Manulife Investments

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Money in, money out

Developing a retirement income plan

Amy is 64 years old, and she hopes to stop working at 65. With retirement just one year away, she is giving serious thought to how she will balance her income and expenses in the future. Alfred, her financial advisor, has helped her accumulate a comfortable nest egg. Now she needs advice on how to turn her retirement savings into retirement income.

As a first step, Alfred asks Amy to complete a simple worksheet that encourages her to think about how much money she'll need in retirement. The worksheet has space for her to list all her expenses in two categories: essential and lifestyle. For the essential expenses section, Alfred advises Amy to carefully consider the expenses that will change in retirement. For example, compared to her current expenses, she can allot less to transportation because she won't be commuting to work every day. On the other hand, her retirement benefits from her employer don't include health care, so she will need to include an amount for health insurance. Alfred also reminds Amy that she should consider the effects of inflation on both her essential and lifestyle expenses.

Amy finds the lifestyle expenses section more challenging to complete – but also very satisfying, because it forces her to think hard about what she wants to do and how she wants to live in retirement.

In the end, Amy's expense worksheet looks like this:

Essential expenses per month	
Housing – rent	$900
Utilities	$300
Food	$300
Transportation	$675
Health insurance	$255
Total monthly essential expenses	**$2,430**
Lifestyle expenses per month	
Clothing	$100
Entertainment	$300
Travel/vacation	$200
Estate transfer	$0
Gifts (including charitable)	$35
Other	$0
Total monthly lifestyle expenses	**$635**
TOTAL MONTHLY EXPENSES	**$3,065**

After Amy has completed her expense worksheet, Alfred invites her to his office to talk about the next step: identifying the sources of her retirement income and determining how best to use her investments to cover her expenses.

Amy will qualify for Canada Pension Plan (CPP) and Old Age Security (OAS) benefits and she has a defined benefit pension plan with her employer. Amy also holds approximately $100,000 in registered investments and $50,000 in non-registered investments. She plans to put her house, valued at $200,000, up for sale so she can downsize to an apartment in a retirement complex.

Alfred and Amy record these sources of income on the income worksheet:

Monthly income guaranteed for life	
CPP	$833
OAS	$487
Employer pension (indexed to inflation)	$1,020
Total monthly guaranteed income	**$2,340**
Other income	
RRSP	$100,000
Locked-in retirement account (LIRA)	$0
Non-registered investments	$50,000
House	$200,000
Total other income	**$350,000**

Now it's time for Alfred to help Amy decide the best way to invest her portfolio to support her retirement.

BRIDGING THE EXPENSE GAP

When Alfred and Amy compare the income worksheet to the expenses worksheet, they realize that Amy's guaranteed income won't be quite enough to cover her essential expenses. Amy is very worried about this "expense gap," especially because her mother and grandmother both lived into their 90s so she feels there is a real danger that she'll outlive her savings. Alfred suggests that she bridge the gap with an annuity to ensure she always has enough money to cover those essential expenses.

Amy decides to put aside $47,000[1] from her registered investments to purchase a life annuity that will generate a set amount of guaranteed payments for the rest of her life. She also decides she will "index" the annuity so the payments increase by a set amount each year – in her case, three per cent – to help her annuity income keep up with inflation.

LOOKING AFTER THE BALANCE OF THE PORTFOLIO

Now that they have taken care of the essential expenses, Alfred and Amy start looking at how to fund her lifestyle expenses.

Alfred explains there are three key retirement risks:

- Outliving savings
- Inflation eroding savings
- Losing money to the markets

Outliving savings and inflation eroding savings seem clear enough to Amy, but she asks Alfred to tell her



more about the risk of losing money to the markets. Alfred explains that a market downturn, especially early in Amy's retirement, will make it hard for her non-guaranteed investments to recover. This has the potential to seriously affect the amount of income she can withdraw without exhausting her assets while she is alive.

For example, if Amy withdraws five per cent of her registered savings in a given year and her investments return eight per cent that same year, then Amy's asset base will grow by three per cent.[2] She can choose to reduce her withdrawal percentage and save the growth for a rainy day, or she can choose to leave her withdrawal rate unchanged and increase her income. If, however, her investments lost two per cent in that year, instead of gaining eight per cent, Amy's assets would shrink by seven per cent, leaving her with a smaller asset base from which to withdraw her five per cent in future years.

Amy wants to make the most of her retirement savings by participating in the markets. However, she feels she cannot deal with the uncertainty of losing money and the effect this will have on the retirement lifestyle she has saved and planned for.

Alfred assures Amy there is a solution. He introduces her to a new type of income guarantee, available on some segregated funds, called the Guaranteed Minimum Withdrawal Benefit (GMWB). He explains that GMWBs, which are exploding in popularity in the United States and are now available in Canada, can help Amy address many of the retirement risks, including market risk. They ensure that Amy will get back all of her principal in the form of regular payments. These payments will be made for a minimum of 20 years and provide a guaranteed minimum income with the potential to increase if the markets do well.[3] Amy is guaranteed not to lose any of the money she invests and her income will continue even if the market value of her investments drops to zero.

While GMWBs aren't indexed to inflation like her pension and annuity, she will have the opportunity to do better than the rate of inflation by participating in the markets. Alfred suggests a balanced portfolio under a GMWB option.

Alfred adds that, on top of the potential growth of assets and income, segregated funds with GMWBs also offer Amy control over her investments – a feature that is not available with her annuity or pension assets. Amy can allocate her money in a range of vehicles, from money market to growth funds, giving her the opportunity to participate in the upside potential of the market, while protecting her from the downside risk by guaranteeing a minimum income. She will also have access to the market value of her portfolio if she needs to make an unexpected withdrawal. As an added feature, as with any segregated fund, Amy can enjoy potential creditor protection and estate planning benefits.

BUILDING A MORE SECURE FUTURE

Amy decides she'll invest $200,000 from the sale of her house to purchase a balanced segregated fund with a GMWB. She feels confident enough in this new option to convert her RRSP to a RRIF and invest these proceeds in a balanced segregated fund with a GMWB as well.

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Amy's sources of income, after these decisions, look like this:	
Monthly income guaranteed for life	
CPP	$833
OAS	$487
Employer pension (indexed to inflation)	$1,020
Registered annuity	$200
Total monthly guaranteed income	**$2,540**
Other monthly income	
$200,000 segregated fund contract with a GMWB and allocate the deposit to a balanced portfolio[4]	$833
$50,000 non-registered 10-year GIC ladder[5]	$163
$53,000 RRIF balanced segregated fund with GMWB and allocate the deposit to a balanced portfolio[4]	$221
Total other income	**$1,217**
Total monthly income	**$3,757**
Total annual income	**$45,084**
Annual tax (approximate)	**$6,700**
Annual income after tax	**$38,386**

With her essential expenses covered by her life annuity, government and employer pensions, and her lifestyle expenses covered for at least 20 years thanks to GMWBs, Amy then decides she will invest her non-registered portfolio in a 10 year GIC ladder to protect her capital and provide her with annual access to her capital that she may choose to spend or reinvest for future years.

Amy feels confident she has a plan that will leave her financially secure so she can enjoy her retirement.

[1] Assumes single life, female aged 65, three-year guarantee, indexed at three per cent.

[2] Rate of return is for illustration purposes only.

[3] Provided withdrawal thresholds are not exceeded.

[4] Assumes a minimum GMWB with five per cent payout.

[5] Assumes an initial compound interest rate of 3.90 per cent each year.

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