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Executive Summary

The Risk of Ignoring Risk in Retirement Income Planning

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Retirement financial security has become critically important with an aging population. As the shift away from defined benefit pension plans continues, it is becoming increasingly important (and necessary) for workers to be engaged in their own retirement income planning and for you to help clients manage the inherent risks in retirement income planning to help meet their retirement planning goals.

The findings from this research reveal the significant risks inherent in retirement income planning based on a number of factors, which can impact clients' ability to maintain their desired lifestyle over their retirements or provide assurance of sufficient funds to avoid outliving their savings.

These factors include:

- Investment returns
- Unexpected expenses
- The passing of a loved one
- Changing tax eligibilities
- Changing goals
- Changing inflation rates
- Changing life expectancy

While these risks are not limited to clients' retirement years, they are perhaps more significant in retirement. While younger, healthier seniors are generally better able to absorb financial risks by adjusting spending, or even returning to the workforce to supplement any income shortfalls, seniors at later ages are more likely to be more financially, mentally, and physically vulnerable to income shortfalls. For example, it is at advanced ages (e.g. 85 and beyond) that inflation has eroded any nominally fixed pension income by nearly a third (2 percent compounded over 20 years), increased frailty and skills attrition has reduced the possibility of returning to the workforce, and cognitive declines expose vulnerable seniors to financial decision-making mistakes. In addition, the advanced-aged elderly are much more likely to experience the impacts of financial shocks associated with the onset of chronic health conditions, which creates fixed and ongoing health care costs that cannot be postponed without impact. With the population aging and a decline in secure employer pension plan income, more and more Canadians will face this reality.

This research supports the practice of regularly reviewing and adjusting recommended withdrawal rates and financial strategies based on emerging information, including the above factors any other material changes in the client's circumstances (including divorce, widowhood or needed home renovations to accommodate clients in retirement).

The research also reinforces the importance of considering the risk implications of key decision opportunities that can have significant impact on client's future well-being and are either non-reversible decisions or reversible at significant cost.

These include decisions as to:

- when to take Canada Pension Plan (CPP)/Québec Pension Plan (QPP) and Old Age Security (OAS);
- whether to choose the pension or commuted value of a pension;
- whether to tap into home equity to help fund retirement;
- whether to direct funds to reducing debt and/or savings;
- renting versus owning primary residence; or
- converting retirement savings to an annuity and/or RRIF.

The impact of these decisions can have significant life-long implications for clients. Lack of information or guidance or misinformation can be the difference between a client feeling confident in their futures and significant concern for seniors who do not have adequate secure retirement income. While younger seniors generally prefer financial flexibility, advanced age seniors often require financial security – and unfortunately, "risk" operates in precisely opposite terms, as the elapse of time enables risk to have greater opportunity to generate significant, interacting, cumulative impacts.

All else equal, financial strategies that ignore risk are progressively more likely to fail with time. As a result, an elderly senior is increasingly more likely to deplete financial savings as they advance in years.

Some seniors choose not to use their savings to protect against future risks. This precautionary behaviour, however, leads to significant unspent savings at the time of death and an unnecessarily reduced lifestyle.

Rather than not spend and benefit from their savings in retirement, you can help your clients manage the risk by:

- choosing withdrawal strategies that respond to risk. Known as "variable" drawdown strategies, this requires adjusting annual payments each year to reflect financial market performance and other changes that may have taken place in the client's life; and
- taking full advantage of key decision opportunities and events both leading up to and in retirement.

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