FP Canada
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Frequently Asked Questions about the Projection Assumption Guidelines

This FAQ document provides responses to questions addressing the following topics:

CONTENTS

Projection Assumption Guidelines Development 2

Use of the Projection Assumption Guidelines 4

The Projected Rates in the Projection Assumption Guidelines 6

Asset Groups not included in the Projection Assumption Guidelines 9

PROJECTION ASSUMPTION GUIDELINES DEVELOPMENT

1. Who develops the Projection Assumption Guidelines?

The Projection Assumption Guidelines Committee is responsible for the ongoing maintenance and annual update of the Projection Assumption Guidelines (Guidelines) published jointly by the FP Canada Standards Council™ and Institut de Planification Financière (formerly the Institut québécois de planification financière (IQPF)).

The Guidelines are developed and maintained by the Projection Assumption Guidelines Committee and approved by the Standards Panel annually, typically in March. The Standards Panel is an independent panel of the FP Canada Standards Council™, and is composed of CFP professionals, licensed financial planners from the province of Québec and at least one public member. Additional information can be found here: FP Canada Committees and Panels

2. Who is on the Projection Assumption Guidelines Committee?

The Projection Assumption Guidelines Committee is comprised of individuals who are professional financial planners (through either Certified Financial Planner® certification or the F.Pl. designation in Québec) in addition to being actuaries or Chartered Financial Analyst charterholders. All members have extensive financial planning experience, represented across multiple financial planning areas.

Current committee members: Nathalie Bachand, A.S.A., F.Pl.; Jeff Cormier, CFP®, CFA; Derek Dedman, M.Sc., CFP®, CFA; Martin Dupras, A.S.A., F.Pl., M.Fisc., ASC; Nick Hearne, CFP®, CFA; Benjamin Felix, MBA, CFP®, Pl. Fin., CFA®, CIM® and Tanya Staples, CFP®, B.A., M.A.

3. How are the Guidelines Developed?

The Projection Assumption Guidelines are established using a variety of reliable and publicly available external data sources, as well as results from an annual industry survey of Canadian investment and financial services firms. They do not represent the individual opinions of the members of the Projection Assumption Guidelines Committee, the Standards Panel, Institut de Planification Financière or FP Canada. Using numerous sources of data eliminates the potential bias that may be created by relying on any single source.

4. How frequently are the Guidelines updated?

The Projection Assumption Guidelines and the supporting Addendum are updated annually and are typically released in late April.

5. What data sources does the Projection Assumption Guidelines Committee rely on to develop the Guidelines?

The Projection Assumption Guidelines Committee currently uses three data sources to arrive at the projected long-term rates of return for short-term and fixed income assets, which are: the CPP actuarial report; the QPP actuarial report; and an annual industry survey of Canadian investment and financial services firms. As of April 2024, an additional data source, the yield to maturity (YTM) of the Canada Total Market Bond Index, was included in the calculation of the projected return for fixed income assets.

For equity-based assets, these data sources are used: the CPP actuarial report; the QPP actuarial report; an annual industry survey of Canadian investment and financial services firm; and the historic returns over the 50 years ending the previous December 31st (adjusted for inflation). As of April 2024, the use of the Shiller earnings yield was included as a data source in calculating the projected returns for equity-based assets. The Shiller earnings yield is the ratio of 10-year smoothed real earnings to market prices.

The Guidelines are accompanied by an Addendum which provides links to sources, data and calculations used in the development of the Guidelines. The Addendum is provided for transparency and replicability of the Guidelines by financial planners and firms.

Although some of the assumptions set out in the Guidelines may change from time to time, this does not mean that projections based on previously published assumptions are no longer valid. In fact, projections are considered valid at the time of preparation.

6. What is the purpose of the Addendum?

The Projection Assumption Guidelines are accompanied by an Addendum containing the data sources on which they are based. The Addendum offers financial planners an opportunity to fully understand and replicate the recommended calculations by providing links to sources, data and calculations used in the development of assumptions for inflation and each specified asset class presented in the Guidelines. The Addendum is provided for understanding, transparency and replicability of the Guidelines by financial planners and firms. Further, the Addendum includes a chart outlining the Projection Assumption Guidelines results from 2009 and how they have tracked compared to real rates of return over the years.

The Addendum is updated each year with the release of the Projection Assumption Guidelines

7. Are the projected rates of return calculated based on historical data only?

The Projection Assumption Guidelines use a blend of forecasting and back casting.   The Guidelines consider expected future economic behaviour based on assumptions provided in the QPP and CPP actuarial analysis and the most recent industry survey of Canadian investment and financial services firms. Projecting the future by relying solely on historical returns would suggest an expectation that the future will mirror the past. This is not the expectation. While precise future projections should not be made based solely on past performance, that does not justify the complete exclusion of the long-term historical return experience.

USE OF THE PROJECTION ASSUMPTION GUIDELINES

1. Why should I use the Projection Assumption Guidelines for my financial planning clients?

The use of the Projection Assumption Guidelines is strongly encouraged to promote trust and confidence in the financial planner's projections, given the Guidelines' objectivity and basis in reliable sources.

The Guidelines are intended as a guide and are appropriate for making long-term (10 plus years) financial projections that are free from the potential biases. Predicting the direction the economy will take and how financial markets will evolve is a difficult exercise, requiring the integration of a large number of variables and highly sophisticated valuation models.

To protect themselves and their clients, financial planners are encouraged to rely on these Guidelines. The use of the Guidelines provides clients with a set of reasonable assumptions that can be supported by sound methods and practice.

When presenting financial projections to clients, it is important to disclose the assumptions and rates being used in the preparation of the projections, and to be able to demonstrate that the assumptions and rates used are sound and reasonable.

2. Should I use the Guidelines in times of market volatility?

In times of turbulent and volatile markets, it is important to note the long-term nature of these projections. Professional financial planners can provide perspective on shorter-term current events as they relate to clients and their individual circumstances. Planners must always use professional judgement in the application of the Guidelines for long-term projections.

3. Should I use the Guidelines in times of fluctuating inflation rates?

In times of rising or changing inflation rates, it is important to note the long-term nature of these projections. For projections with a time frame of 10 years+, it is recommended that the inflation rate calculated and provided in the Projection Assumption Guidelines be used. Adjusting the inflation rate to reflect the current economic data is not advised when preparing longer-term projections. A current experience of rapidly changing inflation is unlikely to continue over a longer-term time frame of 10 years+. This is supported by the CPI Rates chart provided in the Addendum. In addition, increasing just the one data point, e.g., inflation ignores the corresponding movements that would likely occur with interest rates, short-term income, fixed income and equity-based assets.

4. What is required to properly use these Guidelines?

Technical knowledge is at the heart of fundamental financial planning practices. Through certification standards and continuing education, a financial planning professional is expected to have and to maintain high standards of competence and professionalism. A financial planning professional should therefore have the knowledge and judgment to apply the Projection Assumption Guidelines in an appropriate and reasonable manner, taking into consideration:

- The client's unique circumstances with regard to socioeconomic status and risk tolerance, at the outset of the financial planning engagement and throughout the engagement,

- The operation of financial instruments and markets, the client's current and future asset allocations, and their approach to investing,

- Average life expectancy and longevity risks, to help ensure their client's financial future is secure, and

- The obligation to discuss the relevance and implications of assumptions with clients so that the clients understand and agree to their use.

5. As a licensed financial planner, am I required to use the rates in the Projection Assumption Guidelines?

The use of the Projection Assumption Guidelines is beneficial for both the financial planning professional and the client. It provides a level of protection for financial planners since their projections are based on sound assumptions that can be defended. For clients, the Guidelines provide rates of return that are transparent and objective, based on reliable sources.

That said, financial planners are in the best position to understand their clients' unique circumstances. Because every client situation is different, assumptions that vary from the Guidelines may be used. It is also important to note that the Guidelines do not contemplate personal risk profiles. Since an individual's risk profile or change in risk profile may have consequences at least as significant as, or more significant than the rate of return guidelines used in developing financial projections, sound risk assessments are critical.

Assumptions may also differ from the Guidelines based on local market peculiarities. As an example, projections of education costs, which tend to be impacted by local market differences, may justify using an inflation rate that differs from the Guidelines. Projections of salary increases may justify an inflation rate that differs from the Guidelines, where such a difference is reasonable and supportable.

For shorter term financial projections (less than 10 years), financial planners may use actual rates of return on fixed term investments held to maturity.

In all cases, assumptions used should be documented, with sound rationale, and clearly communicated to clients. A financial planner's professional obligations regarding documentation of material assumptions is set out in Rule 30 of the *Rules of Conduct* and referenced in PS 5 and 8 in the *Practice Standards* both contained in the *Standards of Professional Responsibility*.

6. Is it a breach of professional responsibilities to use rates other than those in the Projection Assumption Guidelines?

The use of the Projection Assumption Guidelines is beneficial for both the financial planning professional and the client. It provides a level of protection for financial planners since their projections are based on sound assumptions that can be defended. For clients, the Guidelines provide rates of return that are transparent and objective, based on reliable sources.

Financial planners are encouraged to use and rely on these Guidelines. Where appropriate, financial planners may deviate within plus or minus 0.5% from the investment rate of return assumptions and continue to be in compliance with the Guidelines.

That said, financial planners are in the best position to understand their clients' unique circumstances. Because every client situation is different, assumptions that vary from the Guidelines may be used. In addition, for shorter term financial projections (less than 10 years), financial planners may use actual rates of return on fixed term investments held to maturity.

There may be instances when it is appropriate to deviate from the rates of return provided in the Guidelines. If this occurs, the financial planner should document the rates used and the rationale to ensure the assumptions are both sound and supported. These assumptions should be discussed with clients to ensure they understand them and are comfortable with their use.

A financial planner's professional obligations regarding documentation of material assumptions is set out in Rule 30 of the *Rules of Conduct* and referenced in PS 5 and 8 in the *Practice Standards* both contained in the *Standards of Professional Responsibility*.

THE PROJECTED RATES IN THE PROJECTION ASSUMPTION GUIDELINES

1. Do the rates of return include inflation?

The rates of return shown in section 4 of the Projection Assumption Guidelines are gross nominal rates that have been adjusted to include inflation. For the guidelines that are based on historical data, the adjustment is based on the guideline for future inflation. The Addendum, which accompanies the Guidelines, details the calculation behind the rates of return.

2. Why is there a different rate used for salary and inflation assumptions?

In 2015, the Guidelines introduced an assumption for the growth of the yearly maximum pensionable earnings (YMPE). When doing financial planning, some variables are tied more closely to the inflation rate and others to the growth of salary. For example, the income tax tables (tax brackets, credits, etc.), the annual TFSA contribution limit and the Old Age Security payment are amounts that are rising in accordance to inflation. However, the Canada Pension Plan maximum benefit is growing at the pace of the YMPE before retirement. Once the benefit is payable, the annual indexation is based on inflation. The maximum RRSP limits and pension limits for registered pension plans (DB and DC) are adjusted annually on the growth of the salary, so the use of the YMPE assumption is better suited than the inflation assumption. For the salary growth of an employee that is planning for retirement over a long career, either inflation or YMPE growth on his future salary could be used. Usually with salary growth there is a component for inflation and another for promotion. To be more conservative, a financial planner could prefer using inflation, but a good conversation between the financial planner and the client will help to determine the proper expected salary growth.

3. What about the impact of income tax on portfolio returns?

The rates of return presented in the Projection Assumption Guidelines do not include income tax. The Guidelines state that income tax is a consideration for non-registered assets.

The client's asset allocation will help determine the type of investment income to be earned. Historically, from 25% to 50% of overall equity returns has been made up of dividends. The Guidelines suggest that for equity holdings, it might be appropriate to divide the return into two categories: dividends and capital gains; and suggest that 33% of the return be taxed as dividend income and the balance as realized and unrealized (deferred) capital gains.

Determining the income tax liability on investment income earned in a non-registered account will require additional work by the financial planner to factor in the preferred tax treatment on Canadian dividend income and realized capital gains, as well as the client's tax rate.

4. Why are the projected rates on investment assets different than current market rates of return?

The projected return assumptions for investment assets represent a long-term view of what level of return could be earned by the various asset classes. They do not represent short-term expectancy. Current market fluctuations in rates and investment values can occur in the short-term but would not last for a 10+ year time frame. The projected rates of return in the Guidelines are meant to be used for a longer-term planning horizon of 10+ years.

5. Why are the longevity assumptions so long?

The Projection Assumption Guidelines present several levels for the probability of survival and recommend projection periods to the age that an individual has only one chance in four to reach. This period is longer than life expectancy to add security to financial planning exercises.

When presenting financial projections to clients, it is important to disclose the assumptions being used in the preparation of the projections, and to be able to support them as sound and reasonable.

6. In section 6 of the Projection Assumption Guidelines document, the sample application uses a single fee charge, but what if there are other fees?

The rates of return are presented before any fee expenses. The fee amount used in the sample application is meant to be an example only, and not a directive on an expected charge amount.

Any fees paid by the clients need to be subtracted from the rates of return to arrive at their net return. Fees paid by clients can include a variety of different costs, such as, commissions, trailing fees, advisory fees, custodian fees, redemption fees, transaction costs, and management expenses ratio fees. All fees paid by the clients, either directly or indirectly, needed to be factored into the calculation to arrive at their actual return net of costs.

7. Does the portfolio shown in section 6 of the Projection Assumption Guidelines document provide a recommendation on asset allocation?

No, the sample application is not intended to offer a suggestion or recommendation on asset allocation.

Section 6 of the Projection Assumption Guidelines is included to illustrate how the projected rates can be applied when different asset groups are held in an investment portfolio. The sample application is not meant to be a recommendation for asset weightings, but rather to show how to use the rates for various investment holdings.

8. How would a conversion be done from a return calculated using geometric mean assumptions, as presented in the Guidelines, to one using arithmetic mean assumptions?

In certain circumstances, it can be appropriate to convert the assumptions from the geometric mean (GM) to the arithmetic mean (AM). The GM is the annualized rate of return. The AM is simply the total of a series of rates of return, divided by the number of returns, an easy, simple average. The table below shows an example with the Canadian stock market for a ten-year period, the AM, the GM and the standard deviation. With this information, it is possible to

estimate the AM from the GM with the standard deviation (σ). Using this formula for equity assets:

$$AM\ (est) = GM\ \text{from the Guidelines} + 0.5\ \% + \sigma^2/2$$

ASSET GROUPS NOT INCLUDED IN THE PROJECTION ASSUMPTION GUIDELINES

1. The rate of inflation in the Projection Assumption Guidelines is not consistent with the growth in real estate values in my region. What rate should I use when preparing projections for my clients?

The Projection Assumption Guidelines are intended to be used when making long-term projections of 10 years or more and are meant to look beyond the current day rate environment. Although the inflation experience in your region today may exceed the inflation rate in the Guidelines, this may not be the case over the next 20 or 30 years.

The Guidelines provide rates of return for the main asset classes—short-term assets, Canadian fixed income, Canadian equities, foreign developed-market equities (including U.S. equities and Europe, Australia and Far East equities) and emerging-market equities.

However, the Guidelines do not provide a rate of return for real estate. When making assumptions around real estate growth, it is important to consider an appropriate starting valuation for the property and use an inflation-based assumption that is suitable based on the local market context.

When presenting financial projections to clients, it is important to disclose the assumptions and rates being used in the preparation of the projections, and to be able to support them as sound and reasonable. A financial planner's professional obligations regarding documentation of material assumptions is set out in Rule 30 of the *Rules of Conduct* and referenced in PS 5 and 8 in the *Practice Standards* both contained in the *Standards of Professional Responsibility*.

2. What rate of return should be used for preferred shares?

The projected fixed income rate of return in the Projection Assumption Guidelines can also be applied to preferred share holdings. Please note that this is not an opinion regarding the volatility of preferred shares versus fixed income securities and that preferred shares can have different characteristics that can impact their pricing.

3. What rate of return should be used for currencies?

The Projection Assumption Guidelines do not provide for exchange rates since the net long-term effect of changes in exchange rates is generally nil. Financial planners should develop sensitivity analysis to illustrate and assess the potential ramifications of changes in exchange rates. Clients

who may require income in a foreign currency may wish to maintain assets in that foreign currency to minimize foreign exchange rate risk.