PENSION NEWS

UBC FACULTY PENSION PLAN | Second Quarter 2010 Edition

Paving the Path: A Look at Retirement Planning

Retirement is one of life's most important and difficult decisions: your full-time profession is replaced by leisure and volunteer activities; and your income stream from that job also stops, and is replaced by other sources. This article examines some of the issues in planning for retirement.

RETIREMENT

Retirement may be a gradual move or a complete one. As life expectancies lengthen, the period of retirement can extend for 30 years or more: in the mortality tables used by the plan's actuary, the expected future lifetime for a 65-year old female is 22.2 years; for a 65-year old male it is 19.9 years.

The period of retirement can be considered to have three phases: the initial period often devoted to travel and other energetic activities, followed by a period of slower activity, and then the period towards the end of life. Most individuals spend some time in each of these periods, but the amount of time within each is unpredictable. The retirement planning process should recognize the different needs and the potential costs within each period.

FINANCIAL PLANNING

A successful retirement requires advance planning to ensure sufficient resources. The process is complex because of the uncertainties – the length of retirement, unanticipated expenses, and inflation amongst others. Nonetheless, potential problems should be identified and managed through some planning.

As a prospective retiree you might decide to simply replace your pre-retirement income with the same amount of retirement income, but that is a crude estimate of your actual needs. Before retirement, your gross pay is reduced by deductions such as Canada Pension Plan contributions, Employment Insurance premiums, pension plan contributions, employee benefit premiums and income tax; after retirement, all the deductions cease except income tax.

Sometimes a rule of thumb is used to estimate needed retirement income at 70% of gross employment income, in which the 30% reduction of gross income is intended to represent the standard employment deductions; but the rule of thumb does not recognize your own circumstances as your retirement income needs may be significantly different from your pre-retirement needs. During your 40s or 50s you may be making payments on

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your mortgage and supporting your children. You also might have not-insignificant expenses such as travelling to work. After retirement, the mortgage might be paid off, the children might have left home (with luck), you no longer commute to work, but there may be additional expenses such as travel or a winter home.

The best way to plan for retirement is to estimate the costs. Although not an appealing task, estimating future expenses is the best approach because the expenses can then be translated directly to the income requirement. The most detailed plans will project expenses year to year, and will take into account potential additional substantial expenses such as home repairs, vehicle replacement, and health insurance.

INCOME SOURCES

After retirement, you will typically receive income from a number of sources, including government administered pension plans, employment pensions and income from savings. You might also generate income from investing the capital acquired from downsizing to a smaller home. Your plan should also take into account your spouse's income.

Income can arrive in several forms. Some income is paid as a pension for life; some of this lifetime income is adjusted for inflation, some might be level. Some income may be paid for only a specified period; some income might depend on the investment performance of the underlying assets, and might be available only as long as the underlying assets have not been expended. Your retirement plan should identify all income sources, the time period over which they are paid, any adjustments for inflation, and any exposure to the financial markets, to determine the amount and possible variations in annual income.

RISKS AND RISK MANAGEMENT

You face a number of risks in retirement that should be addressed in the planning process because after retirement, the opportunity to recoup losses (for instance investment shortfalls) by employment income is gone. The retirement planning process takes into account the risks in retirement and incorporates risk management. Risk management requires the identification of the sources of risk, the impact of the risk, and the identification of means to manage the risk, taking advantage of choices that might be available from all retirement income sources.

A serious risk is arriving at retirement age with insufficient resources. If you retire with insufficient assets and don't wish to work part-time or reduce expenditures, you could consider investing in the stock market to earn additional income. Although conventional wisdom dictates that when you retire, you should take a cautious approach to investing, primarily by investing in fixed income investments, that advice does not recognize the current low-interest rate environment, the potentially long period of retirement and the impact of inflation. Sustaining retirement income through retirement and protecting it from inflation might only be met by taking risk in the financial markets and investing in equities. However, taking risk clearly has a downside, as was illustrated by the market decline in 2008.

Longevity is the risk that you might outlive your accumulated assets. As a UBC FPP retiree, you can create additional lifetime income either by purchasing an annuity from an insurance company or by transferring some or all of your FPP account balance to a Variable Payment Life Annuity (VPLA) from the FPP (see "The Variable Payment Life Annuity Explained" in the 1st Quarter 2006 issue of *Pension News*). Both types of annuities provide income for as long as you live, mitigating the longevity risk. The insured annuity is typically paid as a flat amount (although inflation-adjusted annuities are available as well); the FPP VPLA is adjusted each year for investment performance and for a mortality adjustment.

You also face inflation risk: even inflation at the seemingly low rate of 2% (the inflation rate has been close to 2% for the past 20 years), compounded over 20 years will increase costs by approximately 50%. Some items in the retiree basket of goods and services, such as food and heating, are highly exposed to inflation; some are not, such as computers and other electronic devices. Inflation risk can be mitigated by purchasing an insured annuity that is adjusted for inflation. The FPP 4% VPLA will provide increasing income if the Balanced Fund earns more than 4% annually. Inflation risk can also be met by reserving resources at retirement for future inflation, or can potentially be met (without any guarantee) by

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investing in assets with the potential for higher returns, such as equities.

If you expect your expenditures to vary in retirement, for instance travelling in the early years, you might wish to have greater flexibility in your income by transferring some or all of your FPP account balance to LIF-type payments (see "LIF-type and RRIF-type Payments" in the 1st Quarter 2007 issue of *Pension News*) or to a Life Income Fund at a financial institution. If you have an RRSP, you could transfer the balance to FPP RRIF-type payments or to a RRIF at a financial institution. All of these income sources allow you to choose the amount of annual income (within limits); however, you are exposed to the potential for early depletion and to investment risk.

You face investment risk if a substantial portion of your assets are invested in the financial markets and those assets do not deliver the rate of return required for your target level of income. The risk of declining income can be met by investing in less risky assets or by purchasing an insured annuity, which provides income that is independent of the performance of the financial markets. With interest rates currently very low, however, reducing risk could lead to very low investment income and low annuity payments.

RETIREE HEALTH AND BENEFITS

No one lives forever – a reality that is often ignored in retirement planning – and as you approach the end of life, the costs of medical care can be substantial.

If you live in B.C., you will continue to be covered by the B.C. Medical Services Plan (MSP), which provides a basic level of medical and hospital care, as long as you live in Canada. But coverage can be limited: MSP does not cover prescription drugs, routine eye examinations before age 65, ambulances, alternative therapies, or wheelchairs. If you travel outside of Canada, MSP covers only a portion of the potential costs of foreign medical care, which can be very high, especially in the U.S.

Before retirement, UBC Faculty are covered by extended health insurance that covers a wide range of expenses up to a lifetime maximum of $1 million. After retirement, group health insurance (UBC Retirement and Survivor Benefits; www.hr.ubc.ca/retiring/rsb) is available but the premiums are not paid by UBC. Also, the lifetime maximum drops to $100,000, which might appear high, but can easily be reached, especially with a hospital stay in the U.S. In addition, the coverage for certain services such as psychologists and physiotherapists is significantly reduced. You might wish to purchase extended health care insurance, especially if you intend to travel outside Canada.

In the last years of retirement there may be a need for personal care. You may need part-time in-home care, or you may wish to move to assisted living. If your medical needs increase, you may need 24-hour care. But personal care is not inexpensive, and it is not covered by MSP or the retiree extended health care program. Your retirement plan should recognize the potential need for additional care in the final stage of life, by earmarking specific assets at retirement or by purchasing insurance, such as Long Term Care insurance.

Retirement planning is a complicated and rewarding process. You are encouraged to seek the assistance of a financial planner to help develop your plan. Retirement counselling funding is available for Faculty Association members. For more information, visit the "Planning for Retirement" section on the UBC Faculty Relations website (www.hr.ubc.ca/faculty_relations). ■

This article was prepared by Satanove & Flood Consulting Ltd. Comments should be sent to: fpp@hr.ubc.ca

Information on FPP Retirement Options is available on the FPP Website on the 'Thinking of Retiring?' page.

Upcoming Retirement Workshops

Understanding Your Retirement Income Options - August 24, 2010

The Faculty Pension Plan offers this workshop for members approaching retirement. This helpful seminar explains the various options available.

If you are interested in attending this session, please contact Jim Loughlean by e-mail at jim.loughlean@ubc.ca or by telephone at 604-822-8987. For up-to-date workshop information and dates, please visit the Workshops page on the FPP website.

MARKET COMMENTARY

THE SECOND QUARTER OF 2010 witnessed weak returns for stock markets worldwide, pushing year-to-date returns into negative territory. Issues with high government debt levels in several European countries, and concern over slowing economic growth worldwide, led to increased fears with investors.

The Canadian stock market saw a weak second quarter, returning -5.5%, which lowered the one-year return to 12.0% (from 42.0% last quarter). The four-year return is still low at an annualized rate of only 2.2%. Most of the industry sectors had negative returns in Q2/10, with the Energy sector down 4.9%, and the Financial sector down 9.8% for the quarter. These two large market sectors comprise almost 57% of the weighting in the Canadian stock index.

The U.S. stock market also had a weak second quarter, down 11.4%, which reduced the one-year return to 14.4% in U.S. dollar terms. This translated into returns of -7.2% for the second quarter and 4.7% for the one-year period in Canadian dollar terms. Non-North American equities (as measured by the EAFE index) returned -11.2% over the second quarter and 9.9% over the one-year period, in local currency terms. These returns were -9.9% and -3.1% over the second quarter and one-year period respectively when translated into Canadian dollars. Emerging markets were also weak in the second quarter at -4.0%, but were positive over the one-year period at 12.7%.

The Bond market had another positive return in the second quarter of 2.9% and 6.9% over the one-year period. Long Term Bonds were the strongest sector in the second quarter, returning 5.1% versus 3.3% for Mid Term Bonds, and 1.7% for Short Term Bonds. The Corporate sector at 2.3% underperformed Federal Bonds (3.1%) and Provincial Bonds (3.3%) in the second quarter. Real Return Bonds continued to perform well at 3.0% and 12.2% for the second quarter and the one-year period respectively. ■

PERFORMANCE OF THE FUNDS
FOR PERIODS ENDING JUNE 30, 2010

	3 months	YTD	1 year	5 years*	10 years*
Balanced Fund - gross	-2.52%	-1.24%	6.64%	3.90%	4.34%
Balanced Fund - net	-2.64%	-1.48%	6.12%	3.41%	3.88%
Composite Index 1	-2.07%	-0.65%	6.50%	3.62%	3.70%
Bond Fund - gross	2.83%	4.47%	9.71%	5.15%	6.52%
Bond Fund - net	2.75%	4.30%	9.37%	4.87%	6.25%
Composite Index 2	2.94%	4.20%	7.59%	4.79%	6.53%
Canadian Equity Fund - gross	-6.62%	-3.60%	9.57%	5.87%	6.70%
Canadian Equity Fund - net	-6.73%	-3.82%	9.12%	N/A	N/A
Composite Index 3	-5.56%	-2.73%	10.93%	5.53%	3.68%
Foreign Equity Fund - gross	-8.44%	-8.92%	0.66%	-3.31%	-3.46%
Foreign Equity Fund - net	-8.62%	-9.21%	0.12%	N/A	N/A
Composite Index 4	-7.69%	-7.84%	1.43%	-2.37%	-2.87%
Short Term Investment Fund - gross	0.09%	0.14%	0.27%	2.71%	3.10%
Short Term Investment Fund - net	0.04%	0.06%	0.10%	2.55%	2.89%
Composite Index 5	0.07%	0.11%	0.21%	2.55%	2.93%

The Average Rate of Return for the FPP funds are updated on a monthly basis and are available under the QuickFind menu on the FPP website.

**Annualized returns*

Composite Index 1:** 32% DEX Universe, 10% S&P/TSX Capped, 5% S&P/TSX, 5% S&P/TSX 60 Capped, 6% S&P 500, 21% MSCI World Ex Canada, 3% Dex 91-Day TB, 10% IPDCPI, 8% DEX Real Return Bonds

Composite Index 2:** 80% DEX Universe, 20% DEX Real Return Bonds

Composite Index 3: 25% S&P/TSX, 50% S&P/TSX Capped, 25% S&P/TSX 60 Capped

Composite Index 4:** 73% MSCI World Ex Canada, 21% S&P 500, 6% DEX 91-Day TB

Composite Index 5: DEX 91-Day TB Index until August 2007, DEX 30-Day TB Index commencing September 2007

***Composite Indices 1, 2, and 4 have changed as of April 1, 2010 to reflect investment changes within the Balanced, Bond, and Foreign Equity Funds.*

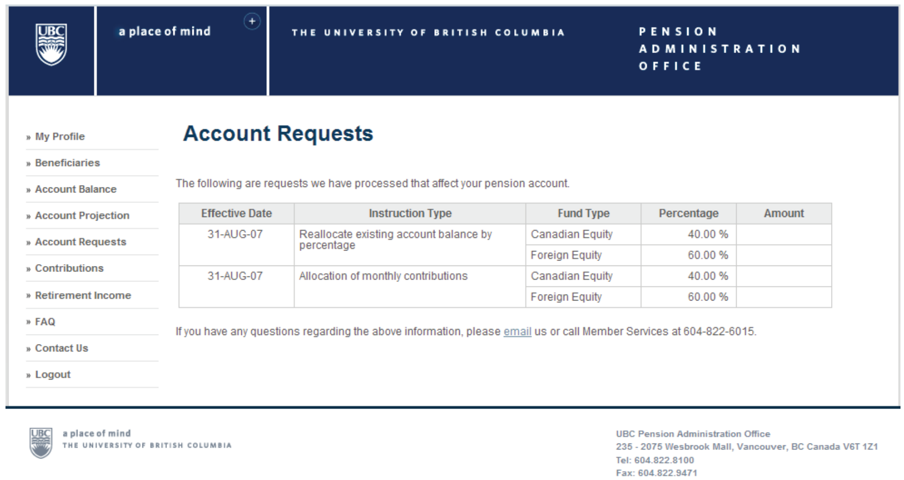
COMPOSITION OF THE FUNDS
AS AT JUNE 30, 2010

	Market Value ($ Millions)	% of Funds
BALANCED FUND		
Equities - Canada	202.7	20.1%
Equities - Non-Canadian	254.6	25.2%
Absolute Return Hedge Fund	29.8	2.9%
Real Estate - Canada	90.1	8.9%
Fixed Income	342.7	33.9%
Real Return Bonds - Canada	85.1	8.4%
Cash	5.7	0.6%
Total Balanced Fund	1,010.7	100.0%
BOND FUND		
Fixed Income	40.8	74.6%
Real Return Bonds - Canada	10.1	18.5%
Cash	3.8	6.9%
Total Bond Fund	54.7	100.0%

	Market Value ($ Millions)	% of Funds
CANADIAN EQUITY FUND		
Equities - Canada	87.0	98.8%
Cash	1.1	1.2%
Total Canadian Equity Fund	88.1	100.0%
FOREIGN EQUITY FUND		
Equities - Non-Canadian	28.0	92.1%
Absolute Return Hedge Fund	1.8	5.9%
Cash	0.6	2.0%
Total Foreign Equity Fund	30.4	100.0%
SHORT TERM INVESTMENT FUND		
Total Short Term Invest. Fund	55.3	100.0%

View Account Requests at myPension

Members can now view their investment allocation changes, transfers-in, and withdrawals through myPension. Requests are updated on myPension on (or shortly after) the 15th business day of the following month. MyPension is accessible via the CWL Login button on the FPP website.



Account Requests

The following are requests we have processed that affect your pension account.

Effective Date	Instruction Type	Fund Type	Percentage	Amount
31-AUG-07	Reallocate existing account balance by percentage	Canadian Equity	40.00 %	
		Foreign Equity	60.00 %	
31-AUG-07	Allocation of monthly contributions	Canadian Equity	40.00 %	
		Foreign Equity	60.00 %	

If you have any questions regarding the above information, please email us or call Member Services at 604-822-6015.

Trustee Election

Annually, in November, an election is held to select two trustees for the upcoming two-year period. A Call for Nominations is sent to all members in September, asking for candidates. If you are interested in running for one of these two positions, please contact Cheryl Neighbour, Secretary to the Board, regarding the responsibilities and duties of Board members.

FPP Info Seminar at Okanagan Campus

An information seminar for Faculty Pension Plan members at the Okanagan Campus is being offered on Wednesday, September 15, 2010. Session times are listed below:

10 - 10:30	Plan Provisions
10:30 - 12	Investment Options & Principles of Investing
12 - 12:30	Lunch
12:30 - 1:15	2009 in Review
1:30 - 3	Retirement Income Choices

All Faculty Pension Plan members are invited to register for any of the sessions that are of interest to them. We invite you to attend and hear the presentations, and to have your questions answered. All sessions will take place at the Science Building, Room SCI396, Okanagan Campus.

Register by Sept 10: lynne.mcpherson@ubc.ca
Please indicate which sessions you will attend.

Correspondence/Queries:

Reception, 604-822-8100
Jim Loughlean, 604-822-8987
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