Investors: Are You Making These 3 Massive RRSP Mistakes?

Description

Investors spend a lot of time thinking about TFSAs, and for good reason, too. TFSAs are versatile products that never incur any tax liability. They've pushed RRSPs to the periphery, as many folks focus on the sexy new kid on the block.

But just because Canadians prefer TFSAs over RRSPs doesn't mean investors should ignore the latter. RRSPs can be valuable in many different scenarios, including as a way to minimize taxes during your high-earning years. And if executed correctly, cash can drip from your RRSP virtually tax-free come retirement time.

The bad news is, many Canadian investors are making some big RRSP mistakes — errors that collectively are costing folks billions of dollars each year. Let's take a closer look at three of the most common ones — the kinds of setbacks that could put a real damper on your retirement plans.

Strategic contributions

Many Canadians max out their RRSPs each and every year, eager to put aside cash for their retirement.

While I'd never want to discourage anyone from saving for their golden years, investors must also consider the tax implications of making contributions. Remember, any cash you put towards your RRSP is treated by the CRA like it was never earned. You automatically get any taxes paid on the contribution back through your tax refund.

Contributing to your RRSP is a fantastic idea if you're squarely in a top tax bracket. It's a poor idea if you're just scraping by. Remember, RRSP contribution room accumulates over time, so it's best to save your cash for a year when you're making more.

Employer match

There are millions of Canadians who are leaving money on the table because they're lazy or uninformed.

Most companies offer RRSP matching to employees — a program that will see an employer match every dollar contributed to a RRSP up to a certain percentage of one's income. Most RRSP-matching programs will match between 3% and 5% of your savings, but some are more aggressive.

This is serious money. If you make $60,000 per year, your employer match could be worth anywhere from $1,800 to $3,000. That adds up to tens of thousands of dollars over your career, not including the gains on those contributions. We're talking serious money here!

Poor investment choices

Many investors put their hard-earned retirement savings into expensive products like mutual funds, simply because they don't know any better.

These funds are a poor choice for one big reason. They come with ridiculous fees, often charging investors 2-3% each year. 2% doesn't seem like much, but it's 25% of total returns if the fund gains 8% before fees. It's a serious chunk of money.

The good news is, it's easy for investors to plunk their cash into cheaper options. Exchange-traded funds (ETFs) are very similar to mutual funds, but the big difference is they come with much lower fees.

Take, for instance, one of Canada's top ETFs: **BMO Canadian Dividend ETF** (TSX:ZDV). This fund holds a collection of blue-chip, dividend-paying Canadian stocks, with large holdings in solid sectors like banking, telecom, and pipelines. It has approximately $1.5 billion in assets and is well established with nearly a decade of history behind it.

The fund has performed well over the last year, increasing nearly 13%. And that doesn't include dividends, which make up a big chunk of this ETF's returns. The current dividend yield is a robust 4.4%.

Now let's talk about the fund's management fee, which checks in at 0.35%. That's already much lower than the average mutual fund, but it's not particularly low in the world of ETFs. I think it's an acceptable trade-off for access to a solid portfolio of dividend growers; however, investors who are really opposed to fees should note it's possible to buy ETFs with management fees below 0.10%.

The bottom line

Many investors don't fully understand RRSPs, underutilizing the product. This ends up costing them thousands in extra taxes, missed cash to be used for contributions, and excess fees.

Don't fall victim to these RRSP mistakes. Maximize the account, and you'll maximize your retirement dollars, which is the ultimate goal.

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