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The challenge of meeting retirement needs

Market movements have made planning more difficult

Canadians are at risk of outliving their retirement income. Life expectancy in Canada is 80.7 years and the average retirement age is just over 62, which means the average Canadian will require at least 19 years of retirement income.

However a recent study by Fidelity Investments shows there is a 50% chance that at least one member of a couple, both 65 years of age, will live to 90 and a one-in-four chance that at least one will live to 94. The possibility of requiring upwards of 30 years of retirement income has significant implications for planning.

While longevity poses a danger to retirement income, it is only one risk. According to Fidelity, 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. TD Economics estimates that cash will provide an average annual return of 3.40% over the next decade. Unfortunately the Bank of Canada has an inflation target of 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. According to Fidelity, 39% of retirees believe that out-of-pocket age-related health care expenses could deplete their savings and lower their standard of living. 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. Fidelity Investments estimates that 72% of non-retirees and 71% of retirees 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.

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A favourable retirement outcome requires analysis to determine financial priorities and compare income needs against discretionary goals. Cash flow models should account for such factors as lump sum cash needs for special events, future inflation, and debt reduction.

Analysis should be followed by a comprehensive financial plan with a retirement income strategy that reflects income sources, retirement expenses, cash flow needs, tax considerations, estate goals, and funding gaps as well as a strategy for required withdrawals of registered accounts and locked-in assets.

Good retirement income plans will make use of guaranteed income sources that guard against volatile markets and inflation erosion. These include government benefits, available pension income, and annuities.

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