Annuities for your retirement

Introduction

This is an introductory guide designed to provide basic information about using annuities for retirement planning.

How much do you need for retirement

In general, a retired individual may need approximately 60% of his/her last drawn salary to maintain his/her existing standard of living during retirement. The Employees Provident Fund (EPF) contribution can be an important source of retirement income but it may not be sufficient to finance your total retirement needs. A survey by EPF showed that about 72% of contributors spent all their savings within three years of withdrawal upon retirement. As such, you may need to supplement your EPF savings. One way of doing this is to use annuities to provide you with a stream of income during your retirement years.

What is an annuity and why do you need one?

An annuity is a contract by which an insurance company agrees to provide a stream of income to someone for life, in exchange for a lump sum payment, or otherwise called premium contribution. This ensures the lump sum that you have is converted into a lifetime income, thus removing the uncertainty and problems that you may face should you outlive your financial resources. You may also purchase an annuity plan that guarantees income payment for your loved ones after your demise.

To purchase an annuity plan, you may pay to an insurance company a lump sum premium just before retirement. Alternatively, you can make periodic premium payments until your selected retirement age. Upon retirement, the insurance company would provide monthly income payments for the rest of your life. You can buy annuities from any life insurance company which offers annuity products

Types of annuity

The common types of annuity plans are:-

Immediate annuity – the income payments begin within 12 months after you buy the annuity. This is suitable for those who are about to retire or have already retired. The premium is paid as a lump sum at the time of purchase.

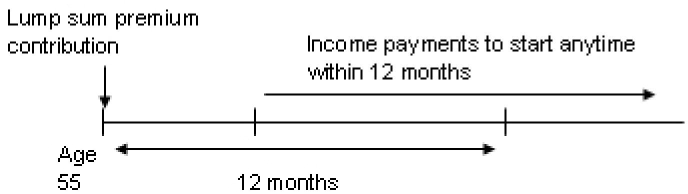

Diagram 1: Immediate Annuity

Deferred annuity – the income payments begin more than 12 months after you buy the annuity. You may buy this type of annuity plans at any time during your working years. The premium can be paid as a lump sum, which will be left to accumulate with the insurance company, or you may make a series of periodic payments up till your retirement.

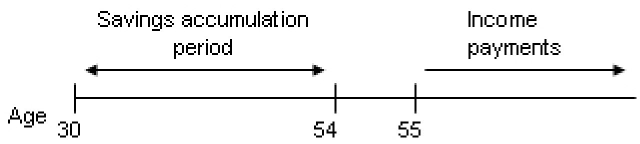

Diagram 2: Deferred Annuity

Example: At the age of 30, you may purchase a deferred annuity that begins income payments at age 55. You can choose to either pay a lump sum premium then or make yearly premium payments until you are 54. The lump sum premium paid at age 30 will be smaller compared with what you have to pay if you purchase an immediate annuity at age 54. This is because the premium paid at age 30 will be invested by the insurance company during the savings accumulation period (refer Diagram 2).

Saving for an annuity

In order to purchase an annuity, you may need to have a savings arrangement that enables you to purchase an immediate annuity upon your retirement. Alternatively, if you want to pay a smaller premium, you may want to consider purchasing a deferred annuity, where the premiums paid earlier in your life will be invested by the insurance company to accumulate the amount needed to provide for your retirement income.

It is advisable to start saving as early as possible during your working years to build enough funds to provide you with a worthwhile income when you retire. For example, if you save RM30.64 per month for 30 years, and assuming an average interest rate of 6% per year, this will give you a lump sum of RM30,000. With this lump sum, you can purchase an immediate annuity that gives you an income of about RM120 per month. If you save RM102.12 per month for 30 years, with the same average interest rate of 6% per year, this will give you a lump sum of RM100,000. With this lump sum, you can purchase an immediate annuity that gives you an income of about RM400 per month.

Note: the above figures are used purely for illustration purposes. The actual premium rates of annuity payment (i.e. the income stream) are subject to changes].

Choosing the right annuity

The type of annuity you choose and its benefits will determine the amount of income you will receive during retirement. It is important to check all the options offered by various insurance companies before you buy the annuity plan that best suits your needs.

The amount of income payment you will receive will depend on:

- the amount you pay to purchase the annuity;
- your age when you purchase annuity and your sex; and
- the benefits options you choose (see below).

You can usually choose to have your income paid every month, every three months, every six months or once a year.

- **Level annuity without guaranteed period** – pays a fixed regular income as long as you live.

- **Level annuity with a guaranteed period** – pays a fixed regular income for the rest of your life, or at least for a guaranteed period.

- Example: A person purchases an annuity with a guaranteed period of 10 years. If he dies after 6 years, the annuity payments will continue to be paid to his beneficiary for the remaining 4 years. If he outlives the guaranteed period of 10 years, he will continue to receive the income payment for as long as he lives.

- **Increasing annuity** – pays an income which increases each year at a specified rate to partially protect your income from inflation, for the rest of your life. With increasing annuity, the starting income is normally lower than you would get from a level annuity, but it will provide you with better income some years later in your retirement period.

- **Joint-life annuity** – pays an income for the rest of your life, and then continues to pay the income to your partner for the rest of his/her life, after your demise. However, income to your partner may be for a reduced amount.

  Example: A joint-life annuity for RM1,000 per month may continue to pay a reduced income of RM500 per month after the demise of the first partner as long as the other partner lives.