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Saving For Retirement: Where Are We?

By: Peter Ridge & Annik Huet-Richard

In a society marked by a notable aging of the population (See Chart 1), where medical progress and the ambitious plans of recent **retirees** are leading to longer, more active **retirements**, encouraging individuals to take charge of their financial future is a key topic of concern.

However, a June 2007 study sponsored by the Canadian Institute of Actuaries (CIA) shows only one in three Canadians expecting to **retire** in 2030 is saving at levels required to meet basic household expenses in their **retirement** and many may need to sharply increase their annual savings or continue working past age 65 to avoid financial hardship. **Benefits** paid under the Old Age Security (OAS) program and the Canada **Pension Plan** (CPP) or Quebec **Pension Plan** (QPP) provide a modest level of income, but not enough to maintain most people's standard of living after **retirement**.

In fact, individuals with an annual income of around $40,000 who retire at age 65 will only receive 37 per cent of this income from government plans, roughly $15,000 a year. Home equity can reduce this shortfall to a certain degree, but not enough. That leaves personal savings as the only way to achieve a person's **retirement** goals.

Are Personal Savings The Answer?

Group pension plans are a key part of a company's employee benefits. Based on a 2003 survey by SOM, 67 per cent of employees would rather have a pension plan than a pay raise. Essentially, employers who want to attract and keep key employees have no choice but to offer a pension plan.

However, merely setting up a group pension plan is not, in itself, enough to guarantee a retirement income for all employees with access to the plan. For instance, the money accumulated in group RRSPs is not locked in, meaning it can be withdrawn at any time, at the member's discretion.

With Defined Contribution or Defined Benefit registered pension plans (RPPs), on the other hand, the accumulated contributions are lockedin, meaning the money saved under the plan cannot be withdrawn until retirement. As a result, employers who set up an RPP ensure that the money accumulated by plan members will generally be used to generate a retirement income.

The plan sponsor can also decide whether to make enrolment in the RPP mandatory or not. By making enrolment mandatory and setting minimum employee contribution levels, the plan sponsor ensures that every employee will receive a minimum amount of additional retirement income. But even under this last scenario, there's no guarantee that the income generated will be sufficient to maintain the plan member's standard of living after retirement. And, in the case of a pension plan where enrolment is voluntary, too many employees fail to join the plan, preventing them from receiving the additional employer contributions which has a detrimental impact on their retirement income.

Moreover, we must not lose sight of the fact that beyond simply joining the pension plan, members also need to make sure they save enough money to meet their retirement goals. In most cases, this means making the maximum contribution to their pension plan. Too many plan members end up saving too little for retirement, believing instead that the government plans will be enough to provide them with a decent retirement income (See Chart 2).

How Much Is Enough?

A study by the CIA suggests a single person with an income of $40,000 who starts saving at age 40 and who plans to retire at age 65 would have to save 14 per cent of their gross salary annually to round out the government benefits and have enough money to cover their necessary living expenses. In 2004, the average member contribution was 4.4 per cent1 which is clearly not enough to provide a decent retirement income. Moreover, if a person wants to lead a more active retirement, which would undoubtedly entail some discretionary spending, the percentage of annual savings required would be even higher.

In combination with home equity, workplace pension plans are the vehicle that best enables people to make up the shortfall, but the contribution rate needs to be much higher than what is currently being observed. Convincing Plan Members To Save More There's no question that, in light of the situation, group pension plan providers need to offer tools that will give their plan members a quick, clear overview of their financial situation – that is, the retirement goal they want to achieve and whether they are on track to achieve this goal.

Some providers have recently taken on this challenge and have found a way to achieve an individual, personalized, and proactive approach. They do this by offering a service that keeps members up-to-date. This service provides an analysis of their financial situation, an estimate of the projected retirement income along with any shortfall, and personalized recommendations for adjusting the strategy if it is not on track for achieving their retirement goals.

Even if members are making regular contributions to their employer's pension plan, it's difficult for them to know if their savings will meet their retirement goal. A multitude of factors need to be built into the calculations – inflation, projected returns, and contribution from government plans, to name a few. By providing members with a personalized projection of their retirement income, the tool gives them the opportunity to see if their savings are in line with their retirement goal.

The tool needs to be adaptable to the retirement age selected by the member and the desired level of income. In order to provide a realistic assessment, it needs to take into account the member's current financial situation; considering all of the member's accumulated savings at the time of the analysis. This last aspect is very important in order to provide the member with precise and accurate information.

In the context of group pension plans, this kind of service is extremely useful since it offers a personalized approach by giving members a clear profile of their individual situation based on neutral, objective information. Keep in mind that under the Guidelines for Capital Accumulation Plans, plan sponsors have certain responsibilities toward plan members. With group pension plans, tools and services that promote sound governance of accumulation plans can add considerable value for plan sponsors.

Moreover, it is essential that the plan sponsor be informed of how the plan is being used in order to assess whether plan members are on track for achieving their retirement goals. If the plan sponsor discovers that the members' rate of savings is insufficient to provide them with an adequate retirement income, it can hold an information session or some other activity to make members aware of the importance of developing and using a retirement savings strategy to help them achieve their retirement income goals.

In short, Canadians need to be more aware of the importance of saving for their retirement and of the current general deficiencies in this regard. Normand Gendron, CIA president, says "Canadians in their early or mid-40s need to get the message that they are going to have to save more if they want to enjoy financial independence when they retire." As well, he says governments need to educate Canadians more about the role that personal savings and retirement plans can play in generating retirement income and provide them with the tools and incentives they need to help them save.

Plan sponsors also have a key role to play in this regard. They need, with the help of their plan provider, to be the driving force behind providing plan members with this awareness. ■

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