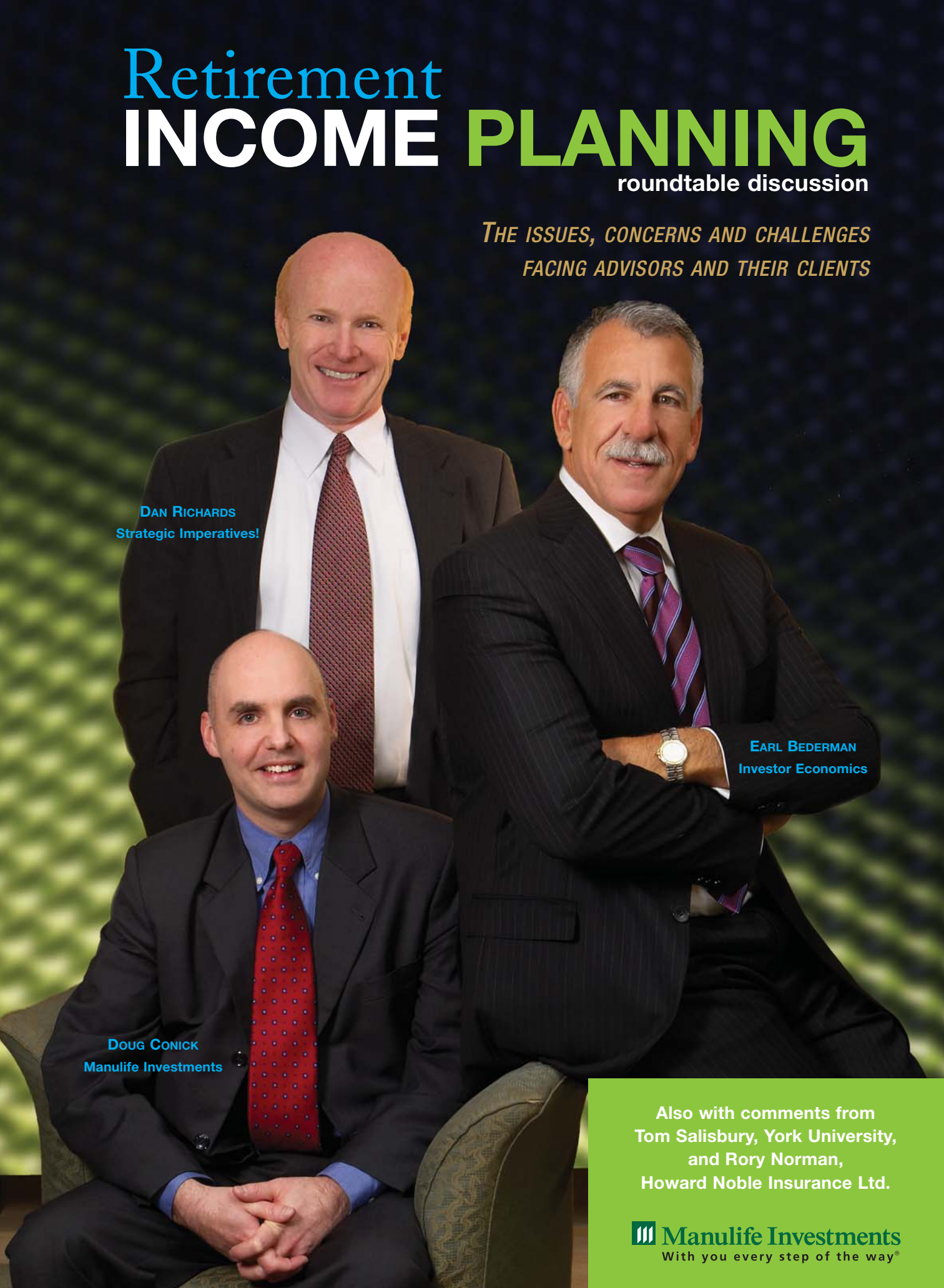


Retirement **INCOME PLANNING**

roundtable discussion

*THE ISSUES, CONCERNS AND CHALLENGES
FACING ADVISORS AND THEIR CLIENTS*



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Strategic Imperatives!

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Also with comments from
Tom Salisbury, York University,
and Rory Norman,
Howard Noble Insurance Ltd.

 **Manulife Investments**
With you every step of the way®

Participants

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Retirement planning has always been a cornerstone of every advisor's business, but as Canadian baby boomers actually head into retirement, it has started to take on new importance. Research shows that the two biggest retirement issues advisors are facing with their clients is saving for retirement and generating income in retirement.

To explore the challenges around retirement, Manulife Investments sponsored a roundtable (January 22, in Toronto) of industry experts who addressed the topic of income planning. These experts discussed the challenges and concerns facing pre-retirees, investment risks (both pre- and post-retirement), misconceptions about retirement, and what advisors need to do in order to continue to add value.

Some of the advice they have for advisors may surprise you. By looking at current trends and forecasting the investment reality for future retirees, our experts give detailed analyses about product structure, necessary changes in the investment advisor business model, and what investment firms and product manufacturers must do in order to support advisors with the impending boom of retired client needs.

What are the issues, concerns, and challenges facing pre-retirees?

Tom Salisbury: There are a couple of reasons that the situation facing investors and retirees today is perhaps a little different from what it's been in the past. There's been a movement from defined benefit pension plans (where basically the stream of income an employee is going to get throughout retirement is completely predictable) to plans that are much more dependent on decisions employees make. Therefore, while employees have more control over their own funds, they also carry more investment risk. In the past, many risks were borne by their company pension fund, but now more people are facing these risks on their own. Among other challenges is that mortality has improved and people are living longer than they once did. Therefore, retirees

need to be thinking about the possibility that they will actually outlive their money. For instance, a married couple aged 65 today has more than a 40% chance that at least one of them will live to be over 90. The issue of longevity has become a very important issue.

Dan Richards: While we cannot make absolute generalizations, as a general rule the single biggest change relates to focus. For a growing number of affluent middle- and upper-class Canadians, the issue is not will I live into my 80s; the question now is how will I live in my 80s or what kind of a life am I going to have? Unlike the current generation of retirees, it becomes more of an issue of quality of life rather than length of life. The other issue is how demanding boomers are and their sense of entitlement. Frankly, the real challenge for the

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healthcare system is only in part due to the aging population; it's also due to the baby boomer attitude among retirees who tend to be more assertive and skeptical of institutions. We're heading to a conflict between what people want, what they think they're entitled to and the reality of what's going to be available.

Earl Bederman: While attitudes about retirement obviously are undergoing change, the definition of retirement is changing as well. Some people who are retiring in a formal way are coming back into the workforce and doing other things. This is a byproduct of the changing demographics and attitudes, longer life expectancy, and the need for individuals in the workforce who have experience. The system is adjusting to all of that. In terms of attitudes, baby boomers, unlike previous generations, have been accustomed to very different kinds of financial and investing behaviour, including taking on debt. We need to take those behavioural aspects into account as we try to figure out how we're going to respond to their needs in the future.

What are some common retirement misconceptions that advisors need to be familiar with?

Dan Richards: Let's start with how much people will need in retirement. Does the rule of thumb of 70% of pre-retirement income apply? Last fall, we surveyed affluent retirees on behalf of Manulife — 50- to 70-year-olds who had at least a quarter of a million dollars. When we talked to them about how much they were spending compared to what they spent before retirement, most of them said they were spending as much, a little bit less, or in some cases a little bit more. A second misconception relates to what people will be doing in retirement. We asked affluent retirees how much time they were spending in ten different areas compared to how much they had expected they would before retiring. In general they were spending about as much or more time as expected — with the two exceptions of spending winter down south and travelling. Interestingly, the two areas that retirees were spending less time and

money than anticipated were the same ones that many cite as their top priority pre-retirement: to travel and spend winters down south. In some cases, people run into health issues. But in other instances, the vision that people had of enjoying a life of leisure and travel often doesn't kick in. Once they've done it once or twice, many retirees find that spending five months in Florida is about three months more than they want to. There's also this fantasy that we're going to continue to be as healthy and as active at age 70 and 80 as we were at age 50 and 60 and the reality is that, while we can certainly mitigate some health risks through exercise and nutrition, time does march on.

We've had a number of conversations around the desire to work part-time. But when people talk about part-time, they're talking about doing interesting, fairly lucrative work such as teaching, consulting and so on, and those opportunities are hard to come by. We may be on the way to a real imbalance between supply and demand when it comes to lucrative work opportunities for retirees.

The final misconception revolves around risk. I think certainly pre-retirees have become much more attuned to risk, investing in the stock market and the whole investor experience, but our survey shows that there is still a real disconnect between the level of risk that people think they're taking and what they're really taking. A common refrain is that "I'm a conservative investor and am not taking significant risks in my investments, because I don't own tech stocks, I only own blue chip stocks, the banks and so on." Many of these

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investors will be in for an unpleasant surprise at some point.

Tom Salisbury: There's a general principle that people are not always very good at estimating risk. People tend to underestimate risk with things they are familiar with and perhaps overestimate some risks with which they're not familiar. So in an era where people don't have defined benefit plans to look after them and they're basically responsible for managing their risks themselves, it becomes problematic for people who are not accustomed to comparing a variety of different risks. Financial advisors are in a good position to try and help them compare risks, get good estimates of what these risks are, and to influence decisions people are making.

Earl Bederman: Advisors need to be able to deal with the fact that investors have a difficult time accepting risk as part of their retirement investing. Part of that stems from the fact that for a long period of time, Canadians were rewarded for

not taking risk. We had periods of enormously high real rates of interest and many people became conditioned in their behaviour around return and risk issues that created all kinds of distortions in their behaviour. It's going to take a long time to sort those out.

What should advisors be doing with regards to addressing some of these misconceptions? Or what are they not doing?

Dan Richards: More and more, Canadians need and want financial advisors who can give them more overall assistance on their financial situations. Often, the most important role for a financial advisor is to be an emotional anchor and a voice of reality to prevent the highs from being too high and the lows too low. Advisors must also introduce issues of lifespan, lifestyle expectations, realistic costs, expected income after retirement, and how much risk and volatility investors are going to have to encounter. These are hard conversations to have, but it's imper-

ative because if a financial advisor isn't going to introduce this reality check with a client, then who is?

Tom Salisbury: The kind of advice people are looking for changes around the time they retire. Prior to retirement, people may have a variety of different investment accounts and get advice from a variety of different people. As people move toward taking retirement income, however, there's a tendency to combine accounts and move to getting advice from a single advisor. And so that advice has to be focused not so much on returns but giving much more of the big picture, much more of how does this investment fit with your lifestyle goals, and with what you plan on doing with the money that you're earning. It becomes a broader kind of advice.

What is the difference between retirement planning and retirement income planning and how does planning shift accordingly? What are investors asking for?

Tom Salisbury: In retirement planning, you're accumulating wealth — you're trying to build up the nest egg that you're going to depend on in retirement. With income planning in retirement, you have to think about other questions about how you go about withdrawing money and many of those questions are quite different and difficult. That's the point at which you really start having to think about what is the risk that I'm going to live a long time and perhaps outlive my money. Throwing in other factors: What do I do with my money? Do I put it in

an annuity? There are tradeoffs. There's no one solution that's going to fit everybody. Traditionally, there's this attitude that when you move from accumulation of wealth in your retirement portfolio to actually drawing on income, there's a shift from risky investments to fixed-income investments. That's not necessarily a wise move. When you move into fixed income, it's true that things become predictable but, if you happen to live a long time, maybe that income stream isn't going to be sufficient to maintain the lifestyle that you want. So a whole variety of different issues need to be addressed: What kind of downward movement in the market can you actually sustain now that you're drawing on income? What kind of liquidity and what kind of bequest do you want to leave behind? How are you going to deal with the fact that you have a substantial probability of living to be age 90 or 95?

Doug Conick: Based on research we commissioned last year, the retirement planning phase is about asset allocation; whereas the income phase is more about product allocation. There's a fundamental difference: Asset allocation is about putting the right amount of assets in certain risk categories — a portion that's higher-risk depending on your age and your objectives and allocating a piece to more conservative investments and then generating a return to accumulate wealth. Product allocation has more to do with selecting the right mix of products that you need in order to generate income and allow you to access capital at retirement in an efficient manner.

What factors should be considered when assessing client needs?

Dan Richards: The real question for many clients today is not how much risk do you want to take, it's how much risk do you need to take. The only way you really get at that is by going through the planning process — which, at its core, is about making tradeoffs. Very often, when you go through the plan output in terms of where a client wants to be in terms of lifestyle and age of retirement and so on versus what they are likely to be able to afford, you see a disconnect. It's at this point where the advisor brings true value by saying, "You're facing a likely gap so let's talk about the options and alternatives to close the gap." With greater longevity, advisors must also help many clients understand that they are going to need higher returns and thus have to accept volatility in their investments, not just before their retirement but also after retirement in a way that it has not been the case historically.

Tom Salisbury: There always are tradeoffs. When identifying the right behaviour for an individual or a couple, it very much comes down to identifying the alternatives and the risks associated with them. There are some cases when it's clear what people should do, like buying an annuity or relying on an already established large investment portfolio. But most people that advisors are likely to run into don't fall into those simple categories. This is where advisors could really add value to their clients — especially when they're coming face-to-face with tradeoffs.

Doug Conick: Advisors have a value-creating role to play in managing behaviour and making sure that clients understand the sort of risk they need to take in order to generate income over a long retirement. You need to be able to do that through a good planning process, but also you need some enabling product solutions. One of our new products, IncomePlus, a Guaranteed Minimum Withdrawal Benefit product, has a downside protection element added to its structure that effectively allows the client to more comfortably take on an appropriate level of market exposure and risk, because the client can have downside protection and guaranteed income. And it's a way for an advisor and a client to set up a portfolio or at least a piece of a portfolio for those years where they need to take income and systematically start to draw down on capital.

Rory Norman: There are three key areas: How they intend to live (lifestyle); what they want to leave behind when they die (estate plans); and the resources they have to meet those goals (financial). In lifestyle, it is becoming increasingly important to recognize that for most retirement is a multi-stage process. People may start out retiring "part-time" and still have some employment income. Some travel for a good part of the year but stop because their excitement or health declines and become homebodies. The notion that you can predict retirement income needs by assuming some percentage of pre-retirement income at a fixed retirement age, which then escalates with inflation, is naive. Estate plans are getting more complex too.

Doug Conick
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Individual Wealth Management
Manulife Investments



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A surprising number of our clients are in non-traditional family circumstances at some time during retirement. For instance, couples who have remarried after the death of their first spouses, who each have their own assets. They want to share expenses during their lifetime and provide some help to their partner if they die first. But, ultimately, they want their assets to go to their own children, not the spouse and certainly not their spouse's children. When looking at resources, it is especially important to think about emergency and catastrophe needs and how they have been looked after. Things like critical illness and long-term care policies make an enormous difference in how you plan for income needs. Likewise, the planning is very different for the client who has little likelihood of exhausting their assets before age 100 compared to those who need a run of good luck to get their assets to last past age 85.

How can advisors adjust their practices to serve the diverse needs of pre-retirees?

Dan Richards: One of the big buzzwords in the financial industry today is wealth management — defined generally as providing a comprehensive and integrated approach to help clients manage their whole financial picture including tax, insurance, cash flow and estate planning issues. In some cases, that could also include charitable giving. If an advisor focuses on a mid-market client base, this may not be an issue; but once you're targeting million-dollar-plus clients, this becomes relevant. That typically takes a lot more support than most advisors currently have. Advisors are going to have to get their heads around how they can provide wealth management as a service to clients.

The other thing is that when it comes to investment alternatives we're moving out of an either/or

environment where you can have upside return or you can have safety; you could have flexibility or you could have predictability. Today, Canadians want both! Financial engineering is creating all kinds of new alternatives to address that desire that didn't exist five years ago and there's going to be more and more going forward. To this point, many of these products have been loaded with costs, which are good for manufacturers, distributors, and advisors, but not always clients. With competition, costs will inevitably come down, so that these will become more interesting alternatives for many investors. Because of this product influx, advisors will be faced with more complex decisions when sorting through solutions and, realistically, it will be a struggle for them to get a good understanding of all the alternatives available. Consequently, there's more pressure on their firms to provide more due diligence. In other cases, some advisors may strike a level of comfort with a manufacturer or a couple of manufacturers.

Rory Norman: The first thing advisors must recognize is that investment planning just doesn't cut it for this generation of retirees. You have to dig a lot deeper if you are going to meet their needs. It is not just about the numbers anymore. The trusted advisor is going to be able and willing to deal with the whole person. Next, I would say that risk management is a lot more critical for retirees than it is for people who are working. That includes the traditional insurance and estate planning. But it also includes managing risks like having to sell assets when prices are depressed. That is something that

specialist retirement planners have been preaching for years but now we have sources giving us more ideas and products targeted for these problems.

Earl Bederman: Part of the challenge around advice and providing good advice is that many advice givers are focused exclusively on only one component of a household's overall wealth picture, which is helping clients to manage their financial assets. But the totality of accumulating wealth is about bigger things than that. Housing has become a very large factor and has become a substitute for investment — one that has paid off in major ways. So a big part of the asset structure of households is in the area where most financial advisors are locked out — unless they're providing holistic advice. Part of the challenge for financial advisors is being fixated only on the part that they're being remunerated on or engaged to look after; whereas, the needs of households, if they want to succeed in accumulating wealth in preparation for retirement, must look more broadly at those bigger issues.

How will all this impact an advisor's business model?

Rory Norman: Advisors must realize that this is a much more hands-on business than it is when you are serving people who are accumulating assets. You have to spend a lot more time with each client and expertise really matters. Part-time advisors who do not want to spend the time to get to and stay at the leading edge of this business can cause significantly more harm to a retiree than they can for the typical 25-year-old client. So if you want to be in this business,

be prepared to swim in the deep end. You also have to consider how you are going to get paid. This is a service business more than a sales business and the traditional trailer probably will not cover your ongoing time commitment to these clients. Fee-based models probably work a lot better and if that is not the model you are following now, you probably want to start transitioning these clients well before they actually retire. Finally, consider getting your Elder Planner Councillor (EPC) designation and building your network with other professionals who are very involved with this market. There are lots of opportunities to refer business both ways and dialoguing with these colleagues will help sensitize you to the issues and help you provide a better level of service.

Doug Conick: Holistic planning takes more time. The big issue is how and what's needed on the part of an advisor to do an efficient job and spend the right amount of time with one client who has smaller account size versus another client with a bigger account size. What may happen is indeed there will be pressure on the advisors' own firms to provide support but I did want to emphasize the fact that there will likely be more pressure on the part

of manufacturers to provide tools, support, and training to advisors to help them do this. In a sense, that's an area of opportunity for manufacturers of products to help the advisor in that respect. And since advisors often have very good contacts with tax consultants, lawyers, and accountants, pulling together a team or support network to provide a solution is something that's going to become more important.

Dan Richards: Going forward, I believe you're going to see significantly fewer advisors operating as self-employed entrepreneurs; compliance issues and the cost of doing business will require a bigger and bigger asset base to operate. In some cases firms are driving the need for a bigger asset base through their payout structure. As a result, an increasing number of advisors are going to be junior partners or quasi-employees, working as part of a larger group and you're going to get more work delegated to lower-cost staff doing routine client service or para planning. Where I hope we don't end up is in a situation where an advisor thinks he or she must sell an insurance policy or some other type of investment in order to get compensated for spending more time with a particular client.

The notion that you can predict retirement income needs by assuming some percentage of pre-retirement income at a fixed retirement age, which then escalates with inflation is naive.

Rory Norman, Noble Financial

Earl Bederman
President, Investor Economics



One of the investing trends that will become increasingly more important, and is also visible today, is tax efficiency.

Earl Bederman: Advisors need to pay attention to changes in the regulatory environment. We can reasonably expect that the trend toward regulation is going to increase and it's going to change over time. Regulation around disclosure — of performance, costs, and added value of providers of financial services — is an increasingly important consideration.

Based on investor need, what are the emerging trends in investing?

Earl Bederman: Over the next 10 years, household investment priorities are going to be shaped by some basic realities of inflation, interest rates, demographics, and the overall performance of the economy, which drives the growth of household incomes. Into the longer-term future, the key is what inflation and interest rates are going to look like. These are the key factors that will drive the performance of long-term financial assets that households will need to own in order to accumulate wealth. At post-retirement age — the exit ramp of the tax-deferred highway — we start moving, whether we like it or not, into a world that is taxable. So one of the trends

that will become increasingly more important, and is also visible today, is tax efficiency.

Tom Salisbury: There are going to be more complex products coming to market, things tailored to particular investment objectives that combine downside protection with equity participation, withdrawal benefits or income benefits. One of the things that have happened in the U.S. is the appearance of products that guarantee the initial investment, and guarantee that an income stream will persist for life. We've seen the blending of annuities with these kinds of protected equity products and we're going to see more of that in Canada.

Dan Richards: We're seeing more innovation in lots of different areas — product innovation will be more and more a way of the world going forward. Where I believe there is going to be some especially dramatic innovation is on the insurance side. If you talk to affluent early-retirees, their number one financial concern by a very large margin is healthcare and our healthcare system. So there's going to be more interest and appetite for priva-

tized alternatives to supplement the healthcare system — particularly critical care and long-term care, as well as insurance that gives Canadians the ability to access treatment in the U.S., Europe or anywhere else in the world. Another source of innovation will be around methods to access home equity. While reverse mortgages really haven't found traction here in Canada, we will see innovation around mortgages and a dramatic increase in the range of alternatives that are client-friendly and respond to investor needs in extracting the value they've built up in their homes.

Doug Conick: We're going to continue with this wave toward insurance — the blending of financial and insurance products. We recently launched a guaranteed minimum withdrawal benefit product and we're certain that we're going to see further product development in that vein. There may be opportunities in the future to start merging things like long-term care and critical-illness products into what would traditionally be classified as an investment or a wealth management product because not only is there the need for coverage, the funding of that coverage now is different. You're not funding your coverage through employment earnings — you are having to fund certain coverages through your nest egg. ●

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