INVESTOR'S GUIDE

A guide to the financial markets, investments and the economy

8 July 2019

NICO Asset Managers

"INVEST today for tomorrow "

Topic 317: ANNUITIES

Introduction

This week we will begin a new topic on annuities.

Annuity

An annuity is a contract where an insurance company promises to make payments to a beneficiary over a specified period of time or for life. One of the purposes for an annuity is to make sure a person does not outlive his income.

Phases of an Annuity

Below are the phases of an annuity:

Accumulation or build-up phase: This is a period in which contributions to an investment are made regularly. The longevity of the accumulation period may be specified at the time when an agreement is being signed.

Annuitization phase: This when the insurance company begins making payments to an investor. In the case of a variable annuity, this is when your investment is converted into annuity units, a portion of the investments the annuity holder has made on your behalf.

Payout phase: This is a final phase of an annuity, in which payments are made to you based on your ownership of annuity units. This phase can be short, or very long, depending on several factors including the payout amount, the type of annuity, and the total amount of investment.

Types of Annuities

There are three main types of annuities namely Fixed, Variable and Indexed annuities**.**

Fixed annuity: This type of annuity accumulates interest on the funds deposited into the annuity on a fixed rate basis. Every fixed annuity has a current interest rate and a minimum guaranteed interest rate. The current interest rate will always be equal to or higher than the minimum guaranteed interest rate. Although this varies from company to company and contract to contract, the current interest rate is declared on an annual basis. With a fixed annuity, the insurance company assumes the risk of paying at least the minimum guaranteed interest rate.

Variable annuity: A variable annuity pays varying rates of interest on the funds placed inside the annuity based upon the investment options chosen by the annuity owner. If the investment choices do well, the annuity will do well. If the investment choices do poorly, the annuity will not grow as well or even could lose value. Because the growth of a variable annuity is not guaranteed by the insurance company, the contract holder assumes the risk.

Indexed annuity: Indexed annuities pay an interest rate that is tied to the performance of a common or well-known index. The growth of an indexed annuity is based upon the participation rate of the index it is tied to. Most indexed annuities specify a "floor" that the annuity growth rate cannot go below or offer a minimum interest rate.

However, the most common type of annuity in Malawi is the fixed annuity. An example of an annuity is pension payments. Employees make monthly pension contributions from their salary and this makes their contributions an annuity. Companies like NICO Life Insurance provide such kind of investment vehicles.

Head Office	Lilongwe Branch
19 Glyn Jones Road	Corner Kenyatta Drive
Chibisa House	NICO Centre
P.O. Box 3173	P. O Box 30729
Blantyre	Lilongwe 3
Tel No: 01 832 085/086 Fax: 01 821 617	Tel no: 01 757 086 Fax: 01 751 617

invest@nicoassetmanagers.com | www.nicoassetmanagers.com

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