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The Retirement Spending Challenge

By: Donald A. Stewart

The message is pervasive – we must save for **retirement**.

A generation ago, a mix of economic and business trends began shifting the responsibility for **retirement** saving to individuals and away from institutions and employers. RRSPs became popular in Canada, giving rise to the wealth accumulation strategies, products, and services so indispensable for Canadian **retirees**-in-waiting today.

Much attention has been focused on building the **retirement** 'nest egg,' but much less has been said about the draw down of wealth during **retirement** – the disbursement phase.

There are a number of reasons why this is becoming increasingly important. The leading edge of the baby boom wave is about to come crashing onto the shores of **retirement** and attention goes where the boomers go. The focus will shift from accumulation to disbursement.

Greater Reliance

Along with the demographic shift comes another important shift affecting retirement – the shift away from Defined Benefit pension plans. This has meant a greater reliance on RRSPs and other wealth accumulation instruments, and greater market risk.

In addition, health and long-term care costs continue to escalate faster than wages and inflation, and longevity is increasing at a remarkable rate. It's often difficult for Canadians to fully comprehend the impact of increased longevity on all aspects of our society, let alone how to manage the risk that they may outlive their money.

To understand this issue, it is important to realize the true impact of longevity risk. A 2005 study by the Society of Actuaries found that two-thirds of retirees under-estimated their average life expectancy, and that two-thirds of that group under-estimated it by five years or more.

Another trend with a significant impact on retirement is the decline in DB pension plans. Not so long ago, employees retiring with 30 years in a DB plan did not worry about outliving their assets – their plan was designed to provide an income for life. Today, DB plans are being replaced with Defined Contribution pension plans and other savings arrangements. These have many positive features, but the path to a predictable lifetime income is not as clear as under a DB plan.

One way to increase income security for DC plan members is to introduce an annuity feature within the plan, as we've seen in the U.S. These 'in-plan annuities' offer plan members the benefit of a lifetime income stream coupled with the opportunity for investment growth.

Spending Patterns

Another factor to consider is spending patterns in retirement. They are just as volatile as longevity and investment returns.

A recent study by Sun Life in the United States shows that most pre-retirement boomers expect to be very active in their early retirement, signaling the need for flexibility in their investment regime. Simply put, the boomers don't plan on staying home. Many of us will be major consumers of healthcare in our twilight years.

The retirement risks are clear – longevity, investment returns, and retirement spending. The life insurance industry is responding with more sophisticated income security products designed to help manage the risk of outliving assets. Such products are timely, but they are only part of a broader set of solutions including longevity insurance, target date investments, and auto-pilot DC plans.

Financial institutions have an obvious interest in helping individuals draw down their retirement assets in an orderly way. We see it as our responsibility, but the life insurance industry is not capable of addressing this challenge on its own – others must step up as well.

Financial planners need to educate themselves and their clients on mortality trends, the latest product innovations, and offer a wider range of solutions. Employers can introduce more lifetime income options to their DC plans and provide easier access to rollover options when people leave the company DB plan.

Finally, individuals must open their minds to the possibility of outliving their assets and seek out financial advice on the full spectrum of solutions.

The baby boom generation has redefined society's expectations throughout their lives, and they will continue to do so as they retire.

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