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APATHY: A Retirement Plan's Kryptonite

March 2021

QUBE WHITEPAPER

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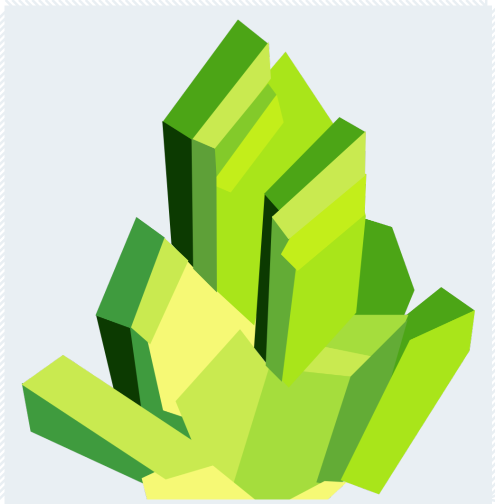
Let us be clear - saving for retirement is essential!

We dream of the day when we can retire stress-free, obligation-free and on our terms. Before we get to this idealistic moment of freedom in our lives, we may face some challenges.

For the last 20 years, there have been changes within the Canadian retirement system that, unfortunately, have made retiring more difficult. These changes and trends may make retirement seem impossible, discouraging Canadians from saving for retirement; in fact, nearly 1 in 5 Canadian households fail to retire adequately.[1] In effect, retirement may seem like an unattainable goal! However, the lack of motivation or concern observed in pension planning could be attributed to the irresistible desire for satisfaction or the necessity to meet our needs today. Because of this, we may become apathetic towards goals that are not within our line-of-sight—brushing those obligations aside to deal with at a later date.

Apathy is a retirement plan's kryptonite!

As we focus on the retirement challenges Canadians face, it would be inappropriate to point fingers and blame the government, the employers, or the employees. These challenges could, in fact, just stem from this dreaded human condition of apathy. As we look for solutions, we need to focus on what has changed in the retirement planning environment and focus on the steps necessary to help employees in this transition.



Consequences of Apathy

We believe that the Canadian retirement system's ultimate test is the measure of poverty within the senior population. In 2017, 3.5% of retired Canadians lived in poverty[2], a rate that has only just started to decline in the last couple of years!

[1] Building on Canada's Strong Retirement Readiness. (2015). McKinsey & Company.

[2] The Daily — Canadian Income Survey, 2017. (2019). Statistics Canada. https://www150.statcan.gc.ca/n1/daily-quotidien/190226/dq190226b-eng.htm

The 2016 Census also shows an increase in seniors' median debt level, \$25,000, up from only \$9,000 in 1999 (2016 constant dollars).[3] The median debt to income ratio has also doubled from 24% to 52% in recent years. We view this as a troubling trend, highlighting the importance of retirement planning; should interest rates rise, many seniors may be unable to service their debt. This increase in debt results in the retired leaving less income to meet their living standards.

McKinsey's 2015 article, Building on Canada's Strong Retirement Readiness, went deeper into the retirement issue, finding troublesome variances in the support offered by employers. Canada is in a situation of "have's" and "have-nots"; this ability to retire is often determined not by who you are but by where you work(ed). In other terms, those employers who are concerned and have an active interest in their employees post-retirement see higher instances of a successful retirement. They show that those employees with traditional DB pensions can be successful; two other demographic groups are considered at-risk. The first at-risk group is mid-high-income earners, who have an employer retirement plan but fail to save enough. The second are those who do not have an employer plan and also are not saving enough (on their own)—resulting in the common theme of Canadians not having adequate annual savings.

Here lies one of the problems: Once a pension plan is set up, many employers simply become unconcerned with what the employee does with it. Whether it is funding their pension appropriately or just doing the bare minimum. But unfortunately, this is not enough, and sadly the employer remains uninvolved after setting up the plan. The saying, "Give a man a fish, it'll feed him for a day. Teach a man how to fish; it'll feed him for life," fits appropriately in this situation. Employers need to ensure their employees know how to use the tools they have. However, the responsibility and burden of the retirement gap cannot be placed entirely on the employers' shoulders; instead, we have to start acknowledging that some level of apathy runs through both the employees and the employers.

Troubling Pension Trends

The fuel that had driven a successful retirement in the past isn't there anymore. There has been a declining trend in pension coverage in Canada, and the Federal Government has noticed. Canada's 2019 Budget focused on filling this pension gap.[4] Employers are becoming less concerned, interested or are unable to provide an employer-sponsored pension. Since 1998, the decreasing trend in the private sector's use of pension plans fell about 20%, while the public sector experienced a 1% rise in pension coverage.[5] In 2018, nearly 9.3 million (77%) Canadians working in the private sector were not covered by a registered pension plan (RPP). The public sector saw 450 thousand (12%) of employees not covered by an RPP.[6]

[3] Debt and assets among senior Canadian families. (2019, April 3). Statistics Canada. https://www150.statcan.gc.ca/n1/pub/75-006-x/2019001/article/00005-eng.htm

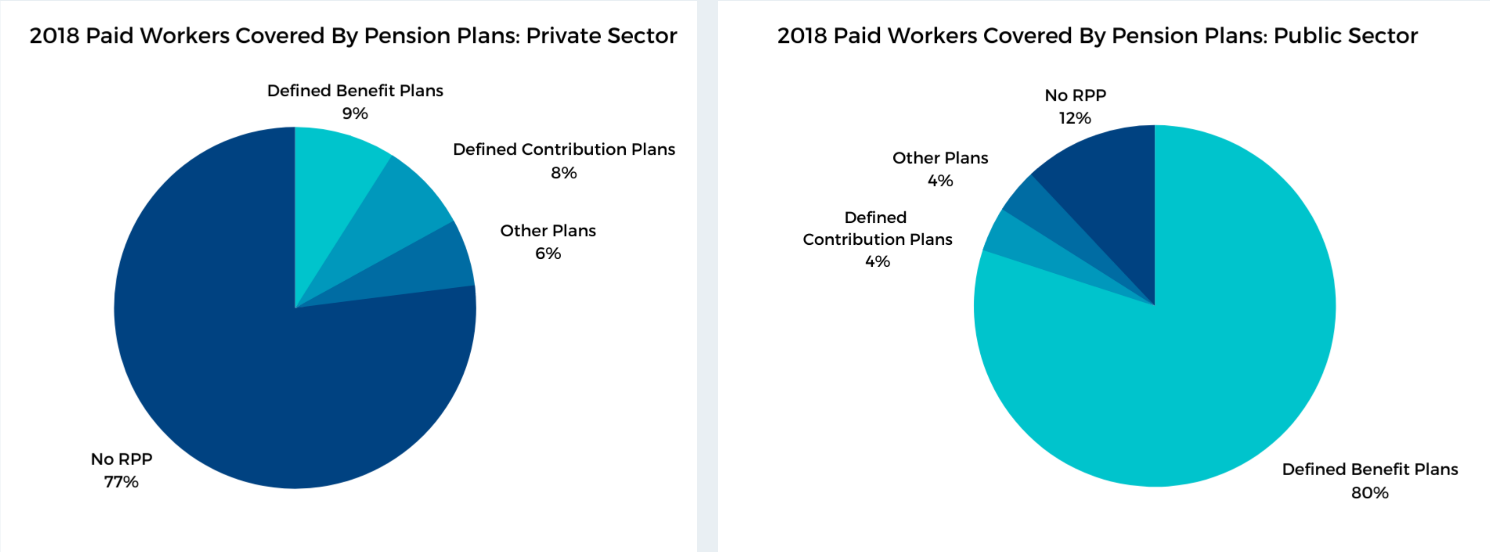


Figure 1: 2018 Pension Coverage in the Private and Public Sectors

Figure 1 depicts this difference between RPP coverage in both the public and private sectors.

Unlike the government, whose responsibility is to all Canadians, the same cannot be said about employers. For employers, it ultimately comes down to the cost. When providing a pension, the liability associated with it can be expensive and infeasible. The cost of offering an RPP can vary from providing an annual pension for life to supporting an employee's retirement motivations through supplemental yearly contributions. None-the-less, pensions are an added cost. Companies that ultimately absorb the costs of an RPP acknowledge that their employees need the support or, as an employer of unionized workers, must fund a plan.

Interestingly, within the same 1998-to-2018-time frame, the decline in RPPs offered mirrored the decrease in unionized Canadians. With a reduction of 31% of union coverage in the private sector and an increase of 1% in the public sector.[7] With this current trend, if union coverage falls, we will also likely see the number of Canadians covered by RPPs fall. Unless changes are made, and employers become more involved with retirement, we will continue to see more and more Canadians unable to retire successfully.

[4] Investing in the Middle Class Budget 2019. (2019). Department of Finance Canada.

[5] Statistics Canada. Pension plans in Canada as of January 1, 2019. August 13, 2020. Accessed from: https://www150.statcan.gc.ca/n1/daily-quotidien/200813/t002b-eng.htm

[6] Statistics Canada. Table 14-10-0027-01 Employment by class of worker, annual (x 1,000)

[7] Statistics Canada. Union status by industry. Accessed by: https://doi.org/10.25318/1410013201-eng

Funding Your Retirement

The Case of Jose and Katie:

Picture two 30 years old's, each making $80,000/year. They are now thinking about retirement planning. Jose's company funds his pension by matching 2% of his contributions. Katie's company does not have a retirement plan, but she saves 10% of her salary each year.

Will they be ready to retire at 60 or 65? Perhaps, but it depends on a few factors.

In Canada, the retirement system has three different pillars: government benefits, a mandatory pension plan, and voluntary savings programs. The employer-sponsored pensions that unions promote apply to only one pillar. Each alone is not enough to fund retirement. Instead, it is vital to understand all three, as they create a stable retirement foundation. A stool with only two-legs won't stand. Just like the stool, Canadians need all three-pillars to retire.

The first of the three pillars are the government benefits: Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). These benefits support Canadians income through retirement, but much of the time, it will not be enough to maintain a pre-retirement income. When the recipient's income exceeds set annual thresholds, these benefits begin to be 'clawed back,' reducing the total one gets.

In 2019, we saw that 52% of Canadians who did not have a retirement saving plan expected to fund most of their pension through government benefits (Pillars 1 and 2). In contrast, only 19% who had a plan relied on them.[8] This difference is significant. Because unfortunately, these government benefits fall short of what the majority of Canadians need in retirement. It stresses that many Canadians may not be concerned enough about retirement planning to realize the potential shortfall.

The second pillar that is heavily relied on is Canada's mandatory pension plan: The Canadian Pension Plan (CPP) or the Quebec Pension Plan (QPP). Historically, these plans were designed to replace 25% of lifetime earnings to a set maximum with annual contributions totalling 9.9% of an employee's salary (split 50-50 between the employer and employee).

[8] Financial Consumer Agency of Canada. November 2019. Canadians and their Money: Key Findings from the 2019 Canadian Financial Capability Survey.

However, due to the shortfalls within employer-sponsored pensions, some changes were introduced in Budget 2019; they called it the CPP Enhancement Program. CPP is changing to increase the total income replacement from 25% to 33%. There are two stages to this change: The first stage results in increasing the total annual contributions to 11.9%, up from 9.9%. The second stage creates a second earnings ceiling that will be 14% higher than the first earning ceiling with an 8% contribution rate.

Why is there a two-tiered contribution?

The new earnings ceiling is unlike the first because the CPP administrators are changing how they invest their funds. The base pension plan will continue to be primarily funded through future contributions by employers and employees at 11.9% and won't rely on investment income. This second earning ceiling will focus more on income generation through CPP investment activities, so the contribution rate is lower. The CPP investment committees' goal is to cushion stock market volatility and reduce the chances that either contribution rates or benefits will be affected in the future.[9]

The third pillar is voluntary programs. These are optional retirement saving plans that either the employee can take part in themselves or are offered within the workplace. As we will discuss later, this third pillar is imperative for a successful retirement.

The two pension plans traditionally seen in the workplace are the Defined Benefit (DB) and Defined Contribution (DC) plans. Other programs include both individual and group Registered Retirement Savings Plans (RRSPs), Tax-Free Savings Accounts (TFSAs), and Pooled Registered Pension Plans (PRPPs). RRSP programs are integrated with DB and DC plans, so all Canadians have equal access to total pension savings opportunities. For example, suppose you have a registered pension plan with your employer. In that case, that program will proportionally reduce what you can contribute to an RRSP.[10]

DB plans define the benefit at retirement based on years worked and annual income. The plan sponsor (employer) guarantees the benefit payment and manages the plan.

DC plans define the contribution and generally leave plan management to the employee. The retirement benefit is not guaranteed, and the plan functions almost identically to an RRSP program.

[9] CPP Investment Board. (2021, March 8). Frequently Asked Questions. CPP Investments. https://www.cppinvestments.com/faqs

[10] This mechanism is called the "Pension Adjustment" or PA. A PA is created to capture the equivalent RRSP value the employer's pension plan created and is reported in Box 52 of the T4 slip. The PA then reduces RRSP room accordingly.

The Golden Ticket - Employer-Sponsored Retirement Plans

Employer-sponsored pension plans are an exciting benefit for employees! With the pension programs, employees have an opportunity to boost their retirement savings. But offering a plan isn't just a perk for employees. A retirement plan is also associated with an enhanced corporate image, increased employee morale, and improved productivity .

For years DB pensions incentivized people to work for the same company their entire life. These DB plans gave the employee the confidence to retire, knowing exactly how much they would receive. However, as stated earlier, these gold-star pensions have grown less popular over the years. The responsibility of retirement savings has shifted from the employers to the employees. Too often, the mentality is still that of older generations, with the employee retiring on a government pension. This itself is an issue! This perspective, paired with the increasing CPP benefits, may fuel this lack of concern or apathy towards retirement planning.

This attitude needs to shift, and employers have the capability of changing it. It can be as simple as education and offering a plan! Easy changes can break this apathetic cycle and lead to happier, more confident employees. It is an opportunity for employers to make a meaningful difference in their employee's lives.

The True Challenge: How much should we be saving?

Every employer and non-retired Canadian should be looking to understand how much they need to be saving. Even with an employer-sponsored pension, employees who aren't concerned about their savings rate can quickly fall short of their retirement needs. So, what is the right amount to invest? It depends on several factors, including how much we can get from pillars 1 and 2.

In October 2020, retirees saw an average CPP payment of $614.21 , far less than the maximum $1,203 stated for those age 65. There are a few reasons for this difference. Their annual income was less than the maximum pensionable earnings, year after year. Potentially they did not have enough contributory years or may have retired early. Either way, few Canadians should assume they receive full CPP income at retirement.

Canadians who rely on government benefits as their primary source of income may be surprised at how little they may receive during retirement. Table 2 shows what someone could expect as an income replacement ratio at varying levels of income.

Table 1: 2021 Annualized Income Replacement Ratio of Pillar 1 and 2 Pensions Benefits

Annual Pensionable Earnings	Annual CPP Payment	Annual OAS	Total Annual CPP & OAS	Income Replacement Ratio
$20,000.00	$4,687.01	$7,380.00	$12,067.01	60%
$30,000.00	$7,030.52	$7,380.00	$14,410.52	48%
$40,000.00	$9,374.03	$7,380.00	$16,754.03	42%
$50,000.00	$11,717.53	$7,380.00	$19,097.53	38%
$60,000.00	$14,061.04	$7,380.00	$21,441.04	36%
$70,000.00	$14,436.00	$7,380.00	$21,816.00	31%
$80,000.00	$14,436.00	$7,356.75	$21,792.75	27%
$90,000.00	$14,436.00	$5,856.75	$20,292.75	23%
$100,000.00	$14,436.00	$4,356.75	$18,792.75	19%

*For illustration purposes only
**Assumptions are based on the eligibility for maximum Pillar 1 and Pillar 2 benefits at 65. The annual salary was taken into account when calculating benefit maximums and minimums.

Do you know how much you need?

A successful retirement is defined as the ability to maintain your standard of living. When we retire, we typically have fewer expenses than we do today. This drop is usually because of lower tax rates, no or little mortgage debt, and hopefully no dependants. Most people don't realize that we should look for a 60-70% income replacement of our pre-retirement income to maintain our standard of living.

Meaning that if you earned $80,000 gross income, you would need $48,000 to $56,000 of gross income in retirement. It sounds like a lot, but with a bit of planning, it is within reach! But those who believe that relying solely on Pillars 1 and 2 was enough may be surprised. They would only be eligible for a maximum total monthly payment of $1,816 or $21,792 per year—accounting for only a 27% replacement ratio, far less than the 60-70% needed.

Apathy in retirement planning won't get you the retirement you need!

[11] Vettese, F. (2020). Retirement Income for Life: Getting More without Saving More (Second Edition) (Second ed.). ECW Press.

[12] Service Canada. (2020). CPP retirement pension: How much you could receive. Government of Canada. https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-benefit/amount.html

While pillars 1 and 2 are not enough, it leaves us with this third pillar – voluntary savings. Although, they are often overlooked or misunderstood with misleading RSP limits. This 18% contribution limit is only a stated maximum; it may be leading many to believe that maximizing their contribution is necessary for retirement. It creates this fear that retirement is impossible. Because of that fear or perception, it destroys any motivation that someone could have. It is triggering apathy towards retirement. But fortunately, you don't need to maximizing RSPs, and this needs to be emphasized. It would only take saving 5-11% each year to reach a 60% replacement ratio for retirement![13] [14]

In summary, a comfortable retirement IS achievable by starting early and utilizing an employer plan with 3% matching by the employer (6% total contribution), representing only 33% of the annual RSP limits! Nevertheless, the decreasing retirement coverage in the private sector has not been enough to encourage employees. Nor do many Canadians understand that a reasonable retirement is NOT unattainable. Ultimately, reducing this fear of an unfeasible retirement and alleviating their apathy towards planning.

How can an Employer make a difference?

There are two issues that employers can help solve: The first is the fact that 53% of Canadians do not know how much they should be saving.[15] The second could be a consequence of the first, but Canadians are apathetic towards retirement. They don't see it as a current issue as it is not within their line-of-sight and will continue to face this retirement challenge unless changes are made.

At Qube, we know the importance of having retirement programs in the workplace. With the decreasing trend in traditional pensions, we will continue to see many employees remain disengaged in their retirement planning.

So how will our couple Jose and Katie fare in retirement?

Jose, who has been saving a total of 4% each year through both his and employer matching contributions might not be able to achieve a 60-70% replacement ratio in retirement. Katie on the other hand who has been saving aside 10% of her salary each year, should be able to meet her retirement goals. Other factors could be considered, like their investment allocation, if they could downsize their house one day, inheritances or future job promotions. Nonetheless, attention is required to make sure they are not the 1 in 5!

[13] Horner, K. (2009). Approaches to Strengthening Canada's Retirement Income System. Canadian Tax Journal, 57(3), 419–459.

[14] OAS, GIS and CPP were included in the calculation. Required saving rate is based on the following assumptions: a 35-year accumulation period during which earnings grow at the same rate as the average wage; a 20-year retirement period; an inflation-indexed pension benefit; 2 percent inflation; 3 percent growth in the average wage; and a rate of return on investment of inflation plus 3.5 percent.

Thus, we believe that more employee engagement and education are desperately needed to support employees and combat retirement apathy. Closing the gap between the "able-to" and "not-able-to." We believe that a successful retirement is achievable in a couple of ways. First, by reducing decisions and increasing simplicity. Second, by providing more education and opportunities for financial literacy. These changes will help break down any barriers that may prevent someone from retirement planning. But we know that this is only the start. We still observe worrying levels of employee apathy about retirement planning and think that the employer's role in 2021 and beyond will have to transition from facilitator to collaborator.

Qube focuses on three initiatives that would help promote retirement planning and set employees on the right path for a successful retirement. But it requires employer support in the year ahead to help connect those distant goals and emphasize the purpose and impact of retirement planning today.

1

Mandatory Participation

We believe that employees should automatically be enrolled in the retirement program after a reasonable waiting period (e.g., one year of service). If they withdraw funds, the employer should then cancel or suspend its co-funding. Very few of our plans offer automatic enrollment today.

2

Healthy Contributions

Retirement at age 65, with reasonable replacement ratios, requires funding between 5 and 11% of income throughout a 30–35-year career. Therefore, matching 3% (or better) contributions will represent a fair and reasonable employer's collaboration. While most of our plans offer this, we need to communicate what this means to both the employer and employee and encourage increasing the matching formula for long-tenured staff.

3

One-On-One Retirement Counseling (Retirement Visioning Sessions)

The most important element is helping the employee engage in the program. Tools have been created to assist in portfolio selection and retirement projections, but they remain mostly unused. Qube has conducted many one-on-one sessions in the past and believes these are key to creating a vision and encouraging ongoing engagement. In these 30-minute sessions, the employee reviews a basic retirement projection and sets goals for the years to come. We believe that human resources should make these sessions mandatory and ensure they are scheduled on a rotation no less than every 60 months.

[15] Financial Consumer Agency of Canada. November 2019. Canadians and their Money: Key Findings from the 2019 Canadian Financial Capability Survey.

Those three initiatives create empowerment and encourage employees to plan for retirement. As we focus on the next steps, it's essential to focus on the goal: A successful retirement for all. By making changes today, it's possible to be a part of the solution and create happier, more confident employees.

Qube is Happy to Help!

Our slogan, Make It Matter is more than just words on paper; we are always actively looking to make a difference. Supporting employees like Jose and preventing retirement the challenges employees face is a big part of how we want to do that. Qube intends to help meet this challenge head-on because we know it's not a small endeavour! In our experience, providing the One-on-One sessions relieved some of the anxiety of retirement planning; with 4 out of 5 leaving the session pleasantly surprised and motivated, these sessions are vital to treating apathy.

Sessions can be done remotely, by video consultation (zoom) or by telephone.

Retirement success shouldn't only be a dream.

Let's talk about how Qube can support you and your employees.

Contact us!

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