Shifting to retirement income

Get your high-net-worth clients retirement ready

Retirement can be complex, especially for high earners. Our recent workshop featured **Ron Hanson, Head of Retirement** and a variety of our in-house experts to help you get your high net worth (HNW) clients ready for the future.

Hanson discussed the new retirement reality that Canadians are facing. Demographics pose not only a challenge, but an opportunity. Within 20 years, Canada will be home to more than 10 million people over the age of 65. The average age of retirement is currently 63, with a life expectancy of 87 to 89 years, so the average Canadian can expect to live more than 25 years in retirement.

The opportunity for advisors is immense. By 2030, retirement assets are expected to nearly double, from $2.4 trillion to $4.7 trillion – accounting for almost half of Canadian financial wealth. Expanding the age range to 55+, the asset base grows to $6.4 trillion, two-thirds of Canadian financial wealth.

Clients tend to consolidate their assets as they transition from accumulation to decumulation, which requires a shift in mindset for both clients and advisors alike. To ensure clients can live the meaningful retirement, they will need a comprehensive decumulation strategy that balances the needs for income, stability and growth. This strategy must also focus on optimizing after-tax income and consider the order of asset withdrawal.

Case study

Throughout the webinar, we revisited a case study of a HNW couple, Tom and Gina Amos. Tom, 65, is a business owner with 95% of the shares in TG Inc. He is collecting $10,000 per year from CPP and $7,000 from OAS. Gina is 63, owns 5% of TG Inc. and is a retired psychologist. She currently receives $20,000 per year from her DB plan and will begin collecting $14,000 from CPP and maximum OAS when she turns 65.

They expect to sell their home and downsize in five years, netting $500,000 from their real estate transactions and invest these proceeds. Their desired annual retirement income needs are estimated at $120,000 after tax.

	Tom		Gina		
	FMV	ACB	FMV	ACB	Total
RRSP	$ 400,000		$ 200,000		$ 600,000
TFSA	$ 90,000		$ 85,000		$ 175,000
Non-Reg	$ 300,000	$ 200,000	$ -		$ 300,000
TG Inc.					
Cash	$ 400,000				$ 400,000
Investments	$ 600,000	$ 450,000			$ 600,000
Total					**$ 2,075,000**

TG Inc Tax Accounts	
CDA	$ 150,000
NERDTOH	$ 250,000
ERDTOH	$ 150,000
GRIP	$ 150,000
LRIP	$ 250,000

The business opportunity

Retirees have two resources they will spend in retirement: their money, and their time, explained **Larry Distillio, Assistant Vice-President Practice Management**, Mackenzie Investments.

There's an opportunity for advisors to help their clients navigate the extra 2,000 hours that will have available each year. Some clients may have a list of everything they want to do in retirement, while others may be anxious about how they will use their extra time in a way that makes them happy and fulfilled.

The advisor who can help clients with the emotional side of retirement, as well as financial, will have an advantage over those who focus on numbers alone.

Tom and Gina Amos are staring at the blank canvas, unsure of the picture they want to paint of their lives in retirement.

A good starting place with them as clients would be to ask them what emotions they are experiencing when they think about retirement. They may feel anxious, or even frustrated that they haven't come up with a lifestyle plan.

Following up on their response, it would be helpful to understand the thoughts that come to mind when they experience these emotions. They may be wondering if they will be okay, if they will find meaning without work, or worry that they may outlive their assets.

What would it mean to them if these thoughts were to come true? They may have to work longer, or find they are getting in each other's way.

"An uncertain mind says 'no'," Distillio said. "They don't follow through on the plan. They create a 'safety behaviour' – a self-sabotaging behaviour where the amygdala part of the brain kicks in and your clients will worry, procrastinate and avoid putting together a plan. Our job is to change how the clients are thinking, so they can change how they feel and change how they are acting."

It is important to show that you have heard and understand their concerns, to reduce their anxiety and begin a discussion on creating a plan that will consider their lifestyle needs as well as their income needs.

This is the cornerstone of Mackenzie's Purposeful Retirement Coaching Process, which entails taking an inventory of their:

- Stress points
- Happiness
- Retirement mindset
- Unique talents and skills
- Personal (non-financial) needs

With this information, you can address their stress points and help your client identify themes and goals. This would help Tom and Gina, who are both in the uncertainty stage of retirement, determine where their life together is going. Leveraging their unique talents and skills, they can direct their energy toward fulfilling their personal non-financial needs.

Tax-efficient retirement income

Tom and Gina have substantial assets but are still worried about whether they have enough to last their lifetime. The order of asset withdrawal can have a significant impact on the taxes paid in retirement, said **Frank Di Pietro, AVP Mackenzie Tax & Estate Team**. It can affect how long their money will last as well as their net estate value at time of death.

"This process involves layering income in a manner that uses a combination of fully taxable, tax-preferred and non-taxable sources of income," said Di Pietro. "It also requires creating an exit strategy for your RRSP; do you choose to accelerate registered savings and draw down as a priority, or do you defer them to a later age as a last priority."

He presented three withdrawal strategies based on their maximum after-tax income until age 90 (Tom) and 92 (Gina), projecting 10 years beyond their expected mortality age. That income is $144,072, which is greater than their expected need of $120,000 – this answers the common question among retirees: Yes, they will be OK.

The best strategy for obtaining maximum income is to generate retirement income from non-registered funds first, followed by registered and finally their TFSA. This would leave their estate with a net value of $845,698 at expected mortality.

The second-best outcome would target registered accounts first, then non-registered, and finally their TFSAs. The goal here is to accelerate RRSP withdrawals to reduce the risk of high taxes at the time of death. This plan would result in a net estate value of $763,592 at expected mortality.

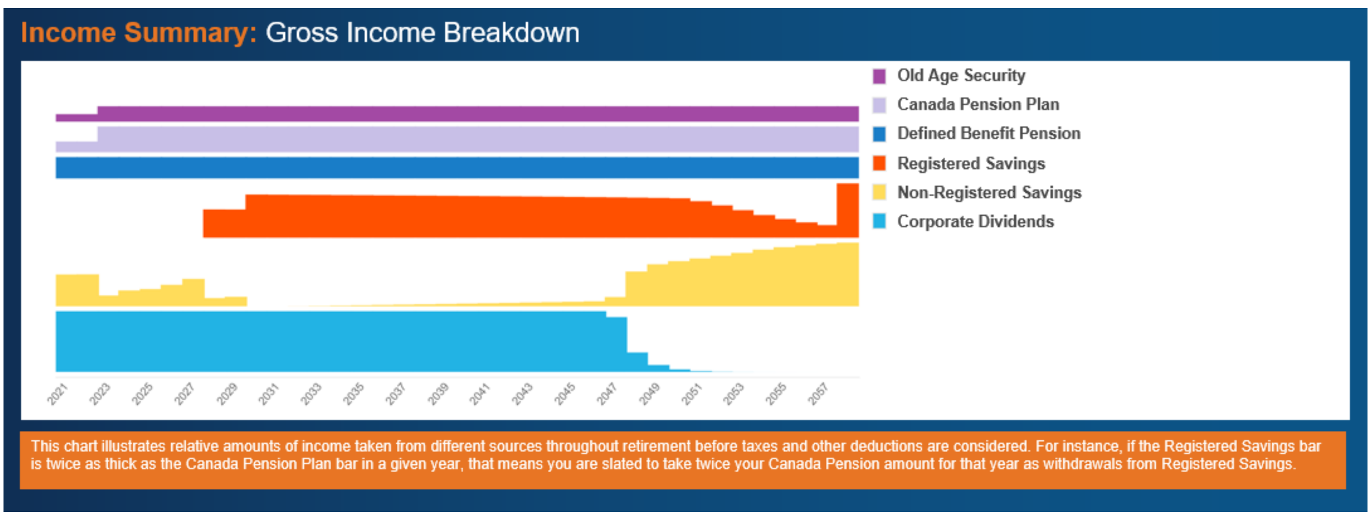
The third withdrawal strategy is the maximum deferral strategy, which defers registered plans as a last withdrawal priority. Their estate's net value should be $763,501 at expected mortality.

Targeting their desired income needs of $120,000 after tax, the withdrawal strategies still rank in the same order, but with net estate values of $1.61 million, $1.54 million and $1.52 million, respectively at expected mortality.

The details

For the best-case scenario, their non-registered account drawdowns supplement their other income sources: their CPP and OAS, as well as Gina's DB plan. This relies heavily on corporate dividends from their company. Their OAS and CPP rises in 2028 when Gina starts collecting these benefits.

Registered savings only come into play when each of them reaches 72 and must begin withdrawals. At this point, they reduce their income derived from non-registered savings. By 2048, their corporate assets have been depleted and their non-registered accounts must make up the shortfall.



Tweaks

In this case, they do not need to tap into their TFSA, which continues to grow throughout their retirement, passing to their estate on death. However, Tom may be subject to OAS claw back in the future. Therefore, if he wishes to reduce his exposure to OAS claw back, he could choose to reduce his corporate dividend income and take withdrawals from his TFSA instead, as an option.

If Gina defers CPP/OAS until she is 70, it could add $2,500 per year to their net income and increase their estate's net value by $21,390.

When they downsize their home, they may also consider a prescribed rate investment loan from Tom to Gina, as she is in a lower tax bracket to enhance after-tax retirement income.

Since Tom is 65, the retirement exclusion is available, and Di Pietro calls it the “default solution” for clients looking to pay dividends to non-active shareholder spouses. But if he was under age 65, he could still split income with Gina under the second-generation income exclusion. If the company is not carrying on business, any dividends earned in its portfolio of marketable securities would be second generation, and therefore not subject to the federal tax on split income (TOSI) if paid to Gina.

“We can pay out that portfolio income and have it safely taxed in Gina’s hands,” he said. “Any original capital used to purchase the securities is paid out to Gina, then TOSI may apply. They could invest the money and keep the investment earnings separate from the capital, and flow those earnings to Gina, providing another way to enhance retirement income to Gina.”

Retirement income portfolios in today’s complex economic environment

Dan Arsenault, **Senior Investment Director** Mackenzie Multi-Asset Strategies Team pointed out that in 1995, a 7.5% return could be generated with a portfolio that was 100% government bonds, with a standard deviation of 6%.

Over time, as interest rates have fallen, the required portfolio for a 7.5% return has changed dramatically. By 2020, achieving the same 7.5% return requires the following allocations:

- private equity, 49%
- non-US public equity, 37%
- US large caps, 7%
- US small caps 7%

Bonds have fallen out of the portfolio entirely, and standard deviation has tripled since 1995, to 18%. To avoid taking on undue risk, clients will need to have a clear set of goals and a robust strategy to achieve these goals.

Fixed income will still play a role, Arsenault pointed out, as the need to diversify riskier assets and provide income remains. But it will become harder to manage the risk of that yield. Engaging with a professional portfolio manager will be critical for those who are unable to piece their portfolio together on their own.

Alternatives can be used to make a portfolio more independent of the market cycle, or to amplify the market cycle. The overarching benefit is to have returns disconnected from overall market movement. Assuming alternatives are suitable, an investor with a relatively diversified portfolio may benefit from holding 10-25% in alternatives, funded from both the equity and fixed income portions of the portfolio.

Steven Armstrong, Dedicated Portfolio Manager to Mackenzie Private Wealth Counsel and Member of the Multi-Asset Strategies Team, explained how he constructs portfolios with an allocation that is customized to the client's needs.

The equity/fixed income ratio is determined through a detailed questionnaire and discussions with the advisor. The portfolios are then built with seven to nine funds, with 5% increments in risk/return efficiency. The portfolios are diversified across geographies, market capitalization and investment style.

The portfolios are built upon three pillars that are critical for stable retirement income:

Recognizing that many HNW clients may have substantial holdings in shares of their own company, Mackenzie Private Wealth can tailor the model portfolio to accommodate their existing geographic and sector concentration.

For the full event, including the Q&A session, please watch the replay video.

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