

RISK ASSESSMENT

*What's keeping clients and their advisors up at night—
and what can they do to **minimize risk**?*



Participants

Top, left to right

- Dan Richards, President, Strategic Imperatives
- Dessa Kaspardlov, CEO, Kaspardlov Laverty and Associates
- Keith Brasier, CFP, KFB Financial Services Inc.

Seated, left to right

- Doug Conick, Vice President, Investment Funds, Individual Wealth Management, Manulife Investments
- Tricia Benn, Director of Research, Rogers Business and Professional Publishing Group

When markets are volatile, clients and their advisors become more anxious about a variety of risks. A recent survey sponsored by Manulife Investments found that the top advisor concerns for clients approaching retirement are longevity risk (72%), followed by health risk (71%) and behavioural risk (66%). Stepping over to the other side of the desk, advisors think their clients are most concerned about sequence of returns risk (64%), longevity risk (57%) and health risk (56%). But when consumers were asked what worries them most, they said inflation risk (46%), followed by longevity risk (37%) and sequence of returns risk (34%).

Wherever the precise focus for investor and advisor anxiety lies, there's certainly a growing awareness of the need for investment products that protect consumers against certain risks—particularly as they approach retirement and start drawing a regular income from their savings. On April 25, 2008, a panel of industry experts assembled to share their insights into the perception and reality of risk, and to consider the solutions advisors have available to them to mitigate risk.

What follows is a condensed version of their spirited discussion.



Tricia Benn,
Director of Research,
Rogers Business & Professional
Publishing Group

Nearly four in 10 investors (39%) say they hardly ever make major changes to their retirement fund investments. That suggests they are sticking to their investment plans. How then do we explain the dominance of money market fund sales during RRSP season?

Dan Richards: What we're seeing is effectively a buyer's strike. Investors are saying, "I'm not going to cash in what I've got, but I'm not going to put any new money in." Investors with automatic investment plans may end up doing the best through this period. A lot of advisors think automatic investment plans are for less sophisticated, smaller investors. But if you sit down with clients once a year to decide what to do with their money and it's during a period of turmoil, investors may be apprehensive—and then will it take a year for them to get back into the markets? With automatic investment plans, you've got inertia and momentum going for you.

Keith Brasier: So many investors at RSP season just want to invest in something but don't want to think about it. They are more concerned with a tax receipt. They'll come in and say, "Park it in money market and we'll decide about it later. I don't want to make that decision right now."

Doug Conick: Study after study shows that when the market starts to drop, people get out of long-term funds and go to money market funds, and then when the market starts to go back up, people get back into the marketplace. Mutual fund sales are driven by fear and greed. People buy high and they sell low. The advisor's ability to manage people's emotional reaction to volatility is huge in this.

How do we account for the fact that fully retired investors are the most comfortable with riding out ups and downs for long-term results—at 17%, compared to 7% of partially retired investors, 10% of investors retiring in the next five years, 4% of investors retiring in five to 10 years, 9% of investors retiring in 10 to 15 years and 12% of those with 15 or more years to go before retirement?

Doug Conick: Workplace benefits were richer and now they're getting more and more watered down—that could explain why younger investors are more concerned. And the fully retired group may have already made the choice to ratchet down equities and focus on fixed income so they don't have to worry about the ups and downs. The flip side is that approach can be pretty risky if they want income that lasts.

Dessa Kaspardlov: People who are 10 or 15 years away from retirement are still trying to save money. They're in that period where the house isn't paid off yet, they've still got kids living at home, they're paying too much in income tax and they're scared because their pension plan at work is going out the window. I think it's two different markets with two different mindsets.

Dan Richards: Another explanation is that 15 years out, retirement is still far away. It's a concept, not a reality. Investors visualize that they'll retire and put everything in bonds or GICs and not have to worry about volatility. Fast forward 15 years: you're now in retirement and you've hit the reality of the tradeoffs you'll have to make. It's not that people in retirement embrace risk enthusiastically, because they don't, but they understand better the price they have to pay for a risk-free option in retirement.

Nearly one-third of investors (31%) say they prefer to take very little risk, and security of investments and savings is their biggest concern. How can advisors accommodate this while still delivering long-term growth potential?

Dan Richards: As people get older, they're looking for more predictability. And with the fundamental shift away from defined benefit plans to defined contribution plans, companies have transferred market performance risk to employees. So now Canadians are saying, how do I off-load the risk of market volatility? Much of the success of Manulife's IncomePlus product is fuelled by that desire for greater predictability.

Dessa Kaspardlov: If my client needs a certain amount of income every year to cover lifestyle expenses and taxes, then I'll help make sure that amount of money is available in some form. The rest of the money can be allocated in many different ways.

Keith Brasier: You've got to have diversification of products, as well as diversification of assets. You need a safe part and a long-term growth part. This will help in periods of volatility.

Four in 10 (41%) investors say they often wonder if they have saved enough for retirement, and only about half (55%) are confident their retirement savings will be enough to provide a steady income for the rest of their lives. How can advisors build investors' confidence?

Dessa Kaspardlov: It comes back to trust. As people age, they want a trusted relationship with an advisor. When you work with several generations of a family for many years, they learn to truly trust what you're doing.

Keith Brasier: I've had most of my clients through several economic cycles and they've become more educated, but I always encourage them to ask questions if they're nervous. We also do more proactively, sending them information about what's happening in the market. Rather than them wondering what is going on.

Dessa Kaspardlov: The most common question I get on my live call-in radio show is, how do I determine how much retirement income I need? They really don't know. We ask clients, what are you going to do when you're retired, when every day is Saturday and you can go shopping every day or take the boat out every day? All of that costs money, but they haven't got a clue how much they're going to spend.

Dan Richards: The other complication is that creating a financial plan is not a static process. It's a dynamic process. To get it right you've got to do mid-course corrections. Taking all of that into consideration, I'm surprised we don't have more concerned Canadians.

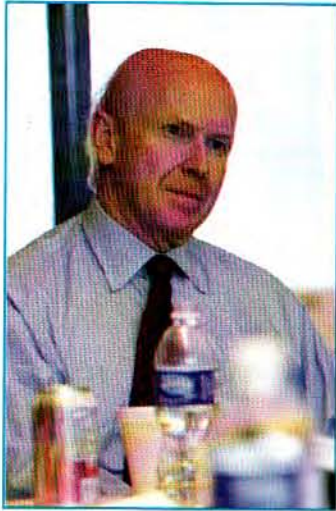
Clients say that their number one concern is inflation, but advisors think clients should be worrying about longevity and sequence of returns risk. How do you account for that disparity?

Doug Conick: Advisors recognize that market volatility is an important trend. In the last 10 to 15 years we've seen more volatility than we have over a very long period of time going all the way back to the crash in 1929. But there's a fundamental change in the way you deal with these risks. It used to be all about asset allocation. But as you're getting closer to drawing an income, you have more risks to manage and it becomes more about product allocation. How do you bring products



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**Keith Brasier, CFP,
KFB Financial Services Inc.**



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Dan Richards,
President, Strategic Imperatives

together to manage longevity, inflation, tax and medical cost risks?

Dan Richards: Investors worry about the things they can’t control. An investor says, “I can control my spending habits to a certain extent. What can’t I control? I can’t control inflation.” And those in their 50s and 60s remember that 25 years ago inflation was a significant issue. Some of them lost their houses. In my research with investors about their retirement concerns, the other big worry was government cutting back on healthcare funding and shifting costs to consumers.

Doug, you mentioned the role fear and greed play in investment decisions. Are investors aware of how their emotions influence their financial choices?

Dessa Kaspardlov: Emotions are huge. When I sit down to rebalance my portfolio it’s a lot harder than when I do it for clients, so I understand what clients are going through. When we provide advice to clients, it’s easy because every decision is based on our knowledge and experience and there’s no emotion in that.

Dan Richards: Investors are rational from their point of view. The difficulty is that the timeframe of pain versus gain in a choppy market is tough for a lot of investors to deal with. The pain is right now and the gain is down the road. The gain to being out of the market is today and the pain to being out of the market is down the road. An advisor can provide perspective and be an emotional anchor, keeping the highs from being too high and the lows from being too low.

Keith Brasier: Clients go through cycles. From 1998 to 2003 it was a huge up and then a huge down. Around June 2003, we sent a letter to clients who had been with us for a number of years and congratulated

them on becoming “investors,” because they’d been through an up and a down and they had stuck to their plan. They were proud—and we don’t get as many calls in periods of volatility anymore.

Dessa Kaspardlov: We brought in all of our A and B clients and some of our C clients and literally said, “Thank you for trusting us because it worked and this is where you are today.” Those are the kinds of things that build long-term trust.

Just 31% of investors plan to consolidate their investments with one financial advisor when they retire. Why are clients still so reluctant to consolidate?

Dessa Kaspardlov: We take a holistic approach. We look at both sides of the balance sheet and show how clients can pay debt off faster, reduce interest costs and reduce income taxes. We rebalance clients’ Group RRSPs even though we don’t get paid to do it—but they know that’s value added. Trust is something that’s earned; it’s not given.

Dan Richards: Some investors don’t want one advisor having control of their money. The real issue is that advisors don’t do a good enough job of demonstrating how clients would be better off if they consolidated their assets. On the plus side, advisors can do a better job in terms of tax-efficient planning and maintaining a balanced portfolio if they have all the money—but advisors don’t do a good enough job of communicating that. Unless you demonstrate a clear advantage to changing, many investors will stay in their comfort zone and maintain multiple historical relationships.

I’d say to clients, “I understand you have an established relationship and I respect that. But here’s what I suggest. I’m going to get my assistant to call you once a quarter and ask you to send

over your statements. I will provide a total portfolio that gives you a complete picture of your money and look for suggestions that may reduce your taxes." Over time, investors will be more willing to give you those assets.

Keith Brasier: People who are dedicated to the financial planning process are not going to hide \$100,000 in a bank account. If they haven't consolidated all their money with me, I know why they're keeping an account open somewhere else.

Dessa Kaspardlov: I use an analogy with my clients: what if you go to the doctor and you tell him you have only one of three symptoms? You tell a second doctor you have the second symptom and a third doctor you have the third symptom. But you never tell any of the others what you're doing. The first guy is going to guess and write you a prescription. The second guy is going to do the same thing. And that combination could kill you. You cannot do that.

Willingness to consolidate rises with an investor's asset level. Less than \$50,000 is 23%; \$50,000 to \$100,000 is 33%; \$100,000 to \$250,000 is 45%; and \$250,000 or more is 43%. What's behind those numbers?

Doug Conick: I'm a good example of the person who has different pots of advice, but I've got a lot of time in the marketplace to ride the ups and recover from the downs. As you're getting closer to your retirement date, and accumulate more assets, it becomes more efficient to consolidate your advice to manage risks that have become more relevant to you. The other thing is, you've got more saved and so you've got more to lose. That gives you more motivation to make sure you've got the right advice.

KEY SURVEY FINDINGS

Consumers

- 48% agree the need for a trusted advisor becomes more important as they age.
- 31% plan to consolidate their investments with one financial advisor when they retire.
- 31% prefer to take very little risk, saying that security of their investments is their biggest concern.
- 10% are comfortable with riding out ups and downs for long-term results.
- 21% would respond to a sharp decrease in the value of their investments in retirement by moving into more secure, conservative investments, and 18% would only choose guaranteed investments.
- 55% are confident their retirement savings will be enough to provide a steady income for the rest of their lives.
- 68% would be interested in an investment product that offers guarantees to protect retirement savings.

Advisors

- 45 is the average client age at which advisors start discussing longevity risk.
- 53 is the average client age at which advisors recommend their clients start investing in retirement income-generating products.
- 59% believe the number of clients who are concerned about sequence of returns risk is increasing.
- 61% want brochures to help them educate clients about risk; 52% would prefer online calculators and 33% like PowerPoint presentations.

Methodology

Rogers Business and Professional Publishing Group conducted an online survey of 1,085 consumers aged 40 to 64 between February 22 and 26, 2008, and an online survey of 380 Canadian financial advisors between February 20 and March 12, 2008. The margin of error for the consumer survey is +/-3.0% and the margin of error for the advisor survey is +/-5.0%.



“As people age, they want a trusted relationship with an advisor. When you work with several generations of a family for many years, they learn to truly trust what you’re doing.”

Dessa Kaspardlov,
CEO, Kaspardlov Laverty
and Associates

Dessa Kaspardlov: Also, the older people get, the simpler they want their lives. I’ve sat with clients who had more than 50 different RRSP accounts. I look at that and say, “Do you really want 50 RRIF cheques going into your bank account every month?”

Doug Conick: From the product manufacturer’s perspective, we see there is an opportunity to provide materials, products and other support to help the advice channel consolidate, to help advisors find ways to bring product solutions together and earn their clients’ trust.

Keith Brasier: Diversification of product is key—we don’t directly sell mortgages, but we refer mortgages now, whereas 10 to 15 years ago we never did. Now it’s become a huge part of our business because clients are coming to us for mortgage business. It’s opened up a whole new window for us. With additional products and services, clients with larger assets and needs are not as keen to deal with several persons if one person can provide all the products they require.

How do you explain to your clients the value of investment products with guarantees?

Dessa Kaspardlov: To illustrate sequence of returns risk I simply say, “We’ve got \$100,000, it’s January 1 and we’re RRIF-ing that money today. The government says you’ve got to take out 7.5%—that’s \$7,500. But you’re not going to get your RRIF payment until December. So, between January 1 and December 15, when you get your cheque, the market drops 25% and your market value goes to \$75,000. But you’ve got to take out \$7,500. How much do you have left?”

Dan Richards: You’ve translated conceptual risk into reality. But I think a lot of investors would look at products with guarantees and say, this sounds too good

to be true—what’s the catch?”

Keith Brasier: When clients ask that, I tell them the companies that provide this product make a living too and the catch is that there are limited investment choices and over a period of time insurance companies will win selling this product. And you will win owning the product.

Just 27% of investors are “very interested” in a product that includes a guarantee against losing invested principal, participation in market gains and a guaranteed lifetime income. What do you make of that?

Dessa Kaspardlov: Investors don’t understand the new products in the marketplace—and they’re still skeptical.

Doug Conick: Simplicity is hugely important, but there is a certain amount of complexity you have to put up with when you introduce a new product to meet an important client need. We were talking about trust and the question, “Is there a catch?” Part of the issue is, as we’ve seen in this study, a lot of investors don’t understand the risks. When you ask a client, “Do you know what market volatility or sequence of returns risk is?” They’ll say “yeah”—but they don’t really get it. And because they don’t get it, they may not see the value in the guarantee we offer.

Do clients know what risks they are covering off if they choose to invest at large institutions?

Dan Richards: They’re covering off two things: the catastrophic risk that they will wake up and the institution will not be there and the risk that their advisor will be below an acceptable standard. Many investors take the view that large institutions have policies and procedures in place so they can be confident the quality of advice won’t drop below a certain level. With an independent

advisor, some investors believe they don't have that same level of assurance.

Dessa Kaspardlov: If you look at a product like IncomePlus, for the first time, advisors at big and small companies can sit down with a client and guarantee that this is exactly how much money you're going to have. It may be better, but it will never be worse than this.

Keith Brasier: When I'm talking to one spouse with a pension and one without, I say to the one without—because he's got all the RRSP assets—"You can buy something like that pension. You can buy a product with that guarantee." They understand the word "pension" and they look at it as nice, big, boring and dependable.

How does guaranteed income fit into an investor's portfolio?

Doug Conick: A recent study by Ibbotson looked at a standard retirement portfolio with bonds and stocks or balanced funds and the impact of replacing fixed income with a guaranteed minimum withdrawal benefit, like IncomePlus. Two things happen when you do this: you get more retirement income and your risk, as defined by shortfall of income, goes down. That's hugely important in the sense there is a disservice being done to clients by advisors who haven't realized the old rules of thumb are out of date.

Dan Richards: There is no one product that is right for everyone. Mutual funds are still suffering because in that run-up during the tech boom some investors were put into solutions that were not appropriate for them. Some investors have enough to meet all their needs and leave their kids as much as they want by investing in strip bonds. And why wouldn't you simplify your life and take all the risk off the table? But the reality is

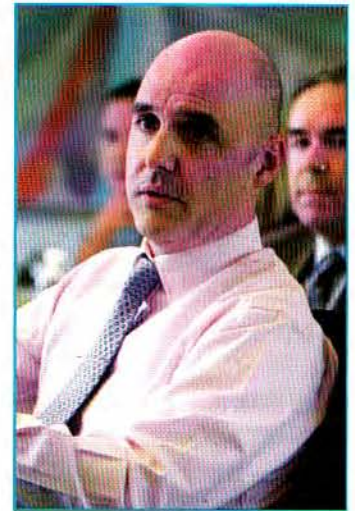
the large majority of Canadians don't have the money to do that and, before they get to retirement, many don't understand the tradeoffs they're going to have to make. I think going forward there's going to be a new set of rules around the kinds of investments you have at age 80, 85 and 90. Some people will need more growth going forward, so they're going to have to get used to risk and volatility at much older ages than they did historically.

Doug Conick: We have an interest in making sure advisors know how to use products like IncomePlus, and we don't at all condone the idea that 100% of someone's nest egg ought to be put into this one product solution. It's not one size fits all. So, besides providing product solutions, we know it's important to support advisors to help them figure out how and when to use these products. Insurance companies and banks need to do more of that.

Dessa Kaspardlov: If I have a client who needs another \$50,000 a year on top of his CPP and OAS, \$1 million is going into IncomePlus so I know for a fact that he's got \$50,000 a year of guaranteed income on a go-forward basis. Then we can do something else with the rest of his money.

How do you think the industry will evolve in the future to effectively address risk?

Dan Richards: Advisors need to encourage clients to start thinking about longevity risk as soon as they start investing. If you have a financial plan at age 25, you need to start having that conversation: when do you want to retire, what kind of lifestyle do you want to have, how much are you going to be saving? One of the fallouts from the current market condition is that institutions are all looking to simplify products so investors understand their liabilities. Also, new financial engineering



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Doug Conick,
Vice President,
Investment Funds,
Individual Wealth
Management,
Manulife Investments

capabilities are making it possible to create products that unbundle and staple together different kinds of risk, where you give up the upside above a certain threshold to dramatically reduce your downside. I believe we're going to see more products delivering what investors want. The downside is they are going to be complex and initially they're going to be expensive. Advisors are going to have to work harder to explain them, but five years from now you are going to have tools you don't have today.

Doug Conick: There will undoubtedly be more innovation in products that provide guarantees or insurance to handle the key retirement risks, such as sequence of returns risk, longevity, healthcare risks and inflation. There will

be more competition among product manufacturers in this space. Along with that, advice is going to become even more paramount. Clients need help understanding what risks they actually need to take, and the way they look at risk changes as they get closer to retirement. The manufacturers who produce these products have an accountability to make sure they're explained properly and there are effective tools and support to go with them.

Keith Brasier: Also, advisors need to communicate to investors the risk of not getting advice, of not getting knowledge. They need to emphasize that that's going to hurt you more than anything. You must seek knowledge to make better-informed decisions.

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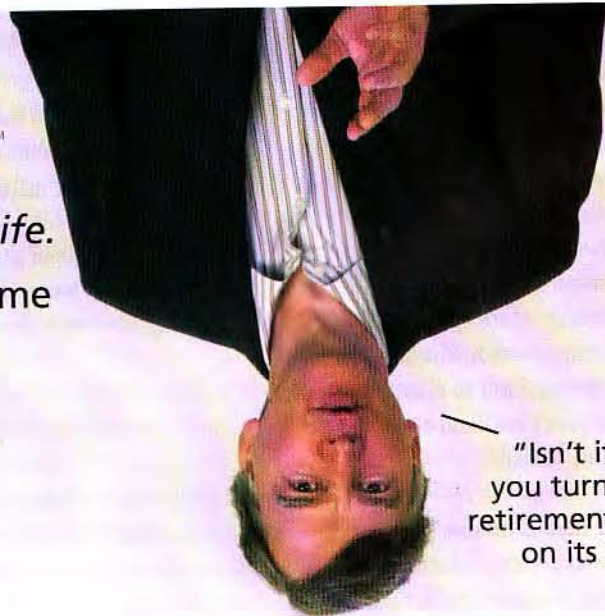
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