CAUTION! MAY CONTAIN NUTS

Accumulation and Retirement
Principles that may not work in Decumulation

Peter Wouters
Director, Tax & Estate Planning
May 2014

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AGENDA

- Major Accumulation Principles
- Accumulation vs. Decumulation
- Retirement Rules of Thumb
- Alternative Considerations

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COMPLEX REALITIES

- Outliving savings
- Erosion of purchasing power
- Prolonged, debilitating personal/family illness, disability

capital accumulation vs. income generation and estate preservation

The Retiree’s dilemma

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RETIREMENT INCOME MARKET

Not a priority for most advisors with most clients

- Negative cash flow
- Limited growth potential
- Time consuming
- Process vs. transaction and event
- Complex if done properly

70% investable assets in hands of retirees or near retirees in 5 years *(Source: McKinsey & Company, 2013)*

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THE OPPORTUNITY

63% of pre-retirees and **69%** of retirees with **detailed retirement income plans** were **"very satisfied"** with their advisers.

"very satisfied" clients and **asset consolidation** with their primary adviser:

Pre-retirees **72%** and Retirees **81%** of assets

Source: Fidelity Advisor Survey of Investors at Retirement, Investment News 2011

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WHY THE OPPORTUNITY IS SO GREAT!

Consumers are …

1

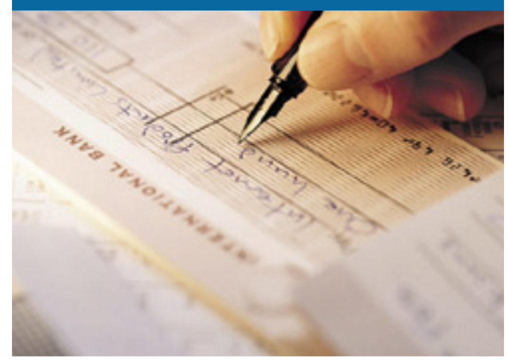
Ineptly advised

2

Under serviced

3

Over charged



Improving any or all of these factors **will bring business** and referrals

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THE OPPORTUNITY

81% of surveyed pre-retirees and retirees who work with advisors **felt having a detailed retirement income plan was very important.**

18% actually had one. About **½ showed them how to proceed** with their retirement plans.

Source: Want to retain retiree clients? Put Their Retirement Income Plan on Paper June 2011 (Investment News)

RULES OF THUMB

- Origin
- Appropriateness;
  - then and now

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ACCUMULATION
DIFFERENT FROM
DECUMULATION

THE UNCONTROLLABLE FACTOR

ACCUMULATING MONEY – 3 THINGS YOU NEED

Dollars Time Rate of return

Focus and control?

MORE ON RATE OF RETURN

The biggest number?

- Generally: bigger number → bigger risk
- Gross, after tax, reportable, most probable, predictable?

- **Match needs to plans**
- **Document**

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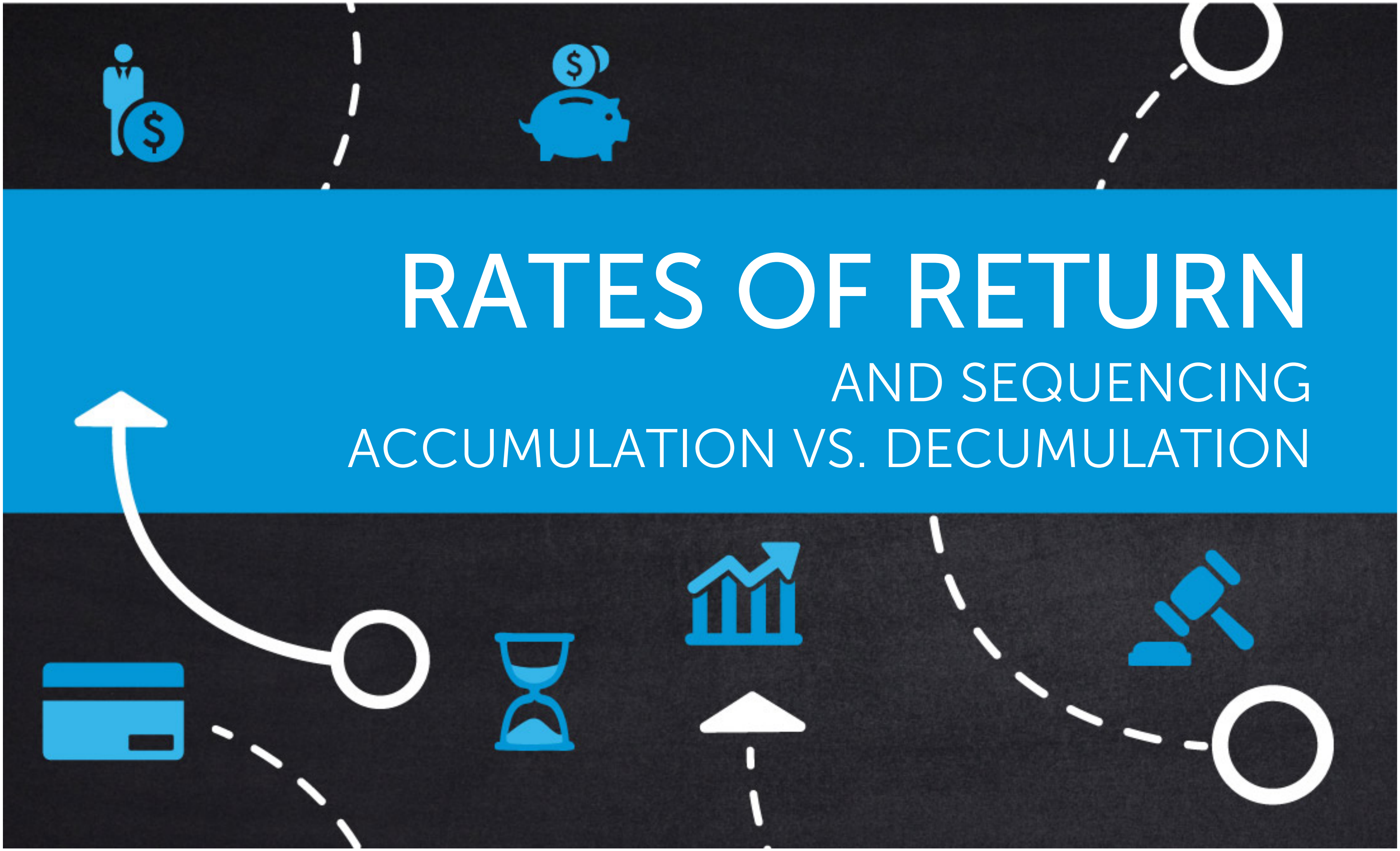
RATES OF RETURN
AND SEQUENCING
ACCUMULATION VS. DECUMULATION

CONSISTENCY VS. OCCASIONAL BRILLIANCE INVESTING $100,000

Year	Scenario #1	Scenario #2
1	+20%	+8%
2	+21%	+8%
3	+10%	+8%
4	- 16%	+8%
5	+12%	+8%
6	- 2%	+8%
7	+22%	+8%
8	- 6%	+8%
9	+11%	+8%
10	+15%	+8%
	$215,571	$215,892

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RATE OF RETURN AND IMPACT ON ACCUMULATION VS. WITHDRAWAL

Year:	1	2	3	4	5	6	7	8	9	10	Average Return	Acc. Value	
A	7	7	7	7	7	7	7	7	7	7	7%	$196,715	
B	9.4	14	13	23	-4	10	-1	21	-4	-7	7%	$196,715	
C	-7	-4	21	-1	10	-4	23	13	14	9.4	7%	$196,715	

Assuming: $100,000 deposit for accumulation comparison
$ 100,000 starting balance for withdrawals
$ 7,000 annual withdrawal for withdrawal comparison

WHEN DID YOU GET ON RATE OF RETURN CYCLE?

Return Sequence (repeated)	Ruin Age	+/- Months
+7%, +7%, +7%...	86.50	
+7%, -13%, +27%...	83.33	-38
+7%, +27%, -13%...	89.50	+36
-13%, +7%, +27%...	81.08	-65
+27%, +7%, -13%...	94.92	+101

14 yrs.

Assuming $9000 annualized spending/withdrawal beginning age 65

Source: **Retirement Ruin and the Sequencing of Returns** Moshe Milevsky

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LIFE EXPECTANCY

HOW LONG INCOME NEEDS TO LAST

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OUTLIVING RETIREMENT SAVINGS

The probability of a relatively healthy 65-year-old living to:

Age	Male	Female
70	93%	96%
80	71%	81%
90	33%	44%
95	16%	23%

*Source – Annuity 2000 Mortality Table, Society of Actuaries

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HOW MUCH IS ENOUGH?

- The number
- Income focused
- The missing link

PROJECTING RETIREMENT INCOME

AND THE REALITY GAP

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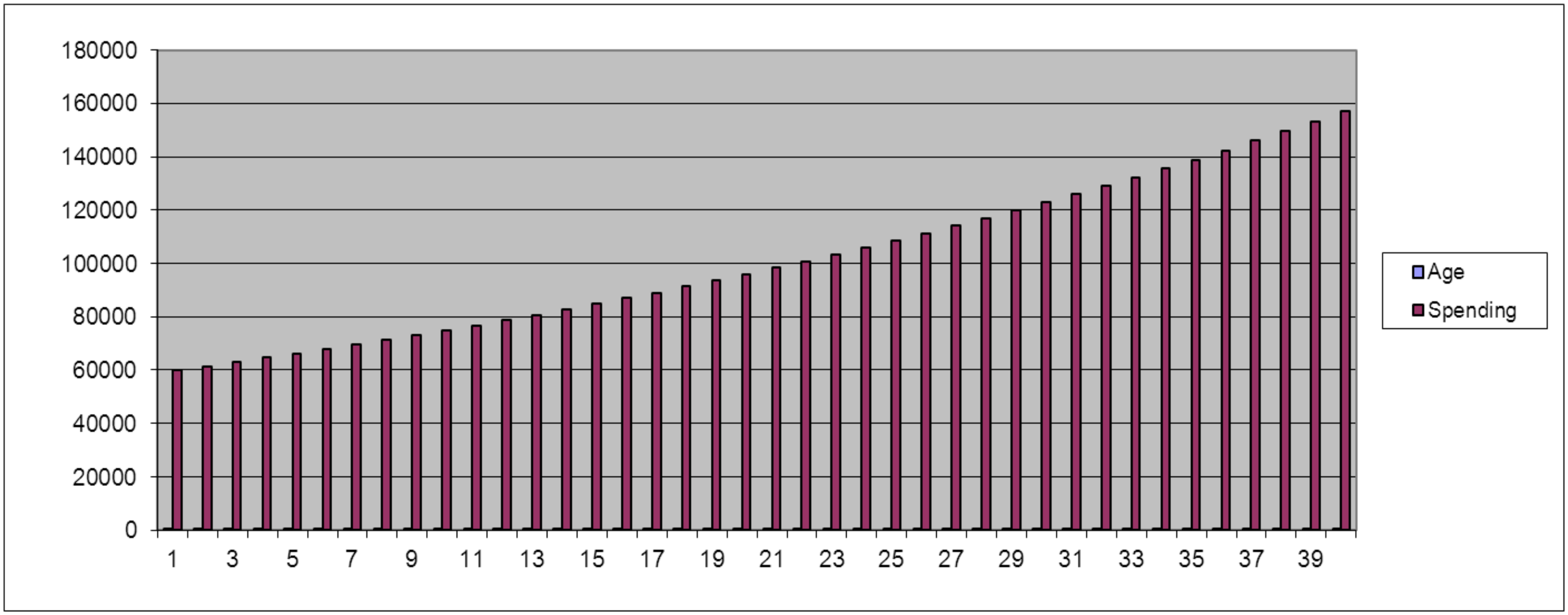
WIDELY USED RETIREMENT INCOME NEED



Indexed for inflation (assume 2.5%)

This is not a retiree's reality!!!

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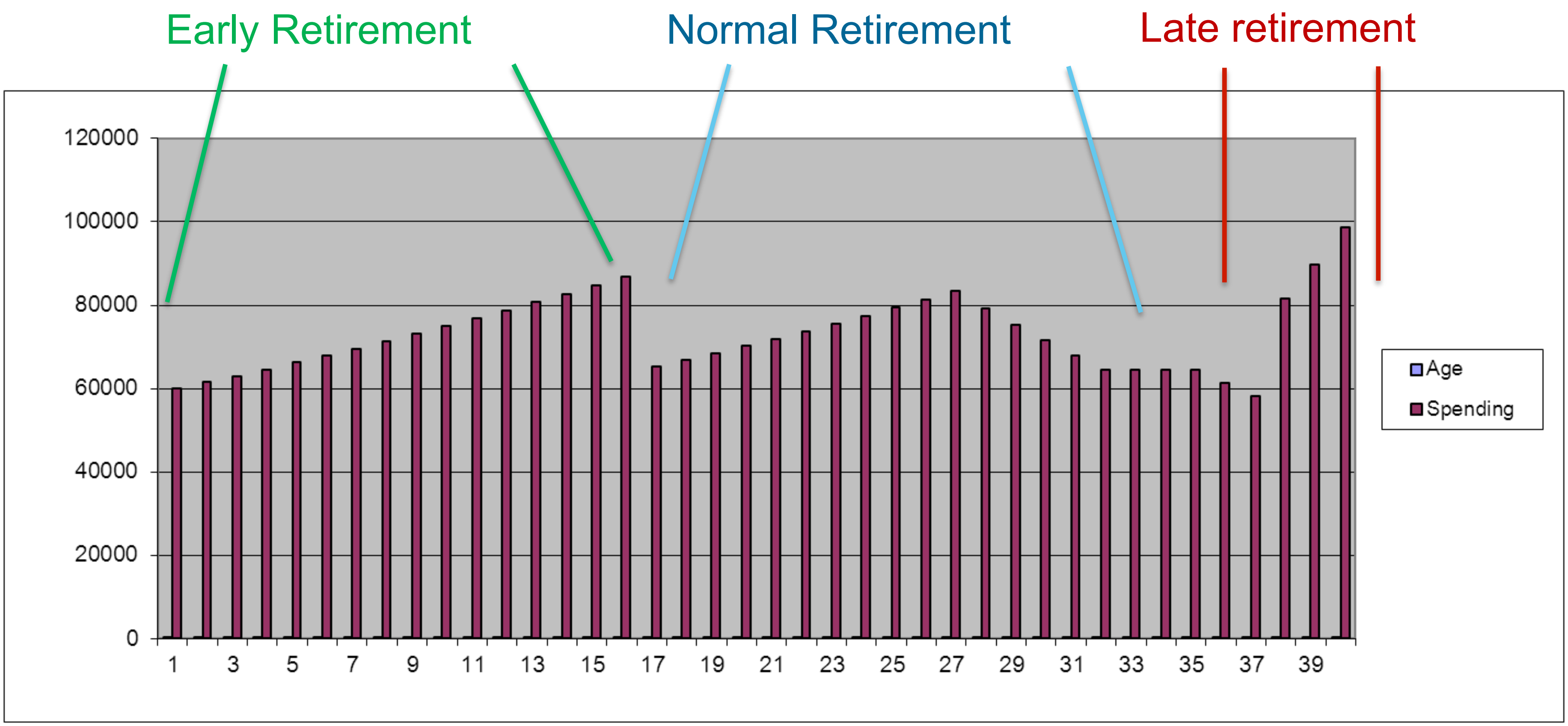
INCOME TRENDS OVER TIME



Addressing phases of retirement

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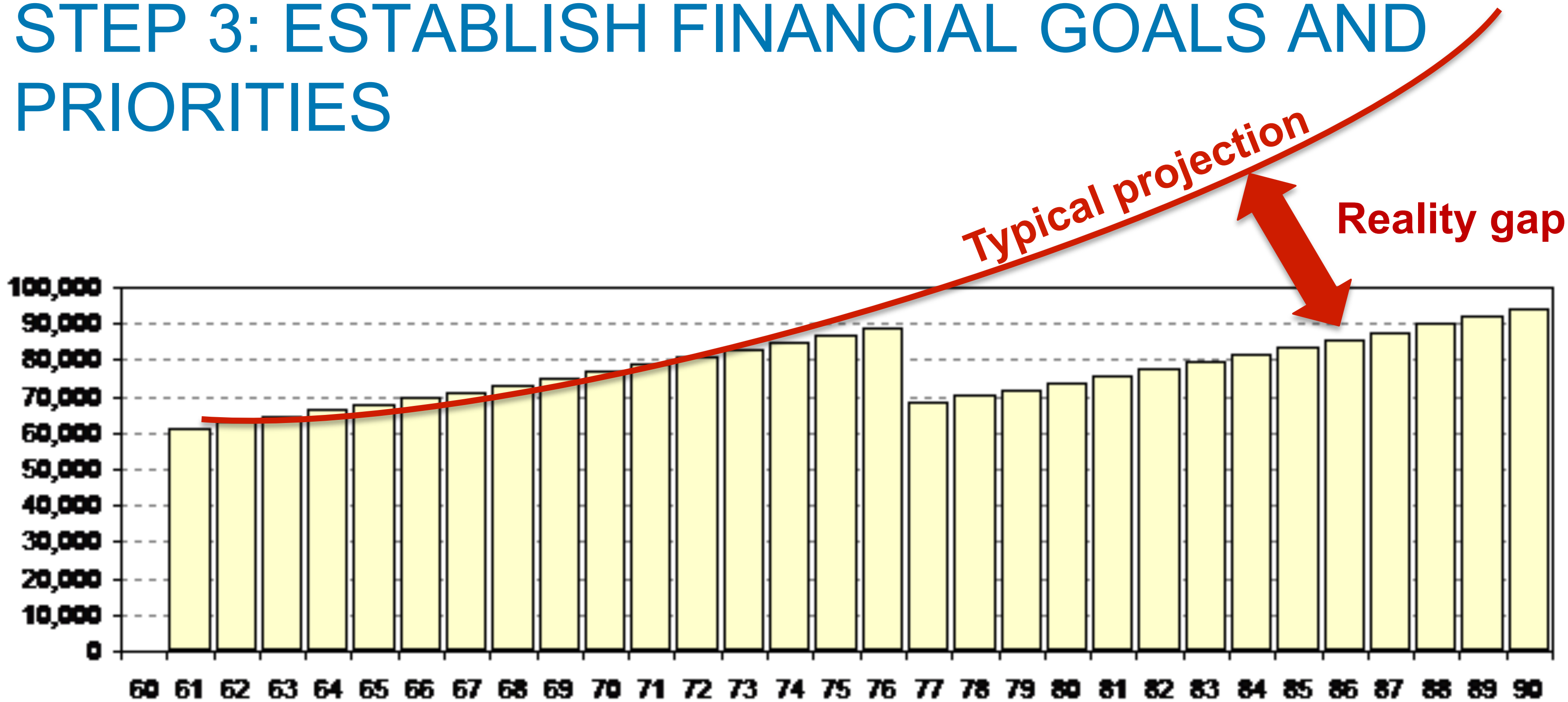
STEP 3: ESTABLISH FINANCIAL GOALS AND PRIORITIES



- Income trends over retirement years
- Spending patterns slow as clients age
- Reflected in 25% reduction at age 75

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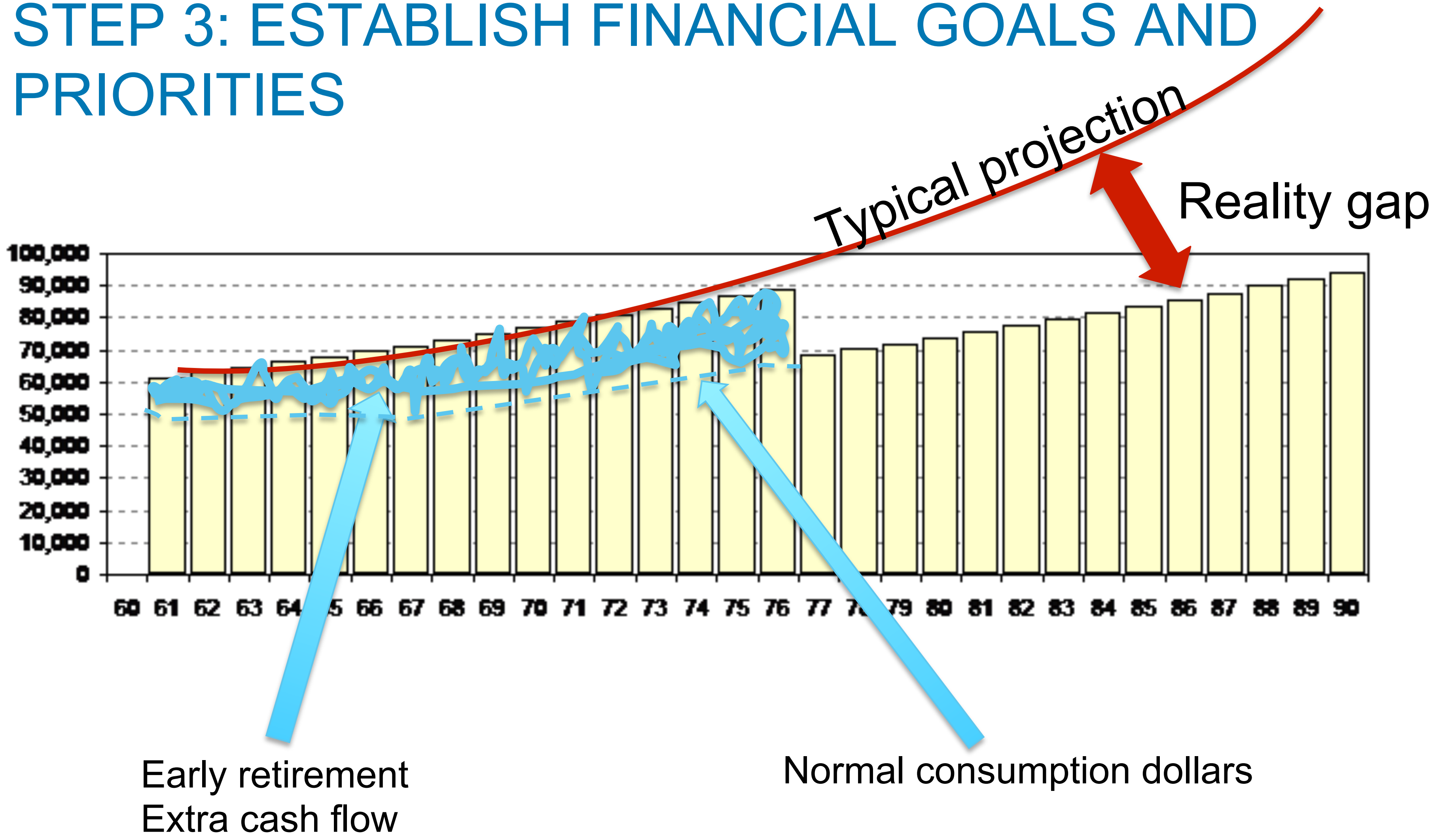
STEP 3: ESTABLISH FINANCIAL GOALS AND PRIORITIES



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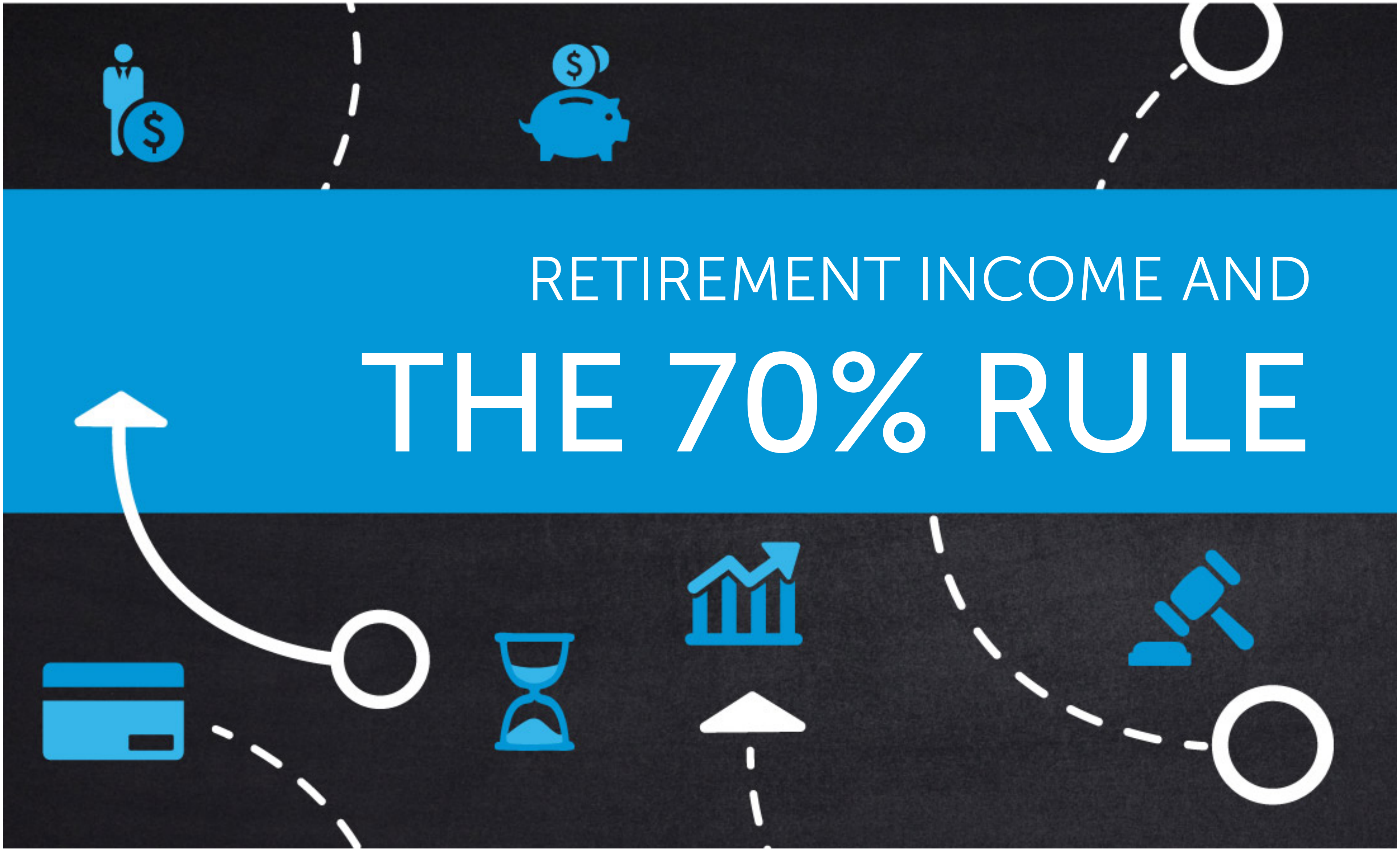

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70% RULE

70% of pre-retirement income needed for retirement, indexed….

- Where did this come from?
- What's not included?
- Why it's too high for many people

ORIGIN OF 70%

Take 100% of employment income

- payroll deductions: CPP/QPP, Employment Insurance (EI), group benefits
- savings for retirement

- **Pay less income tax:**
  - Age credit
  - Pension credit
  - Transfer tax credits
  - Income splitting

= ~70% for middle, upper-middle income levels

NEW RETIREMENT MATH – MISSING FACTORS

- **75-85%** of pre-retirement income (Fidelity Research 2103-14)
- Definition of “consumption”
- Questionable assumptions

TARGET 100%+ OF WORKING LIFE CONSUMPTION $$

~~~70%~~ for middle, upper-middle income levels

-  employment related expenses (commuting, attire, dues, meals)
-  mortgage payments
-  child rearing expenses
-  power saving

---

= **40-60%** of pre-retirement income

And majority will need **<50%**

DIFFERENCES IN INCOME BEFORE/AFTER RETIREMENT

	Employment Income	Retirement Income ≥ age 65	Difference
Gross Income	$6,000	$4,000	-33%
Income Tax	$1,237	$ 649	
CPP/QPP Deductions	$ 185		
EI Premiums	$ 65		
Group Benefits	$ 213		
Pension @ 4.5%	$ 270		
Group RRSP	$ 250		
Net Income	$3,780	$3,351	11.35-10.64%
Net to Gross Ratio	63%	84%	

Source: Your Retirement Income BluePrint, Table 3.1, p.42

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CONSUMPTION REPLACEMENT DOLLARS

- Post-retirement ▶ Pre-retirement

75% provides decent standard of living for middle and higher income Canadians *(Statistics Canada)*

60% of middle income Canadian households will be **better off after retirement**

7% will have <75%

Source: LifePaths (Statistics Canada), 2013 and The Real Retirement, p.101

AVERAGE CANADIAN FAMILY

	Before Retirement	After Retirement	ratio
Gross annual income	$ 78,000	$48,600	
- RRSP contributions @ 6.5%	($ 5,100)	0	
- CPP/QPP contributions	($ 3,500)	0	
- Child rearing costs	($ 9,400)	0	
- Mortgage payments	($13,900)	0	
- Employment & gov’t program exp.	($ 3,700)	0	
- Income taxes & prov’l health prm.	($ 9,600)	($1,700)	
Income for regular consumption	**$32,800**	**$46,900**	

Two earner household with house and two children

Source: The Real Retirement , Table 10.1, 2013

AVERAGE CANADIAN FAMILY

	Before Retirement	After Retirement	ratio
Gross annual income	$ 78,000	$48,600	62%
- RRSP contributions @ 6.5%	($ 5,100)	0	
- CPP/QPP contributions	($ 3,500)	0	
- Child rearing costs	($ 9,400)	0	
- Mortgage payments	($13,900)	0	
- Employment & gov't program exp.	($ 3,700)	0	
- Income taxes & prov'l health prm.	($ 9,600)	($1,700)	
Income for regular consumption	**$32,800**	**$46,900**	**+43%**

$14,000

Two earner household with house and two children

Source: The Real Retirement , Table 10.1, 2013

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REPLACING CONSUMPTION DOLLARS @ 65

Family make-up Own home	Gross Income Working Years (1)	Consumption Dollars	Gross Income Retirement (2)	Consumption Dollars	Ratio 1/2
Couple, 2 kids	$78,000	$35,600 after 2.1% RRSP contribution	$35,600	$35,600	**46%**
Couple, No kids	$78,000	$42,800 after 4.7% RRSP contribution	$43,500	$42,800	**56%**
Couple, 2 kids	$110,000	$46,600 after 3.8% RRSP contribution	$48,300	$46,700	**44%**
Couple No kids	$110,000	$59,800 After 6.9% RRSP contribution	$60,500	$58,500	**55%**
Couple, 2 kids	$204,000	$73,700 After 6.5% RRSP contribution	$83,500	$74,600	**41%**

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WHEN TO TARGET **LOWER** RETIREMENT CONSUMPTION RATIO

- Lower life expectancy
- Higher RRSP contributions
- Higher returns
- Later retirement
- Plan to spend more in earlier retirement and less later on
- Expect spending will decline during phases 2 and 3
- Have non-registered investable assets for income
- Expecting inheritance

WHEN TO TARGET **HIGHER** RETIREMENT CONSUMPTION RATIO

- Longer life expectancy
- Early retirement (forced or planned)
- Cushion against lower RRSP projections
- Smaller savings period
- Smaller RRSP contributions
- More conservative risk tolerance
- Divorce, separation
- Caregiver for aging relatives

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LAYERING INCOME

OPTIMIZING TAX EFFICIENCY

STEP 4: CREATE INCOME THROUGH LAYERING

- Layering is income planning in most specific sense
- Year-by-year determination of how to create income you need, from the sources available to you, in most efficient way

STEP 4: CREATE INCOME THROUGH LAYERING

- Use least flexible income sources as they become available
- Use least tax-efficient income sources in lower tax brackets
- Work efficiently within the tax brackets
- Put least amount of “strain” on an asset to deliver the next dollar to spend
- Look for income-splitting opportunities
- Determine which assets are best to use/defer

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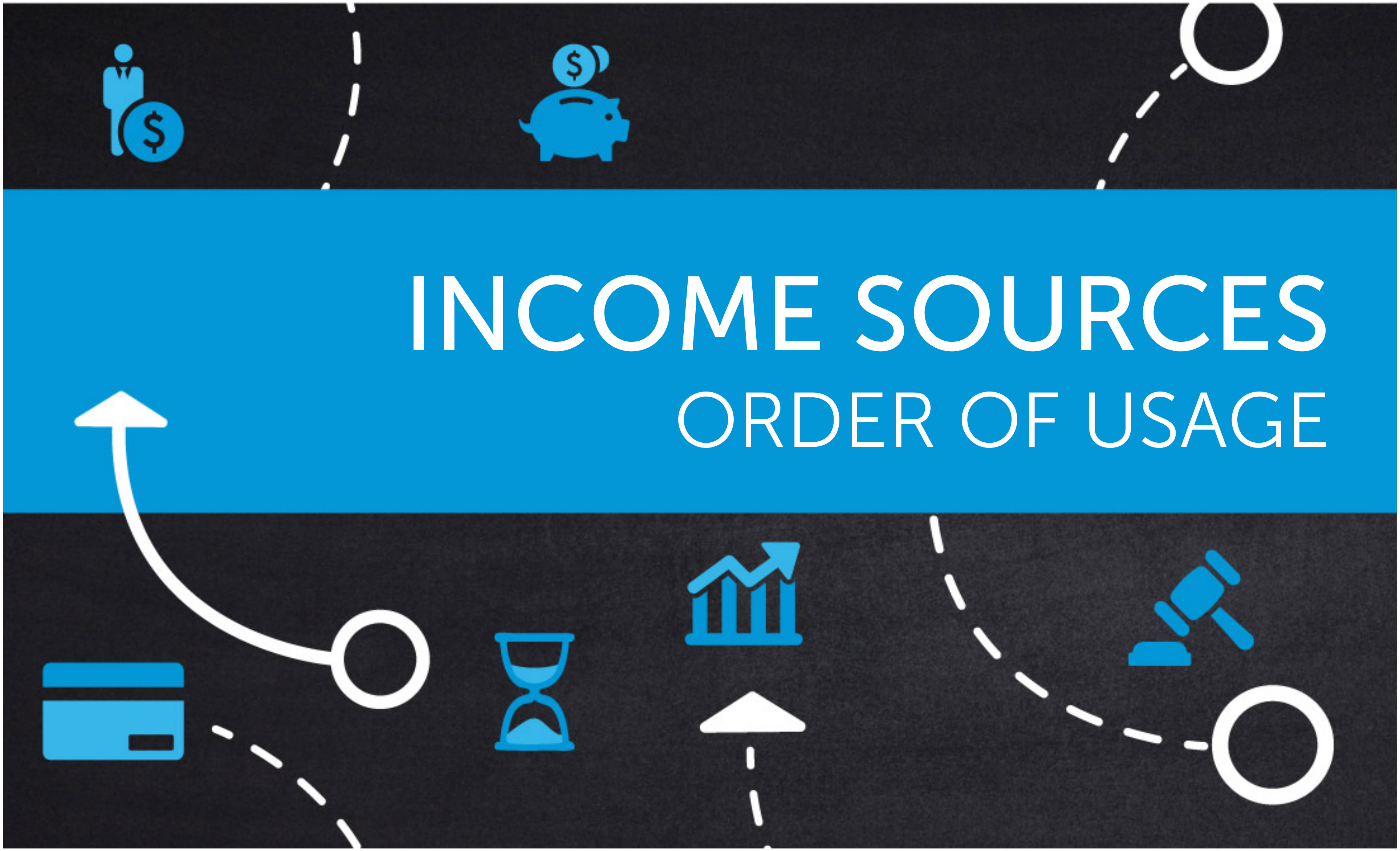

INCOME SOURCES

ORDER OF USAGE

ISSUES AND CONSIDERATIONS

- Don't need income from all sources right away
- What to defer?
  - RRSP? LIRA? OAS? CPP/QPP? Non-registered monies?

Use least flexible income sources early

ISSUES AND CONSIDERATIONS

Use government income sources early

RETIREMENT INCOME AND WITHDRAWAL RATES

THE 4% RULE

- Withdrawal rate (indexed) on asset block to generate income for 30 yrs.
- Bill Bengen research, *Journal of Financial Planning, 1994*

4% RULE

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ADDRESSING INCOME NEEDS

Think Broader

- Consider asset mix and downside protection
- Look at cash wedge concept and liquidity
- Product diversification
- Income diversification
- Use multiple tactics

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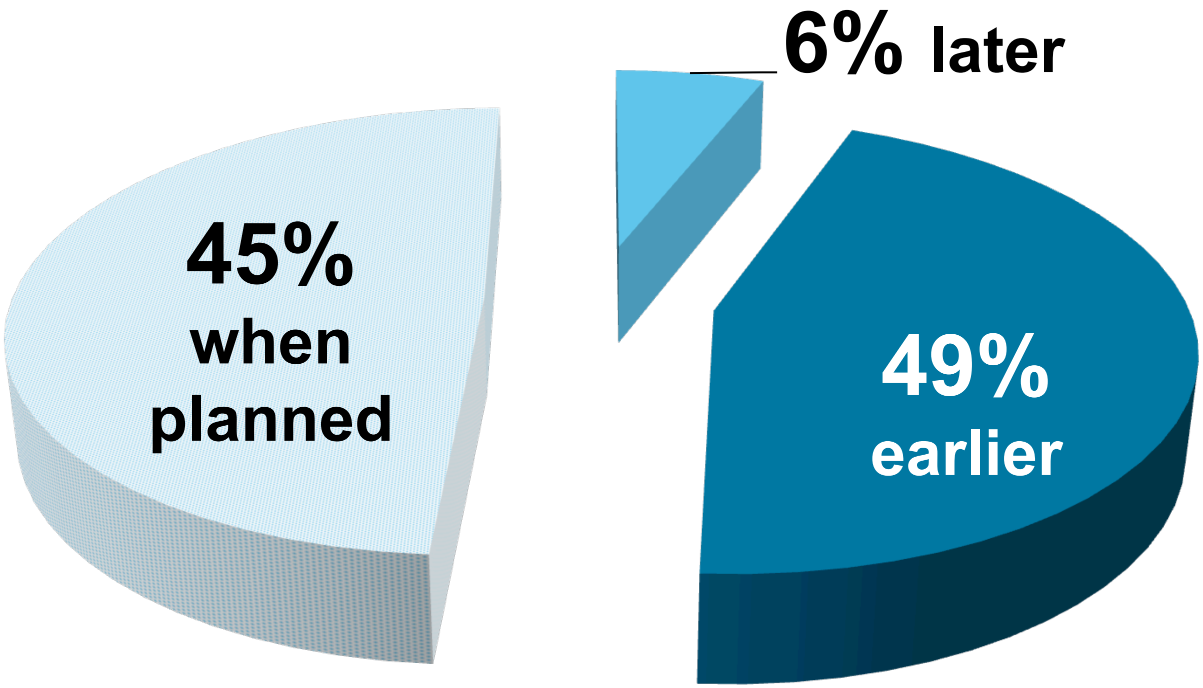
DEALING WITH THE 4% RULE

Flexibility

1. Work longer
2. Adjust income expectation
3. Part-time work
4. Consider life expectancy and options
5. Incorporate inevitable drop in spending
6. Ignore inflation
7. Variable withdrawals/ percentage, dollar amount
8. Periodically stress test assumptions and plans

WHEN DO PEOPLE RETIRE?



17-22% health reasons

14% laid off employer buyout

7% negative work conditions

11% other

Source: LIMRA Retirement Study, 2012
Retirement Myths & Realities Poll, 2013

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DIVIDENDS

THE BE ALL AND END ALL

ARE DIVIDENDS ALWAYS GOOD?

Watch net income tested benefits

- Particularly age 65+
- Gross-up by 38% can have large negative impact
- **Clawbacks:**
  - Government benefits
  - Tax credits
  - Long term care access and costs

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OTHER OPTIONS TO BOOST SPENDABLE INCOME

- **Tax preferred products:**
  - prescribed annuities, Series T, guaranteed withdrawal plans (or combos)
- **Income splitting**
  - Preferred products
  - Beneficiary/ownership structures for segregated funds
- **Spousal loans**
  - Low, locked-in prescribed rates (1%)

DOLLAR COST AVERAGING

ACCUMULATION VS. DECUMULATION

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DOLLAR COST AVERAGING

- Accumulation phase vs. Decumulation phase
- What we think we know and what happens next

$$ going in

$$ coming out

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$1200 invested annually for 10 years

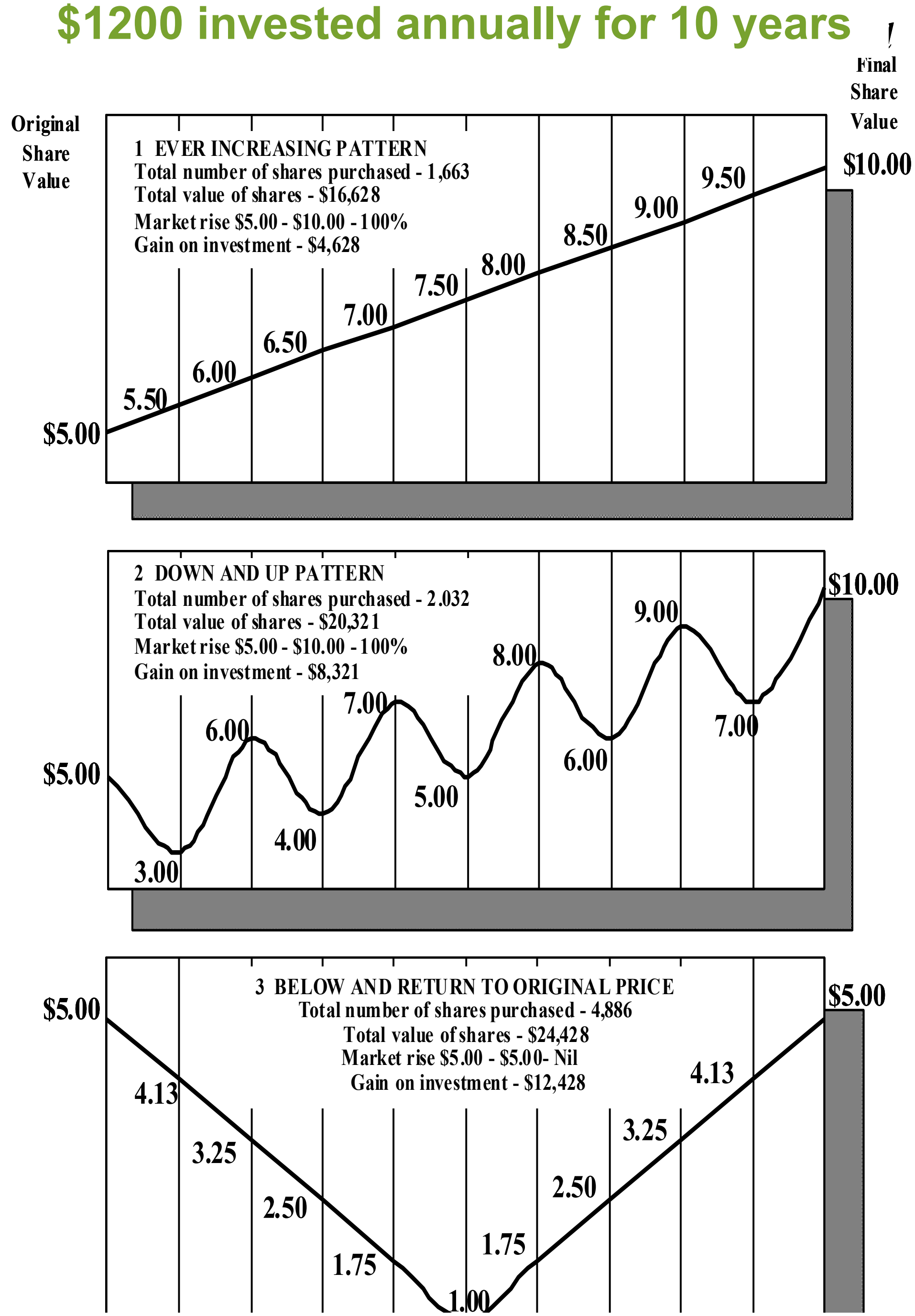
Going in

better

$16,628

$20,231

$24,428



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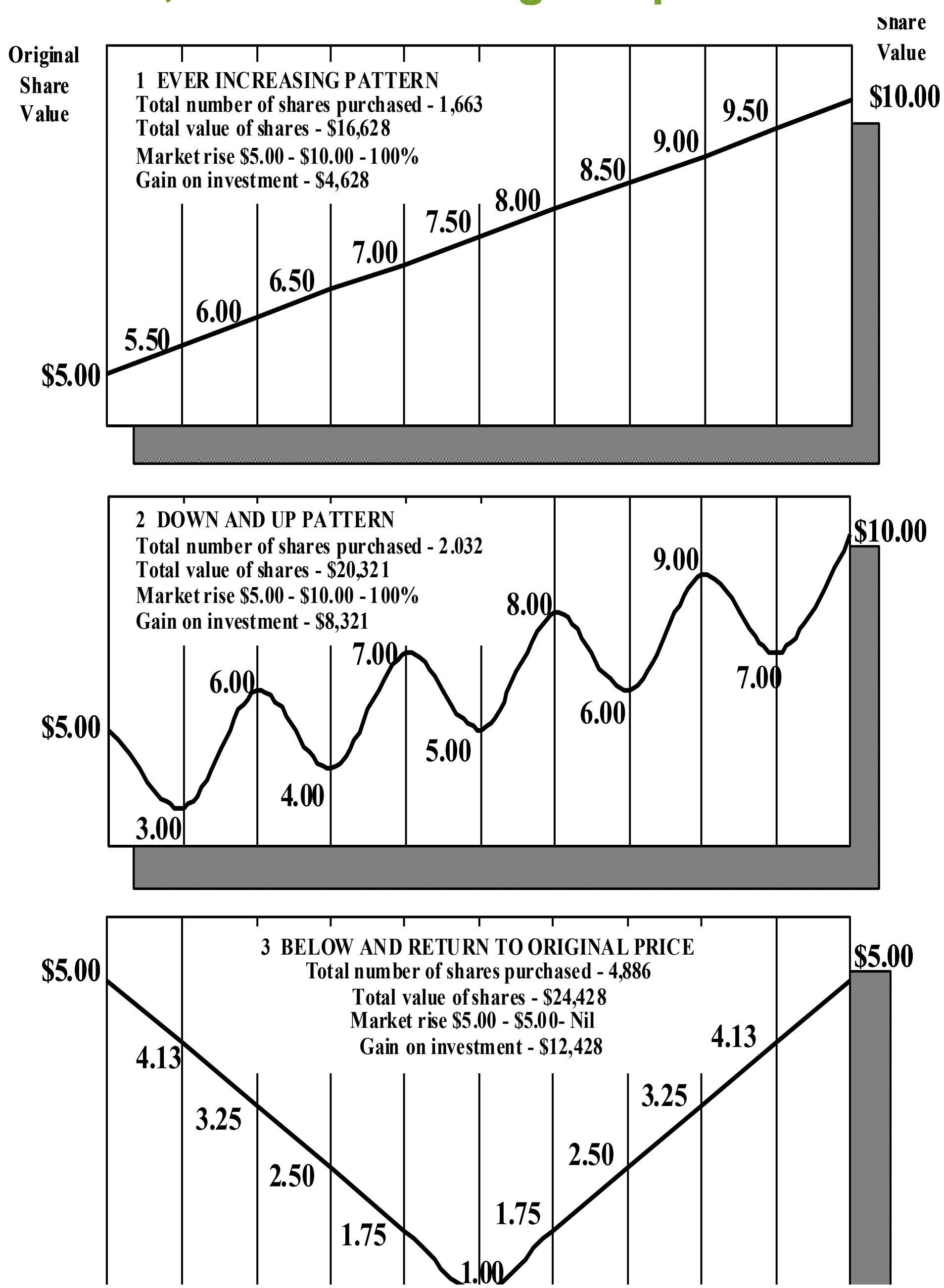
$12,000 withdrawing $50 per month

Going in

Coming out



Going in	Coming out
$16,628	$14,975
$20,231	$11,678
$24,428	$ 9,626

better

worse

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EMPIRE LIFE MUTUAL FUNDS®

RETIREMENT INCOME PLANNING – WITHDRAWAL PHASE

Three factors to consider that create a more predicable and stable cash flow:

1. **All Equity**: select a Portfolio Manager that displays competent downside protection
2. **Portfolio**: select a Portfolio Manager that displays competent Tactical Asset Allocation decisions
3. **Distributions:** in cash to create a “cash wedge” to fund future income needs

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SERIES T

TRUST OR CORPORATE CLASS

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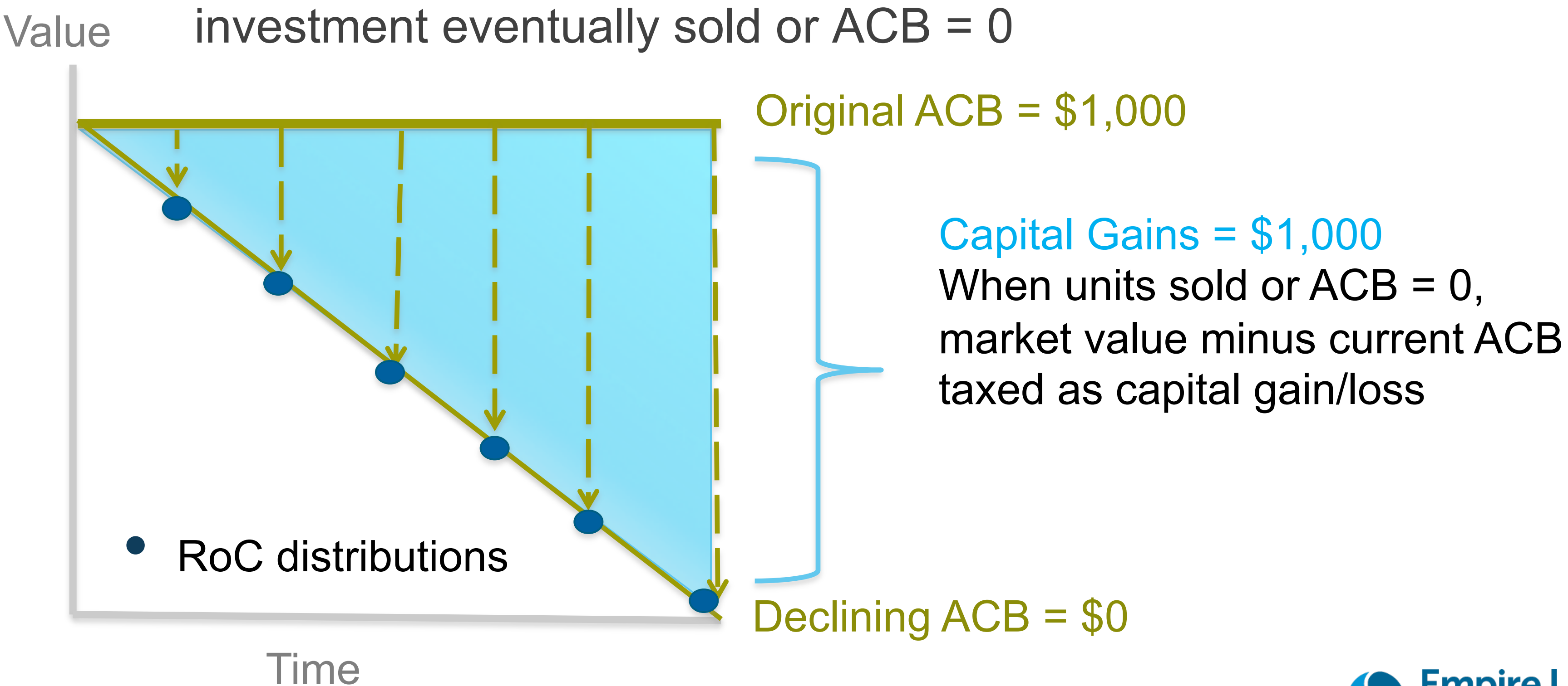
WHY SERIES T

- Demographic trend
- Industry trend, especially for independents
- Relationship building opportunity

RETURN OF CAPITAL (ROC)

- Not immediately taxable; tax-deferral benefits
  - Each monthly Return of Capital (RoC) distribution lowers Adjusted Cost Base (ACB)
  - Distribution tax-free; will result in larger capital gain when investment eventually sold or ACB = 0



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DISTRIBUTION PERCENTAGE CALCULATED ON NET ASSET VALUE AMOUNTS TAKEN FROM ADJUSTED COST BASE FIRST

Initial Period

NAV= 100 = ACB

ACB = 100

Cash flow = 6% of NAV

ACB at year end = 94

Period 5

NAV = 100

ACB = 50

Cash flow = 6% of NAV

ACB at year end = 44

Period 6 alt. scenario 1

NAV = 100

ACB = 44

Cash flow = 6% of NAV

ACB at year end = 38

Period 6 alt. scenario 2

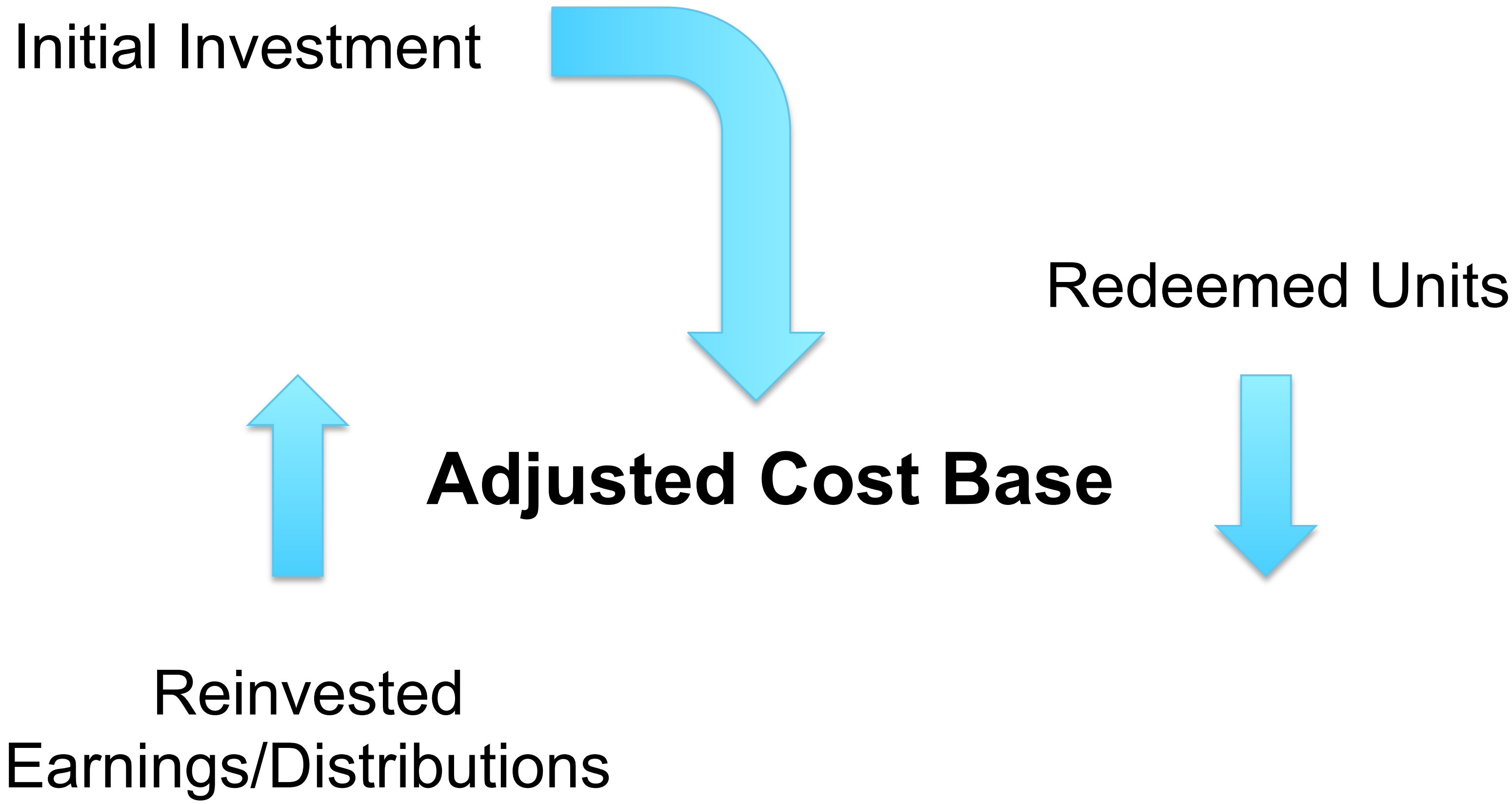
NAV = 130

ACB = 44

Cash flow = 6% of NAV

ACB at year end = 34.8

ACB ADJUSTMENTS



ACB ADJUSTMENTS

Initial Investment

Redeemed Units

Adjusted Cost Base

Reinvested Earnings/Distributions

PRODUCT SOLUTION
PROBLEM MISMATCHES

ISSUES AND CONSIDERATIONS

- Both Individual Pension Plan and Guaranteed Withdrawal Benefit define benefits
- Payout mismatch
- Loss of flexibility
- No product solution optimization

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ISSUES AND CONSIDERATIONS

- Locked in Retirement Accounts (LIRA) and Guaranteed Minimum Withdrawal Benefit plans
  - fix payouts
  - Payouts don’t match
  - Lose flexibility in unlocking funds

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RISK MANAGEMENT

PROTECTING YOUR RETIREMENT NEST EGG

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COMPREHENSIVE RISK MANAGEMENT

Withdrawal risk

Longevity risk

Health-cost risk

Investment risk

Taxation risk

Encroachment risk

No stress testing

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CONTINGENCY PLANNING

WEALTH PRESERVATION AND WEALTH TRANSFER

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YOUR GREATEST **ASSET**

YOUR GREATEST **DRAIN**

health: ability to earn income and enjoy assets

ill health: drain on income and assets one of greatest risks to health of income producing assets

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DELAYING RETIREMENT

30%

retirees returned to work

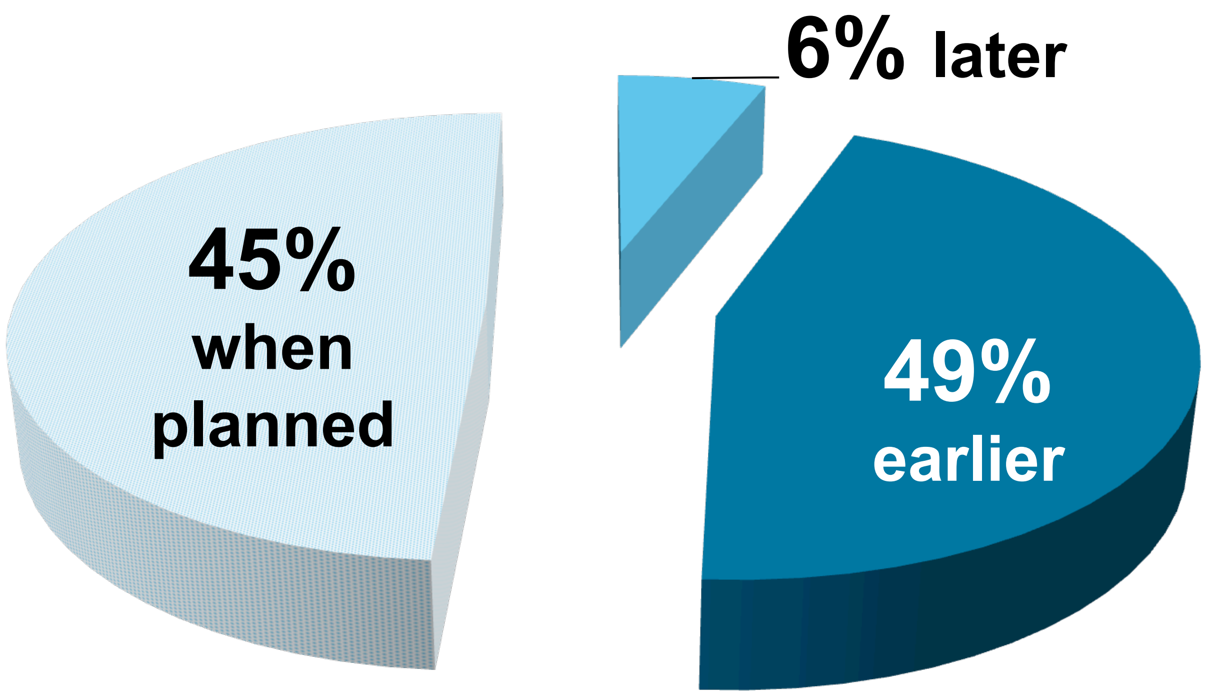
Source: ING Direct Study, 2014

1/3

chance, someone age 65-74 being disabled

Source: Dr. Lesley Horton, UBC, Statistics Canada (2014)

WHEN DO PEOPLE RETIRE?



17-22% health reasons

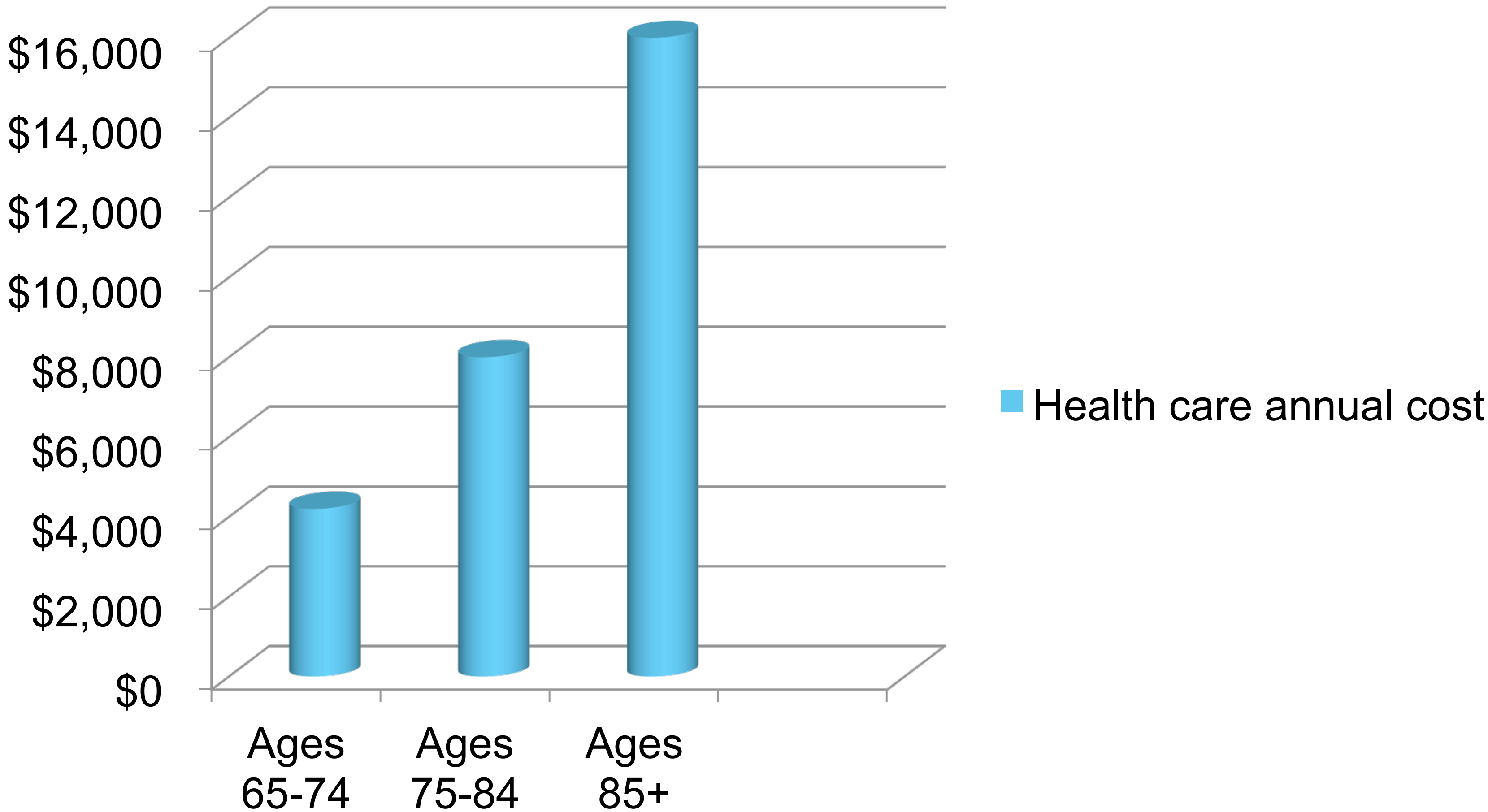
14% laid off employer buyout

7% negative work conditions

11% other

Source: LIMRA Retirement Study, 2012
Retirement Myths & Realities Poll, 2013

PRICE OF GETTING OLD



Source: Canadian Institute for Health Information

HEALTH-RISK MANAGEMENT

- Protect incomes and assets
- Preserve dignity and lifestyle
- For both clients and caregivers
- Replace capital spent on health care

- Health drives time hub priorities
- Time hub priorities drives decisions and objectives
- Think safety and accommodations

PLANNING STEPS

1. Identify risks and issues
2. Relate to lifestyle goals and timing
3. Relate to legacy planning and wealth transfer
4. Assess available programs, plans and funding
5. Set up game plan for contingencies
6. Set up/ review Powers of Attorney and directives

HEALTH CARE & CRITICAL ILLNESS NEEDS

- ~~$250,000~~
- ~~$500,000~~
- ~~$1Million~~

?

- **One-two years of income**
- **$50,000-$100,000**

FIVE STAGES OF CARE

	Stage	Description
1	Independence	No special care or support from family
2	Interdependence	Elders accept help from family members only
3	Supportive Living	Elders receive support from family and limited formal care services
4	Crisis Management	Health and personal care needs are beyond family's capacity to help – formal care needed
5	Dependence	Long-term care home admission required to receive continual skilled nursing care and extensive personal care

Source: Taking Care Inc.

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WEALTH TRANSFER

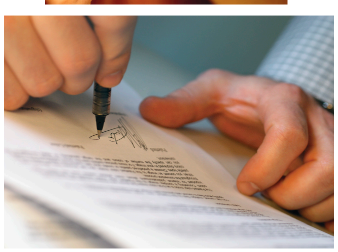
LEAVING LEGACIES NOT LIABILITIES

WHAT’S THE BEST USE OF CAPITAL?
(COST OF EVERY $1 PAYING FOR OBLIGATION/ OBJECTIVE)

Cash → **$1.00 + lost income**

Sell assets → **$1.00 + liquidation costs**

Borrow → **$1.00 + interest**



Life insurance → **$0.01 to $0.05 a year**

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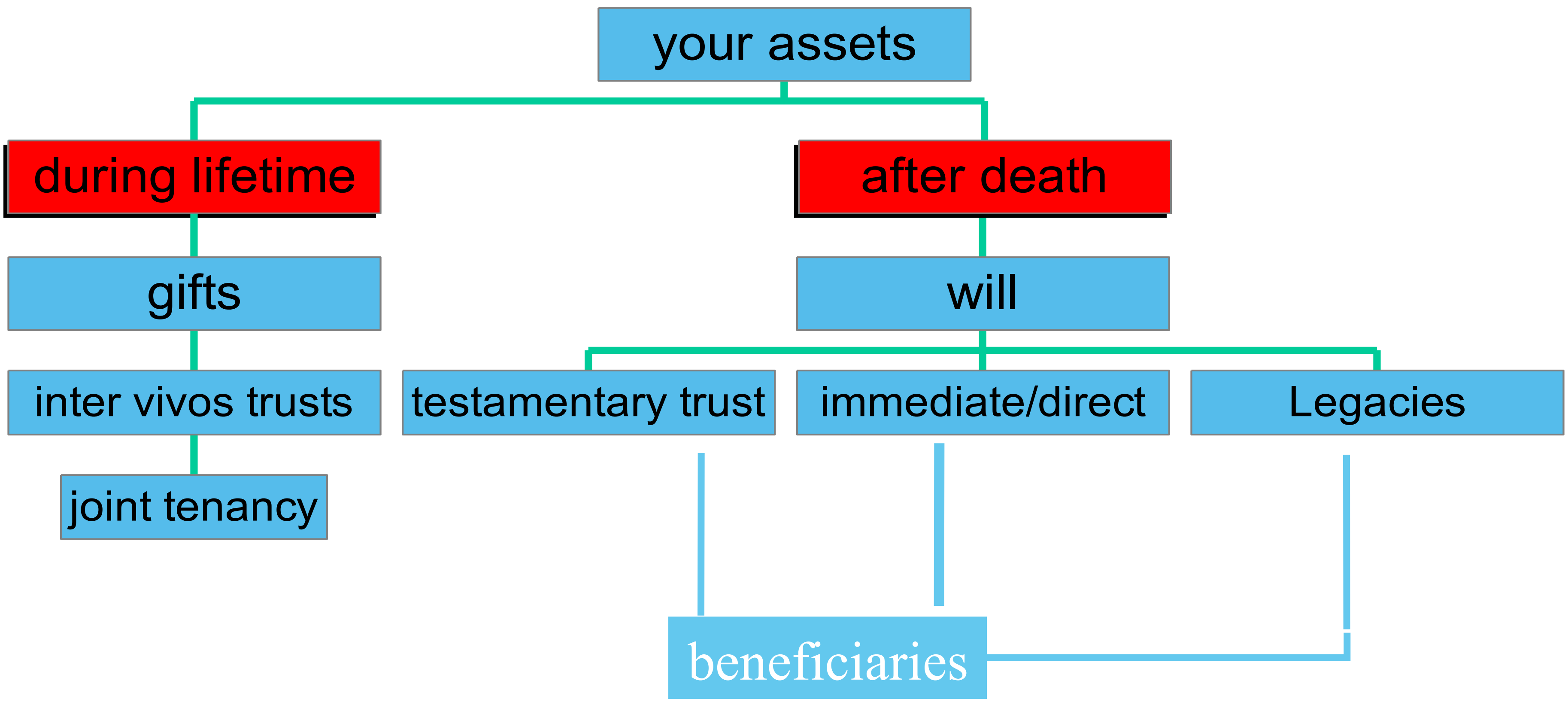
LEGACY

~~ESTATE PLANNING~~



HOW MUCH OF YOUR ESTATE IS IMPORTANT TO YOU?

- Of the part of your estate that you don't get to spend, where do you want it go?
  - Heirs – children, grandchildren
  - Accounting and legal costs
  - Favourite cause – church, hospital, foundation
  - Canada Revenue Agency

pick two

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ESTATE LIQUIDITY & CONTINGENCY PLANNING

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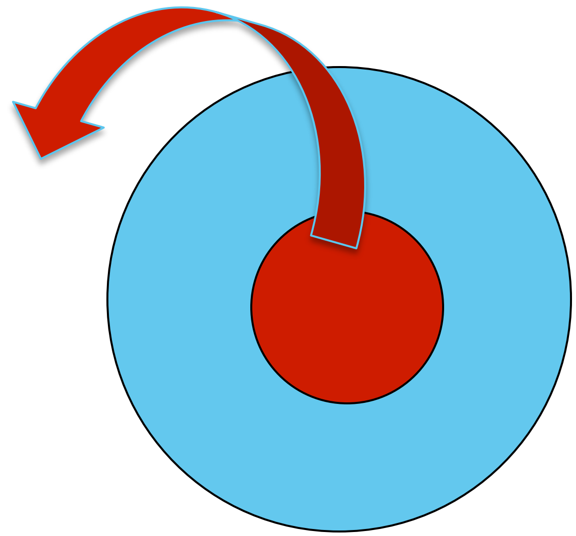
CONSIDER AN ESTATE TO BE A CHERRY PIE... WHEN THE GOVERNMENT WANTS ITS SLICE...

It doesn't want liquid and crust



It just wants the liquid

STEP 7: WEALTH TRANSFER/LEGACY PLANNING

- **Of the part of your estate that you don't get to spend, where do you want that to go?**
  - Spouse, children, other heirs, favourite causes/charities

- **Do you need an income from all of your investable assets?**
  - Yes….Insured Annuity Strategy
  - No…Personal/Corporate Legacy Builder strategy

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COMMON ESTATE PLANNING MISTAKES

- Wills
- Integration
- Liquidity—Debt
- Equal vs. Fair Distribution
- Unfettered use of joint tenancies
- Documentation—Planning

SHOULD WE HAVE A BUSINESS **BUY/SELL AGREEMENT?**

A business life insurance questionnaire

1.	If you survive your partner, do you want your business liquidated even though you are still active in it?	yes ◯	no ◯
2.	If the business continues, would you like to take over your partner's share?	yes ◯	no ◯
3.	Would you be satisfied to take over your partner's work and let your partner's widow continue to get your partner's share in the income?	yes ◯	no ◯
4.	Do you want to have the right to decide whether or not you need a new partner if your present partner dies?	yes ◯	no ◯
5.	If you need a new partner, do you want the right to select him/her?	yes ◯	no ◯
6.	Are you willing to give implied consent to granting your partner's or executor right to select your next partner?	yes ◯	no ◯
7.	Would you be willing to agree today with your present partner that you will hereafter shoulder all losses yourself but divide all profit with him/her?	yes ◯	no ◯
8.	Are you willing to agree today to buy out your partner at a price to be set by his/her spouse?	yes ◯	no ◯
9.	Would you be more willing if the price were set by his/her widow(er)?	yes ◯	no ◯
10.	Are you and your present partner better judges of the value of your partnership than your spouses or their lawyers?	yes ◯	no ◯

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SHOULD YOUR BUY/SELL AGREEMENT **BE FUNDED WITH LIFE INSURANCE?**

A business life insurance questionnaire

1.	Would you want to settle promptly with your partner's widow(er)?	yes ◯	no ◯
2.	Do you want him/her to settle promptly with your widow?	yes ◯	no ◯
3.	Do all partners have ready personal cash or equivalent in adequate amount for such prompt settlement?	yes ◯	no ◯
4.	Even if they have, is retention of personal assets intact preferred to reduction in personal assets?	yes ◯	no ◯
5.	If any partner does not have such personal resources, does (s)he have quick long term, sure-fire credit in adequate amount?	yes ◯	no ◯
6.	Even if (s)he does have, is freedom from debt preferred to debt?	yes ◯	no ◯
7.	Would your bank put aside capital today and guarantee that you may use the capital to purchase your deceased's partner's shares at the time of his/her death; on the basis that you pay the bank an annual interest factor of less than 5% on the capital set aside, and that once you used the capital you would not have to pay back the bank and all future interest payments would be cancelled?	yes ◯	no ◯
8.	Would you like a contract similar to that stated in the question 7 above?	yes ◯	no ◯

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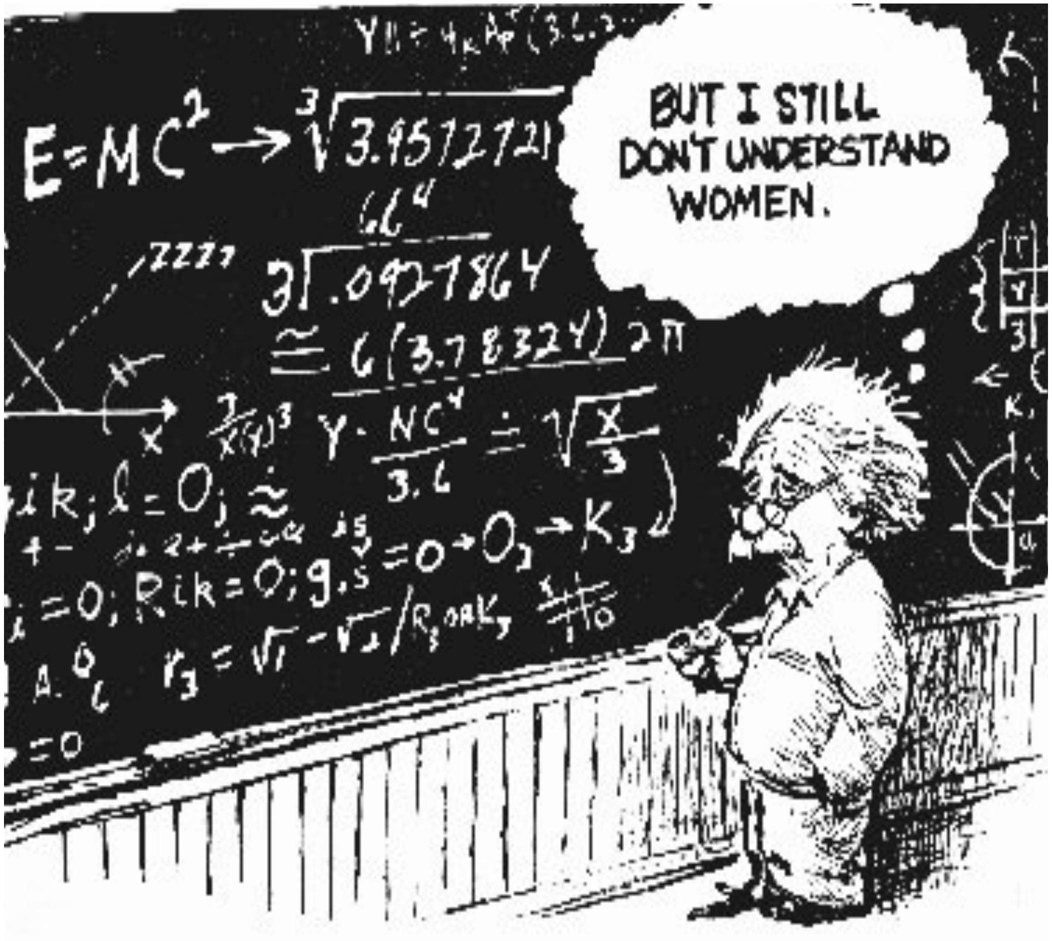
Empire Life™

ENG-08/11

Empire Life Investments®

A COMPREHENSIVE PLAN

Math is not everything



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RETIREMENT SUCCESS FACTORS

15 key factors that will determine how successful investors will be during retirement

1 is financial

Source: Dr. Richard Johnson, Ph.D., Retirement Success Profile

THE VALUE INDICATOR

value-added

differentiation

unique offering

from their perspective

beyond the numbers

"THE WORDS WE USE ARE JUST AS IMPORTANT AS THE NUMBERS WE SHOW THE PROSPECT."

ROGER ZENER

Empire Life Investments

RETIREMENT INCOME PLANNING POINTS

- The myth of “**One**”
- Retirement phases and stages
- Orderly disassembly
- Flexibility with balance
- Match cash flows with income flows
- Finances in retirement more complex
    - uncertainty
- Retirement income planning ≠ planning during working life

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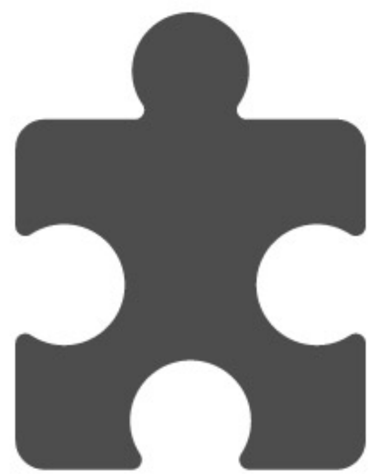
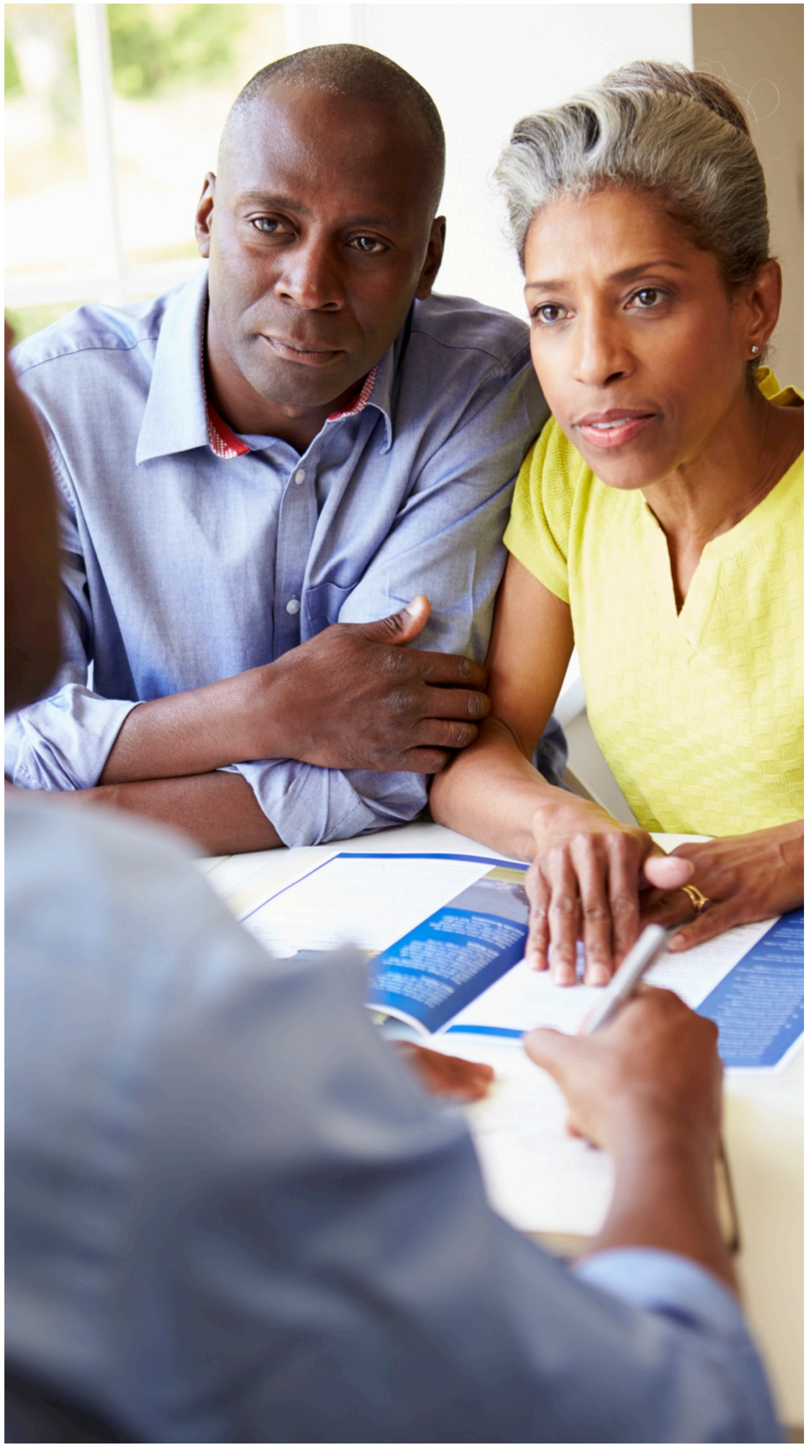
WHAT PRODUCT TO PICK

- It depends
- No one size fits all product solution
- No one product solution fits all situations



IN COMPLICATED TIMES, PEOPLE WANT SIMPLE SOLUTIONS TO COMPLICATED PROBLEMS.

- Simplicity
- Quality
- Peace of Mind
- Predictability



AGENDA REVIEW

- Major Accumulation Principles
- Accumulation vs. Decumulation
- Alternative Considerations

IMPORTANT INFORMATION

Empire Life Investments Inc. is the Manager of the Empire Life Mutual Funds (the "Funds"), is the investment manager for the Empire Life segregated funds and is a wholly owned subsidiary of The Empire Life Insurance Company. The units of the Funds are available only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such units.

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Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The payment of distributions is not guaranteed and may fluctuate. The payment of distributions should not be confused with a fund's performance, rate of return or yield. If distributions paid by the fund are greater than the performance of the fund, your original investment will shrink. Distributions paid as a result of capital gains realized by a fund, and income and dividends earned by a fund are taxable in your hands in the year they are paid. Your adjusted cost base will be reduced by the amount of any returns of capital. If your adjusted cost base goes below zero, you will have to pay capital gains tax on the amount below zero. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

The sale of Series T units may trigger capital gains or losses.

Past performance is no guarantee of future performance. A description of the key features of the individual variable insurance contract is contained in the Information Folder for the product being considered. **Any amount that is allocated to a Segregated Fund is invested at the risk of the contract owner and may increase or decrease in value.** Policies are issued by The Empire Life Insurance Company.

The investment recommendation illustrated within this presentation includes both insurance and mutual fund products. Insurance products are issued by The Empire Life Insurance Company and the mutual funds are offered by Empire Life Investments Inc. The recommendations for these products may only be offered by financial advisors who are licensed to sell these products.