WELCOME

WELCOME TO THE FIFTH EDITION OF PENSION POINT OF VIEW, where you’ll find industry insights and ideas on pension trends and plan design.

This latest edition continues the theme of retirement preparedness from the previous newsletter and looks at how would-be retirees’ expectations stack up against actual experiences. Additionally, we ponder marketing strategies in plan member communications, different perspectives on the decision to retire and how to work better with age. New to this edition is a book review.

Once again, I welcome your emails with feedback and suggestions for further topics of interest.

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FEATURE

If you’ve ever wondered what retirees themselves have to say about how prepared they are for retirement, we have answers. Spoiler alert: just don’t expect retirees to neatly align with everyone else, especially would-be retirees. READ HERE

BOOK REVIEW

Need suggestions for adding to your pension library? Look no further. Here we review Keith Ambachtsheer’s The Future of Pension Management. READ HERE

FACTUAL SNIPPETS

A generation of retirees with unprecedented economic influence and a quest for unending youth makes for an interesting communications conundrum. Curious? READ HERE

STATS AT A GLANCE

Has all the talk about working later in life got you rethinking your “ideal” retirement age? We compare Canada’s labour stats internationally with an added focus on the country that seems to have it all when it comes to retirement: Denmark. READ HERE
A story of contrasts

Far from being dreamers, today’s retirees are nothing if not practical; they approach financial risks responsibly and with prudence. Yet according to Tim Cottee, vice-president retirement planning for Investors Group, many could be missing out by unnecessarily giving up on a truly meaningful experience. The real risk facing today’s retirees, says Cottee, is underliving.

The fear of running out of money in retirement runs deep. Study after study cautions we aren’t saving enough. Take the latest findings from a 2016 retirement survey indicating expenses had actually increased after retirement for not quite half of Canadians. This challenges the common notion of a 30 per cent expense drop in retirement.

The lifestyles of today’s spry retirees, however, may play a greater role in explaining such findings rather than, say, the collapse of the Canadian dollar. With 70 being the new 50, retirees are no longer seen as being content whiling away their days on the patio playing rummy. Instead, we’re told, they’re keen to embrace the long-awaited phase of travelling, good meals and other dreamed-of indulgences.

Fact or fiction, one thing is certain: the nature of retirement is changing and how people manage the financial risks along with it. Who better to help us understand how financial risks are viewed in retirement than retirees and soon-to-be retirees?

Surprising survey findings

Canadian and U.S. survey data shows some surprising results:

- It’s possible to feel confident about your financial future and at the same time fear outliving your retirement savings
- The decision to retire often comes quickly—many retirees report feeling pushed out of work rather than pulled into retirement
- Retirees want to hold onto their homes for as long as possible instead of downsizing
- Working with a financial advisor can make a measurable difference to your perceived retirement readiness and, consequently, your spending/saving behaviours

So how has retirement been working out?

By and large, Canadian retirees feel their retirement is on track with their expectations. The most important driver of retirement satisfaction isn’t money, however—though retirement happiness increases with wealth, income and education level—it’s self-assessed health status. (And according to a 2016 report from the Society of Actuaries, married retirees are happier than singles.)

Retirees are more satisfied than many will have us believe—88 per cent of respondents in a 2015 Canadian survey described retirement as positive; a University of Michigan U.S. retirement survey (carried out every two years) shows similar data.

Yet, U.S. findings point to a gender gap in perceived financial security. Men are more likely than women to appear optimistic and confident, and think they’ll be able to adapt to any financial situation; women are more concerned about running out of assets, needing long-term care and being a burden to their children. This angst is even more prevalent among pre-retirees.

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1 Franklin Templeton Investments, 2016 Retirement Income Strategies and Expectations survey.

2 Unless otherwise indicated, the terms retirees and pre-retirees refer to Canadians.
Mind the gap: fears and risk awareness of retirees and pre-retirees

Multiple surveys indicate fears and the perception of risks are distinctly different for pre-retirees and retirees. And though there are some variations between the findings, overall trends align. 3

**Most feel financially prepared for retirement and have realistic cost-of-living expectations**

Significantly more retirees (81 per cent) than pre-retirees (57 per cent) say they are financially prepared for retirement. Remarkably, pre-retirees appear to have realistic expectations about the cost of living in retirement—48 per cent estimate they will need $20,000 to $50,000 annually, which is the reported spending range for 47 per cent of retirees. This doesn’t mean pre-retiree expectations will keep pace with inflation, but it does suggest retirees adjust their spending to compensate for inflation.

**Adjusting works for many**

Adjusting to financial circumstances as they arise is an ability displayed by many retirees and may be the most common approach to managing finances in retirement. The Society of Actuaries found that U.S. retirees often describe themselves as thrifty or frugal to explain their spending behaviour and paint a picture of a conservative, somewhat resource-constrained financial manager who limits spending for travel and meeting their dreams.

Here in Canada, the biggest financial surprise in retirement for 32 per cent of Canadian retirees is their ability to manage on a reduced budget. That said, for a smaller minority (22 per cent), the biggest financial surprise is how difficult it was to live on a reduced budget. Another 10 per cent said they spent less than expected while the same number of retirees said they were spending more. Talk about a lack of consistent responses!

Still, survey findings strongly indicate that retirees adjust much more readily to financial circumstances (and still feel positive about retirement) than would-be retirees anticipate. It’s one more important message for this latter group.

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3 Inconsistencies are a consequence of methodology variations among different surveys, such as applying different respondent age brackets.

The fear of outliving retirement savings is real

Despite retirees’ confidence in being able to adjust, 51 per cent expressed concern over depleting all their savings, compared to 62 per cent of pre-retirees. Yet, half of retirees say they’ve saved enough for retirement—this figure is higher for those working with a financial advisor (62 per cent). Still, a significant minority of pre-retirees, and to a lesser degree retirees, fear outliving their money.

If at this point you are confused, you aren’t alone. Although the vast majority of retirees express confidence about being financially prepared, half are concerned about depleting their savings. Read on for more apparent paradoxes and a possible explanation.

**Expectations about life events affecting retirement adequacy don’t necessarily match reality**

No fewer than 75 per cent of pre-retirees say they have no idea how much they are likely to spend on health care in retirement. Company retirement packages with extended health care benefits are increasingly a thing of the past and retirees fear having to foot the costs. The Canadian Institute of Actuaries concludes such concerns indicate Canadians doubt the current public system will make the delivery of services available to them and they will have to pay for private delivery instead.

What amounts to yet another puzzling observation is that, even though respondents commonly cite fears over having enough money to pay for health care or long-term care, they express little doubt over their ability to leave money to their heirs. This paradox implies respondents are confident about their financial future in retirement so long as they evaluate it in the context of known, measurable events, but they waiver at the prospect of unforeseeable larger expenses. In other words, fear of the unknown may cloud judgment.
If perceptions (and subsequent spending behaviour) hinge primarily on this factor, then this has implications for pension reform approaches aimed at curtailing benefits. For example, reducing benefits by delaying or lowering pension entitlement amounts may be more palatable than reducing—let alone removing—group benefits for retirees. Put differently, a possible takeaway for policymakers and pension plan administrators is that a share in beneficiaries' burden of uncertainty may prove more significant to them than getting the largest possible monthly pension payment.

Aside from shared fears over unknown future costs of health care and nursing homes, the retiree experience differs quite dramatically from pre-retirees’ “top 5 list” of expectations about life events that will make saving for retirement more difficult. It’s assuring that retirees’ reality isn’t as bleak as pre-retirees anticipate—one more important message to relay to would-be retirees.

Views on maintaining reasonable living standards in retirement are mixed

Retirees are far more confident than pre-retirees that they will be able to live comfortably in retirement and maintain their current standard of living. However, both groups express strong concerns over maintaining a reasonable standard of living for the rest of their life.

A December 2015 survey by Sun Life Financial revealed that, on average, retirees are living on 62 per cent of the income they had before retiring. This average doesn’t change much when comparing men with women or taking marital status into account.

For Kevin Dougherty, President of Sun Life Financial Canada, these figures are a good news story. “Life in retirement is more sustainable than you might think,” he says. “Despite current economic conditions, Canadian retirees are doing quite well living on 62 per cent of the income they had when they were working.”
Who doesn’t want more?

Despite the apparent satisfaction with a 62 per cent replacement rate, retirees recommend an average replacement rate of 71 per cent. We don’t know whether this is because current retirees can only afford to pay for their needs but not wants or feel they must lead a more frugal lifestyle than is necessary, or whether the recommendation reflects the deeply ingrained mantra of the “70 per cent golden rule.”

We do know that 28 per cent of pre-retirees expect their financial situation to improve in retirement but only 19 per cent of retirees report this is the case. Whereas, 31 per cent of pre-retirees fear things will get financially worse in retirement and 28 per cent of retirees report it does.

An international comparison between 16 countries indicates Canadian retirees are far less likely to say their standard of living improved after they stopped working:

<table>
<thead>
<tr>
<th>Country</th>
<th>Malaysia</th>
<th>Mexico</th>
<th>Indonesia</th>
<th>Argentina</th>
<th>Egypt</th>
<th>Taiwan</th>
<th>UK</th>
<th>Brazil</th>
<th>China</th>
<th>USA</th>
<th>Australia</th>
<th>Singapore</th>
<th>UAE</th>
<th>Hong Kong</th>
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<tr>
<td>Source</td>
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</table>

The only country with a lower percentage is France—maybe retirement in France isn’t all it’s made out to be, after all!

Theory versus reality: strategies to protect against retirement risks

There’s no shortage of expert advice on how to bolster the retirement cushion to protect against risks. But how do these strategies hold up in reality? Here, we look at three examples.

Too sweet a home for downsizing? Homes are frequently cited as a source of retirement income—just don’t tell retirees. They have little interest in using their homes to finance retirement, except as a last resort. Nearly 60 per cent of retired Canadians say staying in their home is critical to the quality of life. That number is higher in the United States where a less aggressive housing market makes downsizing less attractive. Among Canadians, 20 per cent of retirees expect to be forced to sell to fund their retirement, compared to 25 per cent of pre-retirees. Yet, only five per cent of retirees and three per cent of pre-retirees reported having actually sold their homes to generate income.

Working 9 to 5 a little longer? Delaying retirement by a few years is much touted expert advice. And people are listening … at least with one ear. No fewer than six in 10 Canadian and U.S. survey participants report that delaying retirement by three years would increase their financial security. However, it often doesn’t play out that way.

After everything you’ve read so far, you might expect that would-be retirees think carefully over time about the decision to retire. And some certainly do. However, a U.S. study by the Society of Actuaries reveals many quickly decide on this crucial milestone, frequently in less than a week!

People regularly retire sooner than intended because work becomes too difficult or unpleasant. Indeed, the most striking finding is the extent to which people leave work because of feeling devalued and “pushed out” even though they could have worked longer. This challenges views about the capability and practicality of delaying retirement. And the numbers speak for themselves. Twice as many Canadian pre-retirees as retirees say they intend to work during retirement; 70 per cent of retirees say they will never work in retirement compared to 31 per cent of pre-retirees. It’s one more example of the gap between intention and reality.
Planning ahead: how hard can it be? Apparently quite hard. Though many Canadians take retirement planning seriously, most pre-retirees are only planning for stage one of retirement, where needs and abilities are essentially the same as in pre-retirement. What’s more, only half seek financial advice. This suggests the need for guidance in retirement planning is not being met. It’s a missed opportunity. Canadians working with financial advisors worry quite a bit less—71 per cent of those without an advisor struggle with enjoying retirement while making money last, compared to 58 per cent who use an advisor.

Canadians without financial advisors compensate with precautionary behaviour, which gives them some feeling of financial security in the face of their fears: inflation, a health event or the need for long-term care in old age. However, they don’t have a good sense of how much money they need as they age and may feel they need a larger financial cushion than is optimal.

Getting more punch out of retirement
Fulfilling all of one’s dreams in retirement may not be available to everybody; some will have to curtail spending for various reasons. While Canadians are less likely to report their living standards increase in retirement, they mostly report doing just fine; though the picture is tainted by fears over unpredictable financial shocks. In turn, this may lead to an overzealous quest for frugality.

Along with multiple other stakeholders, including governments, schools, employers, investment companies and insurance carriers, pension plan administrators may have a role to play in helping move retirees from pursuing a lifestyle of “needs” to one of “wants.” Promoting a more widespread use of financial advisors seems an obvious step. Being more aware of the importance of preserving predictability and certainty (rather than maximizing pension payment amounts) can guide pension reform and plan design change considerations. And finally, creating awareness about common misperceptions of life in retirement may have a place on plan administrators’ communications agendas.

Because, at the end of the day, don’t we all deserve to live and dream a little more in the enchanted wonderland of retirement?

References


French, Cameron. “Retirement is more expensive than you think, and that’s a problem.” Yahoo! Finance Canada, 2016.


Sun Life Financial. “Canadians are living on just over 60 per cent of what they earned before retiring.” Canada NewsWire, February 17, 2016.
BOOK REVIEW


In his fourth book on pension management, Keith Ambachtsheer provides further commentary on the evolving international pension industry, striking a good balance between academic theory and real world application with cases and examples to illustrate his points.

The Future of Pension Management: Integrating Design, Governance, and Investing explores the area of plan design, the ongoing question of sustainability and the continuing shift away from traditional defined benefit vs. defined contribution plan design to formats such as “defined ambition” and “target benefit.” Ambachtsheer suggests the ideal pension system should have two goals—affordability (for workers and employers) and payment security (for pensioners)—and that good progress is being made on both.

Pension plan governance appears to be of concern, however. Ambachtsheer believes that, not only does the effectiveness of governance need to improve, it must happen in a world where fiduciary duty is evolving. He also looks at value measurement and compensation in the pension industry.

The last part of the book considers investment returns and risk, exploring investment beliefs and the challenges of investing for the long term. Final thoughts dwell on risk management and how the introduction of climate change risk is continuing to change how risk is assessed and measured.

Although this book came across as a kind of marketing platform for the University of Toronto Rotman School of Management – International Centre for Pension Management and CEM Benchmarking Inc. (both organizations with which Ambachtsheer is very much involved), overall it was a worthwhile read. Ambachtsheer doesn't propose to have all the answers; rather, he asks thought-provoking questions to motivate the minds of stewards across the pension industry.
FACTUAL SNIPPETS

Consider the Peter Pan effect when communicating with retiring boomers
Should pension plan administrators look to advertisers for lessons on how to communicate with a generation often characterized by a quest for unending youth?

Boomers (those between the ages of 50 and 69) have enormous spending power. Yet, not only are they largely invisible in advertising, they often feel ignored. A 2013 Nielsen report found that boomers represent 50 per cent of the spending on packaged-goods products in the United States, but only 10 to 15 per cent of the spending on advertising. The report predicted that, by 2018, those aged 50-plus will control 70 per cent of the U.S. disposable income.

The picture is similar here in Canada. The average boomer household income is $98,000 per year, compared to millennial households averaging $71,000, according to Environics Analytics. And boomers’ consumer spending is 66 per cent higher than millennials’.

Critics say youth-obsessed advertisers have not yet woken up to boomers’ enormous spending power; to others, it seems a deliberate and effective marketing strategy. “A principle in marketing is that you are always drawn toward your ideal self,” says Donald Shiner, a professor at Mount Saint Vincent University who researches boomers’ decision making. “For boomers, the ideal self is a younger, healthier, more exciting one. ... They’re a bit like Peter Pan.”

Source: Globe and Mail article by Susan Krashinsky, “Older people have the spending power. So why are ads obsessed with youth?” November 12, 2015.

Taking ‘carpe diem’ seriously: should you retire sooner?
Living longer doesn’t necessarily mean you’ll have more time to do the things you dreamed about in retirement; what matters is your disability-free life expectancy (DFLE). Consider that a Canadian male’s DFLE is close to age 70—sobering news if you plan to retire at 65. And after that, the incidence of disease and death climbs exponentially. U.S. data shows a worrying trend: even though life expectancy has gone up, the number of healthy years for both men and women has declined. So what can you do? Make healthy lifestyle changes, for sure. But re-evaluating retirement plans based on your DFLE rather than your life expectancy may also be something to consider.

Percentage of healthy people who develop a critical illness or die:

<table>
<thead>
<tr>
<th>Ages</th>
<th>Men (%)</th>
<th>Women (%)</th>
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<tbody>
<tr>
<td>50 to 60</td>
<td>18</td>
<td>–</td>
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<tr>
<td>60 to 70</td>
<td>36</td>
<td>22</td>
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<tr>
<td>70 to 80</td>
<td>56</td>
<td>–</td>
</tr>
<tr>
<td>80 to 90</td>
<td>82</td>
<td>69</td>
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Keeping track of U.S. public pension reform litigation
Here’s an online tool you might find interesting. The Pension Litigation Tracker was created in response to numerous U.S. lawsuits over pension reforms aimed at reducing the cost of pension benefits. This tool allows you to search the type of pension reform litigation and where it took place. Some examples: reducing cost-of-living adjustment, converting to defined contribution plans and increasing retirement age. Check it out HERE.
Stats-at-a-glance

Working better with age

A topic we can expect to hear more about over time is older workers’ attachment to the labour force. To reduce pressures on public pension systems, governments around the world are looking at strategies to promote longer working lives.

Working after age 55 varies considerably across Organisation for Economic Co-operation and Development (OECD) countries. While in some cases this is due to preferences, it also reflects available opportunities, older employees’ ability to work and feelings of being “pushed” out of employment.

In 2011, the OECD decided to carry out a new series of policy reviews to encourage greater labour market participation at an older age. To get the full scoop on who’s involved and to read case studies and comparative policy reviews, visit the OECD website under Ageing and Employment Policies.

Recommendations coming out of the reviews were presented at an OECD Labour Ministerial meeting in early 2016. They include:

- Ensuring that transitory “bridging” benefits are not used as alternative pathways to early exit from the labour market
- Providing more information to help people make well-informed choices between work and retirement
- Focusing wage-setting procedures more on performance and skills, and less on age and tenure (particularly in the public sector) to encourage employers to retain and hire older workers
- Improving access to suitable, flexible work arrangements
- Increasing the likelihood of returning to work by better coordinating health care and employment services

In the graph below, the employment rate of 55–64 year olds is shown for select OECD countries. The employment rate is a percentage of the population aged 55–64 who are employed. The data is for the fourth quarter of 2015.

Denmark, touted as having the world’s best pension system, is one of the countries that implemented reforms to promote longer working lives. Findings suggest some of the measures have been effective. For example, employment in the 60–64 age group increased following pension reforms. However, in contrast to Canada and especially the United States, working past age 65 remains uncommon in Denmark and other parts of Europe.

The review also found that large gaps remain between hiring older workers and those in their prime. Despite efforts to the contrary, perceptions of age discrimination in the labour market prevail.

Note: “EU 21” refers to the unweighted average for 21 European OECD countries.


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