The Just Word Podcast

Transcript of Episode 2 – Retirement Planning Overview

Pat Bolland 0:02
Joining me now is Malcolm Hamilton. He's a senior fellow at the CD Howe Institute. And he's been retired for eight, nine, years or so. But before that he spent three decades, more than three decades, at Mercer, the pension company. And in fact, your Canada Pension Plan might be at the level it is because of the work he did at Mercer. He was a proponent of increasing the CPP. So he's the perfect guy to talk to about putting together a retirement plan. It's kind of everybody's situation is unique. We get that overall. But what Malcolm and I are going to discuss is how you actually should start thinking about your financial plan. So to start off, Happy 2021 Malcolm.

Malcolm Hamilton 0:46
Thanks, Pat. It after 2020 I'm sure it's gonna be good.

Pat Bolland 0:51
It can't get much worse. Sure. Although starting off with a bit of a bang, Malcolm, as people put together their retirement plans and their financial future, part of that financial future is what you get from the government. And I mentioned your work in the CPP Do you want to discuss to start the discussion? Talking about CPP? Or do you want to get into what the government actually gives us all the security and guaranteed income supplements those kinds of things.

Malcolm Hamilton 1:21
It's, it's probably easiest for most people to think of the government pensions you will get in aggregate, you know, they support the government support for retired people is unbelievably complicated. You know, if if we spent the next half hour describing in detail, all the different programs that governments have to support seniors, and all the different levels of support, and how they take it away as your income rises, everyone will just get frustrated and give up because there's no hope of understanding it. You know, the The bottom line is, if you're, let's say, a lower income Canadian. So let's say lower income means you're working part time for minimum wage, or you're unable to find work. If you're in that situation, the government pensions you get when you retire will undoubtedly be larger than the income you had during your working years. You know, the boat, the minimum income you can get in Canada, even if you never work your whole life. from government programs like old age security in the guaranteed income supplement and gains in Ontario, takes you to about for a single person 19,000, maybe 20,000 per year after tax and for a couple about 30,000. And that's before we even get to the Canada Pension Plan. And if you compare that if you're working full time for minimum wage in Ontario, you make about 25,000 a year and you take home about 21,000. So there's not much difference between the guaranteed minimum income for a single senior and the take home pay of people who work full time for minimum wage, which means at low income levels. Retirement Savings shouldn't be a priority. Now, I'm not trying to discourage anybody from savings because you there are other reasons you might save. You might save so you can buy something that you want, you might save so you've got some spare cash to

deal with emergencies. There are good reasons, let's say but retirement saving per se for low income people is largely will be handled by the government through government programs. When you when you your income rises above that. So let's say we look at the Canada Pension Plan, it covers income up to 60,000 or so today. So if you earn 100,000, only the first 60,000 is subject to CPP benefits and contributions. So if you took, let's say, a couple, and each of them earned 60,000 a year and they work their whole life. They will get from government pensions, old age security and the Canada Pension Plan have enough income to replace about 44% of their 60,000 or 120,000 family income. And, and so that's Now the 44% is probably for many of them less than they would like to have in retirement.So what I'm talking about is The other family incomes 120,000 split between the couple. If you take 44% of that you're in the low 50s. Their government pensions, from old age security and CPP will be below 50,000 number, which will replace 44% of the income, they had pre retirement between the two of them, between the two of them. And so they get 44% of their family income will be continued into retirement by government programs. They then have to ask two questions, the first foremost will be an easy answer. Is that enough to give you the retirement standard of living you were hoping for? And most will say no, that's less than we want and less than we need. And then the question is, well, how much more than that do you think you need? And what is it that you have to save in RSP or TFSA? Or both combined to get there? And that's that's the retirement planning exercise. Basically, when do you think you want to be able to retire? How much income do you think you're going to need post retirement? How much of that do you think will come from government programs? What's leftover for you to provide for yourself? How much do you need to save to achieve that goal? And when does it make sense to do that saving so that that roughly is the retirement planning process?

Pat Bolland 6:37
Okay, so what you're telling me is the government is providing enough money for you to live and to get by bottom line, and anything that you save would be above that. But is it your sense that Canadians are saving enough?

Malcolm Hamilton 6:56
So the you know, the conventional wisdom is that Canadians aren't saving near enough. The that has been the conventional wisdom. My entire lifetime, when I was a young actuary, was probably 40 years ago. Now. The view was the baby boomers, unlike their parents, were pampered spoiled, profligate. They spent extravagantly save too little, they would get theirs when they retired. You know, fast forward 40 years later, the baby boomers are now described as the richest generation in Canadian history. They've all got pots of money, they retire early. You know, when we don't have pandemics they take cruises around the world. They have a very pleasant standard of living. But all of the things that were said about the baby boomers 40 years ago, are now set about millennials, they're extravagant, they don't manage their money. Well, they, they don't save enough. And that the truth of the matter is that first we don't nobody really knows how much Canadians should save. You know, the it is a function of when you want to retire, it is a function on what you think future rates of return will be. It is a function of how much money you're going to need to be comfortable with your retirement standard of living. And there are no obvious easy answers to those questions. But But life is very different than then it's often described as being like, one of the things you have to appreciate, is the you know, the the proof, the alleged proof that Canadians didn't save enough was always you look at retired people, you say, what's the

average income of retirement can a retired Canadians? And then you look at working Canadians, you say, what's the average income of working Canadians? And they say, How do those two compare? And typically you would find? I haven't looked at it in the last few years. But typically, you would find that retired Canadians have half the income of working Canadians, and on that, and people would look at that and then say, See, isn't that tragic? They only have half as much money as working Canadians. And they would allow encourage people to jump to the conclusion that if you're retired and have half the income of a working Canadian, you have in some sense half the standard of living of a working Canadian, so you haven't saved enough to have a comfortable retirement.

Pat Bolland 9:45
That's a fair assumption.

Malcolm Hamilton 9:47
Not a fair assumption. Sounds like a fair assumption. But he so here's, here's the catch. The assumption underlying that is you're spending as a couple I'll use a couple weeks to children as the the sort of traditional nuclear Canadian family, even though it's a relatively small minority of the population, but let's take the two income family with two kids. You know, the assumption underlying the the 50% income replacement being tragic, is that the couple's spending, the amount they need to spend every year throughout their life, to have a consistent standard of living is the same. And the reality is very different than that if you if you look at your working years, so let's say you work from 25 to 6540 years, and you say what are the major expenditures you have during that 40 years. And I'll, I'll sort of define expenditure loosely to include everything that you have to use your income for, you'll find that about half of the income will go to for things, it'll go to buying a house, it'll go to raising the two children, it will go to saving for retirement, and it will go to taxes. And things like the CPP contribution, etc. So, half your money goes to those four things. And the interesting thing about those four things, is they are all gone, or much diminished in retirement. You know, you buy and pay for your house. Typically, while you're working. You know, if you've done your financial planning and management, well, your house will be paid for, let's say in your 50s. And you won't have to rebuy it, you won't have to continue the mortgage payments into retirement, they'll just stop. And the cost of raising your children will be high when they're young, may be high when they're in college. The costs are formidable. But we all hope that by the time we retire the children who have become financially independent and moved out. We don't want to have to continue to support them. Usually you don't have to continue to support them. You should not rely on them supporting you. But but the heavy expenditures of putting children into daycare. You know, supporting them as they grow, feeding them caring for them, sending them to private school like you I mean, as your as your income level goes up, you're just become more and more money into things like private school

Pat Bolland 12:56
and wake up dad mum. Yeah,

Malcolm Hamilton 12:58
well, exactly. No, no, no, if they want them to participate in sports, there's a whole bunch of other bills, you want to send them to camp, those are bills. You want to take them on vacation that increases the cost of your vacation. So there's a lot of spending and it's it's it's

virtually impossible for people to know what it is like if you approach the average Canadian say, How much did you and your wife spend on your children last year? There's just no way to answer that question satisfactorily. But it is a good pile of money. retirement savings is a good pile of money, CPP contributions, income taxes, you know the way income tax works in Canada, and we have a very progressive tax system. So that when you're a working couple with the full income, and you retire with the half income, one of the things you'll find is your income taxes don't fall by 50%. And they fall by like 80 or 90%, you're paying a very small fraction of the income taxes you paid when you had the big working income. So, all that to say that anytime I have looked at this, I have concluded that if you look at the average Canadian couple and you say restrict that average to couples with children who buy a house, probably 50% income replacement will give you in retirement, a similar standard of living to what you had as a working person. Now. I'm not trying to impose that as a goal on anybody like if I think people should know that now if some people say yes, you know, but I'm tired of the misery of my day to day existence is I want to travel I want to do things when I retire. Yeah, you know, I have been you know, my wife and I have been denying ourselves for decades. To pay for the house, get rid of the mortgage, raise the children, you know, and now, so in retirement, I don't want the life I've grown accustomed to, I don't want the life I have as a working person, I want a much more luxurious life where I can finally enjoy things, then maybe you do need to replace 70 or 80 or 90% of your pre retirement income. But my guess is not for long. Because I'm in what I would, you know, I, I now have the benefit of being many years into retirement myself. So I've completed my eighth year of retirement. There are some there are some ambitious stored up wants that get addressed in the early retirement years, when you're still young, relatively speaking, energetic, healthy. So you will do some travel, you will do some spending that you didn't do before. And if you're if you're really wealthy, maybe that continues indefinitely. Maybe you buy a house in Hawaii and a house in the Riviera, you spend all your time flying from one of your mansions to another. But yeah, that's not the life that awaits normal people, it's not the life, Canadians are used to, it's not the life they need in retirement, if, you know, if the objective is I want, you know, five years to do some travel, to enjoy some things that I couldn't enjoy as a working person. And then I can go back to the standard of living I was used to income the last half of my working life. Your you know, your maybe you're talking about 70% replacement for five years, and then something closer to 50. Thereafter, whatever unintended needs, like health care, for instance. So, so you unintended needs are important to plan for. And everybody, you know it, like when you're retired, you typically have a lot of available money, as compared to when you're working. Like when you're working, you're typically living off a paycheck, you know, and the you know, the paycheck comes in, and it gets spent. And there's alarmingly little leftover at the end of the month, and then you go to the next month, and this sort of continues until your income goes up, and your expenses, mortgages, etc, get more more under control. When you're retired. If you have a pension, it's sort of like that, like if, if your only assets in retirement or pension, then your life would be like that, but for for most people, they will have government pensions, they may have employer pensions, but mostly what they have is piles of cash in TFSA and rsps in bank accounts, and and investments brokerage accounts. And so it's relatively easy for them in the in the case of an emergency to put their hands on some money. Now, in Canada, you know, most of your medical emergency expenses will be dealt with by the public healthcare system. So you know that that's not to say there aren't financial emergencies, but it's probably not going to be an emergency, like, you know, I have cancer or I had a heart attack or those types of things happen, but they're not formidable financial burdens for Canadians because of Medicare and drug benefit programs and those types of things. So you, you, you, most most seniors, they have the cash, they're able to deal with emergencies. And, and that will tend not to be a problem. Of course, if, if you have an emergency and you use up a bunch of your money, then you need to factor that into the level of spending that you can support going forward. So you may have to step back a little but but a lot of the things people worried about worry about I think they probably worry too much about So, you know, one of them is well what if what if I need to go into a nursing home now that you know they have in the in the past that concerned about going into nursing home was maybe I can't afford it. You know, now they're concerned about going to nursing home is maybe you know maybe that's not going to be good for my health. But if if you do get to the point where you are Not, you can't live independently, that you you need support either daily or every day, or record or intermittently, and you can't get it from your family, then you're going to have to pay up for that. But understand the paying up for it means that you're probably not going to need to keep your house. So you can sell your house, if you have a house and most most retired people do have houses. And if you're in a nursing home, you know, your spending on everything else is pretty low, like you, you tend not to be in a nursing home and traveling around the world, you know, intermittently, or spending a lot of money on other things. So I haven't seen many instances where seniors end up financially constrained by virtue of having run out of the money they save for retirement, not saying it never happens. Undoubtedly it does happen. But bottom line is, I think, right today, and in the last several decades, Canadian seniors have had a standard of living as good as if not better than the rest of the population, like the notion that this is a conspicuously poor minority, about whom everybody should be concerned, is I think misplaced.

Pat Bolland 21:39
Okay, I'll play devil's advocate, what you're describing is that the government will take care of us as a base case, and then whatever we save above that we can use at our own discretion. But as we've seen through the last year, in COVID, the cost to the government for other programs nevermind, providing for our retirement continued to escalate, and government debt continues to climb, climb, climb,... how long can that go on?

Malcolm Hamilton 22:10
Well, I think it depends on how how long they can pick money. Like they, you're onto something that I think is a legitimate concern. And that is the sustainability of the system that has done and is doing quite well for baby boomers and their parents. Will it work as well for their children. And here, there are a bunch of things about which we can be concerned. One is government's ability to meet its financial obligations. Our governments have promised Canadians a lot in terms of income support when they're old. And in terms of medical, and even housing support for elderly Canadians. And they haven't set aside any money to deliver those, those promises. And they are now beginning to enter the period where the baby boomers all transition into retirement. And the baby boomers transitioning into retirement represent two problems for government and they'll happen one after the other. The first is the escalation of pension costs. And the escalation starts as the boomers retire. I'm an early Boomer, I'm 70. So the boomers are already starting to retire. But that's going to go on for another decade. And we're not at peak pension costs for another 10 years. So we're looking at 10 years, with the cost of old age security, the cost of guaranteed income supplement, will go up for no reason other than there are simply more and more and more people who qualify for the benefits because they're over age 65. So that's the first and the

second hand is health care. The healthier hip comes later, you look good. When you retire at 65. You go, let's say from no pension to full pension from the government's perspective, but your health care spending doesn't go up a lot. It creeps up. But it sort of doubles every decade. And so when you get to 7585, now you're in to the big health bills. And so what we're going to get is the next 10 years largely a pension hit. And then the 10 to 20 years after that they'll be healthcare and the government knows all of this is coming. It has been told this is coming for decades. It has projected the growing costs of these things for decades. It has told everyone not to worry about the fact that it hasn't set any money aside to deal with it. It's on top of things. Unfortunately, the COVID thing wasn't in the projection, we were actually doing pretty well, we had taken our national debt down as a percentage of GDP quite a bit. I like to think in part to prepare for these demographic financial burdens that come from entitlement programs. The provinces didn't do the same, they sort of marched the other direction. COVID obviously, you know, we that wasn't planned for, and that is a significant disruption on where the governments are, I would say the provinces are in quite bad shape. And the federal government, which was looking to be in quite good shape, is now going to be neutral to bad. And that's going to be a problem. And they're there, they're going to try to deal with the problem by keeping interest rates very low. And by the Central Bank, buying government debt, as required, and they'll try to borrow their way through it. And if you can keep interest rates really low, and borrow your way through what, it'll probably be fine.

Pat Bolland 26:19
Okay, so then, against that background, it's still a good idea to hedge your bets, it's still a good idea to save as much as you can, or at least plan to put some money aside, in case the worst thing happens.

Malcolm Hamilton 26:36
No one can save enough to deal with the worst thing that can happen. Look, avoid. The worst thing that can happen is you lose your job tomorrow, your house burns down, your wife divorces you. You're never employed again. And all your investments go to zero in a depression, you know, and so no matter how well prepared you are, someone can conjure up, you know, a list of events which have happened to people in the past that you would not survive. So I think we need to set more realistic goals, you know, like a more realistic goals is if things go as expected, you'll be fine. If you're not if things don't go as expected. So one of the downsides of this low interest rates, if government's need low interest rates to save them, what does that mean for savers? Right, because the savers are the flip side of the coin the government can afford to borrow? Because the savers aren't getting any reasonable return.

Yeah, like, like my parents in the retired years. I mean, they were looking at two 3% inflation and getting 10% on gi C's and government bonds. You know, and now we're looking at one 2% inflation and, and, and getting 1% on gic and government bonds. So, so the landscape for savers isn't what it used to be. And so we do need to be careful saying, you know, because the boomers are okay. And because their parents were okay, that means the next generation who are facing, you know, perpetually low interest rates will be okay, because that's not necessarily true. So, so I think everybody needs to have a plan. But equally everybody needs to be prepared to modify or abandon the plan. When it doesn't come true. And it won't come true. Now virtually guarantee you, you take, you take 40 year olds retirement plans, almost nothing in the plan will come true. You know, they will retire when they think they'll retire. their savings folder and the returns they expect them to make. They'll have unforeseen expenses, they'll have untrusting windfalls, they may inherit money from parents that they weren't expecting to inherit. So nothing's going to go according to plan. That doesn't mean you shouldn't have a plan. That means when you have the plan, and you notice that things are evolving in accordance with the plan, you need to modify behavior. The most important lever that people have to deal with uncertainty is if you're cruising into retirement, and you don't have the money that you thought you would need, or you need more money than you thought you would need. The number one thing you have to do is defer your retirement. You know, like if if you if you approach retirement as you know, sometime between the age of 55 and 70. I will probably want to leave my career employment and either retire or seek more enjoyable alternative, less well compensated employment. But I can be flexible as to when between the age of 55 and 70. that occurs if, if you have that flexibility you can overcome low returns, government's not delivering the benefits, you've thought, all sorts of things, because it's the amount of money you need in retirement. And the amount you need to save before retirement is so different. When you say I'm going to retire at 70 versus 55. It's, it's probably tripled the savings rate, to retire at 55 and 70. And I'm just pulling a number out of that. So no one, no one should quote me on that, or remember that, but it's an awful lot more you have to save to retire early than late. So I the best advice I can give people is aim up the middle, you'll be realistic, things aren't going to go as expected, they may get better, they may be worse. If they go better, you can retire either richer or earlier, to go badly, you're going to retire later or poor. But you will be able to find a reasonable compromise, as long as you can maintain flexibility on retirement age. Now the the catch, of course is, you know, you may change your mind about when you want to retire. But your employer's interest in continuing your employment may not change. So so it may not be your choice, you know, you can look, I think there are lots of people who if they're forced to retire at 60, which they would not otherwise have done, you know, then continuing employment becomes more problematic. Maybe they can work part time, they can undoubtedly supplement their income somehow in retirement, but they may not get back to where they would have been. So life's filled with these sort of twists and turns and unpredictable things. It can be much better than you expect, just as it can be much worse than you expect. And so you, you do need to be ready to roll with the punches both the good and the bad, and to modify your plan accordingly. Because they know the strength of the plan isn't the accuracy of the forecast. I mean, I I was it was an actual I did, you know, pension projections my whole life trying to figure out how much needed to be contributed. And they The only thing I'll say to my credit is I told people in advance the assumptions would never come true. You know that, that when I look back in time, they have never come through in the past and they weren't ever going to come through in the future. Sometimes, the last 30 years, things have been incredibly better than pension funds would have expected returns have been spectacular. For a long time. The 30 years before that returns were disappointing, so long. And so so that's, you know, that's the landscape. And we all have to deal with it. The government pensions help, you know, they give you it's not a matter of, if your return on your personal savings disappoints, you go from being wealthy in retirement to destitute. It's not that transition, the government benefits of and by themselves, you know, will keep you out of poverty at a minimum. And I think provide, you know, an acceptable standard of living not you're not unlikely everybody has in a pandemic where you sit at home and watch TV, and don't spend much money. You know, that I think you'll always be able to do just with the government benefits but the you know, the bells and the whistles, the extras, the have the second home, go skiing every winter, you know, try to travel around the world on occasion. You know, those are the things that if things go badly, you may not be able to do if things go well, you may be able to do more time.

Pat Bolland 34:11
Malcolm will have to leave it there. Great conversation. Thank you so much.

Malcolm Hamilton 34:17
Okay, very welcome.