spend as much as 100% of what they were before retirement. Retirees often maintain their pre-retirement lifestyle, but with more time for extra activities like travel.

Where will your retirement income come from? You may be fortunate enough to have an employer-sponsored pension or you may count on Social Security. However, it may provide far less than what you will need or expect.

That's why so many people use private investments to supplement their retirement savings. One investment product is an annuity. An annuity can provide an income stream for your retirement years. Annuities also provide other potential benefits such as:

- **Tax deferral** — Earnings grow tax-deferred
- **Living benefit riders** — Can guarantee a stream of income for the rest of your life and may also provide principal protection
- **Death benefits** — Guarantee return of premium or lock in gains for your heirs while avoiding probate

Freedom of choice

There are several different types of annuities in the marketplace. The type of annuity you choose depends on your individual situation, your long-term goals and how comfortable you are with risk. Your liquidity needs should also be taken into consideration.

Fixed annuity

Fixed annuities are conservative investments for individuals who prefer guaranteed rates of return on their investments. A fixed annuity pays a fixed rate of interest for a specified period, which could change periodically and typically is subject to a minimum crediting rate. Many fixed annuity issuers pay a higher rate of interest for an initial period of time, usually a year. This higher rate of interest is sometimes called a bonus interest rate. Thus, the issuer may agree to pay 4% for the first year and then pay no less than 1% annually on the annuity after the first year. Usually, the annuity issuer will pay more than the minimum guaranteed rate on the fixed annuity.

Variable annuity

Instead of receiving a fixed rate of return on the money invested in an annuity, a variable annuity allows investors to invest annuity money in one or more investment subaccounts (often called variable subaccounts, which are similar to mutual funds). Variable annuity subaccounts are run by professional money managers. The subaccounts can invest in stocks, bonds, money market instruments and other types of investments. Variable annuities are typically designed for investors who can handle the downside risk of the market in exchange for the upside potential. Unlike a fixed annuity, investors assume the investment risk on the annuity. Investments in variable products will fluctuate and values upon redemption may be less than the original amount invested.

With a variable annuity, the amount of earnings credited to the annuity account will depend on the performance of the underlying subaccounts. Furthermore, most annuity issuers allow investors to move money from one subaccount to another without incurring costs or tax consequences.

Many variable annuities offer living and death benefit riders for an additional cost. Living benefit

riders can guarantee a stream of income to an investor for the rest of his or her life while death benefit riders provide asset protection to the investor and beneficiaries.

Fixed indexed annuity

A third broad type of annuity is a fixed indexed annuity, sometimes referred to as an equity index annuity. When investors purchase a fixed indexed annuity, the issuer agrees to pay a return on the account that tracks to a market index—usually the S&P 500 for example—and is typically subject to a cap or spread. However, the issuer also typically guarantees that the principal is protected if the selected index is negative. Thus, if stocks do well, the investor may earn positive returns on the annuity, and if the index has negative returns, the principal is typically guaranteed.

One of the tradeoffs of a fixed indexed annuity is that the issuer may not pay the full return on the index. Many fixed indexed annuities have caps (e.g., the maximum limit put on the return over a specified period of time). Others have spreads (e.g., the return hurdle the index must overcome in order for an investor to experience a positive return). Thus, with a fixed indexed annuity, investors give up some of the upside potential for the downside risk protection. Fixed indexed annuities are designed for a more conservative investor who wants some participation in the market, but desires principal protection. Living and death benefit riders may be available with these products as well, similar to the riders on variable annuities. With the living benefit riders available on these products, investors have a guaranteed income stream they cannot outlive.

Registered indexed-linked annuities

Registered indexed-linked annuities (RILAs) share some characteristics with fixed indexed and variable annuities. Also known as buffered annuities, RILAs offer investment growth opportunity with a level of protection on the downside. Compared to fixed-rate and fixed indexed annuities, RILAs have a greater potential for growth. What sets a RILA apart from other annuities is the ability to limit losses during a down market. In return, gains may be capped to the same extent the market goes up. A RILA floor is the maximum percentage loss investors are willing to absorb during a down market. Any losses beneath the floor are absorbed by the RILA provider. A RILA buffer is a percentage of loss that investors do not wish to absorb during a down market. Investors are exposed to losses to the extent that the linked market index losses exceed the buffer. The upside gain is capped to the same extent that the downside loss is limited. RILAs expose investors to some market risk but allow participation in some market gains.

Single premium immediate annuity

While there are many variations of single premium immediate annuities, the basics are fairly straightforward.

An investor will invest a single lump-sum payment (premium) with an insurance company, who in turn agrees to pay an income stream over the investor's lifetime, the spouse's or partner's lifetime or during a certain period of years, whichever is selected. Single premium immediate annuities appeal to those investors who want a guaranteed income they cannot outlive.

Deferred income annuity

A deferred income annuity, also referred to as a longevity income annuity, is another variation of an annuity product. With a deferred income annuity, investors deposit a lump sum of money (premium) with the insurance company in exchange for a stream of payments to begin at a designated future date, typically age 65 or older, that will last for the rest of the investor's life or a certain number of years, whichever is selected. The amount of the future payments will depend on a number of factors, including the amount of premium, the investor's age, life expectancy, interest rates and the time until payments are set to begin. Deferred income annuities are a good way to guarantee a future income stream that can last a lifetime.

Advantages of annuities

Guaranteed income for life (living benefits)

Annuities can offer investors a guaranteed lifetime income, either through annuitization—converting the annuity into a series of periodic income payments—or a guaranteed withdrawal benefit. A guaranteed withdrawal benefit gives investors the guaranteed income, but they don't give up control of the account value like they would with annuitization. Single premium immediate and deferred income annuities offer a fixed payment, with some periodically offering a modest cost of living adjustment. Variable and fixed indexed annuities differ in that they provide the opportunity for larger payment increases. With all annuities, investors transfer longevity risk over to an insurance company, which decreases their risk of outliving their assets and the income these assets produce.

Asset protection (death benefits)

Market volatility can have a negative impact on assets, which can drive down the total value of an estate and the legacy intended for beneficiaries. Annuities may offer a guaranteed return of premium and lock in gains for heirs. This type of protection is typically not available in traditional investment products like mutual funds, bonds and stocks. These asset protection riders are available on variable and fixed indexed annuities.

Tax deferral

Clients looking to place assets into an investment to shield these assets from taxes (until distribution) should consider an annuity product. There are no federally mandated contribution limits and no mandatory withdrawals like with most retirement plans.

Choice of payouts

Investors may have several payment choices with an annuity distribution—lump sum, periodic or annuitized payments—over time.

Helps avoid probate

If an annuity has a beneficiary, the beneficiary will receive the money immediately, because annuities avoid probate—a time-consuming and expensive legal process that may affect most assets in an estate.

Why invest in an annuity through RBC Wealth Management?

Annuities may be available through any number of sources. But when investors work with RBC Wealth Management, they may receive a number of benefits:

- **Personalization —** We're in the business of helping our clients plan for their future. When we recommend an annuity solution to investors, we do so after considering their individual circumstances by way of developing a WealthPlan.
- **Experience —** RBC Wealth Management has helped people reach their financial goals since 1909. We have the resources, background and expertise to help investors achieve financial security.
- **Availability —** We are not an insurance company and we do not manufacture annuity products. Therefore, we are positioned to choose from many annuity carriers and products available in the market. Investors will receive a customized recommendation that fits specific goals and objectives.

Investors should consider the investment objections, risks, charges and expense of an annuity carefully before investing. The National Association of Insurance Commissioners provides information on the various types of annuities and features. Prospectuses containing information about variable annuities are available by contacting your RBC Wealth Management financial advisor.

Please read the prospectus carefully before investing to make sure that the annuity is appropriate for your goals and risk tolerance.

To learn more about how an annuity may fit into your overall WealthPlan, contact your RBC Wealth Management financial advisor.

Wealth Management

RBC Wealth Management does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in consultation with your independent tax or legal advisor. No information, including but not limited to written materials, provided by RBC WM should be construed as legal, accounting or tax advice.

Annuities are designed to be long-term investments and frequently involve substantial charges such as administrative fees, annual contract fees, mortality & risk expense charges and surrender charges. Early withdrawals may impact annuity cash values and death benefits. Taxes are payable upon withdrawal of funds. An additional 10% IRS penalty may apply to withdrawals prior to age $59^{1/2}$. Annuities are not guaranteed by FDIC or any other governmental agency and are not deposits or other obligations of, or guaranteed or endorsed by any bank or savings association. With fixed annuities, both the money you invest and the interest paid out are guaranteed by the claims-paying ability of the insurer. Investments in variable products will fluctuate and values upon redemption may be less than the original amount invested. Investors should consider the investment objectives, risks, and charges and expenses of an annuity carefully before investing. Prospectuses containing this and other information about the annuity are available by contacting your RBC Wealth Management financial advisor. Please read the prospectus carefully before investing to make sure that the annuity is appropriate for your goals and risk tolerance.

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