

A green watering can is shown at the top, pouring water onto a row of small green plants. Each plant is growing out of a stack of coins, with the stacks increasing in height from left to right. The background is a dark grey gradient.

# Are You Ready for Retirement? Think Again

Saving enough money for an adequate retirement can be difficult, especially for those who don't have a workplace pension plan. This article describes some of the challenges in planning for retirement and offers some advice.

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**W**hat you don't know about pensions will hurt you—if not now, then later when you can't catch up. Many of the people who will receive a pension have only a vague idea of what it does and what it means to them.

Too many people reach late career and realize they should have saved more, an especially stark realization if accompanied by a layoff notice. So here's a heads-up.

The central question is: What will you live on once the paycheques stop? It can be hard to get a straight answer from someone who is trying to sell you something. And experts differ. Plus, most people never think about the impact of major medical costs not covered by Canada's public health care system. People for whom "math" is a four-letter word can use online calculators<sup>1</sup> to determine how much they should have on hand when they retire. Hitting "send" can elicit a big surprise.

## Health Care and Chronic Care

The most frequently overlooked expense is continuing care. Acute care for a heart attack, broken hip or a stroke might be well-covered by medicare, but chronic care and home care are not. If families cannot afford to pay for a home care worker, a spouse or other family member must step in, often giving up paid work hours to do so. A senior's mobility or cognitive limitations may rule out walking or using public transit, so private transportation costs should be factored in. Even if one spouse is admitted into long-term care, where much

of the nursing care may be covered, the copays are still substantial. Meanwhile, the other spouse still needs to maintain his or her home. Escalating prescription drug costs add to the bills. None of these expenses can be put on a credit card.

Once people get over the sticker shock of what it takes to maintain their current standard of living and take care of unanticipated medical costs, the next question is how to get there from here. Thinking about it later is not an option.

### Calculating Retirement Income

Calculators give a sense of what social security or Old Age Security will provide—generally a bare minimum to keep people out of poverty. Most will need to draw on personal savings to maintain their standard of living.

Those with workplace pension plans should still ask how much they can expect to receive on retirement. What if they retire early, are fired or get sick?

There are still some well-paying pension plans out there—paying up to 70% or more of preretirement income for life plus a survivor pension

or benefit. Those are largely civil service plans; private company plans may not be as rich. Plus, they are all becoming rarer as employers are increasingly unwilling to bear the risk of further market downturns that require them to make up pension deficiencies. So instead of the traditional defined benefit (DB) plans that, if they stay solvent, promise to pay a specified amount on retirement, employers are increasingly turning to defined contribution (DC) plans. With DC plans, employers commit to making certain payments into the plan during the employee's career but bear no overriding responsibility for investment performance of the fund. Employees' retirements are funded with whatever is in their accounts when they're ready to draw on them. There are no guarantees the account balance will provide enough to live on decently.

Then there are the cautionary tales of failed plans, including the high-profile Nortel case now grinding its way through the bankruptcy courts. The 2008 market downturn swamped the once industry giant and its pension

fund, and the division of its assets, including how much will be allocated to pensioners, is being decided by the courts in the United States and Canada. Attempts to change the bankruptcy laws to give pensioners primacy over even junk bondholders have so far failed. The takeaway is that pension trustees need to be proactive and vigilant—not just about how the investments are managed but whether contributions and deficiency payments are paid on time.

Once you've made the calculations for your retirement income, the options become clearer: I will be fine even if I have a major medical event, I will be fine if I stay healthy, I will be fine if I stay healthy and live frugally, I will have to keep working 'til I drop, I will not be fine no matter what I do.

It is small comfort to know that you are not alone in your retirement anxieties; fully 68% of middle-income workers worry that they are not ready for retirement.<sup>2</sup> Many plan to stay in the workforce well past the usual retirement age—some because they want to, nearly half because they have to.<sup>3</sup> Indeed, some experts are already advising people to work to the age of 70 and defer taking social security.<sup>4</sup> Good idea if you can do it—So eat right and keep exercising!

### Income Options

Homeownership, hitherto a reliable source of retirement security, is becoming out of reach for many and sending debt levels soaring. One report said Canadians who were aged 35 to 44 in 2012 have racked up more debt, relative to

#### Takeaways

- Many Canadians have only a vague idea of what a pension does and what it means. Many people reach late career and realize they should have saved more.
- Two-thirds of working Canadians do not have access to a workplace pension.
- Employers are increasingly turning to defined contribution plans for workplace retirement plans.
- Health care costs, including the cost of chronic care, should be figured into calculations for how much income is needed during retirement.
- About 68% of middle-income workers worry that they are not ready for retirement, and many plan to stay in the workforce well past the usual retirement age.

their net worth, than their peers did in the past. This group is more vulnerable to any economic shocks, especially in the housing market.<sup>5</sup>

As you're contemplating how to fund your retirement, an army of financial advisors is ready to help. Some are very wise and will help you make the best of what you have. But all must be scrutinized. In the absence of robust investor protection and restitution avenues, the potential for financial fraud against investors looms high.<sup>6</sup> Seniors are natural targets: They have accumulated assets for retirement, are trusting and want to believe when told that it's possible to get high returns with low risk. There are no easy ways to identify the bad apples—But if it sounds too good to be true, it probably is.

### Saving Enough

How do you make sure you have retirement income sufficient to meet your needs, predictable enough to allow you to make plans and sustainable enough to last as long as you do and possibly leave a little for your kids to remember you by?

One way to think about this is to consider how a model pension plan works. Employees and employers agree to deduct from the paycheques and contribute as much as 18% of current salary to earn pension benefits after a 25-30-year career that will be sufficient to pay out up to 60-70% of pre-retirement income—a very general rule of thumb for what you need for a decent retirement.

Right away you can hear the mental calculations— \$200 off every paycheque sounds like a lot to someone earning just \$40,000. And it is until you realize the potential pension can be as much as \$15,000-\$20,000 per year for the rest of your life after retirement, and that's only if your salary level never increases above \$40,000. Many pension plans also have a survivor pension. Not bad for the equivalent cost of a night out every week. That is not to diminish the hit on the pocketbook, especially early in a career when the payoff is decades away.

The actual contribution levels and payout depend entirely on the terms of a particular pension plan. But for all DB pension plans, accumulated contributions over the years pay for just 20% of the ultimate pension bene-

fit; a full 80% is funded by the investment returns on contributions.<sup>7</sup>

And that brings us to the next major consideration: how to make savings grow safely and adequately to pay out a decent lifetime pension. The well-run DB pension funds fulfill this promise with professional management, high-yield investments that only large funds can access and the advantages of pooling longevity risk. DC plans do not promise any set amount of pension benefit and do not pool longevity risk, so each member's account is subject to the vicissitudes of the market.

DC plans generally invest in retail financial products like guaranteed investment contracts (GICs), stocks and bonds and mutual funds. In addition to market volatility in such cases—except GICs, which have low interest rates—the investor also may sustain high fees that erode returns.

The large pension fund managers have greater financial knowledge, but they also have the benefit of very large funds and investment opportunities unavailable to retail investors. High-net-worth investors have some of those advantages, but it is challenging for average salaried employees to grow their savings into an adequate pension on their own.

So while people embarking on a career should indeed follow their dreams, whether there is a workplace pension should also factor heavily into their calculations as to which job offer they should accept.

Today, two-thirds of working Canadians do not have access<sup>8,9</sup> to a workplace pension, and no other universally accessible plan is in place to help people save effectively for retirement.

The federal government has shown no interest in increasing the Canada Pension Plan (CPP). Ontario has introduced its

### Learn More

#### From the Bookstore

##### **How Much Is Enough? Balancing Today's Needs With Tomorrow's Retirement Goals**

Diane McCurdy, CFP. Wiley. 2013.

Visit [www.ifebp.org/books.asp?8990](http://www.ifebp.org/books.asp?8990) for more details.

##### **The Real Retirement**

Fred Vettese and Bill Morneau. Wiley. 2013.

Visit [www.ifebp.org/books.asp?8989](http://www.ifebp.org/books.asp?8989) for more details.

own pension plan (Ontario Retirement Pension Plan, or ORPP) modeled on the CPP, which is set to become law. However, there is no guarantee that the other provinces will pass similar legislation.

So what are the options if you don't have a workplace pension, the ORPP doesn't come to your province and the CPP is not increased? Take a page from how pensions work and try to replicate it with these five steps:

1. Assess your income and assets and set reasonable goals for covering your retirement needs.
2. Save your money. Set aside something approaching the 18% of current salary that the workplace pensions require. This is also the maximum you can contribute to your registered retirement savings plans (RRSPs).
3. Use tax-deferred vehicles like RRSPs or the more recent tax-free savings accounts to grow your money without paying current taxes on earnings. There's one caveat—Distributions from RRSPs are taxable because the original contributions were deductible. During low-income-earning years, it may not be worthwhile to

make RRSP contributions since the tax deduction will be small. Plus, RRSP withdrawals will erode Guaranteed Income Supplement (GIS) benefits for people who finish their careers still in low-income brackets and will have to depend on GIS.

4. Find a good financial advisor to help set investment goals and achieve them—easier said than done. The key is to ask questions and insist on answers. True, they are more knowledgeable than you—that's why *you're* paying *them*—but they work for you and must be able to demonstrate that the proposed investment risk is suitable to your circumstances. Do you have sizable savings, steady income or other major assets? Are you able to sustain losses, whether financially or emotionally? It bears repeating that there is not yet a robust system of investor protection and remediation, so caveat investor.
5. Plan your financial future with good advice and work your plan. Circumstances change, but a raise or temporary windfall is never an

excuse to dump the plan. Instead, adjust as necessary to stay on track.

That's the tyranny of arithmetic!

So there you have it—most of what you never wanted to know about pensions and you didn't even ask. ☺

## Endnotes

1. A good place to start calculating how much you need to save to prepare for retirement and health care costs: [www.aarp.org/work/retirement-planning/retirement\\_calculator.html](http://www.aarp.org/work/retirement-planning/retirement_calculator.html) and [www.aarp.org/work/retirement-planning/the-aarp-healthcare-costs-calculator.html?cmp=RDRCT-HCSTCAL\\_OCT30\\_013](http://www.aarp.org/work/retirement-planning/the-aarp-healthcare-costs-calculator.html?cmp=RDRCT-HCSTCAL_OCT30_013); the best Canadian calculator doesn't include health care costs but is very useful for adding up revenue sources: [https://srv111.services.gc.ca/INT\\_01.aspx?lang=e](https://srv111.services.gc.ca/INT_01.aspx?lang=e).

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7. The Boston Consulting Group, *Defined Benefit Pension Plans: Strengthening the Canadian Economy*, October 2013. Accessed at [www.newswire.ca/en/story/1246225/new-analysis-confirms-that-defined-benefit-pensions-provide-significant-benefits-to-canadian-economy](http://www.newswire.ca/en/story/1246225/new-analysis-confirms-that-defined-benefit-pensions-provide-significant-benefits-to-canadian-economy).

8. Statistics Canada, "Registered pension plans (RPPs) and members, by jurisdiction of plan registration, sector and type of plan." Accessed at [www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/famil117a-eng.htm](http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/famil117a-eng.htm).

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## BIO

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