# YOUR RETIREMENT INCOME

As the ground shifts, financial advice is key

Live *your* dream.

Investment Planning Counsel®
FINANCIAL SOLUTIONS FOR LIFE

# EXECUTIVE SUMMARY

**1 out of every 5** Canadians will be retired by 2020, a number that will rise to about one out of four, or almost a quarter of the population, by 2030.[1] As the country ages, Canadians need to address an increasingly urgent question: will they be financially ready for retirement? This question becomes even more critical when one looks at the current financial markets, where historically low interest rates are squeezing fixed-income investments and forcing Canadians to consider higher-risk alternatives. All of this is happening at a time when the country's governments are making changes to public pensions, which will have profound effects on when and how comfortably Canadians can retire.

## So are we ready or not? Answering this question is no simple matter.

Recent studies present contrasting views on Canadians' readiness for retirement leaving many wondering: if the experts can't agree on the facts, then who can investors trust to provide reliable advice on retirement planning?

The current body of research underlines the importance of getting professional financial advice. The Montreal-based research organization, CIRANO, found that households who have had professional financial advice for 15 years or longer had 173% or 2.73 times more assets than households that received no financial advice.[2] Canadians who received professional advice were also less anxious about their readiness for retirement.[3]

For Canadians, the answer to whether or not they're ready for retirement is not a clear and simple yes or no. But what is perfectly clear is that, now more than ever, they need help. This is where professional financial advice comes in.

2015 2020 2025 2030

## YOUR RETIREMENT INCOME: AS THE GROUND SHIFTS, FINANCIAL ADVICE IS KEY

As Canada ages, its citizens, residents and governments need to address an increasingly urgent question: will Canadians be financially ready when the time comes for them to transition from the workforce into retirement? Have they saved enough and built a sound retirement plan – one that takes into account the various factors that can affect their ability to live the lifestyle they've envisioned for their next stage of life?

Underlying all these questions are market conditions that have created an atmosphere of uncertainty among Canadian investors. Interest rates at historical lows are squeezing fixed-income investments and forcing Canadians to consider higher-risk alternatives that make them more vulnerable to the vagaries of the market. The risks are especially high for retirees and Canadians approaching retirement, who'll have little to no time – and in many cases, no extra funds to invest – to recover market losses.

At the same time, government-provided pension programs are undergoing changes that will have profound implications for the country's retirees. From the age of pension eligibility to mandated contributions to a supplemental pension, these changes will affect when and how comfortably Canadians can retire.

*Current market conditions have created an atmosphere of uncertainty among Canadian investors.*

## CONTRADICTION IN RESEARCH

Recent studies present contrasting views on Canadians' readiness for retirement. In a February 2015 report titled *Building on Canada's Retirement Readiness*, the consultancy firm McKinsey & Company said a strong majority of Canadian households – 83% – were on track to maintain their standard of living in retirement. McKinsey cited a number of factors contributing to this high rate of readiness: Canada's strong recovery from the 2008 financial crisis, residential real estate values that continue to rise, and the rebound of equity markets to double-digit annualized returns.

In June 2015, the C.D. Howe Institute said reports that Canadians are not saving enough for retirement were exaggerated, and that most Canadians save more than the widely prescribed household savings rate (the ratio between net savings and household disposable income) of 5%.[4]

*If the experts can't agree on the facts, then who can investors trust to provide reliable advice on retirement planning?*

Yet just a few months earlier, a report by the Conference Board of Canada painted a starkly different picture. Based on interviews with employers as well as with working and retired Canadians, *A Survey of Non-retirees and Retirees in Canada: Retirement Perspectives and Plans* found that 60% of Canadians near retirement felt they had not saved enough to live comfortably past their working years. Among respondents aged 65 and older, more than 40% said they did not put enough money aside to fund their retirement.

A number of other studies echo the findings in the Conference Board of Canada report. A 2015 Angus Reid Institute study highlighted a widespread concern over retirement income, with close to 74% of working Canadians acknowledging they felt worried about outliving their funds.[5] Another 2015 study, by the Canadian Institute of Actuaries, concluded that two-thirds of Canadians planning to retire by 2030 are not saving at levels needed to cover their basic living expenses.[6]

## Are Canadians Worried?

**74%**

of working Canadians are worried about outliving their funds

**48%**

of those already retired are worried about outliving their funds

**Source:** *Retirement in Canada: Lots to Enjoy About 'Golden Years' but Financial Worries Loom Large – Especially for Those Still Working, Angus Reid Institute, July 2015*

These findings are echoed by a nationwide survey conducted in early 2015 for the Ontario Securities Commission; more than half of respondents set to retire in the next 10 years revealed that finances were their number one source of stress.[7]

Taken as a whole, the current body of retirement readiness studies creates a somewhat contradictory picture, suggesting at one extreme that Canadians are well prepared for life after work and at the other extreme depicting a large majority of retirees who are unsure about how they will make ends meet. These opposing ideas, broadcast by various media outlets, have created confusion and anxiety among Canadians. Many are left wondering: if the experts can't agree on the facts, who can investors trust to provide reliable advice on retirement planning?

One important fact remains clear: regardless of how they feel today about their readiness for retirement, Canadians need to take concrete steps to improve the likelihood that they truly will be financially ready when it comes time to leave work. The numbers certainly underline the urgent need for action: the latest Statistics Canada and Canada Revenue Agency figures show that only about a quarter of Canadian tax filers contributed to an RRSP, with a median contribution of $2,930. Similarly, only one quarter of Canadians contributed to a TFSA with an average contribution of close to $6,000 per individual.[8 9 10]

*Preparing for retirement is an individual undertaking that calls for tailor-made solutions based on an in-depth understanding of each person's unique circumstances. This is where an experienced Advisor can make a significant difference.*

## LAYING DOWN THE GROUNDWORK WITH A DETAILED, FORWARD-LOOKING PLAN

Many Canadians know that saving is critical to their financial well-being. But even those with the discipline to put money aside regularly often do so without a detailed, forward-looking plan that considers time horizons, life's milestones, and all the variables that could affect their ability to live comfortably in retirement.

While there is no one-size-fits-all solution to retirement income planning, Canadians should, at the very least, review and account for the key factors relevant to funding their post-work lives. These include target retirement age, expected sources of retirement income, retirement lifestyle, health concerns, and legacy planning. In addition, whether or not they work with a financial advisor can affect the financial well-being of retirees.

By undertaking this extensive review, Canadians can finally address that all-important question that many of them ask but fail to answer definitively: how much money do I need to retire, and how do I ensure I'll have enough funds to last my lifetime?

## UNDERSTANDING KEY FACTORS AND THEIR IMPACT ON RETIREMENT PLANNING

How Canadians fare financially in retirement – and how much they need to save to ensure they do fare well – depends on a number of key factors, including:

- **Target retirement age.** It's simple mathematical logic: The longer you work, the more chances you have of building your retirement fund. But setting a target retirement age that makes sense for your retirement isn't always so simple. For some people, when they retire is beyond their realm of control. In the Angus Reid survey, almost half of retirees said they were forced by circumstance to retire earlier than planned – and half of this forcibly retired group said they were struggling financially. By comparison, only 8% of respondents who retired on their own schedule reported money troubles. Given the continued unpredictability of the job market, Canadians may want to map out a retirement plan based on different work departure dates.

### When Will You Retire?



**46%** retired as planned.

**48%** retired earlier than planned, due to circumstances beyond their control.

**6%** retired later than planned, due to circumstances beyond their control.

**Source:** *Retirement in Canada: Lots to Enjoy About 'Golden Years' but Financial Worries Loom Large – Especially for Those Still Working, Angus Reid Institute, July 2015*

- **Retirement income sources.** How much Canadians need to save also depends on their expected sources of retirement income. Those with workplace pensions tend to rely less on personal savings, but the sufficiency of each pensioner's income will also vary based on whether the workplace pension is a Defined Benefit (DB) or Defined Contribution plan (DC). The Canadian Institute of Actuaries looked at several retirement scenarios and concluded that a single person who participated for many years (e.g. 25 years) in a typical DB plan, with a contribution rate of 2% of earnings, should have enough money to cover living expenses when workplace pension benefits are combined with government-provided benefits. On the other hand, a single person receiving government pension benefits and benefits from a DC workplace pension will need additional savings to cover life's necessities.[11]

- **Retirement lifestyle.** Life after work means different things to different people. Some want to travel the world while others prefer spending their days working on a favourite hobby, such as painting or gardening. For the most part, however, Canadians want to ensure they can maintain their current lifestyle and standard of living through much of their retirement years. Without expenses such as mortgage payments, clothing and transportation for work, and the costs associated with raising children, Canadians who have saved regularly will likely have little trouble pursuing the lifestyle they want in retirement. But there's a caveat for single retirees: without the economies of scale enjoyed by couples, they should expect to pay more for travel and other expenditures that a couple would typically pay for jointly.

- **Health issues.** As Canadians get older, their expenses related to health care, such as medications and eyewear, tend to increase. According to Statistics Canada, households led by a senior aged 65 years or older allocate almost 8% of their goods and services spending to health care expenses. This compares with 3% for households headed by someone under 30.[12] It's not surprising that among the retired and still-working respondents interviewed by Angus Reid, about one-third were concerned that health issues could hold them back in retirement.[13]

- **Desire for legacy.** The ability to share some of their wealth is an important factor in retirement planning for many Canadians. Whether this means passing on money to children, a church or to a charitable organization, the desire to leave a legacy must be supported with a clear and realistic plan. In the absence of such a plan, a retiree may fall short of funds to cover living expenses, having given away too much too soon. Tax planning is also critical, for the retiree and for the beneficiaries of the legacy. This is where insurance products, which can off-set or mitigate taxes, often come into play.

- **Access to financial advice.** In an October 2014 report, the Conference Board of Canada touted the multiple benefits of financial advice: an increase in household savings, reduction of anxiety over retirement readiness, and economic gains for the country over the long term.[14] The report pointed to a 2012 study out of the Montreal-based research organization CIRANO, which found that, after taking into account more than 50 potentially influencing factors, households who have had professional financial advice for 15 years or longer had 173% or 2.73 times more assets than households that received no financial advice.[15] Regardless of what they earn, people with financial advisors tend to save a higher percentage of their income.

?

### DB or DC: What's the Difference?

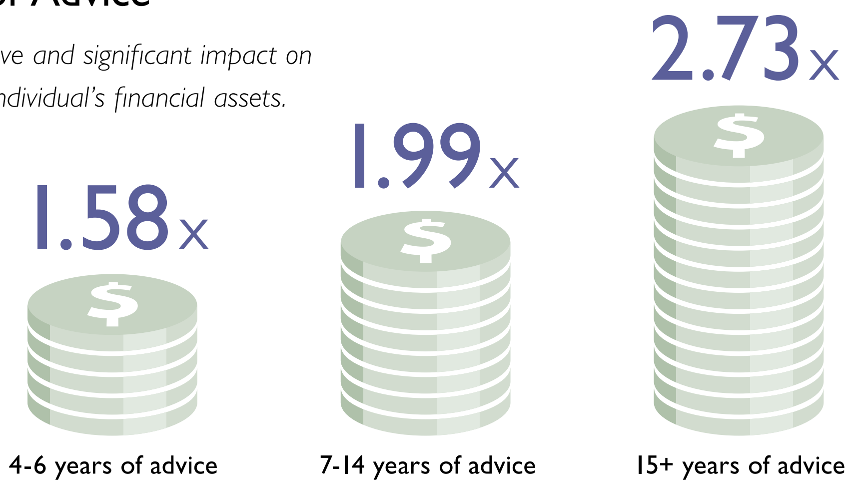
*Canada's pension plans fall into two main categories: Defined Benefit (DB) and Defined Contribution (DC). DB plans provide a pre-set amount of retirement income, typically determined by earnings and years of service. Income from a DC plan, on the other hand, is based on individual plan assets and portfolio performance.*

*Another key difference between the two plans: DB assets are the responsibility of the employer while DC portfolio assets are chosen by each individual from a range of investment options within the plan.*

*The desire to leave a legacy must be supported with a clear and realistic plan.*

## The Value of Advice

*Advice has a positive and significant impact on the growth of an individual's financial assets.*




*"Compared to a similar long-tenured (15 years or more) advised participant in the survey, the non-advised has 2.73 times less financial assets. This amount is too large to be explained simply by better stock picking. One highly plausible explanation of this finding comes from the greater savings that is associated with having a financial advisor and other appropriate advice."*

*– CIRANO Report: Econometric Models on the Value of Advice of a Financial Advisor*

### WHERE WILL THE MONEY COME FROM?

To fund their retirement, Canadians typically draw income from a combination of sources that include Old Age Security (OAS) and the Canada Pension Plan (or the Quebec Pension Plan for those in Quebec), as well as private sources such as a workplace pension plan, a Registered Retirement Savings Plan (RRSP), Tax-Free Savings Account (TFSA), and non-registered investments. Homeowners also often draw from the equity or sale of their property. A small percentage of retirees – about 5%, according to Angus Reid – expect to derive some income from an inheritance.[16]

For Canadians who are relying on their home equity alone to fund retirement, the Canadian Institute of Actuaries spells out a clear message: it won't be enough. Even with house prices projected to rise in the future at the rate of inflation, home equity combined with OAS and CPP/QPP will not provide sufficient income for most Canadians. Likewise, the study adds, those relying solely on government-provided benefits will not have enough to cover basic everyday expenses.

At the same time, private sector employers continue to pull back from their historical role as retirement income providers; today, only three million Canadians working in private companies, or about one in eight workers, belong to a pension plan.[17] Private sector employers are also increasingly switching from Defined Benefit to Defined Contribution plans to reduce their costs. By some estimates, about 40% - 50% of existing private sector DB plans are now closed to new members.[18]

**To live comfortably in retirement, Canadians need to build their private savings. But as the numbers show, that's easier said than done.**

**Registered Retirement Savings Plans** [19] [20]

- Only six million Canadians – or just under 25% of the working population who filed a tax return – contributed to Registered Retirement Savings Plans (RRSPs) in 2013.
- $2,930 was the median RRSP contribution in 2013, that is, half of tax filers reported contributions of more than $2,930 and the other half contributed less than this amount.
- $885 billion in unused RRSP contribution room was available in 2013 to 23.5 million Canadians.

**Tax-Free Savings Accounts** [21]

- 10.7 million, or about 42% of all tax filers, had a Tax-Free Savings Account (TFSA) in 2013.
- $6,000 was the average TFSA contribution in 2013.
- $13,547 was the average unused TFSA contribution room per individual.

**Pension Plans** [22]

- Slightly over six million Canadians were members of either a public or a private-sector registered pension plan (RPP) in 2013, representing just a quarter of the working population.
- $66.7 billion was contributed by employers and employees to RPPs in 2013.

## PENSION CHANGES: WHAT THEY MEAN FOR YOUR RETIREMENT PLAN

A key pillar in retirement planning, government-provided pensions are undergoing changes that could have significant implications for Canada's retirees.

- **Canada Pension Plan.** The federal government recently introduced the Post-Retirement Benefit (PRB), which increases pension income for Canadians aged 60 to 70 who are working and contributing to the CPP, and receiving a retirement pension from CPP or QPP. Employed Canadians contribute to the PRB jointly with their employer, while those who are self-employed pay both the employee and employer portions. CPP contributions toward the PRB are mandatory for working CPP recipients under the age of 65. While this increases CPP benefits, the PRB could reduce OAS or Guaranteed Income Supplement Benefits for some retirees and reduce cash flow for a certain period.[23] The PRB also means more Canadians may be working longer than they had originally planned – an outcome with potentially significant implications for older workers as well as for younger Canadians whose job prospects will be adversely affected by the continued tenure of Boomers in the workplace.

- **Old Age Security.** As of July 2013, Canadians can choose to defer their OAS pension by up to five years after the first date of eligibility in exchange for a higher monthly amount. Other changes are coming: for those born after 1957, the age of eligibility will gradually increase from 65 to 67 years for the OAS and from 60 to 62 for the OAS Allowance, and OAS Allowance for the Survivor. For many Canadians, these changes mean more money must be put aside if they want to retire before they become eligible for OAS benefits.[24]

- **Ontario Registered Pension Plan.** Set to launch in 2017 – starting with the largest employers in the province – the ORPP will require Ontario employers and employees to contribute an equal amount on an employee's annual earnings up to $90,000. Contributions are capped at 1.9% each, and earnings above $90,000 will be exempt. ORPP benefits, which will be indexed to inflation, are based on annual salary and years of contribution.[25] While ORPP promises more money for retirement, mandatory contributions will also mean less money for Ontarians to direct while they're still working. Another disadvantage is that ORPP contributions have little estate value and unlike private savings, apart from a limited benefit, cannot be passed on to heirs.

These changes are driven largely by concerns about the impact retiring Boomers will have on the public purse. Yet public pensions remain robust. The Canada Pension Plan Investment Board, which manages CPP assets, reported $268.6 billion in assets at the end of its first fiscal quarter in June 2015 – a $41.8-billion increase from the same period in the previous year. That's a gain of just over 18%.[26]

The real question is how these changes will ultimately affect Canadians. Mandatory contributions to government programs will mean less income from work, which in turn means less money for private retirement savings. Putting money aside is already a challenge for many Canadians – a fact borne out by RRSP and TFSA contribution room that keeps accumulating each year.

Given the number of changes underway and the complex rules surrounding pension programs, Canadians are well advised to work closely with a professional Advisor who can adjust their retirement plans to reflect the various pension program changes.

*Mandatory contributions to government programs will mean less income from work, which in turn means less money for private retirement savings.*

### How Will Canadians Fund Their Retirement?

*Half of the working Canadians interviewed by Angus Reid said their retirement will be financed primarily by private savings. By comparison, only 30% of retired respondents identified RRSPs as their main source of income. Close to 60% said government pensions were the main source while 53% cited work pensions (Angus Reid allowed for up to three choices).*

## SO HOW MUCH IS ENOUGH?

There are various schools of thought on how much Canadians need to retire comfortably. Some experts say Canadians should aim for a retirement income equivalent to 70% of their working income, while others say 50% is plenty. The research firm McKinsey based its metric for a comfortable retirement income on Statistics Canada data that says Canadians spend about two-thirds as much in every year of retirement as they did during their working years. In the end, however, how much retirement income is enough must be determined by each individual, based on the post-work life they envision.

In the simplest sense, this involves adding up two sets of numbers: expected retirement expenditures and expected income from all available sources. Total income that exceeds expenses means there's likely to be adequate retirement income. Where there's a shortfall, however, retirement savings will be needed to fill the income gap.

In reality, retirement income planning is not as simple as adding and comparing two sets of numbers. Professional financial advisors typically look at a whole host of information and scenarios and account for key factors such as longevity – how long a retiree is likely to live – market fluctuations, and inflation. This comprehensive analysis allows them to build a solid retirement strategy that includes the right mix of investment and insurance products, and asset allocation based on the investor's goals and risk tolerance. Advisors also draw from their knowledge and experience to recommend key strategies that help clients navigate the various challenges and issues associated with retirement income.

Without professional financial advice, determining levels of retirement savings and income can become an exercise in guesswork. Retirement is too important – and fraught with unique complexities – to leave to chance.

*Without professional financial advice, determining levels of retirement savings and income can become an exercise in guesswork. Retirement is too important – and fraught with unique complexities – to leave to chance.*

*Call us to find out how we can help you with your retirement income plan.*

## FOOTNOTES

1 Government of Canada – Action for Seniors Report, Profile of Seniors in Canada
2 CIRANO: Econometric Models on the Value of Advice of a Financial Advisor
3 Conference Board of Canada: Boosting Retirement Readiness and the Economy Through Financial Advice
4 C.D. Howe Institute: Do Canadians Save Too Little?
5 Angus Reid Institute: Retirement in Canada: Lots to Enjoy About 'Golden Years' but Financial Worries Loom Large – Especially for Those Still Working, Angus Reid Institute, July 2015
6 Canadian Institute of Actuaries: Planning for Retirement: Are Canadians Saving Enough?
7 Ontario Securities Commission: Financial Life Stages of Older Canadians
8 Statistics Canada: Summary characteristics of Canadian tax filers
9 Statistics Canada: Registered Retirement Savings Plan contributions, 2013
10 Canada Revenue Agency: Tax-free Savings Account statistics (2013 contribution year)
11 Canadian Institute of Actuaries: Planning for Retirement: Are Canadians Saving Enough?
12 Statistics Canada: Survey of Household Spending, 2013
13 Angus Reid Institute: Retirement in Canada: Lots to Enjoy About 'Golden Years' but Financial Worries Loom Large – Especially for Those Still Working, Angus Reid Institute, July 2015
14 Conference Board of Canada: Boosting Retirement Readiness and the Economy Through Financial Advice
15 CIRANO: Econometric Models on the Value of Advice of a Financial Advisor
16 Angus Reid Institute: Retirement in Canada: Lots to Enjoy About 'Golden Years' but Financial Worries Loom Large – Especially for Those Still Working, Angus Reid Institute, July 2015
17 Statistics Canada: Registered Pension Plan members (RPP) by area of employment, sector, type of plan and contributory status
18 Benefits Canada: The future of employer-sponsored pension plans
19 Statistics Canada: Registered Retirement Savings Plan contributions, 2013
20 Statistics Canada: Registered Retirement Savings Plan (RRSP) room
21 Canada Revenue Agency: Tax-Free Savings Accounts 2015 Statistics (2013 contribution year)
22 Statistics Canada: Pension Plans in Canada, as of January 2014
23 Service Canada: Changes to the Canada Pension Plan
24 Service Canada: Changes to the Old Age Security Program
25 Government of Ontario: The Ontario Pension Plan: Discussing a Made-in-Ontario Solution
26 Canada Pension Plan Investment Board

Investment Planning Counsel®
FINANCIAL SOLUTIONS FOR LIFE