Longer lives pose problems for retirement planning

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By Kim Inglis

Advances in health care, improvements in diet and enhanced fitness programs have contributed to increased life expectancy. The current life expectancy in Canada is 81.24 years and is only projected to rise from here.

According to TD, men born in 1931 have a 2.5% chance of reaching 100 and women 5.1%. Jump forward 30 years to those born in 1961 and the numbers are substantially better at 11% and 16% respectively.

Given that the average retirement age in Canada is currently 63, that translates into at least 18 years where retirement income is required. Those lucky enough to hit 100 will need a whopping 37 years of retirement income. Indeed some rather substantial funding requirements.

While longevity poses a danger to retirement income, it is only one risk. According to Fidelity Investments, there are four more to consider: inflation, asset allocation, withdrawal rate, and health care costs.

A retirement income plan that does not consider inflation is incomplete. A report from PIMCO Investments shows that inflation of just 3% during the course of one decade can erode purchasing power by as much as 25%. Spanned over decades, its impact is dramatic.

Market movements in the last few years have caused an allocation shift towards heavier cash weightings, making it a challenge to meet retirement goals. J.P Morgan found that the average investor generated a mere 2.1% annualized over the last 20 years. Meanwhile annualized inflation over that same time period rang in at 2.2%. A retirement portfolio should have an appropriate mix of assets that is monitored and rebalanced as the retiree ages.

According to Fidelity, annual inflation-adjusted withdrawal rates exceeding 4-5% of the original value of the portfolio raise the risk of outliving one’s investments. Retirees need to think about the rate at which they withdraw funds. Optimum withdrawal rates should reflect factors such as other income sources, inflation, taxation, and changing needs.

Aging can bring health issues that are chronic and complex. Some are not curable, instead requiring continuous care. Canadians should prepare for unexpected health care expenses that may not be adequately covered by our healthcare system.

In spite of the risks, Canadians haven’t placed enough importance on the role of in-depth retirement planning. Many do not have a written financial plan and a survey by the Canadian Institute of Chartered Accountants found that 32% of those retiring in the next five years think they haven’t saved enough. A recent J.P. Morgan report found that average Canadian retirement savings will only last 11 years, meaning many people will outlive their money.

A favorable retirement outcome requires thorough analysis and Canadians need to make this more of a priority. Putting together a comprehensive financial plan takes time, but the time is well spent.

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