THE PRUDENT CANADIAN'S

Guide to a Comfortable Retirement

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Investment Planning Counsel™

FINANCIAL SOLUTIONS FOR LIFE

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Welcome to The Prudent Canadian's Guide to a Comfortable Retirement.

For the majority of Canadians, their most important financial goal is to be able to retire comfortably. Most of us don't want to work 16 hours a day to become super wealthy, but we do want to be able to enjoy a nice standard of living while we are working, and after retirement. This means that careful retirement planning is probably the most important planning you can do, and it is essential to do it right.

While there are many aspects to meeting all of your unique retirement objectives, one important issue that almost everyone has in common is that you're going to need money. Whether your retirement plans include retiring early, traveling, purchasing a cottage or a winter home in the south, being able to financially help your children or grandchildren, or simply ensuring that you don't have to worry about the ever-increasing costs of health care and inflation, you're going to need money, and probably lots of it.

With this Guide and the guidance of your IPC advisor, you will learn about some important issues and strategies to help you have enough money to retire comfortably, securely, without having to worry about finances.

Clarify your Goals

The first step to succeed in any area is to clearly define what success means to you. What is important to you in retirement? Start defining your retirement goals in non-financial terms first. What activities do you want to do, with who, where, when, and how long? Do you want to leave an estate for your children, charity, church, or community? Defining your post-retirement purpose is challenging, but it is very important to have a rewarding reason to get out of bed. How are you going to fill your days? What is going to stimulate and fulfill you?

When you are planning your retirement a significant factor is how much money you will need to save. Retiring five years earlier not only requires an extra five years of living expenses, but reduces the time that your savings can grow before you start withdrawals. The average retirement age for those with pensions is about 55, while those without pensions retire closer to the traditional retirement age of 65. Retiring early is possible if you plan and are prepared. It's important to clarify your retirement goals now so you can define a plan and let the magic of compound growth work for you for as long as possible.

Create a Plan

Imagine trying to build a house without blueprints. Without a detailed plan outlining what materials are needed and how they go together, the task would be nearly impossible for someone who has never built a house before. A skilled contractor with good blueprints can build your dream home. In a similar way, a professional financial advisor can create blueprints for your ideal retirement, and then work with you as the general contractor to make sure that all of the necessary materials come together in the right way at the right time.

When you consider the consequences of not building a financially secure retirement, you might expect that everyone would have good blueprints for constructing a retirement that could last 20 to 40 years or more. Yet amazingly, recent statistics indicate that only about a third of Canadians have a written financial plan.

With your goals defined, you will have a clear picture of what you want your retirement to look like. The next step is to sit down with a financial advisor who specializes in retirement planning and will act as the architect to create a written financial plan. Insist on a written financial plan that, in terms you understand, clearly outlines your retirement goals and how you are going to achieve them. If your current advisor can't do this, find someone who can. At IPC, we specialize in retirement planning and helping Canadians understand what their options are and how they can achieve their financial goals. Our advisors will tell you if you can retire early, how much you need to save, and give you a solid plan to get you started building your dream retirement.

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Sources of Retirement Income

Your retirement plan will outline how you are going to meet your financial goals. Fortunately, you won't be the only one working and saving to meet your retirement funding needs. In addition to your own registered and unregistered savings, other sources of retirement income could include:

- Government programs: Old Age Security (OAS), Guaranteed Income Supplement (GIS)
- Canada Pension Plan (CPP)
- Company pensions
- Casual, part-time, or contract work
- Rental or other income

The OAS and GIS pension programs are payable to Canadian residents over the age of 65, and are subject to clawbacks. This means that if your income from other sources is high enough, your benefit is reduced or phased out. Receiving less government benefits as your income rises has the same impact as increased taxes. Because of this, your financial strategies need to not only account for losses to visible taxes, but also the "hidden tax" of clawbacks.

Less than half of workers have a company pension plan. If you have one, you need to understand how it works, and what your options are. Is it a "defined benefit" plan where your pension is a calculated amount, perhaps indexed, or a "defined contribution" plan where your pension depends on how well your investments grow? Can you buy back years of service? What are your early retirement options? If it is a defined contribution plan or group RRSP, how can you increase returns without exceeding your tolerance for risk? These are just a few of the issues to discuss with your advisor.

How Much is Enough?

Probably the most important number in your retirement plan is the amount of money needed when you want to retire, while meeting all of your lifestyle goals for the rest of your life. If you have worked for a large company or the government for most of your career, you probably have a good company pension and might not need to save much more to secure a comfortable retirement.

On the other hand, it you haven't been part of a company pension plan most of your working life, you may need a very large retirement fund. Depending on your lifestyle goals, you might need over a million dollars saved, especially if you want to call it quits early. Part of the challenge is that with people living longer and retiring earlier, your retirement period could be longer than the time you worked. A common error that could lead to a retirement crisis is misinterpreting life expectancy statistics. Many people are aware that 65-year-old men are expected to live to about age 79, and women to about age 84. But this means that at age 84, half of women are still alive. Assuming that all other assumptions were perfect, if a woman based her retirement plan on having enough funds to last until age 84, there is a 50-50 chance that she would run out of money! Unless your retirement goals include a lot of high-risk activities like skydiving or mountain climbing, those aren't good odds on something as important as retirement. Since about 10% of women live beyond the age of 96, if you want a 90% chance of not running out of money, your retirement plan should last until at least age 95 or 100.

Other factors that significantly affect how much money you are going to need are inflation, taxes (including the hidden taxes of clawbacks), and unanticipated costs. In retirement, most investors become more conservative. Unfortunately, conservative investments with guarantees offer lower returns that generally don't keep up with inflation, and outside of an RRSP are the most highly taxed. This is why your investment choices, before and after retirement, have a big impact on how much you will need to save or how long your money will last.

In addition, it would be foolish to expect that anyone can perfectly predict investment returns, inflation, taxes, and retirement expenses over a period of decades. To be safe, your plan should have some buffer to handle unanticipated costs, like perhaps a critical health care procedure that is either not covered by the government or is not available quickly enough.

To make sure you know how much is enough, you need to carefully discuss all of these issues in relation to your specific goals with a qualified professional advisor. Once you have a written retirement plan, you need to get started on it as soon as possible.

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Invest Early, Invest Often, Invest Well

In a recent survey of retirees, almost half said that if they could take advantage of hindsight, they would have started saving earlier and saved more. About a third said they would have sought professional advice earlier.

Perhaps these retirees have learned how easy it is to retire comfortably — if you invest early, invest often, and invest well. Assuming 8% annual returns, the following table shows how much easier it is to retire a millionaire if you start young and let the magic of compound growth work for you.

How to Retire a Millionaire

Assuming tax-deferred growth in an RRSP until age 65 with 8% annual returns. Source: Talbot Stevens

Benjamin Franklin claimed that the eighth wonder of the world was compound interest. The table shows that he was right. Note that in this case, every decade you wait before you start saving means that you have to invest more than twice as much to end up with the same amount, whether your target is $1,000,000 or a fraction of that. With 8% annual returns, retiring a millionaire requires investing only $8,200 a year if you start at 35, but over $20,200 annually if you wait until age 45.

When you start saving and how much you invest are the two key parameters that you can control. While an IPC advisor can show you several ways to increase your investment returns, only you control how much fuel you put into your financial plan.

In addition to starting early, other simple strategies to increase the size of your retirement fund are to:

- Invest regularly without interruption
- Increase your deposits with inflation
- Adjust investment mix to increase returns
- Defer taxes using RRSPs
- Re-invest RRSP refunds

To quantify how much difference these simple approaches can make, consider an example. Let's say that Ann and Gus are 35-year-old twins, who have the same income and same 35% tax bracket until age 65. Ann is disciplined and committed to ensuring that she can enjoy a worry-free retirement. She "pays herself first" and invests on a regular basis every month. She starts off investing $300 a month, or $3,600 a year, and she increases her investments 3% each year as her income rises with inflation. She invests using RRSPs to defer taxes, and reinvests her 35% tax refunds back into RRSPs. With the help of her advisor, Ann chooses the right balance of investments to increase her projected returns to 7% without exceeding her tolerance for risk.

Gus, on the other hand, isn't as focused on saving to make sure he can enjoy the same standard of living after retirement, and chooses the "safer" investment options at his local bank without much thought. Because of this, he averages 5% returns. He also invests $300 a month, but doesn't start until he is 45, skips his annual investments in years 3 and 7 to instead enjoy larger vacations, and doesn't increase his investments with inflation. Gus also invests using RRSPs, but spends his refunds.

At age 65, Gus has about $118,000. However, if he had acted on the few simple strategies that Ann took advantage of over the same time period, he could have had retired with $734,000 like his sister — over six times as much.

We can't change history, but we can control what we do today, and thus change the future to be closer to what we want. To retire more like Ann than Gus, learn more, get professional help, and start now.

Accelerate Retirement Savings and Save Tax

In reality, most people are more like Gus than Ann. If you're one of them, there are some strategies that can help you make up lost time and get your retirement plan on track. The first is to make sure that your investment portfolio is appropriate for your goals and tolerance for investment risk.

While guaranteed investments like GICs are appropriate for short-term investment goals, having all of your savings in conservative fixed-income investments increases your risk of not having enough funds to meet your needs, especially after factoring in inflation. For long-term time horizons, like the decades that your retirement savings will have to grow, some portion of your investments must be in stocks or equity investments to diversify your investments, increase overall returns, and reduce losses to taxes outside of RRSPs.

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The optimal balance of short-term cash-like investments like GICs, medium-term bond investments, and longer-term equity investments depends on your needs, investment experience, and risk tolerance. An IPC advisor can help you understand the tradeoffs between different investment portfolios so you can achieve your investment objectives while being able to sleep at night.

In addition to designing an optimal investment portfolio for your specific goals and risk tolerance, there are other strategies that can be used to accelerate your retirement savings while saving more taxes. If you don't maximize your RRSP contributions every year, you haven't taken full advantage of the tax deduction and tax deferral benefits available to you with RRSPs. Many people are behind on their retirement plans and have tens of thousands of dollars of unused RRSP contribution room. In these situations, it may make sense to take out a larger, longer-term loan to catch-up on their RRSP contributions.

As long as you can comfortably handle the loan payments, using an RRSP catch-up loan to accelerate your

retirement plan almost always benefits investors, especially when interest rates are near 40-year lows.

For those with little or no RRSP room left, they can consider taking advantage of an alternative wealth-building strategy. By leveraging, or borrowing to invest, your investment returns are magnified. Since leveraging is simply a tool that can help or hurt investors depending on how the tool is used, it is critical to only consider a small, conservative amount of leveraging in a responsible way as part of an integrated financial plan, after you understand all of the pros and cons, and with the guidance of a trusted financial advisor.

While the wealthy often take advantage of leveraging to increase their wealth, most middle-income Canadians are not aware of how they can benefit from the strategy. In addition to potentially increasing returns, investors also use leveraging as a strategy to reduce income taxes. Whenever you borrow to invest outside of RRSPs, the interest expense is generally tax deductible. In Quebec, the deductibility of investment expenses, including interest expenses on an investment loan, may be limited and/or deferred. As always, see a tax professional for your unique situation.

Unfortunately, many people leverage in a negative way, borrowing at expensive non-deductible interest rates to purchase things that quickly depreciate, pushing them further from their retirement goals. This "bad debt" should be avoided and can often be converted into "good debt" where you instead borrow responsibly at lower, tax-deductible interest rates to purchase investments, businesses, or real estate that is expected to grow in value in the long term.

The most important benefit to your retirement plan of any leveraging strategy, whether it is to catch-up on RRSPs or to invest outside of RRSPs, is not the probability of increasing investment returns or saving taxes. The big benefit of leveraging responsibly is the increased discipline and higher level of commitment that comes with a forced savings approach. An automatic, "pay yourself first" approach of investing on a regular monthly basis is better than waiting until February to see if you have money left to invest in RRSPs. Like a mortgage, repaying an investment loan is a forced savings plan that locks in your commitment, and is less likely to be interrupted. For most of us who lack perfect discipline, a forced savings approach is often more effective than an automatic savings approach.

Making the Right Retirement Decisions

Your retirement plan involves important one-time decisions, some of which will last a lifetime and are irreversible. Are you going to mature your RRSP into a RRIF, an annuity, or some combination? For annuities and defined-benefit pensions, do you want a higher payout based on your life alone, or do you want a lower payout that continues after you're gone at a reduced rate for your spouse? For your situation, are you better off with payments that are guaranteed to last at least 10 years, or without? Can your pension benefits be bridged to allow you to retire earlier? Can you benefit from assigning CPP payments from one spouse to another to income split and reduce taxes? Are you better off taking a reduced CPP pension at age 60, or waiting to get a higher pension at 65 or as late as age 70? Are other strategies that could be used to conservatively generate retirement income appropriate for your retirement and estate goals? These are just some of the important issues that an IPC advisor can help you with.

Next Steps

The biggest threat to you enjoying a comfortable retirement is not a lack of knowledge or strategies. The biggest barrier is our natural behaviour that results in procrastinating, not saving enough, not planning, taking risks we know we shouldn't, buying high and selling low, etc.

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As mentioned, the first step is to design a retirement plan that meets your goals. To benefit, you must implement the plan and make adjustments as needed as your situation and/or objectives change. At IPC, we specialize in helping Canadians like you design, implement, and monitor financial plans for your unique goals. As your architect and coach, we will work together with you to turn your retirement dreams into reality.

This guide was written with the assistance of Talbot Stevens, a financial educator, speaker, and industry consultant. To learn more, visit www.TalbotStevens.com.

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