



## PENSION AND RETIREMENT INCOME COMMITTEE

The following article presents a summary of recent reports about the retirement income facing Canadians in the years ahead. And, for those that have available savings, the Tax Free Savings Account (TFSA) appears to be a very interesting vehicle to invest in. These amounts can then be withdrawn for a rainy day or a special treat with the interest gained being completely tax-free.

### **ARE CANADIAN RETIREES AT RISK OF OUTLIVING THEIR RETIREMENT SAVINGS?**

Considering that “the first wave of baby boomers (Canadians born between 1947 and 1966) has already entered their sixties and their peak retirement years are fast approaching” (3), the financial implications of retirement become extremely important. Life expectancy at birth, 77.8 years in 1991, is now (2009) 81.9 for men and 85.1 for women. By 2030, one-quarter of Canadians will be 65 or older. So the risk of outliving their pensions is quite real.

Canadians have three sources of income for retirement: the first consists of public plans - Old Age Security (OAS) which provides a guaranteed annual income for seniors that does not depend on participation in the work force - and the Canada/Quebec Pension Plans (C/QPP) which provides earnings-related pensions for people in the work force when they retire; the second source, employer-sponsored pension plans - registered pension plans (RPP); and the third, personal savings - including registered retirement savings plans (RRSP) that receive tax subsidies.

In its 2009 report, the Canadian Institute of Actuaries concludes: “two thirds of Canadian households expecting to retire in 2030 are not saving\* at levels required to meet necessary living expenses”. (1) These necessary living expenses are defined as food, shelter, clothing, transportation, health care, energy and taxes. True, “certain living expenses tend to drop significantly during retirement as most retirees are mortgage-free and no longer incur employment costs such as daily transportation.” (2) However, income requirements do not appear to decline over time for a number of reasons, “including the fact that relatively few retirees downsize their homes, and the reality that healthier lifestyles allow many to incur expenses related to travel, hobbies, and entertainment for much longer than previous generations.” (2) As the World Health Organization sees it, “years have been added to life, now we must add life to years.”

“In 2003, before taxes living expenses averaged 24 909 \$ for a senior one-person household and 43 717 \$ for a senior two-person household.” (1) “For someone whose earnings are equivalent to the average wage (46 300 \$ in 2009) OAS provides about 13% of pre-retirement earnings and retirement benefits from the C/QPP provide another 25% for a total of 38%.” (3) This is not generous and needs to be supplemented with savings or membership in a pension plan at work. Home ownership “can have a very positive financial impact on the ability of individuals to narrow the gap between what they will receive from the public pension system, and the income they will need in order to cover necessary living expenses in retirement” (1), but, by itself, won’t be enough. “Participation in a workplace pension plan (RPP), by itself, won’t be enough. And, saving through a Registered Retirement Pension Plan (RRSP) plays an important role, but is unlikely to fill the gap. To generate sufficient income in retirement to pay for necessary living expenses, some combination of these resources will be required.” (1)

For example, “a single person who has participated in a typical Defined Benefit (DB)\*\* pension plan for a long period before retirement, say 25 years, could be expected to have earned sufficient benefits in combination with OAS and C/QPP to meet household expenses in retirement; however, if only one member of a couple has participated in a DB pension plan, additional savings will likely be required to meet this threshold. A single person who has participated in a typical Defined Contribution (DC)\*\*\* pension plan for a similar period could still be expected to need additional savings in combination with OAS and C/QPP to meet household expenses in retirement. This is also true if both members of a couple have participated in a DC plan.” (1)

Many Canadians are facing a bleak retirement. Whatever your income level, you will need some portion of that amount to maintain your lifestyle in retirement. What you don’t save now, you won’t have later. This is where the Tax-Free Savings Account (TFSA) should be on the top of everyone’s list for setting aside personal savings for future use. Starting in 2009, a TFSA is a new way for residents of Canada to set money aside tax-free throughout their lifetimes. Contributions to a TFSA are not deductible for income tax purposes, but the income earned in the account is tax-free, even when it is withdrawn. Generally, the types of investments that will be permitted in a TFSA are the same as those permitted in a registered retirement savings plan (RRSP). For 2010, you can contribute up to 5000 \$ to your TFSA. The Canadian Revenue Agency (CRA) will determine the TFSA contribution limit for each individual annually and this will appear on your notice of assessment. This contribution limit will take into account your annual TFSA dollar limit (5000 \$), any unused portion from the previous year, and any withdrawals made in the previous year.

\* No consideration was given to other potential sources of income such as personal savings or non-registered investments in the CIA study

## TERMS

\*\* Defined Benefit (DB) pension plan: benefits correspond to a set amount or are determined with a formula related to years of service; an actuarial valuation is conducted every 3 years to determine contributions.

\*\*\* Defined Contribution (DC) pension plan: the amount of contributions is known, but the amount of benefits is only known upon retirement.

## REFERENCES

- (1) Canadian Institute of Actuaries (2009) *Planning for Retirement: Are Canadians Saving Enough?*
- (2) Russell Investments Canada and Harris/Decima (2008) *Don't Retire From Investing, Invest For Retirement.*
- (3) Townson, Monica (October 2009) *What Can We Do About Pensions?* Canadian Centre for Policy Alternatives.

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