

Do retirement income plans match reality?



Workplace savings plans are often the cornerstone of employee retirement plans.

They should be a comfort to people seeking security after their working years.

On the flip side, these plans can foster too much confidence when employees take them for granted. They assume retirement will take care of itself. Pair a workplace plan with the Canada Pension Plan (CPP) and Old Age Security (OAS), and it's smooth sailing. Right?

That may be the case for many employees covered under a group plan. However, retirement income planning—the decumulation phase—requires more thought and effort than they realize, says John Hallett, retirement strategist for group retirement services at Sun Life.

“In fact, people don't necessarily think a lot about actual retirement. They're saving for retirement, but they don't know exactly what retirement will mean for them.”

When it comes to examining decumulation, it's best to start with the gap between retirement income expectations and reality.

“The core issue about retirement income planning is no longer about saving. It's about decumulation and what people are going to do with those savings once retired.”

Decumulation demands a different mindset. Workers may not appreciate the income stage when their focus is on building up their savings. The same emphasis is true even in the financial industry.

Professionals are adept at helping Canadians save for retirement. But they devote much less attention, Hallett says, to unwinding retirement nest-eggs into sustainable income. Given how long some people live, that income might have to last more than four decades.

When do people need to start thinking about how workplace retirement plans fit with their financial plan? The earlier, the better. That increases their chance to achieve their retirement goals.

Life's brighter under the sun

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Daryl Diamond, a certified financial planner based in Winnipeg, specializes in helping Canadians build solid decumulation plans. That includes people with workplace savings and retirement plans. He says the decumulation phase requires a different mindset from saving and investing.

“One issue, even a few years out from retirement and looking at a pension plan worth several hundred thousand, is figuring how that translates into a monthly withdrawal amount that’s sustainable,” says Diamond.

That’s not an easy task for most plan members, given all the factors to consider:

- their health and life expectancy;
- how other savings like RRSPs and TFSAs fit with retirement income;
- when to draw from government income;
- tax-efficient income planning; and
- rules regarding various retirement plan options, such as insurance guarantees, succession planning or leaving an inheritance

“The pension cannot be looked at in isolation,” Diamond says. “The responsibility falls to each person to assess how the pension fits into their overall picture. Everyone’s situation is different.”

This process doesn’t always happen in a timely way. Plan members who start it in their mid-50s? Some might realize a cold, hard truth: their retirement income, CPP and OAS are insufficient to achieve their retirement objectives. “In turn, they could end up working five years longer than they had envisioned,” Hallett says.

Group retirement services plan sponsors and plan providers play a role in helping members figure this out.

“Central to that role is getting plan members engaged in retirement planning early, through workplace education sessions and enabling employers to promote financial literacy,” says Hallett.

Solving the DC puzzle

DC plans were built to help employees save for retirement but given how much newer they are than Defined Benefit plans, they have yet to solve how to provide sustainable retirement income. As Hallett cautions, “This is not your parents’ pension plan.”

In Defined Benefit, or DB plans, which were commonplace in Canada decades ago, employees and employers contribute, with the responsibility for sustaining income for life falling entirely on the plan sponsor.

Today, most private sector plans are defined contribution plans, or DC. Employees and employers contribute capital and invest it as a group. At retirement, the employee gets a sum of money to provide for future income, presumably for life. It’s left to the retiring employee to decide how to use this asset to build a steady income.

DB plans are a long-term financial liability for plan sponsors. Because of that, these plans are increasingly rare in the private sector, though they remain the standard for the public sector. Diamond notes that for plan members, the retirement income puzzle for DC plans is more complex than with a DB plan.

“With DB plans, the variables and choices are fewer,” Diamond says. Main considerations are the age to start drawing on retirement savings and how plan income will fit with other income sources.

In contrast, with a DC plan, retiring members have a wide range of options. They can convert all or part of a retirement savings plan into an annuity. They can choose to manage that themselves or with an advisor.

Employees can also convert any amount of the retirement savings to a life income fund (LIF). Sometimes, the plan administrator may offer managed all-in-one options that de-risk the retirement portfolio. That's geared toward generating income as retirees age.

"The DC plan may not be the proverbial gold-plated pension. But it does provide options, and in turn more flexibility, that aren't there with DB plans," Diamond says.

Plan sponsors can help members in a couple of ways. Educate them on their choices for decumulation. And encourage them to seek outside assistance from a financial planner.

"It's about making sure you're helping them build an expectation and plan for retirement that matches reality," Hallett says.

How do you manage the range of retirement income options, and what suits different people best? We'll look at that in the next instalment of this decumulation series.

John Hallett is a Retirement Strategist, Group Retirement Services at Sun Life, with 40 years of experience in the pension industry. John is a member of the board for the Association of Canadian Pension Management (ACPM). He was also a member of ACPM's sub-committee on Decumulation, The Next Critical Frontier.

Daryl Diamond is a financial advisor who has specialized in retirement income planning for more than 30 years. He is the author of the Canadian bestseller *Your Retirement Income Blueprint*, and has recently released his new title, *Retirement for the Record*.