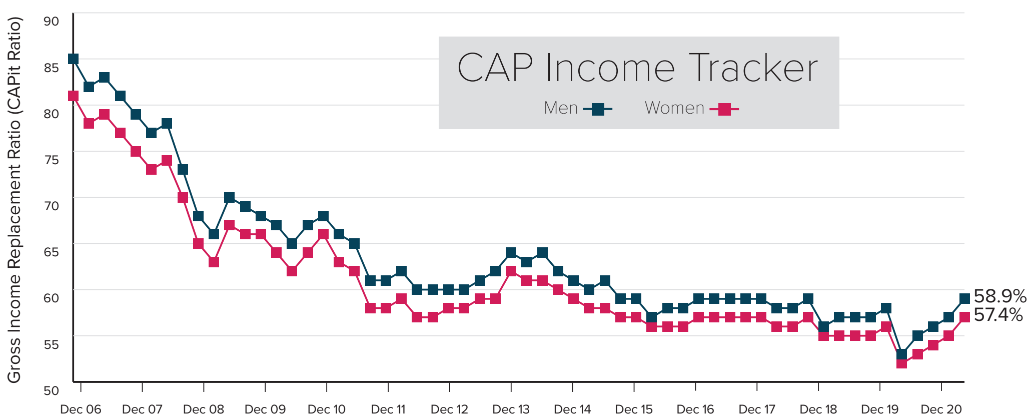
CAPit

Capital Accumulation Plan Income Tracker

April 2021

Time to start thinking about annuities

Against the backdrop of above-trend economic growth and accommodative monetary policy, equity markets around the world finished strong in the first quarter ending March 2021. For a typical male DC plan member retiring at age 65 at the end of March, the gross income replacement ratio bounced back to 58.9% – a replacement ratio that has not been seen since 2017. For a female DC plan member, the ratio improved to 57.4%. While strong market returns have accelerated the recovery of income replacement ratios back to pre-pandemic levels, the biggest driver of the increase over the past quarter was the rise in long-term bond yields and annuity rates.



Given the record-low interest rates over the last number of years, annuities grew increasingly out of favour as a viable option for DC retirees. However, with interest rates moving back up, it's time to recognize the value of annuities – from both a financial and mental health perspective. Much like the benefits of a defined benefit pension, with guaranteed income for life, annuities provide DC members with a steady stream of retirement income and peace of mind that comes from knowing they won't run out of money.

In addition to the financial security and mental wellbeing that annuities provide, they have also been shown to provide a higher income over a greater number of retirement years. Members who choose to drawdown their retirement assets are faced with the ongoing decisions of how much to withdraw each year and how to invest the remaining assets in order to maintain their standard of living while reducing the risk of outliving their assets.

If a DC retiree withdraws the maximum LIF amount each year their portfolio will be depleted by the time they are 90. However, 53% of women and 41% of men will live past the age of 90! We can also see from the chart below, that while the maximum LIF withdrawal amounts will provide a higher income for the first few years of retirement, an annuity provides a higher income over the majority of years at no risk.

THE CAP INCOME TRACKER

The CAP Income Tracker assumes the member made annual contributions at a rate of 10% starting at age 40, will retire at 65, will receive maximum Old Age Security and Canada/Quebec Pension Plan payments, and will use their CAP account balance at retirement to buy an annuity. The member's CAP account is invested based on a balanced strategy. Salary has been adjusted annually in line with changes in the average industrial wage, and is set at $68,416 at March 31, 2021.

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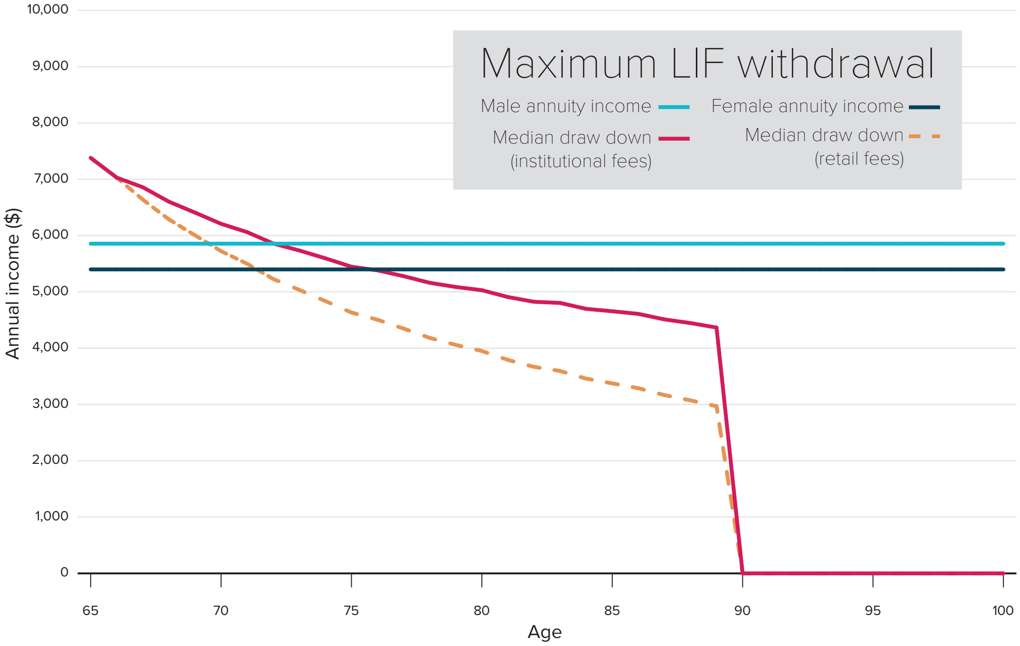

Survival probabilities

Age	65	70	75	80	85	90	95	100
Male	100%	95%	87%	77%	61%	41%	20%	5%
Female	100%	97%	92%	84%	72%	53%	31%	11%

ANNUITIES PROVIDE HIGHER INCOME

This chart compares the income a Canadian could receive from the two main pension retirement income vehicles in Canada: an annuity and a Life Income Fund (LIF). Each province requires a minimum and maximum amount to be withdrawn each year from a LIF. This graph shows the maximum withdrawal allowed. If a person withdraws the maximum each year, their savings will be gone by age 90. An annuity, however, is a guaranteed payment for life. Women generally receive a slightly lower annuity because they are expected to live longer. Below the chart are the probabilities of still being alive at various ages. Clearly, annuities provide a higher income over almost all retirement years and will be paid for life.

COVID-19 has shown us how fragile many Canadians' financial positions are. While annuities can provide a higher income and peace of mind to DC retirees, members don't have to choose one income option over the other. Depending on their personal financial situation and risk appetite, members can choose a combination of options to meet their needs. Sophisticated member tools and unbiased financial planning expertise can help with the key decisions that are unique to each member.

Assumptions:

- *Return assumptions based on Eckler's 2021 stochastic model of capital market returns*
- *$100,000 starting balance*
- *Invested 40/50/10 in global equity/universe bonds/cash from age 65-70, moving to 20/70/10 over 20 years from age 70-90*
- *LIF fees: institutional 0.35%, retail 2.0%*
- *Single life, 10-year guarantee annuity rates at March 31, 2021. Male annuity rates from CANNEX.com. Equivalent female annuity rates estimated by Eckler.*
- *Survival in line with CPM2014 private sector mortality tables, projected with CPM-B.*
- *Based on maximum withdrawal rates applicable for 2020 in ON, NB, SK, NL, BC & AB. Different rates apply in other jurisdictions.*