MONEYWISE
FINANCIAL PLANNING

An ARF/Annuity hybrid; a critique

Investment · Pensions · Approved Retirement Funds · Annuities

Introduction

"**ARFs for All**", affording almost universal pension fund access, and contrasting starkly with erstwhile "*compulsory annuity purchase*", serves as a backdrop to this timely initiative on the part of *Canada Life*. Timely inasmuch as interest rates being so low, never has this annuity-purchase compulsion weighed so heavily.

Uppermost in our minds in all of this, it seems, is the attraction that in the new régime, our pension funds don't die with us; a legacy in one form or another is in prospect. But if it is, hand-in-hand with ownership comes responsibility – a combination previously denied.

The initiative comes in the style of an ***ARF/Annuity hybrid*** featuring the security of an *Annuity* in protecting a lifelong income guarantee, and the flexibility and ownership qualities of an *Approved Retirement Fund*.

Akin to all hybrids, there are compromises on either side; for example, the pricing of the guarantee (a lifelong income-stream) is likely to weigh heavily on the size of the residual kitty – in an *ARF legacy* context, and, given *ARF* access and control, the *Annuity* income will be seen to be somewhat foreshortened, compared to a traditional common-or-garden *annuity* model. It stands to reason.

The "***Approved Retirement Fund with lifelong income***" as the hybrid is described, represents an important jig-saw piece in an ever-evolving *retirement finance* landscape – and it if does, it warrants something significantly more than cursory evaluation. This being the case, those having an interest in looking under the bonnet can access a 7-page insight as interpreted by the ***Moneywise ARF and Annuity Bureau –*** in hardcopy, for the asking or ***online*** . . . . Herein is a summary of the salient features in the lengthier narrative.

The ***Moneywise*** take is that, paradoxes notwithstanding, the initiative, in presenting a hybrid option, is ground-breaking, principally on two counts: firstly that it ***invites debate, affords choice*** and ***fosters self-reliance***; secondly and crucially, that ***it affords the luxury of suspending judgement*** (explained below*.) Who in his/her right mind would select year 2012 as the time to retire in an *annuity* setting? What choices have we?

* The "*suspend judgement*" and "*hidden under a bushel*" references have to do with a built-in facility to as regards possible eventual annuity purchase at a more favourable time (see case-study overleaf.)

Paradox parade

Below is a collection some apparent contradictions that envelop the *ARF/Annuity* hybrid offering.

The first is that even allowing that four of the remaining five read negatively, the overall evaluation is positive.

The two more significant ones are that:

(i) despite the attraction in the eyes of a cautious individual of the prospect of an income guaranteed for life, and despite our giving it a thumbs-up on this account, in all probability events will overtake it; it is destined for obsolescence, we believe.

(ii) Its shining light; its redeeming feature, to all but a trained eye, lies hidden under a bushel (as explained below*.)

Here are the others:

(iii) There's a requirement for a somewhat restrictive AMRF (an *Approved Minimum Retirement Fund*) in situations where a retiree doesn't have a guaranteed (*annuity-type*) income of €18,000 p.a. Despite the annuity-dimension to this hybrid instrument, as yet it doesn't satisfy this AMRF requirement.

(iv) Less risk-averse individuals who might be drawn towards the hybrid in a less conservative asset-mix, will be rebuffed by above-average charging structures that can take hold – conceivably by dint of a double-edged lock-in that distort pricing. The very quality that might attract, at once repels.

(v) By same token, the characteristic which, more than any other, will attract the cautious individual – the residue or legacy potential – is likely to be dramatically eroded in a combination charges - such that the conservative growth pattern likely to unfold, impacted-upon by this charging mix, will deliver little if any surplus or residue in the event of survival to any significant degree beyond normal life expectancy.

As description promotional literature tells us:-

"Now for the first time in Ireland, an Approved Retirement Fund is available which allows you to keep control over your investment by providing access to your retirement fund while at the same time allowing you to enjoy the security of a guaranteed income for life.

By providing both security and flexibility the "Canada life Approved Retirement Fund with lifelong income benefit" provides a creative and innovative new retirement option, offering you:

- *A secure, predictable, guaranteed income for life;*
- *Access to your retirement fund when you need it;*
- *A choice of investment options;*
- *The potential for your income to be increased through income 'lock-ins';*
- *A minimum payment on death."*

Taking on the job of independently reviewing this innovative product, the **Moneywise ARF and Annuity Bureau** will say, first and foremost, that with the possible exception of the last-listed bullet point, the product will deliver along these lines . . . and a little more. The "*potential for income to be increased*" may be deemed a bit iffy or speculative; if not, it may be found to be redundant (ref. "*obsolescence*.") The promise of "*minimum payment on death"* may also prove to be fanciful, depending on how events might unfold.

N.B.

Where this summary has generated interest, the invitation is extended to seek-out our more detailed report.

The likelihood or probability of "*obsolescence*", as alluded to, reflects the possibility that events will overtake this model; annuity rates will rise, facilitating a "*jump-ship*" momentum and/or in time, pricing will be seen to be comparatively out-of-sync. But this isn't to say one shouldn't have been there in the first instance.

The luxury that facilitates the "*suspension of judgement*" is common to all ARF situations but then no other ARF comes with "*annuity-type*" income guarantee.

Case study: "*suspending judgement*" – parking retirement kitty in safer-haven closet, very probably to be revisited later.

	€100,000	Initial Fund value
	5.00%	fund growth
	1.25%	Fund management
	1.00%	Gtee charge - on income base
Apr '012	5.0%	imputed drawdown
	4.25%	Income withdrawal percentage
	€36.00	policy fee
	10.0%	Annuity rate @ 75

Yr.	Age	Fund value	withdrawal	Annuity @ 75
1	66	€97,714	€5,000	
2	67	€95,457	€4,886	
4	69	€91,026	€4,661	
6	71	€86,706	€4,443	
8	73	€82,472	€4,250	
10	75	€78,003	€4,250	
Moneywise ARF and Annuity Bureau			€45,399	€7,800

Initial fund €100K: growth 5% p.a., charges 2.25% p.a., draw-down 5% p.a.,: fund value year 10: €78K. *(outgo > income.)*

Annuity rate @ age 75 – combination of natural aging plus inevitable hike in interest rates: 10% p.a., conceivably.

Option presents to risk-averse individual to reverse into a traditional annuity €7,800 p.a. @ 75? (or c. €7,000 p.a. joint)

Overview / verdict?

Who will buy into this hybrid?

Well, for a start, given a choice in the matter, who would buy an annuity at to-day's rates when deferral points to dramatic hike? So, when compared to an annuity, the hybrid makes its mark.

Then there are the risk-averse individuals where the promise of a lifetime income, come what may, will outweigh all other influencing factors, such as pricing.

And who will not buy into it? Probably those of lesser risk-aversion where *cost/benefit analysis* will tilt the balance negatively.

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