

Part Four: Flexing your financial muscle

Martin O'Connor has tried to stay fit physically, particularly as he gets older, even working with a personal trainer.

He has taken a similar approach to planning for his retirement, creating a plan to maintain his financial fitness.

The holder of a defined-benefit pension plan — one of the fortunate 30 per cent in British Columbia to have a workplace pension — O'Connor also contributed to a Registered Retirement Savings Plan. Along with his wife, who also contributed to RRSPs, they amassed a nest egg of \$500,000, partly with the help of an inheritance.

Like other working Canadians, O'Connor is able to draw upon the Canada Pension Plan and Old Age Security.

O'Connor, 66, also has downsized from a house in Tsawwassen to a condominium in Surrey.

“I am feeling very, very fortunate in the grand scheme of things,” says O'Connor.

But he stresses that if he had not paid careful attention to the details of his retirement and contributed to RRSPs — exercising his financial muscle — he would not have been able to maintain his lifestyle, which includes a love of golf, wine and travelling, when he retired.

The lesson that O'Connor learned — that it is important to save at a high level in order to preserve your pre-retirement income — is an important one.

Need to save more

David Dodge, the former governor of the Bank of Canada, said as much recently, calling on Canadians to save more.

In a study he co-authored for the C.D. Howe Institute, he said that except for the working poor, Canadians must save a very high fraction of pre-retirement earnings every year — either through employer plans or private saving — to provide for reasonably adequate and assured retirement incomes.

“We estimate that most Canadians, should they wish to retire at age 65 and replace 70 per cent of their working incomes, will need to save from 10 to 21 per cent of their pre-tax earnings every year, if they save for 35 years,” Dodge and co-authors Alexandre Laurin and Colin Busby said in their report.

Fidelity Investments Canada ULC came to a similar finding following a survey of 2,200 Canadian households in 2007: People who want to maintain their lifestyle in retirement will need to replace 75 to 85 per cent of their pre-retirement income.

The Fidelity report found that retirees are only replacing 50 per cent of their pre-retirement income — 47 per cent in British Columbia.

The report also showed that some Canadians have taken no action at all to prepare for retirement. One in five Canadian working households had no retirement savings, and 10 per cent of those aged 55 and older had no retirement savings.

Fidelity Investments economist Peter Drake says the 2007 report is reinforced by more recent data.

A 2010 Fidelity survey found that depending on their income, 45 to 66 per cent of retirees were spending less than when they were working.

Another 18 to 41 per cent were spending the same.

The survey also showed that 10 to 16 per cent of retirees were spending more than when they worked.

“What you are dealing with when you are talking about how much people have to save is you are dealing with one of the oldest and most difficult decisions that we think about in economic analysis. And that is: Do I consume more now? Or do I consume less now and save more now, so I can spend more later? That’s difficult because now is reality,” observed Drake, vice-president retirement and economic research.

Living longer

That decision is even more important today because people are living longer.

Life expectancy increases are dramatic. Life expectancy in Canada at birth in 1950 was 70.3 years for women and 65.8 for men. That had been extended significantly by 2010, to 83.8 for women and 79.7 for men.

Canadians’ life expectancy is expected to continue to increase in the next several decades, said Ryan Berlin, an economist with Vancouver-based Urban Futures, a consultancy firm that specializes in demographics.

He noted life expectancy is even greater as people get older, since they have already survived potential causes of death such as diseases, workplace accidents or car crashes.

“If you look at the life expectancy at age 65 it’s actually quite a bit higher than life expectancy at birth. So, for all these baby boomers that are alive, when they retire, it’s not that they can expect to live another 20 years, they can expect to live another 25-plus years,” said Berlin.

Increasing life expectancy was a fact that 58-year-old Gord Campbell, who has already been retired two years, was well aware of when planning his retirement.

He's already planned out to 89 years of age, and is in the midst of planning beyond that.

"You have to do it," says Campbell, a North Vancouver resident who worked at Imperial Oil's refinery in Port Moody before becoming a union representative with the Communication, Energy and Paperworkers Union.

While Campbell acknowledges he benefited from a workplace pension — as does his wife, who was a nurse — he made sacrifices when he was younger, spending less than so he could spend more in his retirement.

He points to his choice to live in the basement suite in one of the first houses he owned, renting out the main floor, in order to pay off the mortgage more speedily.

The strategy has paid off, and he and his wife have been able to travel in retirement. "We're not rich, but it's a good life," he said.

Challenge for pensions

Increased longevity also poses challenges for workplace pension plans, considered one of the key underpinnings in saving for retirement.

A recent report by Swiss Re, one of the world's largest reinsurers, concluded that many public and private workplace pension funds have not set enough money aside to account for longevity risk.

Swiss Re identified more than \$1 trillion of pension assets and immediate annuity reserves as "at risk" in Canada as of 2010.

Underestimating life expectancy by just one year can push a pension fund's liabilities up by five per cent, so getting it right is a major challenge for pension funds and annuity providers, said the report, published in October.

That increased longevity risk is just one of the factors pushing companies to abandon the kind of defined benefit plan to which O'Connor and Campbell belong.

O'Connor had a pension plan both as an employee of Canadian Airlines — although he transferred its value to a restricted RRSP when he left in 1991 — and as a public-sector worker with BC Ferries.

Campbell had pensions with Imperial Oil and his union.

Defined-benefit public pensions in British Columbia have shown no hint of disappearing, but defined-benefit plans in the private sector are a different matter.

The Fidelity Investments report marked the decrease in defined-benefit workplace plans as a key challenge in saving for retirement.

Data the firm compiled showed the proportion of the labour force in Canada that had a defined benefit plan dropped from 33 per cent in 1992 to 26 per cent in 2006.

Education critical

Sylvia MacLeay, president of the Council of Senior Organizations in BC, says these changes to pension plans, and the importance of retirement income, make it critical for people to educate themselves about their retirement finances and their workplace pensions.

She said she often gets calls from seniors who need counselling on their retirement finances.

However, the calls often come too late.

For example, when planning for retirement, people need to understand now the effect of inflation on their retirement income and know whether their pension has inflation increases.

She pointed out if you retire at 55 to 65 — and expect to live another 25 to 30 years — cost-of-living increases will erode the buying power of a fixed retirement income.

In those 25 years to 30 years, at a conservative increase in inflation of two per cent, half the value of a retirement income would be eaten up by inflation.

It's also important to know whether you will continue to collect any health or dental benefits under your pension plan, said MacLeay, a retired teacher who has a public-sector pension.

Knowledge about the Canada Pension Plan, Old Age Security and Guaranteed Income Supplement is also important, she stressed. MacLeay noted that some retirees do not know that they must apply in order to collect a benefit such as Old Age Security.

She believes most people are not well prepared financially for retirement.

“One of the things people have to learn is when they are making money, yes, there are times to spend money on entertainment and relax. But it's not reasonable or sensible to spend all you make. You can't spend up to and beyond your income,” said MacLeay.

Similar advice

O'Connor has similar advice for retirees.

He says you need to be knowledgeable about your workplace pension plan if you have one.

He also recommends contributing as much as you can to RRSPs. It also makes sense have a good financial planner, and build a relationship with a banker you trust.

O'Connor said you also have to be prepared financially for changes in retirement, changes that can come suddenly.

The loss of his wife to cancer in 2010 was a terrible personal blow, but it also had financial implications in reduced pension and CPP benefits.

The O'Connors had planned for that eventuality as well, with a joint life-insurance policy.

But smaller, more mundane changes can also affect your finances, noted O'Connor.

He was involved in accidents with the family's two vehicles — neither was his fault — that caused enough damage to have both older cars written off.

It meant O'Connor had to buy a new car when he neither wanted nor planned to. "You never know when a crisis might hit," O'Connor says of the need to be financially fit in retirement.

Campbell also encourages young people to begin planning financially for their retirement as soon as possible. "I would tell young people to do everything you can to retire early. It's the best job I never had," he says.