Retirement Planning

The current generation entering or approaching retirement is essentially the "baby boomers", born in the two decades after World War II. They are a different breed from their parents and grandparents. For one, they live longer. Previous generations expected to retire at 65 and live to 70 or 75. The current retirement generation may take early retirement (55 to 60) and can expect to live 80+ years. The longer life expectancy is due to a better health care system and healthier lifestyles (better eating, less smoking, more active lifestyle). Longer life expectancy means more resources needed to see these retirees through their retirement years.

RETIREMENT INCOME SOURCES

Where do these resources come from? Canadians have six income streams that they can access to finance their retirement years. Some are government sponsored and some are private. The six potential streams are as follows:

1. Canada Pension Plan (CPP) or Quebec Pension Plan (QPP)
    - The Canada Pension Plan provides a monthly taxable benefit to retired contributors. The amount of the pension is dependent on the amount contributed during the contributor's working life. Currently, the maximum annual CPP benefit is just over $11,000.
    - A similar plan (QPP) operates for those who work or have worked in Quebec.

2. Old Age Security (OAS), Guaranteed Income Supplement (GIS)
    - The OAS provides a basic pension benefit at age 65 for those who have lived in Canada for at least ten years after their 18th birthday. The maximum annual OAS benefit is currently just over $6,000. It can also provide benefits for low-income seniors when they reach 60.
    - Included in the OAS program is the Guaranteed Income Supplement (GIS), a monthly benefit for eligible persons who receive the OAS but have little or no other income.

3. Employer-sponsored pension plans (either private or public sector)
    - Pension plans, whether private or public sector, provide a monthly income annuity once the pensioner reaches an agreed to retirement age or has worked a certain number of years. The annuity usually expires on the death of the pensioner, though some plans have "survivor" benefits.
    - Pensions come in two varieties – Defined Benefit Pension Plans and Defined Contribution Plans.
        - Defined Benefit Pension Plans (DBPPs) provide a specified monthly benefit that is dependent on earnings history and tenure or age. A DBPP is not dependent on investment returns. Contributions can be made by the employer, the employee, or both.
        - Defined Contribution Plans (DCPs) set a specific annual employee contribution. The contributions are guaranteed, but not the benefit, which will vary according to investment returns. Contributions are made by the employer and the employee

4. Personal Registered Retirement Savings Plans (RRSPs)
    - An RRSP is a registered savings plan that allows the holder to contribute a certain amount each year (based on income) to a tax-free account. RRSP contributions serve to reduce your income tax. The funds are then invested in RRSP eligible mutual funds, bonds, GICs (Guaranteed Income Certificates), etc. Tax is paid on the funds only when they are withdrawn or the RRSPs are cashed in. Currently, the maximum RRSP contribution is $22,000 per year.

5. Personal Savings (Non-RRSP) and Tax-Free Savings Accounts (TSFAs)
    - Personal savings can take the form of cash, investment real estate, and non-registered GICs, mutual funds, stocks, bonds, etc.
    - The TSFA program allows Canadian residents over the age of 18 to contribute up to $5,000 annually into a TSFA. Investment options include GICs, mutual funds and bonds. Investment income earned in the TSFA is tax free.

6. Work Income
    - More and more retirees continue to work after "retirement". Some have been offered an early pension and don't feel that they're ready for retirement yet. Some work part-time to augment their retirement income. And some work because they want to keep "busy". They may work for others or they may work for themselves, for instance, turning a hobby into an enjoyable business.

RISKS

The amount of income available at retirement age is to a large extent dependent on your earning power during your working life and you ability to save. Maximizing CPP benefits, pension plans, and RRSP contributions are all dependent on income. Likewise personal savings depend on your ability to earn and your discipline to set aside money for the future, over and above living expenses and non-essential spending (vacations, homes, automobiles).

If your income stream during the working years is interrupted by sickness or injury, or job termination or layoffs, then your earning power is reduced and your ability to contribute to a retirement portfolio is threatened. Of particular worry is the temptation, and sometimes there is no alternative, to make withdrawals from RRSPs to fund living expenses during times of personal financial crisis. There are serious tax implications to removing funds from an RRSP prior to reaching retirement age. These should be discussed with your accountant or tax advisor.

Another risk is market risk – the risk that volatility in the capital markets will erode our retirement investments. One particular fear is that the cyclical nature of the stock market could result in a drop in investment values at the specific time that we need our retirement income. An ill-timed market downturn could result in a lower retirement income stream that is inadequate to support the retiree's expected lifestyle and spending behavior. This is one of the reasons that, as we grow older, the asset mix in our retirement portfolio needs to be adjusted from high-risk investments such as equity-based mutual funds to low-risk fixed income securities such as GICs and bonds. (For more information about asset mix, please see our section on Retirement Portfolio Fundamentals.)

Inflation poses a very real risk during retirement – in particular because of the conservative, low-risk investment philosophy advocated for retirees. Having converted a retirement portfolio from a growth-oriented portfolio during your earning years to an income-generating, low-risk, capital-protecting portfolio during your retirement, it is possible to see your buying power significantly reduced by inflation.

Finally there is the risk of longevity. Normally, longevity shouldn't be seen as a negative thing, but with increased life expectancy, there is always the risk that you could be one of those people who live to be 90 or 95 or even 100. If you have planned your retirement funding for 80+ years, will you have enough income if you last longer?

RETIREMENT BUDGETING

In order to plan your retirement portfolio, you need to set goals. One way to do that is to figure out what your living costs are today versus what your expected living costs will be during retirement. Basically your costs will break down into two main categories – essential monthly living expenses (housing, utilities, car, food, clothing, healthcare, etc.) and discretionary spending (holidays, travel, entertainment, restaurants, etc.)

Many government or corporate pensions are designed to provide, when added to CPP, approximately 66% of your salary. Most people make do with far less than that in retirement income. Therefore, careful budgeting is necessary to ensure that your retirement income stream meets your monthly living expenses.

As a starting point for your calculations, we have provided a Retirement Budget Worksheet, which will allow you to compare your current monthly expenses with your expected monthly expenses at retirement and also compare income before and after retirement.

STEPS TO RETIREMENT

It's never too early to begin planning for your retirement. Starting early allows you to maximize your investments and ensure an adequate retirement income. What is "adequate"? Enough to meet your monthly living expenses in a style that you would be comfortable with and provide enough for discretionary spending. Here are some steps that you can take:

1. **Set goals**
   What do you want out of retirement – travel, relaxation, a chance to volunteer, pursue a new hobby, socializing, expand your education, get to know your children or grandchildren better, etc? It should be a chance to do the things you've always wanted to do and explore your potential. For some help in lifestyle planning for retirement, visit our webpage on Retirement Lifecycle Management.

2. **Get advice**
   There are so many investment options open these days that it is impossible for one person to understand them all. Find an investment advisor that you can trust – either an independent advisor or a personal client manager at your bank (though they tend to move around). But do not abdicate your own responsibility. If you don't fully understand a recommendation, don't do it. Ultimately it is your money and your retirement nest egg and only you are responsible for it.

3. **Maximize your RRSP contributions**
   Every year that you work, you are allowed to contribute to an RRSP plan according to how much you earn and what your deductions are. The current maximum contribution is $22,000. Because of the tax benefits involved, maximizing your contributions is one of the best investments you can make and for some it justifies the cost of a loan or use of a line of credit to make the contribution. The earlier in life that you start contributing to an RRSP, the sooner your retirement portfolio starts earning money for you.

Also, it makes sense to make regular RRSP contributions throughout the year. The sooner you make a contribution, the sooner it is invested and is making money for your retirement.

4. Eliminate major expenses
By the time you reach retirement age you should have eliminated many personal expenses. Your mortgage should be paid off and any major renovations or repairs to your home should be dealt with. Any credit card debt or outstanding loans should be paid down. Major personal items such as furniture, appliances, and vehicles should be paid for.

5. Diversify and adjust your portfolio
A well-balanced portfolio with investments in different asset classes will protect the portfolio from the inevitable ups and downs of the capital markets. Create a portfolio with a mix of equities, mutual funds, GICs, bonds, preferred shares, etc. And as you grow older, move more of your assets into low-risk, income generating investments such as GICs, corporate and government bonds, and dividend-paying preferred shares. For more information about diversifying your portfolio, see our webpage entitled Retirement Portfolio Fundamentals.

6. Review annually
Every year, review your progress. Have you maximized your RRSPs? Is your portfolio asset mix working? Are you paying down your major expenses or are your outstanding loans and credit card debt gaining on you? Are you on target for your retirement date?

Retirement can be an exciting journey, an opportunity to explore new things and new challenges. Some simple planning now and financial discipline in the years ahead will ensure that your retirement meets and exceeds your expectations.