



Income solutions for life

Not long ago, the popular dream of retirement started early, at 55, followed by many healthy years away from work enjoying hobbies, travel and time with family and friends. That picture of the future may never have been very realistic financially, and it has certainly changed over the years.

At retirement 60 per cent of Canadians aged 47 to 64 plan to work full or part time¹. They imagine themselves employed full-time, part-time or as consultants and business owners.

Why is the idea of a working retirement becoming so popular? In part, retirees are motivated by a desire to remain connected to the working world. More ominously, though, many are worried that the money they've saved for retirement won't last long enough.

There's reason for concern. According to Statistics Canada, a 65-year-old man can expect to live another 19.5 years. A 65-year-old woman can expect to live

22 years². And not all of that time will be healthy. Disability-free life expectancy for Canadian men is just 66.9 years. For women, it's not much better, at 70.2 years. As retirees' health deteriorates, they may need significantly more income to support modifications to their homes and, possibly, accommodation in a long-term care facility or other long-term care expenses.

Nevertheless, while fear of running out of money might be causing a majority of Canadians to consider softening the transition to retirement by remaining at work, few people approaching or at retirement age succeed in staying employed. Just 27.9 per cent of people over 55 and 6.7 per cent of people over 65 were in the labour force in 2002, says Statistics Canada. (www.statcan.ca)

That means the majority of older Canadians are not working. These individuals have to rely on the principal they have amassed, supplemented by income generated by their investments and government benefits, to support them throughout the rest of their lives.

¹ Strategic Guidance Consulting Inc., The Aging Boomer Canada - 2006.

² 1996 US Annuity 2000 Basic, Male and 1996 US Annuity 2000 Basic, Female.



WILL YOUR MONEY LAST LONG ENOUGH?

Let's assume that you've retired at 65 with a Canada Pension Plan or Quebec Pension Plan benefits and a small pension from your employer. You've paid off your house and you don't have any other significant debt. You work out that you need an additional \$10,000 in after-tax income drawn from your investments to maintain your pre-retirement standard of living.

Fortunately, you've built up a \$250,000 nest egg inside an RRSP. How long will it last? That depends on a number of factors, including inflation, your marginal tax rate, and the average annual rate of return on your investments. Let's assume 3 per cent annual inflation, a 33.33 per cent tax rate and a 5 per cent rate of return from a mix of fixed-income and balanced mutual funds. Under these conditions, your nest egg will support you for approximately 20 years.

That sounds like a long time. However, if you're a 65 year old man, you have a 49.3 per cent chance of reaching age 85 and running out of money. If you're a 65 year old woman, you have a 62.2 per cent possibility of reaching the same age and outliving your nest egg³. Those aren't very good odds. There are a few things you can do to make your money last longer. Earning a higher rate of return makes a significant difference. In fact, if you can achieve an 8 per cent rate of return every year, the growth in your investments will be sufficient to fully cover your withdrawals and your money will last well past age 100. But as we've

seen over the past few years, earning 8 per cent annually can be difficult to achieve. It may also require you to invest in equities that are more volatile than your post-retirement risk tolerance will allow.

PROTECTING YOUR INCOME WITH AN ANNUITY

Another option is to purchase an annuity that pays out a guaranteed income for life or for a specified period of time. An annuity is basically a mortgage that works in reverse. When you take out a mortgage, you borrow a large sum of money and pay the principal and interest back gradually over a number of years. With an annuity, you invest money with a financial institution, which makes income payments to you consisting of both principal and interest. Of course, a mortgage ends when the loan has been completely paid off. An annuity, on the other hand, can be set up to pay you income for the rest of your life.

There are many types of annuities, but three of the most common are:

- Life annuities, which pay a set amount of income for life
- Accelerated annuities, which offer a higher level of income to people with serious medical conditions who may face higher living costs
- Term certain annuities, which pay a set amount of income for a time period you choose

For example, you could invest your \$250,000 RRSP into a life annuity. This investment would produce an annual after-tax income of \$9,651.92⁴ for the rest of your life no matter how long you live – guaranteed.

³ 1996 US Annuity 2000 Basic, Male and 1996 US Annuity 2000 Basic, Female.

⁴ Based on August 2006 annuity interest rates, male age 65, 10 year guarantee of payments and indexed at 3%, 33.33% marginal tax rate.





Annuities often have a “joint and survivor” clause that allows you to base the annuity contract on the lives of two spouses so that the income stream continues even after one spouse passes away. Many also help combat the effects of inflation with annual increases so your purchasing power doesn’t decrease over time. Most even provide a “payment guarantee” option that allows your beneficiaries to receive annuity payments if you die within the guaranteed period – which may range from, for example, three to 30 years.

The biggest challenge you face in trying to ensure that you never run out of money is that you, as an individual, don’t know how long you’ll live. Financial institutions are able to offer annuities because they have many annuity purchasers. The bigger the pool of annuity purchasers, the more accurately the company will be able to predict how long an average purchaser will live – because the life expectancy of a large group will approach average Canadian life expectancies. Once a financial institution has done the math, it knows with a fair degree of certainty what returns its annuity assets need to earn in order to keep pace with their annuity income demands.

If you’re interested in finding out more about annuities or other income protection solutions, talk to your financial advisor. There are many solutions available that can help you enjoy retirement without worrying about whether you will outlast your money.

Life expectancy in years at given age		
Age	Male	Female
50-54	29.7	33.8
55-59	25.3	29.2
60-64	21.1	24.8
65-69	17.2	20.6
70-74	13.7	16.7
75-79	10.5	13.0
80-84	7.9	9.8
85-89	5.6	7.0
90+	4.1	5.0

Source: Life expectancy, by age group and sex, Canada, 2002, Statistics Canada

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