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## **Your RRSP is Not Really a Pension**

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As global stock markets remain volatile and depressed, now is a good time to remember that your RRSP – despite its name or its size – is not a pension. And, more importantly, retirement planning is more than just a number. It's what you do with that number and the products you buy with that number that count.

Allow me to explain.

A traditional workplace pension, often called a Defined Benefit (DB) plan promises a guaranteed paycheck during your retirement golden years. The size of your monthly pension check depends on the number of years you work for the company sponsoring the pension as well as your best salary around the time of retirement. The classical pension formula is 2% per year of service times your final year's salary. So, if you work at the company for 30 years, you are entitled to 60% of your final salary. If you have 40 years of service, your pension income would be 80% of your final salary, paid for life, regardless of the stock market, often inflation adjusted or with annual cost of living increases. No worries, concerns or risks. That is a pension!

Other than public sector employees and a hand-full of other large private sector companies in Canada, this sort of retirement is just a dream. Sure, the Canadian Pension Plan (CPP) together with Old Age Security (OAS) program are also true pensions, but for most Canadians it will replace less than a quarter of their pre-retirement earnings. For many others it is a rounding error on their retirement needs.

Alas, in recent years an increasing number of companies have frozen or eliminated their traditional plans and replaced them with Defined Contribution (DC) pensions, such as Group RRSP plans or Capital Accumulation Plans. Other companies have never offered Registered Pension Plans (RPPs) to begin with and have left the responsibility in the hands of employees and their RRSPs.

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Either way, and despite the word pension in the titles, absolutely nothing is guaranteed.

The way these (non-pensions) work is that you the employee contributes money to an investment account and the company may (or may not) match a portion of that contribution. Your nest egg is now in the hands of the stock and bond market. In other words, most companies are shifting the responsibility of retirement income directly to their employees. The risk and possible reward sit squarely on the shoulders of individuals. If markets don't live up to their expectations -- and especially if stocks decline around the time people are expected to retire -- the nest egg will be woefully inadequate. Your retirement is at the mercy of the market.

So, what can you as an individual Canadian do about all this risk and uncertainty?

Unfortunately, in the short-run the answer is nothing. Selling all your investments and moving to cash is futile. On any given market day, it's virtually impossible to predict how markets will perform. Moreover, market timers have to get two things right: exiting prior to further declines, and entering again prior to the inevitable rebound. Some might get the first one right, but the odds of hitting both nails on the head are exponentially minute. Professional money managers have an extraordinarily difficult time getting this right, so don't expect any better odds yourself.

Yet, for your long-run financial health and sanity I do have some economic aspirin. It is time to *Pensionize Your Nest Egg* (which is also the title of a book I have just published with Alexandra Macqueen from the QWeMA Group)

Some public commentators – well aware of the statistics and facts I have just shared with you – are advocating for an increase in the CPP, or mandating that Canadians save more for retirement, or perhaps creating a new type of pension system.

Alas, that is not the point of this article.

Rather, I think it's time for Canadians to embrace the use of retirement longevity insurance, akin to the fine tradition of life and disability insurance. Recall that this type of insurance, for example, promises to replace the income that is lost when a wage earner loses the life of their ability to work. The insurance company guarantees a payment to the insured or their family and dependents.

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A form of retirement longevity insurance is currently sold by a handful of insurance companies under the name of life annuities and segregated funds. Although these products could certainly be improved – full disclosure here, I am working with some companies to do exactly that – I think that the underlying concept is moving in the right direction.

The essence of these longevity insurance policies is that they guarantee a payment for the rest of your life – as long as that might be – which is precisely what a pension is meant to achieve. The income is known and predictable from retirement day one, and the income is not subject to the random vagaries of the stock market. If your retirement ends-up lasting 30 or 40 years you continue to get your paycheck. Of course, the way an insurance company can guarantee something like that is by stipulating that if you do not reach these advanced ages, the monies you have given them will be distributed to others, and not your heirs and loved ones. This might be difficult to swallow or accept, but is a price that has to be paid for the guarantee of lifetime income. Of course, nobody is suggesting you do this with your entire nest egg, and if you already have a secure pension income there is likely no need for anymore. But, it is something to seriously consider for the rest of Canadians.

In sum, if you don't have a true employer pension then take a very close look at your RRSP and other retirement savings and ask yourself whether the number inside is large enough to sustain 25 or perhaps even 35 years of retirement income. If the answer is no, then you might want to consider *Pensionizing* a fraction on your nest egg.

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