Three Risks: Inflation, Longevity, Sequential

Affect on Pension Income and Transfer Option Income

Inflation

"The Bank of Canada aims to keep inflation at the 2% midpoint of an inflation-control target range of 1 to 3%. The inflation target is expressed as the year-over-year increase in the total consumer price index (CPI)—the most relevant measure of the cost of living for most Canadians." (April 2015, bankofcanada.ca)

Many pension plans have some provision for inflation protection. But often they have a floor, a cap, or other restrictions linked to the consumer price index or plan performance. For example, the University of Guelph's pension indexing is "CPI minus 2%". It's tough to get inflation protection when a pension's indexing provision threshold equals the Bank of Canada's target!

The transfer option provides few limitations. One can increase withdrawals to offset inflation. While a life income fund (LIF) has certain minimum and maximum withdrawals, 50% of LIF assets may be transferred to a registered retirement income fund (RRIF) within 60 days of the LIF set-up. RRIFs have no maximum withdrawal.

Longevity

In Canada, the average life expectancy is 79 for males and 83 for females (statcan.gc.ca). This is an average, which means half die sooner and half live longer. So, it's important to make plans and provisions based on living longer; that way you won't outlive your money!

While defined benefit pension plans promise to pay income for life, their guarantees are based on strong assets. Plans that are continuously in deficit may one day be forced to wind up, and pensioners and plan members may get a fraction of what was promised. E.g. In 2011, Nortel pensioners' benefits were cut 25-41%.

Taking the transfer option upon termination or retirement puts you in control of your money.

Sequential

The order or the sequence of investment returns is a primary concern for retirees. Low or negative returns during the first few years of retirement, especially if withdrawals are made, will have a major impact on wealth.

Sequential risk is important for members in defined contribution and hybrid pension plans. Lump sums and minimum guarantees are affected by negative markets. Sometimes plan members will defer retirement until investment markets have improved. Sequential risk may seem less important to defined benefit pensioners; but, as stated above, pension plans that face continuous deficits may be forced to wind up.

Following a conservative investment strategy is often the best way to isolate sequential risk. The transfer option puts you in control and you may invest your funds in any manner.

All information is believed to be accurate at April 2015

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