RETIREMENT PLANNING

Generating Consistent Income

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Your clients are anxious about outliving their retirement savings. **Wayne Miller** and **Jim Lyons** explain how guarantees can complement wealth and ease their minds

As Canada celebrated its 150th birthday this year, consider this: In 1871, just four years after Confederation, 3.6 per cent of the Canadian population was age 65 years or older. The average life expectancy was 40 and only one in three people reached the age of 65. Today, life expectancy is more than 82 years, and nine in 10 people can expect to reach age 65.[1]

Roll the clock ahead to the early 1980s and we see interest rates at an all-time high and a proliferation of defined benefit (DB) pension plans. Canadians looked forward to many years of retirement and were somewhat reassured that their DB pensions, along with Canada Pension Plan (CPP) and Old Age Security (OAS) benefits, would give them peace of mind about their retirement income, especially if their DB pensions were indexed.

Today, as life expectancy has grown, so too has the number of years people are spending in retirement. Longer retirements, in turn, have fuelled the need for more savings. And while Canadians are saving — contributions to registered retirement savings plans (RRSPs) totalled $39.2 billion in 2015[2] — several factors are contributing to an overall uneasiness about retirement readiness. Interest rates are at an all-time low, and in an effort to reduce risk and achieve more cost certainty, employers have gradually shifted away from offering DB plans. Once the cornerstone of working Canadians' retirements, DB plans have largely been abandoned in favour of defined contribution (DC) plans, in which workers bear the investment risk.

But even pension plan coverage as a whole is dropping. The proportion of all employees covered by a registered pension plan (DB and DC) edged down to 37.8 per cent in 2015 from 38.1 per cent in 2014.[3]

This shift in the pension landscape, coupled with volatile markets and prolonged low interest rates, has made retirement planning more challenging than ever.

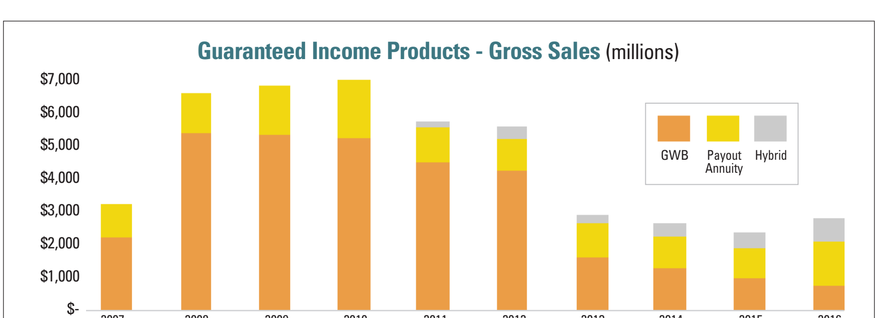
And yet, advisors appear reluctant to have conversations about guaranteed income products, such as segregated fund contracts (also known as guaranteed investment funds) and annuities. In fact, the sale of such products has been on the decline.

Two reasons advisors are reluctant to discuss these guaranteed solutions are the perception these types of products aren't suitable for clients in the current low interest rate environment and faith that the long-term market performance of their clients' investment portfolios will get them adequately through retirement.

It's time to change the conversation.

Your clients may be anxious about running out of money. Wealth insurance solutions have guarantees to create certainty and reduce this anxiety. Clients aren't looking for products, they're looking for peace of mind.

Let's look at the case of Norm and Joyce. Norm and Joyce are both 65, retired, and have combined retirement savings of $600,000. Is this enough for them to retire comfortably? Can Norm or Joyce confidently answer that question without your help?



SOURCE: STRATEGIC INSIGHT

[1] 2016 Census of Population, Statistics Canada.

[2] Registered retirement savings plan contributions, 2015, Statistics Canada.

[3] Pension plans in Canada as of Jan. 1, 2016, Statistics Canada.

Guarantees for Basic Income

One way you can help clients achieve this peace of mind is with a planning model that guarantees a portion of their basic retirement income.

How does it work? Consider these three steps:

1. Help clients divide their expenses into discretionary and basic (i.e., food, shelter, clothing, transportation, tax, healthcare) categories.

2. Deduct existing sources of guaranteed income, such as DB pensions, CPP, and OAS income.

3. Cover the basic income gap — basic expenses minus guaranteed income — with a guaranteed product, such as an annuity or segregated fund contract.

Income Floor

Let's return to the case of Norm and Joyce. After discussing their current and future lifestyle needs, you determine their basic living expenses are $2,500 per month ($30,000 per year). Together, they receive $2,000 per month in CPP and OAS benefits, leaving a basic income gap of $500.

To cover this basic income gap, they can use $115,000 of their retirement savings to buy an annuity that will provide $500 in income per month for the rest of their lives, guaranteed. The annuity begins immediately and continues until the death of the last annuitant.[4]

By way of simple comparison, if Norm and Joyce wanted to generate $500 per month from their $115,000 through market returns, their $115,000 investment would need to earn a 5.2 per cent rate of return each year for the rest of their lives.[5]

For clients, there are multiple choices in the guaranteed income space. Annuities are one option, but segregated fund contracts can also provide guaranteed income for life. To generate the same guaranteed income, the initial investment is typically higher, but the segregated fund contracts come with additional features and benefits. For example, if Norm and Joyce wanted the same $500 per month of income, but wanted greater flexibility and access to their capital in case of an emergency, a segregated fund contract may be a better option. An initial investment of approximately $145,000 into a segregated fund contract with a lifetime income would provide the income Norm and Joyce are looking for, as well as access to their capital if they need it.

By using an annuity or segregated fund contract to create an income floor, Norm and Joyce can rest easy, knowing their basic living expenses are covered.

Who Can Benefit?

Not every client needs a guaranteed income product. Clearly, not everyone will have a basic income gap. For affluent clients, annuities can fill a legacy planning need or help alleviate concerns about covering future healthcare costs. But research indicates some Canadians are concerned about outliving their money — nearly half (48 per cent) of retired Canadians surveyed by Angus Reid are worried about outliving their money, and this anxiety is shared by 74 per cent of those surveyed who are not yet retired.[6]

What's more, Canadians recognize the importance of guarantees. Research suggests 98 per cent feel it's very or somewhat important that some of their retirement income is guaranteed, no matter how long they live in retirement.[7]

Financial literacy levels also add to retirement anxiety. Members of DB plans benefit from professional investment management and oversight. In a DC world with no guarantees, the onus is on the plan member to ensure adequate investment returns. How do they do this? They can conduct their own time-consuming research. Or they can work with an advisor. Advisors are a big part of the solution to closing the financial literacy gap and helping clients reduce their anxiety about outliving their retirement savings.

Action Plan

For advisors, annuities offer upfront compensation. Other guaranteed products, such as segregated fund contracts, offer more flexibility than ever before, with features such as inflation protection and pension-style investment management.

But our behaviour is often governed by inertia. We're comfortable sticking with what we know. The challenge — and opportunity — is for advisors to approach their conversations with clients in a different way. With the breadth of guaranteed products on the market today, you can — and should — mix and match products to build solutions that meet client needs.

Of course, you'll have to make assumptions and projections over an extended period of time. But by looking in detail at clients' use of personal savings and pension benefits, you can help them assess their retirement income needs. This will involve a combination of strategies, tools, and products. It's not simple. But the last thing you want is for your client to retire into a situation where their income doesn't match their long-term spending.

By including guaranteed products, you can help your clients develop a customized plan that meets their personal objectives, respects their risk tolerance, and provides the following key benefits:

Peace of mind: clients have income for life, without having to worry about investment risk or ongoing investment and management decisions.

Flexibility: guaranteed investment funds provide many options, including guaranteed periods, inflation protection with indexed rates, and single- or joint-life contracts.

Simplicity: annuities are a single cash premium for clients, with no ongoing investment decisions, benefitting both clients and advisors.

Security: guaranteeing a portion of your clients' basic income is part of an integrated strategy to convert clients' retirement assets into the guaranteed stream of income they'll need to enjoy retirement.

Stability: market volatility doesn't affect guaranteed income, an important reason segregated fund contracts can be an attractive retirement income option.

Sustainability: clients won't run out of money to cover their basic needs in retirement.

As an advisor, you can reduce clients' anxiety about longevity and market risk by bringing a combination of wealth products that provide guarantees and the potential for growth to their retirement portfolios.

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[4] *Assumes a joint last-to-die policy, with 15-year guarantee period. Illustration run September 2017.*

[5] *$500 in monthly income = $6,000/year. ($6,000/$115,000) x 100 = 5.2%.*

[6] *Retirement in Canada: Lots to enjoy about 'golden years' but financial worries loom large — especially for those still working, Angus Reid, 2015.*

[7] *Sun Life Financial Unretirement Index, 2015.*