

STEPUP

Sales Tax Estate Planning Underwriting & Product Newsletter

4th in a series

Is there a product solution that can provide a guaranteed income for life and allow investors to participate in the market?

What is a Guaranteed Withdrawal Minimum Benefit (GMWB)?

Guaranteed Minimum Withdrawal Benefit plans provide long time wealth accumulation and capital preservation for investors. They are a combination of investment and income solutions built into one package. In general terms, a guaranteed minimum withdrawal benefit plan works as follows.

The investor allocates for example, \$100,000, with the issuing company. This provides the income base. First year income will depend on the age at which income begins. Again, for example, Empire Life's most recent version, Class Plus 3.0 offers a range from 2.85-5.25% of the notional value of the plan at the time withdrawals begin. Class Plus 3.0 offers a 4% payout at age 65, which would amount to \$4,000 in this example beginning right away.

The money is placed in an underlying portfolio chosen by the investor.

For each year that the investor waits to receive income, (s)he receives an annual 4% income base bonus. This annual bonus is not a guaranteed rate of return or a cash deposit. It's not available for withdrawal. It serves to increase the figure used to calculate the guaranteed lifetime withdrawal amount. The income bonus for Class Plus 3.0 is available for the first 20 years of the contract.

Essentially, a 65 year old investor is being guaranteed at least \$4,000 (per \$100,000 of investment) a year for life, with the potential for increases if the underlying funds perform well and for each year they defer taking that income. The issuing company charges a fee for this guarantee over and above management expenses. Furthermore, as guarantees and income can differ between Guaranteed Minimum Withdrawal Benefit products, it's very important to understand and compare policy terms and conditions before deciding to invest.



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Peter works with independent advisors and other professionals raising awareness on issues and concerns faced by affluent individuals, professionals and business owners. He supports efforts in researching and developing optimal solutions for clients aimed at improving their financial well-being and supporting their personal wishes and lifestyles. He has provided 1000s of workshops, seminars and technical support throughout the country on tax, retirement income and estate planning issues, concepts and strategies to both advisors and consumers. As an accredited Registered Financial Gerontologist, a good deal of his time is spent on building awareness and educating people of all professions who work with or specialize in the needs, expectations and issues of elders. Comprehensive lifestyle planning is an important element of these processes.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides internal and broker support, including seminars, education, advanced concept illustrations & Client case technical consultations.

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Who may this be for?

Here is one of the many implications of the transition from defined benefit pension plans to defined contribution pension plans and the overall drop in numbers of people covered by any company pension plan. Current and future retirees may no longer be able to rely on a guaranteed retirement pension that provides lifetime income adjusted for inflation and is independent of market performance, interest rates and the general economic environment. Individuals are being handed the responsibility and task of protecting and optimizing their retirement nest egg themselves. In a world where volatility and unpredictability are the new norm, this is a scary task.

There are a lot of people in their 60s and early 70s who have been hurt, financially and emotionally by market performance, and are now fearful of the extreme volatility and uncertainty of the markets. It's a real challenge today trying to find high yield, fixed-income investments for these customers. Bond yields and GICs (Guaranteed Interest Certificates) aren't generating the rates of return necessary to build a retirement asset base and generate sufficient, sustainable income unless you have a very large amount of retirement savings which most investors do not have and cannot accumulate.

When it comes to generating investment income, most clients want a guaranteed floor, where they know what their income is going to be in the future and how it's going to be calculated. Furthermore, given the low interest rate environment, investors are doing the math and realizing interest income isn't enough to generate adequate lifetime income. They also know that investing in equities entails taking risk and potentially losing money. They recognize the need to participate in the equity market as much as possible, to boost income and extend it over the long term. If market performance spikes, these investors value the ability to lock in gains. Guaranteed Withdrawal Benefit plans allow investors the opportunity to do both. They get a 4 or 5% rate of return on their invested principal, added to their income base (depending on their contract) that is used to calculate a guaranteed, lifetime income in years they do not make a withdrawal. Plus they get an exposure to the market if that's what they need and want. They have the flexibility to cash out if that's what they decide they want to do down the road. In summary, these plans are designed for individuals about to retire, in their early retirement years, or who are investing for retirement.

Guaranteed withdrawal benefit plans allow investors the opportunity to generate a contractually guaranteed lifetime income AND participate in the equity market as much as possible to boost their assets and income.

Investors remove certain risks and receive downside protection by repositioning part of their money into products like guaranteed minimum withdrawal benefit plans. A severe market downturn takes on added significance around retirement. Losing value in investments near retirement can be devastating and income could suffer throughout the retirement years. Guaranteed Minimum Withdrawal Benefit Plans are one way of safeguarding investors against market declines and sequence of returns risk.

This type of plan may be suited for supplementing a long-term retirement income portfolio by providing guaranteed retirement income for life. Retirees can benefit from adding this product solution to their portfolios as the guaranteed retirement income for life will help minimize the risk of outliving their retirement income. On the other hand, pre-retirees who are years from retirement can use this plan to grow their savings and protect their capital from the effects of inflation and downward markets. This type of product operates like a pension asset. Pension income acts as a buffer and allows investors to consume more of the balance of their assets or invest it more aggressively to potentially yield higher returns and increase their assets. This may then extend or increase income or cash flow. What's more, it isn't restricted to registered assets. It can effectively be used for non-registered investable assets too. There are some additional advantages to using non-registered funds in a guaranteed minimum withdrawal benefit plan to generate income, namely the way income comes out, primarily capital first and then capital gain. This improves tax efficiency of income.

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