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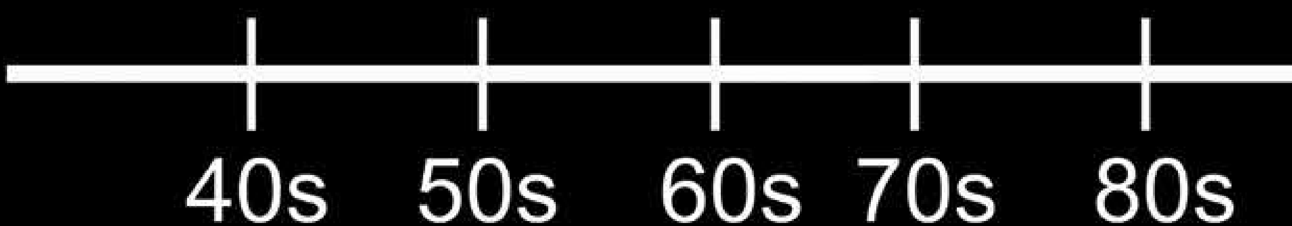

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Navigating the complexity of financial planning for retirement poses a significant challenge for plan members. The authors examine plan sponsors' and organizations' opportunities to assist their members on this intricate journey.

Financial planning for retirement is one of the most complicated tasks your members will do. Nevertheless, it is also one of the most impactful and can set them up to enjoy the years they have worked so hard for. There are many steps employers and organizations can take to support their members on this journey and create successful retirements.

Most people are aware that secure pension income is on the decline. However, what needs to be understood is how shifting demographics and economic forces impact retirement income security. For the first time in Canadian history, there are more people over the age of 65 than there are under the age of 15. People are also living longer than ever before. The average life expectancy in Canada is 82.96 years of age in 2023. The United Nations predicts that it will increase in Canada to 84 years by 2030 and to 86.4 years by 2050.[1]

For many Canadians, this increase in life expectancy creates a genuine—and often significant—challenge to creating a secure retirement income. People are living longer than ever, and Baby Boomers have had fewer children than previous generations. When we consider that adult children traditionally provided most of the care for seniors in their homes, without that family support, retiring plan members may need to finance a longer retirement period with less money and higher expenses.[2] Against this backdrop of shifting demographics is the impact of higher inflation, investment volatility and lagging government health support. This reality has changed, and so must our approach to retirement planning.

Retirees are aware of these financial risks. A recent CPP Investments retirement survey shows that more than half of Canadians need to learn how much they need to save for retirement, and nearly two-thirds of working Canadians worry about running out of money during retirement.[3] Unfortunately, awareness is not enough without accessible solutions—That is a fundamental problem for Canadians and their employers.

How Much Is Enough?

Retirement planning has never been more critical or fraught with risk and anxiety about getting it “right.” The longstanding objective that we have come to rely on to determine the adequate amount of retirement income is a 70% final earnings replacement rate. This figure is used by actuaries, financial advisers, academics and public policy analysts across Canada and worldwide. But is it accurate? One of the authors of this article led a study to ask just this question, using actual real-world data to test its validity.[4] Unfortunately, the results found that this traditional benchmark, no matter how widely used, does not do the job it is supposed to do. In particular, the data showed that workers who hit the 70% replacement rate could have living standards that are substantially higher or lower after retirement. As a result, not only is the 70% rule of thumb a scientifically invalid measure, but it is also misleading and potentially harmful to those told to follow it. To fill the gap left by the invalid 70% replacement rate, this research proposed a more reliable and scientifically accurate alternative: the living standards replacement rate (LSRR). The LSRR determines how well a person’s living standards will be maintained after retirement.

Typically, if a person wanted to measure the current cost of their living standards, they would need to figure out their income and expenses by reviewing their spending, collecting receipts, reviewing credit and bank statements, and then figuring out whether they would have enough money to support this living standard during retirement. This is essentially a bottom-up approach to build an estimate, piece by piece, of how much a person spends to support their living standards. The LSRR streamlines this by taking a simplified, top-down approach to arrive at the same estimate. It looks at gross employment income; subtracts major income deductions such as taxes, mort-

Takeaways

- Demographic shifts, increased life expectancy and changing economic forces have added complexity to financial planning for retirement.
- Living standards replacement rate (LSRR) simplifies retirement planning by comparing spendable income before and after retirement, enabling individuals to assess their preparedness for maintaining their desired lifestyle.
- In recent decades, there has been a decline in traditional workplace-defined benefit pension plans. Dynamic pension pools present a shared dynamic option enabling Canadians to combine their registered savings upon retirement and generate lifetime pension income less expensively than with a traditional annuity.
- Employers and plan sponsors can support their members by providing information and resources that empower them to create personalized plans and foster financial confidence and well-being throughout their retirement journey.

gage payments, and retirement savings; and adjusts to recognize any partners and dependents the member supports. That provides a reasonable estimate of the income that a member is spending to support their living standards (spendable income) while working. It then does the same thing for retirement by adjusting to reflect anticipated changes to income and expenses. Comparing the two will answer the most crucial question: Are you on track to have the same amount of spendable income in retirement?

With this basic understanding, adjustments can be made to support a member's desired living standard. Once members meaningfully understand how much they are spending on their current living standards today, it can be empowering for their retirement planning. Understanding how much of their current lifestyle they can expect in retirement can motivate members to make more insightful decisions about today's financial actions that will impact their future. They can implement strategies to improve their LSRR, like saving more, adjusting their retirement date or reevaluating their desired retirement lifestyle.

Achieving Inflation-Protected Income for Life

Of course, understanding how much is needed to support a desired lifestyle in retirement is an essential piece of information. However, plan members also need to have financial vehicles to allow them to achieve their retirement goals. Members need ways to turn their multiple savings and benefits programs (workplace, government and personal) into inflation-protected lifetime pension income that will allow them to continue their lifestyle after retirement. Otherwise, a lack of financial security for older Canadians compromises their well-being and has consequences for those people and systems supporting them. At a societal level, the impact will become more and more severe as we move further into an aging population. The absence of clear financial decumulation options for plan sponsors could also mean having unengaged members work beyond their desired retirement age as they lack a clear, confident plan to securely finance their retirement years.

Workplace retirement plans contribute greatly to a person's retirement income. However, over the past several decades, there has been a decline in traditional workplace defined benefit (DB) pension plans that promise lifetime pension income after retirement. In Canada, only one in ten Canadians will receive income from a workplace DB pension. In response, Canadians have contributed over $1.5 trillion to registered savings like RRSPs and defined contribution pension plans.[5] While this is encouraging news, the missing piece is the actual pension that will help replace employment wages in retirement. Motivated by this gap in Canadian retirement income, we at the National Institute of Ageing formed a coalition of leading pension experts, organizations and industry stakeholders to ask the federal government to change tax and pension legislation to allow for a shared risk decumulation option, called *dynamic pension pools* (DP pools).[6] DP pools would allow Canadians to combine their registered savings at retirement and generate lifetime pension income less expensively than with a traditional annuity. In a DP pool, pension payments may fluctuate from year to year. Removing this guarantee means that retirees can stay invested in capital markets and benefit from the higher expected returns while ensuring they do not run out of money. In the last budget, the federal government continued to move forward, promising to make DP pools (or variable payment life annuities) a reality in Canada. Work continues to be done to help make this solution accessible to all Canadians.

Government retirement benefits and when to take them also play a key role in ensuring that members have enough lifetime income for retirement. When to claim the Canada Pension Plan (CPP) or the Québec Pension Plan (QPP) is an important financial decision for most Canadians. In less than ten years, one-quarter of Canada's population will be age 65 years or older—making us one of the world's few super-aged countries and making it even more critical for plan members to understand how to get the most from the CPP/QPP.

While each member's situation will be unique, members in reasonable health who can afford to wait and want to optimize their CPP/QPP benefits should consider delaying the start for as long as possible (maximum to age 70); this would more than double the payments of this gold-plated, inflation-indexed, lifetime DB pension. However, fewer than 1% of Canadians choose to delay benefits until age 70. Most Canadians take their CPP/QPP benefits as soon as they are eligible at age 60, potentially without understanding that they may be giving up substantial lifetime income, protection from financial market risks or the potential for outliving their retirement income. An upcoming 2024 NIA paper series will walk plan sponsors through solutions on how to best communicate this advantageous financial option to members, helping them make more informed, confident decisions that will enhance their retirement financial security.

Supporting Members With Retirement Planning

Retirement financial planning is very difficult and does not come naturally. Plan members are asked to look beyond their financial interests today to prepare for their far-off future. This becomes even more difficult when we consider the changing economics of ageing and a complex financial services industry motivated to sell your members products that may (or may not) be in their best interest.

Income streams will also change in retirement. Plan members often go from having a single or perhaps two paycheques per family to a retirement where they could receive up to a dozen sources of income. For the average plan member, forecasting what their retirement financial resources and expenses will look like and creating an optimal income stream that will last for life is a daunting task.

The good news is plan sponsors and employers are ideally positioned to support members through their retirement planning journey. Plan members trust their employer and consider them a source of unbiased information. Plan sponsors can help their members by providing information, tools and support to create a retirement plan that is personal to them.

It is never too early or too late to start retirement planning. From new hire to retire, whether through self-guided resources, expert-led group sessions or one-to-one support with a financial planner, a meaningful and evidence-based retirement planning support package offered by an employer provides a safe place to learn. It empowers members to act to retire when and how they want with financial confidence and well-being.

BIOS

Janice Holman leads the financial wellness consulting group at Eckler and is a principal of the firm. She joined Eckler in 2004 and developed and led the DC Consulting group for over ten years. Holman's unique professional background contributes to her expertise in all key areas affecting CAPs and promoting financial wellness. Her passion for helping companies design effective plans and providing the support members need to reach their financial goals fuels all that she does.

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Endnotes

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