

Design guide for retirement income solutions

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- Creating your client's desired lifestyle in retirement

What is this guide for?

This guide will help you help clients when they are most in need of your advice:

- during the period leading up to retirement, and
- the early stages of retirement.



Of course, their key concern is how to efficiently use the assets they have accumulated. This introduces entirely new concerns and considerations, after decades of saving for retirement.

This guide will help you work with each client to raise and help alleviate their concerns.

Market overview

The retirement market represents a significant opportunity for the financial services industry.

- By 2012, one in three Canadians will be 55 or older and will control more than \$1.5 trillion in assets.*
- You are well positioned to respond to the need for retirement planning expertise given the breadth of products and services you offer and the professional advice you provide.
- Most consumers are intimidated by the prospect of making long-term financial decisions involving such big dollar amounts. They need – and welcome – professional advice!
- Advice is so important. Consumers often consolidate their assets at retirement to benefit from the advice found in a comprehensive retirement solution. When the client consolidates assets, will you gain or lose the assets?

* Source: Household Balance Sheet Report, Investor Economics, 2007.

Discussing retirement needs with clients

What are the risks?

In shifting from asset accumulation to having to live off those assets, clients are exposed to a host of new risks they may not have previously considered. The first step in helping clients prepare for retirement is to understand these new risks and how they can impact the clients' goals for retirement.

Risk	Description
Longevity	The risk of outliving assets or having insufficient funds to last throughout retirement.
Inflation	The risk of the cost of living increasing beyond the ability to maintain the standard of living.
Investment	The risk that earnings won't sustain spending and the risk that investment losses will erode savings.
Lifestyle	The risk of not having efficient access to capital when needed. The risk of unplanned expenses depleting capital and income too quickly. The risk of ill health (leading to expensive medical or long-term care) eroding capital and income.

To better understand these risks, consider a simple budgeting exercise. Using some basic assumptions around life expectancy, rate of return and inflation, you can estimate the amount of regular income that can be generated to maintain a consistent standard of living. However, things will not unfold exactly as planned.

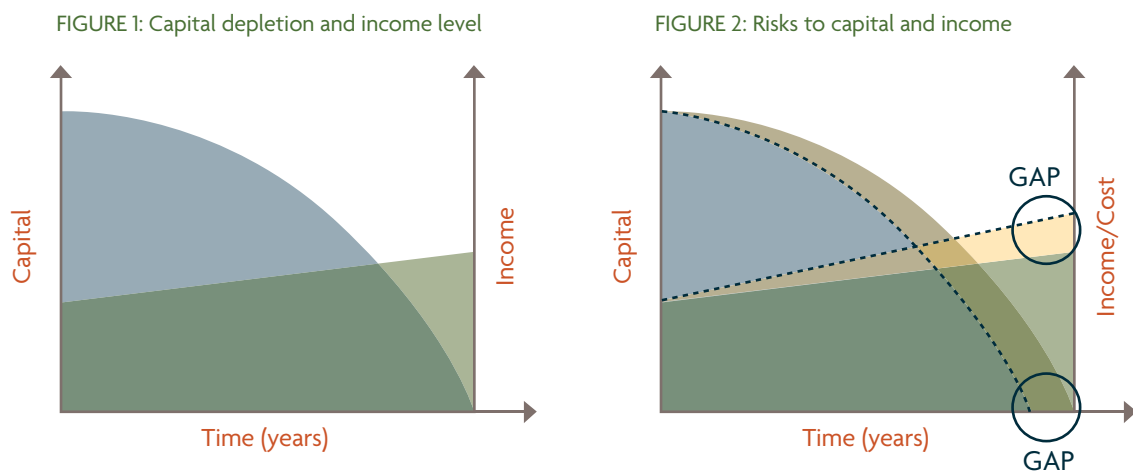


Figure 1 shows the income level and rate of capital depletion over time. Any of the above risks could cause a misalignment between a client's life expectancy, accumulated capital, and income required to cover increasing costs, as shown in figure 2.



Longevity risk and investment risk could lead to a capital gap if the client lives longer than expected or the investments underperform.

Inflation and unplanned expenses can lead to an income gap, a declining standard of living, or the client running out of money.

The cost of poor health has a similar impact if healthcare expenses are not covered under government or private plans. In extreme cases, healthcare costs rapidly erode the client's savings.

Liquid assets are also a factor. In cases where an income gap arises, an option is to increase the spending rate and draw down the capital base more quickly. However, there is a risk that your client's capital is not readily accessible and the additional income needs cannot be met. There is also a risk that reducing capital base would impact the ability of having income last for the client's lifetime.



TAKE A CLOSER LOOK

Selecting the appropriate retirement income product portfolio is a balancing act comprised of:

- identifying key risk exposures and mitigating the effect,
- understanding the client's concern about the income gap and/or the capital gap,
- using multiple products to properly mitigate the risk factors.

What do clients think about risk?

Clients will think on an emotional level and will tend to express concerns about running out of money or not being able to sustain their desired lifestyle.



Client language	What is the risk?
What if I outlive my money? My Aunt Margaret lived until she was 97.	Longevity risk – the client is recognizing that their accumulated capital base must support them for many years into the future and there is a real risk of running out of income. Investment risk – the client may not consider this risk. Poor returns or losses could impact their capital base and therefore also reduce their ability to have income last for life.
Our friend Bob had to move into a nursing home and sell his house.	Lifestyle risk – the client is concerned about the impact of unplanned healthcare costs on their income, assets and standard of living.
I want the freedom to travel.	Liquidity – the client is expressing a desire to maintain some flexibility in accessing capital to fund their lifestyle. Unplanned expenses – these additional expenses must be considered within the retirement income plan to avoid creating an income or capital gap.
Everything just seems to be getting so expensive!	Inflation risk – the client is likely feeling strain on their current income from rising prices. The client will be interested in ways to offset the impacts of inflation in their retirement income plan.

Focus the conversation with some great tools

Check out these valuable resources you can use with your clients to help identify their goals and fears for retirement, document the financial products they currently own, and learn about their retirement income options:

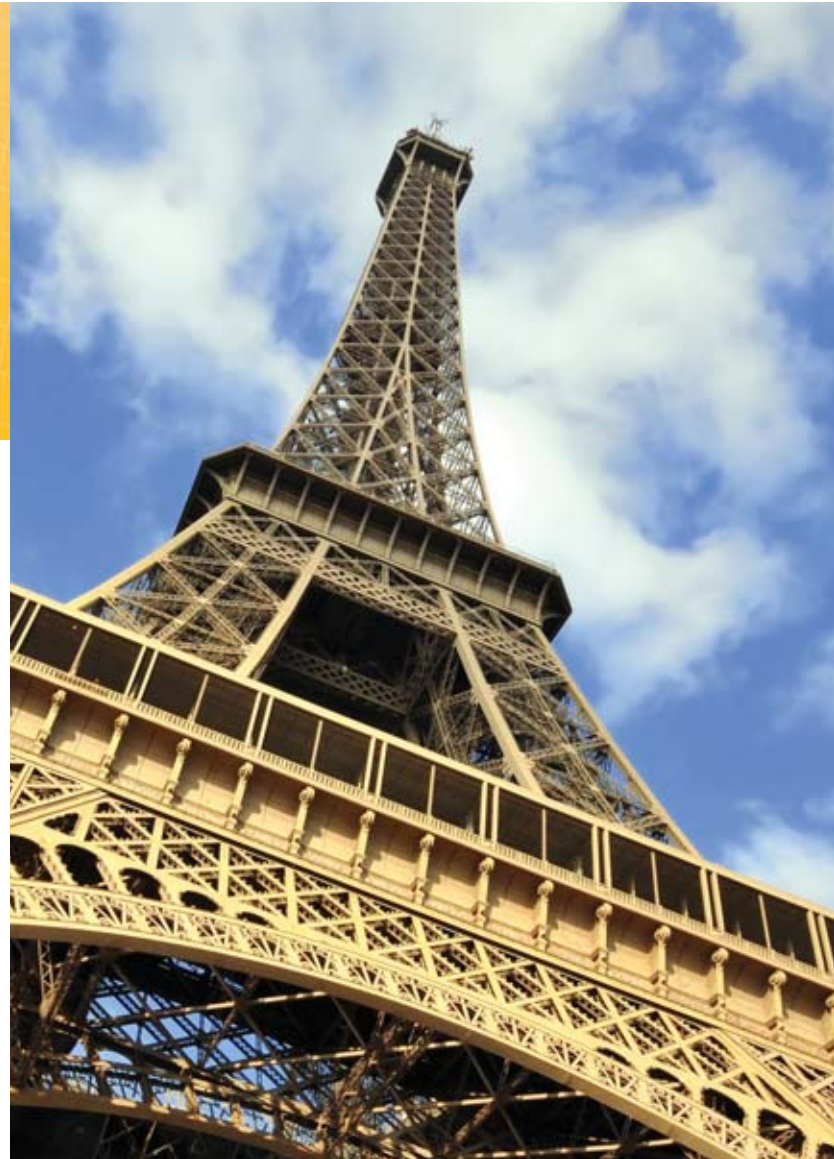
- *Build a retirement income plan to last a lifetime* (810-3554)
- *Create your own unique retirement blueprint* (810-3555)
- *Eight steps to a better retirement workbook* (810-3562)

Creating your client's desired lifestyle in retirement

Now the challenge becomes designing a retirement income blueprint to meet the needs and mitigate the risks of most concern to your client.

There will be multiple needs and many risks that can impact the plan, so a combination of product solutions will be necessary. The first step is to understand the product solutions available. The second step is to understand how to identify the primary needs and concerns articulated by the client and then create the most appropriate blend of solutions.

The table on pages 6-9 compare income product overview, tax treatments and how their features can address the risk concerns of clients.



	Payout annuities	Guaranteed investment certificates/ Accumulation annuities	Registered retirement income funds (RRIF) (Guaranteed or market-based investments such as segregated or mutual funds)
Product overview	- Guaranteed income either for a lifetime or a specified period. - Death benefit provided for beneficiaries during the guaranteed period of a life annuity, or the income period of a term-certain plan. - Income stream guaranteed, including potential for regular, pre-determined increases. - Mortality guarantees for life annuities built into the income calculation which can result in higher cumulative income over time.	Guaranteed investments offer a fixed interest rate for a specific term. Income provided with a monthly or annual interest option which pays out guaranteed interest amount while maintaining capital invested over guaranteed period.	- Registered investments must be placed into an income product, such as a RRIF, by the end of the year a client turns 71. - Guaranteed investments with a fixed interest rate over a specific term, or market-based investments, such as a segregated fund or mutual fund can be held within a RRIF. - Minimum income determined by government legislated schedule. - Long-term income not guaranteed. Poorly performing investments or withdrawals that exceed the minimum can decrease value and income over time.
Target clients	- Risk-averse consumers looking for guaranteed, worry-free income and potential for maximum income over their lifetime. - Active management of investments not desired. - Desire to minimize tax on non-registered investments by using prescribed tax, especially useful in estate plans and insured annuity concept.	- Risk-averse consumers looking for guaranteed returns with continued control over investment decisions. - Desire to preserve capital.	- Consumers interested in having control over investment decisions. - Want the flexibility to take more income when needed, recognizing risk to capital and future income. - Willing to actively manage their own investment.
Control over investment direction	None. No further investment direction possible once annuity is established and income stream purchased.	Some. Client has flexibility to adjust investment choices at reinvestment without penalty. Flexibility at other times may be subject to market value adjustment. (Note: non-redeemable GICs must be held to end of investment term).	Yes. Client can adjust investment choices any time. If invested in guaranteed products, adjustments made at a non-reinvestment date may create a market value adjustment.
Tax treatment (registered)	Income is fully taxable in the year paid.	Income is fully taxable in the year paid.	Income is fully taxable in the year paid.
Tax treatment (non-registered)	- Only product with prescribed tax capability. Prescribed tax uses a blend of interest and capital to provide level tax treatment over the life of the policy, resulting in lower tax in the early years, often as long as 20-30 years. - Non-prescribed tax (or accrual tax) is based on the interest accrual. - Prescribed tax treatment provides level tax treatment, which results in a smaller portion of the payment being taxable in the early part of the payment period. For a non-prescribed annuity, the payments are more like mortgage amortization payments with the early payments consisting largely of interest (which is taxable) and very little return of principal (non-taxable). Over time, the return of principal reduces the interest paid and each payment includes more principal, until the taxable portion is less than in the case of a prescribed annuity.	Interest accrual tax.	Not applicable.

Segregated funds With guaranteed minimum withdrawal benefit (GMWB)	Mutual funds Systematic withdrawal plan (SWP)
- Segregated funds combine growth potential of market-based investments with the security of principal guarantees. - The insurer provides a principal guarantee upon death of the annuitant or at maturity based upon all or a percentage of principal deposits. The guarantee is reduced proportionally by payments or withdrawals from the contract. Segregated funds are offered only by insurance companies. Guaranteed Withdrawal Benefit (GWB) Lifetime Option Beginning at age 65, this option provides investors with a guaranteed annual income of up to 5% of base deposits for life, regardless of market performance, with potential to increase. GWB Withdrawal Period Option Investors can increase their guaranteed income through a 5% annual guaranteed income bonus added to their guaranteed income benefits in years they don't make withdrawals, for up to a maximum of 15 calendar years after the initial deposit to GMWB units. Income payments are subject to legislated minimums and maximums and certain conditions. Withdrawals exceeding the allowed annual withdrawal amounts may have negative impact on future income payments.	- Mutual funds are a pool of investors' money invested in a portfolio of securities (usually stocks, bonds, or a combination of both) managed by an investment professional. - A systematic withdrawal plan provides regular income by cashing in fund units. Return consists of interest, dividends, capital gains or return on capital. Return is not guaranteed. - Offers greatest potential for capital growth, but also greatest risk. - Poor investment performance and continued withdrawals can erode capital and long-term income.
- Consumers willing to invest for a long time. - Willing to accept fluctuations in value of the investment. - Willing to pay higher expenses and management expense ratios (MERs) to have the income, principal and death benefit guaranteed. - Willing to actively manage their investment.	- Consumers willing to invest for a long time. - Willingness to accept fluctuations in value of the investment, and ability to live with volatility to maximize potential growth. - Willingness to actively manage investment.
Yes. The client can adjust investment choices any time and can hold up to a maximum of 70% in equity funds. A minimum 30% of the market value of investments must be classified as fixed income.	Yes. Full flexibility.
Income is fully taxable in the year paid.	Income is fully taxable in the year paid.
- Tax payable is based on return of principal and capital gains. The surrender of units may result in capital gains or losses. - Also, each year a segregated fund is required to allocate all income, gains and losses earned or realized by the fund among policyholders for tax purposes. Each policyholder will receive a tax slip, even if they have conducted no transactions. The allocation from the fund will be based upon the type of securities held in the fund and the trading activities of the fund, and therefore could be interest, dividends, or capital gains or losses.	Tax dependent on income source within the fund and on structure of the product.

	Payout annuities	Guaranteed investment certificates/ Accumulation annuities	Registered retirement income funds (RRIF) (Guaranteed or market-based investments such as segregated or mutual funds)
Longevity risk	- Protects against longevity risk. - A life annuity guarantees income for the life of the annuitant.	No longevity protection.	Minimal longevity protection. Using the minimum schedule ensures some income, but that income could decrease over time with poor performance or unplanned withdrawals.
Inflation risk	- Inflation protection provided through an available inflation (annual) indexing option. - Indexing is not available on annuities with prescribed tax treatment.	No inflation protection.	- Minimal inflation protection provided depending on growth potential of the underlying investment mix. - Some residual inflation risk remains if investment underperforms.
Rate of return risk	Not applicable.	Protects against rate of return risk by providing a guaranteed interest rate.	- Protection against rate of return risk depends on investment mix. - Conservative investments may not provide sufficient return, while more aggressive investments may have greater volatility.
Liquidity risk	No liquidity available. All funds have purchased the income stream.	- Can access funds if needed. Market value adjustments apply if withdrawals are made outside of the reinvestment date. - For non-redeemable GICs, funds are only accessible at the end of the investment term.	Can access funds if needed. Market value adjustments may apply to guaranteed interest products.
Unplanned expenses	Does not provide protection against unplanned expenses.	No protection provided. Withdrawals in excess of the investment returns will erode capital and reduce income.	Some protection provided. Growth in the underlying investments will help offset unplanned expenses.
Poor health risk	Traditional income products do not address this risk, long term care insurance does. For individuals who are unable to care for themselves due to illness, accident or deteriorating physical or mental abilities, long term care insurance provides funds needed to obtain long-term care services, without having to deplete savings.		

Segregated funds With guaranteed minimum withdrawal benefit (GMWB)	Mutual funds Systematic withdrawal plan (SWP)
• The GWB Lifetime Option protects against longevity risk. • Automatic GWB resets (every third year) could increase the lifetime income (LWA) for the GWB Lifetime Option.	• No longevity protection guarantees.
• Inflation risk is reduced by growth potential of underlying fund selection. • Automatic GWB resets (every third year) could increase the lifetime income (LWA) for the GWB Lifetime Option. • Inflation risk remains if investment underperforms.	• No direct inflation protection is provided. Growth potential of the investment provides some mitigation. • Residual risk remains if the investment underperforms.
• Protection against rate of return risk in a market downturn is provided to some extent through principal or minimum withdrawal guarantees.	• Full exposure to rate of return risk. Protection against rate of return risk depends on investment mix. • No downside protection.
• Yes, fully liquid. Withdrawals could negatively impact the guaranteed income level. Redemption fee charges may apply for withdrawals made from deposits purchased on a deferred service charge (DSC) basis.	• Yes, fully liquid. • DSCs could apply in early years after investment.
• Some protection provided. Growth in the underlying investments will help offset unplanned expenses.	• Some protection provided. Growth in the underlying investments will help offset unplanned expenses.

The following section provides more detail on combining the products into a comprehensive retirement portfolio, tailored to each client.



Developing an integrated retirement portfolio

There isn't one perfect product to meet all your client's needs, and each client's solution will be unique to their goals. It's important to build an integrated portfolio drawing on the strengths of a combination of products to best meet the needs of each client.

The following table illustrates the differing situations of conservative and aggressive consumers.

	Conservative	Aggressive
Longevity risk	• Consumers with low risk tolerance will be very concerned about having a regular monthly income to cover living expenses. • More of a concern for those with fewer assets or those retiring early. • May consider using 50% or more of the client asset base to buy a payout annuity. • Putting too much capital into an annuity can increase exposure to liquidity risk and unplanned expenses.	• Those with more capital or higher risk tolerance may be less concerned with longevity risk. • Payout annuities may comprise as little as 10-20% of capital base. • May have an increased appetite for GMWB (10-30%) that provides upside potential and some longevity protection.
Inflation risk	• Those with less capital or those retiring early have more exposure to the effects of inflation. • Those with lower risk tolerance are also at risk here. • Allocating 50% or more of the retirement income portfolio to a payout annuity with indexing could be considered.	• Consumers with higher risk tolerance will want to reduce inflation risk by choosing more aggressive investment mixes. • Non-registered options, such as a mutual fund SWP, can be considered in a range of 20-40%. • Relying more heavily on market returns increases investment risk.
Investment risk	• Consumers with proportionately more holdings in a guaranteed option such as an annuity are less exposed to investment risk. • Some risk remains when part of the capital is invested to provide some income and maintain a cushion for unplanned expenditures. • Consumers will favour guaranteed interest options to preserve their capital and earn some return.	• Consumers with higher risk tolerance will have exposure to this risk through their choice of more flexible income options and returns linked to market performance. • Increased exposure to investment return risk could lead to increased longevity risk in that poor or negative returns may result in having enough money to live on. • Inflation risk can compound the impact of poor or negative returns on the standard of living the client can afford. • Advisors should review the asset allocation process to develop an appropriate investment mix for the client.



	Conservative	Aggressive
Lifestyle risk	• Liquidity will be a significant risk for this type of consumer, given the nature of their product mix. Some capital should be held in a more flexible product such as a guaranteed interest product, or segregated fund contract (non-GMWB), to create some liquidity. • Unplanned expenses are a significant risk for this type of consumer given the nature of their product mix. Some capital should be held in a more flexible product such as a guaranteed interest product, or segregated fund contract, to cover additional expenditures. • Also consider the consumer's goals for retirement and their need for money to travel, fund new hobbies, renovate, replace aging vehicles, etc.	• In terms of liquidity, the more flexible market-based products favoured by this type of consumer provide flexibility in accessing money; however, there is an increased risk of market fluctuation and capital depletion affecting the return potential. • Unplanned expenses will be somewhat of an exposure for this type of consumer, given the nature of the product mix. The consumer will typically have some money for unplanned expenditures. Growth in the accumulated asset base can provide a cushion for these expenditures. But, too many unplanned expenditures can deplete the accumulated capital and available income.
	• The risk of healthcare expenses impacting income and the accumulated capital base applies to all consumers. • Long term care insurance can reduce the risk, but the premiums would reduce available income. • Different types of long-term care policies exist; some provide reimbursement for eligible expenses; others, like Sun Long Term Care Insurance, provide income that can be spent as the insured person chooses, allowing them greater flexibility in terms of who provides their care and in what setting.	

Notes

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