

# What is retirement income success?

By Stephen L. Deschenes



Stephen L. Deschenes  
Senior Vice President and  
General Manager, Annuities  
Division, Sun Life Assurance  
Company of Canada (U.S.)

Some people define retirement income success as not outliving their retirement income. Others define it as having time to do things they love. Still others define success as not worrying about losing everything. The correct definition is actually all of the above, and that's what makes building a retirement income plan so challenging.

There are three elements in any retirement plan that can really make it shine. These elements are 1) the **certainty** of protected income in down markets, 2) the **opportunity** in up markets to increase retirement income over time, and 3) the **flexibility** to adapt the plan to changing needs.

People today debate a lot about how to address potential shortfalls in retirement plans. The financial services industry focuses on four main risks that are key to a retirement income plan: lifestyle, investment, longevity, and inflation. Any of these can derail a plan, so industry players are trying to help consumers educate themselves while crafting solutions that potentially mitigate or even eliminate the effects of the risks altogether.

## A successful retirement income plan can:

- adapt with ever-changing lifestyle needs
- withstand up and down markets
- last for a long retirement (30+ years)

## Key risks to consider when planning retirement income

**Lifestyle** risk relates to how most people want to enjoy certain hobbies and activities during retirement but may have to cut back their standard of living because they haven't adequately planned for the income needed to support their desired lifestyle. Sun Life's Unretirement Index found the lifestyle risk to be a real concern for a lot of individuals. Eighty percent of those people who plan to work at the age of 67 stated it was to earn enough money to live well.<sup>1</sup>

If not properly accounted for, **inflation** will eat away at the purchasing power of people's income or assets. For instance, assuming an annual inflation rate of 3.20%, you will need \$938,780 in 2030 to replace \$500,000 in 2010—that's 88% more in just 20 years.

**Longevity** comes into play when people outlive their assets or retirement income sources. According to the Annuity 2000 Valuation Mortality Table, life expectancy continues to climb. For a couple aged 65, there is a 50% chance of one person living to age 92 and a 25% chance of one living to age 97.

The **investment** risk is generally associated with asset allocation strategies or the opportunity costs of not participating in the stock market. But it's the impact that market losses have had on people's retirement savings that has many investors concerned. This is an all-too-familiar reality for many Americans: the Federal Reserve reported that households, on average, lost \$100,000 in wealth from 2007 to the second quarter of 2010.

Of course, these are not the only risks that need to be considered. The impact of healthcare costs, withdrawing too much income and asset allocation decisions must also be factored into the overall income plan.

Today's retiree is in a unique situation. To that end, there is one thing that the industry, consultants, the financial media, and even the president of the United States now agree on—guaranteed lifetime income is more important than ever before.

1. Sun Life's Unretirement Index contains the results of telephone interviews conducted in October 2010 with a sample of 1,201 respondents who are representative of the U.S. working population.

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## The reality

Those in the Boomer generation, on the cusp of retirement, are realizing that they are on the hook for funding it themselves. Their retirement could span 30 years or more. Employer-sponsored defined benefit plans have become a part of corporate America folklore, and the long-term outlook for Social Security is uncertain. The burden of funding retirement has shifted from the government and employers to consumers, who now need to understand and manage their retirement income plans.

A lack of understanding could have serious implications. A recent poll by the Employee Benefit Research Institute estimated that 47% of Boomers between the ages of 56 and 62 are at risk to run shy of the cash they'll need to pay for basic expenses and uninsured health costs in retirement.<sup>2</sup> That's nearly half of the retirement population that will need to rework their plans, make adjustments to their lifestyles, or return to work during their "retirement."

Now, as consumers work with advisors to try to develop new sources of income to supplement current sources, they are growing more aware and appreciative of the value of annuities in order to meet this income gap. Annuities, which are long-term products designed for retirement purposes, are the only financial solution that can provide lifetime income guarantees in a down market and increase retirement income in an up market. This speaks directly to the *certainty* and *opportunity* factors, which are keys to a successful retirement income plan. Of course, all guarantees are subject to the claims-paying ability of the insurance company issuing the annuity.

## Certainty: A guaranteed core

One of the first conversations many advisors have with their clients is about identifying needs versus wants.

Many Boomers want a specific answer to the question: How much income do I need to live the retirement I want? It can be an overwhelming question and may be why the Insured Retirement Institute, a trade group, found that Boomers who are more than 5 years out from retiring have no idea how much they need to save for retirement.<sup>3</sup> One of the first conversations many advisors have with their clients is about identifying needs versus wants, or in other words, core expenses versus non-essential expenses, for their retirement years.

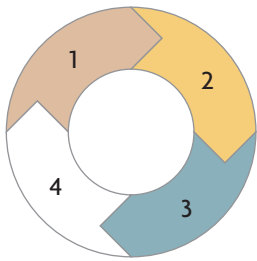
Once clients determine their core expenses—such as mortgage payments, utility costs, food, and the costs associated with visiting grandchildren—they can plan for them by using guarantees offered with retirement income options.

As their core expenses are accounted for, worry dissipates and they can enjoy their lives. Guaranteed income earmarked for these essential expenses gives people freedom to make plans for retirement without having to worry about altering the lifestyle they are accustomed to.

2. Jack VanDerhei and Craig Copeland, "The EBRI Retirement Readiness Rating:™ Retirement Income Preparation and Future Prospects" *EBRI Issue Brief*, no. 344 (July 2010).

3. Insured Retirement Institute (IRI), "Boomers Nearing Retirement" (August 2010).

### Diversified sources of income



- Single-premium immediate annuity
- Variable annuity
- Mutual funds
- Other investments

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## Certainty + opportunity = diversifying among asset classes

Experts typically suggest diversifying—spreading investment risk by making use of various assets, such as equities, fixed income, and cash— while building wealth. With market declines in consumer's portfolios over the past 2 years, many retirees who have begun withdrawing income should think of "guaranteed income" as a stand-alone asset class.

By building a retirement portfolio with guaranteed income sources and financial solutions that help grow income over time, many investors can enjoy the benefits of diversification. One approach to consider is to create a portfolio that combines a single-premium immediate annuity (SPIA), a variable annuity with a living benefit, and mutual funds. This strategy can protect and grow income, and also provides the flexibility to access more income if financial needs change. Allocating assets among these three sources of income showcases how *certainty* and *opportunity* can create a foundation for retirement income success. Please keep in mind that variable annuities and mutual funds involve market risk, including possible loss of principal.

### The advisor's role

Working with a professional advisor can provide the support and oversight necessary to fine tune a client's plan over time and make adjustments to offset risks that may get in the way of a client's success. Guarantees allow people the flexibility to live retirement on their terms. But a retirement plan with guarantees isn't necessarily on autopilot. In fact, people need to meet with advisors regularly to review their portfolio and make the necessary adjustments so they aren't caught off guard with an income gap. Mapping out current spending versus estimated spending and expected sources of income can be tedious, but it's better to uncover income gaps early instead of a few years down the road.

Companies have now developed solutions-based planning tools and materials, and advisors can use these as blueprints to help people move easily from the planning stage to making adjustments to current plans. These tools and materials connect on a different level with consumers given that retirement income planning carries with it an emotional component. Advisors can now provide solutions, not just products.

### On the horizon

Consumers also need to consider three additional risks that could present challenges in developing a successful retirement income plan: healthcare uncertainty, not properly allocating assets, and the effect of withdrawing income. The results of the healthcare debate have real implications for those planning for retirement. Many retirement dreams are just one debilitating illness or severe injury away from not becoming a reality. Similarly, an individual's portfolio can be subject to adverse conditions if asset allocation isn't updated on a regular basis to align with a dynamic retirement income plan. And taking too much income can also adversely diminish future income. How much money can a person withdraw per year without depleting lifetime income? How much should one increase that withdrawal rate to beat inflation?

Consumers should discuss all of these risks with a trusted advisor, who can reveal the key to successful retirement planning: flexibility, guarantees, certainty, and opportunity.

## About the author

Stephen L. Deschenes is Senior Vice President and General Manager for the Annuities Division for Sun Life Financial's U.S. Operations. Deschenes oversees Sun Life's annuity business line, working with the company's marketing, actuarial, and distribution units to build best practices and create a diversified portfolio of competitive products that meet advisor and customer retirement income needs.

## Appendix: key features of a variable annuity living benefit

Factor	How a living benefit can help build a successful retirement income strategy
Investment (down market scenario)	Even in a down market, a living benefit can guarantee a minimum amount of income and protect future income from market loss. This provides the <b>certainty</b> many people are looking for as they seek solutions that help preserve their wealth. In fact, many living benefits provide guaranteed growth of the base used to calculate lifetime income every year (around 7% or 8%) for a set period of time (typically 10 years or more) as long as withdrawals are not taken. This growth is guaranteed even if markets are down. And, some living benefits will also guarantee that future income will be based on an amount equal to at least 200% of premiums made in the first year at a key milestone in the future (such as age 70 or 10 years, whichever is later) if certain conditions are met.
Investment (up market scenario)	The <b>opportunity</b> to increase income over time with potential market gains can help accumulate more annual income throughout life. Income can keep pace with rising costs with what's known as a "step-up" feature (if certain conditions are met).
Inflation	The step-up can help income grow with rising markets and keep pace with rising costs. However, markets are unpredictable, and some retirees need guaranteed increases even if markets are down. There are living benefits available that address this very need by actually guaranteeing growth of the benefit base when beginning to take lifetime income. This feature creates a dependable, increasing cash flow every year for a lifetime even if markets are down.
Longevity	The income provided by living benefits is guaranteed to last a lifetime. And, better yet, a spouse's lifetime income can also be guaranteed.
Lifestyle	The guarantees provided by living benefits provide income growth in a down market and the opportunity to increase income over time when markets are up. Smart solutions like variable annuity living benefits provide the financial freedom to help fulfill retirement dreams.

The benefit base of a living benefit is used to calculate the amount of yearly lifetime income. It cannot be withdrawn as a cash value and it does not represent a guarantee of the account value of the annuity.

All withdrawals of taxable amounts from an annuity, including earnings, are taxable as ordinary income and, if taken prior to age 59½, may be subject to a 10% federal penalty. Withdrawals also reduce death benefits and surrender value.

Investors should consider the investment objectives, risks, charges, and expenses carefully before investing in a variable annuity. The prospectus contains this and other important information. Prospectuses for both the variable annuity and the underlying investment options are available from financial advisors who are licensed to sell insurance products. Read all prospectuses carefully before investing or sending money.

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