3 Horrifying Truths About Retirement in Canada

Description

Most Canadians look forward to retirement as a richly deserved break after a lifetime of work. For a long time, it more or less worked out that way. In 1977, about 46% of all Canadians were covered by a registered pension plan (RPP). Many of those were defined benefit pension plans, which promised to pay a benefit regardless of how the underlying investments performed. In the ensuing decades, however, pension plan coverage declined, with less than 40% of Canadians having an RPP in 2011. Defined benefit plans declined even more sharply.

With employer-sponsored pensions on the decline, retirement is increasingly being financed by three main sources: CPP, OAS, and savings. This is a stark contrast to the late 1970s, when defined benefit pension plans provided Canadians with comfortable retirement income. The unfortunate truth is that retiring comfortably is getting harder and harder for most Canadians. The following three scary truths illustrate why that is.

CPP and OAS won’t cover your expenses

According to a **Sun Life Financial** report, the average Canadian has $2,611 in monthly expenses in retirement. That includes food, shelter, taxes, and transportation. In larger cities, that figure is higher, because rent and mortgage payments are typically higher in urban centres. Unfortunately, CPP and OAS won’t cover $2,611 in monthly costs. In 2019, CPP paid $679 a month on average, and OAS paid $613 a month at maximum. Together, that’s only about $1,300 a month. That’s barely *half* what you’ll need to retire on!

Defined benefit pension plans are on the decline

As mentioned earlier, registered pension plan coverage is declining in Canada. However, the decline in defined benefit pension plans (the kind that pay a guaranteed benefit) has been even steeper. According to the Office of the Superintendent of Financial Institutions (OSFI), the proportion of RPP plans that had defined benefits decreased from 80% to 67% from 2006 to 2016. That implies an even sharper decline in defined benefit pension plans than in pension plans as a whole. That's a problem because only defined benefit pensions pay a guaranteed amount: with other plans, your payout depends on how the underlying investments perform.

Inflation will eat into your spending power

Inflation is one harsh reality that many Canadian retirees are familiar with. Although CPP is supposed to be inflation indexed, the CPI excludes many categories of items. As a result, inflation can really eat up your purchasing power in retirement.

It's for this reason that retirees would be well advised to hold bond funds like the **BMO Mid-Term US Corporate Bond Fund** (TSX:ZIC) in an RRSP or TFSA. Bonds are among the safest assets you can buy, with a higher priority claim on income than stocks. By buying bonds through an ETF, you get the income stability of the underlying bonds, along with the liquidity of common stocks. It's the best of both worlds.

The ZIC fund has a 3.35% yield as of this writing, meaning you get $3,350 back in annual income on every $100,000 you invest. Over time, that can add up to a nice income supplement. The fund's fees are 0.25%, which is a little high but may be worth it for the sake of getting convenient exposure to bonds as you approach retirement age. Also, since ZIC is a *U.S.* bond fund, you may see your income increase if the Canadian dollar continues sliding against the U.S. dollar.

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