BMO Retirement Institute Report

April 2009

Boomers Revise their "Retire-By" Date as Financial Landscape Changes

Not long ago, the future offered the baby-boom generation an exciting array of choices. Many dreamed about retiring on their own terms, creating a sustainable and meaningful time of life, and the decision to work longer often had more to do with self-fulfillment than financial preservation. Now, amidst severe market turbulence, the landscape has changed. Boomers, especially those five years before, or even five years into retirement, are finding themselves having to revisit their options. Working longer may become a necessity for some pre-retirees – even some retired Canadians are seriously considering returning to work. In addition to protecting their nest eggs from volatile market conditions, many worry about not having sufficient income from their RRSPs, CPP/QPP and OAS to afford daily living expenses. Added to the list of concerns are rising healthcare costs, outstanding debt, and the risk of outliving one's savings.

Introduction

When the first cohort of Boomers (born between 1946 and 1964) recently reached retirement age, they wasted no time altering perceptions about this much-anticipated stage of life. According to the 2006 BMO Retirement Trends Study, Canadian Boomers planned to work in some capacity after traditional retirement citing "staying mentally active" as the main reason, wanting to "keep in touch with people" was next and to "earn money" was ranked third.[1] Today the top three reasons have been reversed, according to the January 2009 BMO Working Longer Omnibus survey, 89% of pre-retirees and 84% of retirees who participated cited the main reason they would consider returning to work within the next year would be "to earn money", with "staying mentally active" and "keeping in touch with people" identified as their second and third choices, a distinct shift from just three years ago.[2]

Over the years, trends show that returning to work after retirement has become more commonplace. For instance in 2005, a Statistics Canada survey found that of the 7.4 million Canadians aged 55 and over, 63.7% (roughly 4.7 million) had retired – but more than one in ten had returned

The BMO Retirement Institute was established in 2008 to provide thought provoking insight and financial strategies for those individuals planning for, or currently in their retirement years.

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[1]The BMO Retirement Trends Study, BMO Financial Group, 2006
[2]January 2009 BMO Working Longer Omnibus Survey

to work for pay following their first retirement. However, of this group, less than half cited financial considerations as their motive for un-retiring[3].

For many Boomers today – with their nest eggs shrinking and the ongoing economic uncertainty – the choice to possibly work longer may be replaced by necessity. Under current market conditions, many recognize that choosing to make withdrawals from accumulated savings would result in crystallizing considerable losses. Forced to come to terms with a new economic landscape, many are starting to believe that setting their retirement clocks back a few years may be their best option to rebuild their savings.

By delaying retirement, Boomers are essentially buying time. Their objectives are clear: to keep reserves intact, secure a steady income stream, and "sit it out" in the hopes of recouping some of their losses when the markets recover.

Decline in confidence

Understanding how much is needed in retirement is critical to feeling confident about what the future holds. Yet even before the markets plunged, a 2006 BMO Retirement Trends Omnibus noted that 70% of Canadian Boomers polled didn't feel or didn't know if they were on track towards reaching their retirement goals. These respondents also said they were willing to do what it took to be retirement-ready. As a result, 83% agreed they would work longer if they had to.[4]

The research highlighted that perhaps starting early and careful planning are key factors that fuel Boomers' confidence. Of the respondents interviewed, 81% said they wished they had started saving earlier, even in their teens, and 91% agreed that having enough money for retirement requires a lot of planning and advice to reach their goals.[5]

U.S. studies reiterate this knowledge gap. The Retirement Confidence Study from the Employee

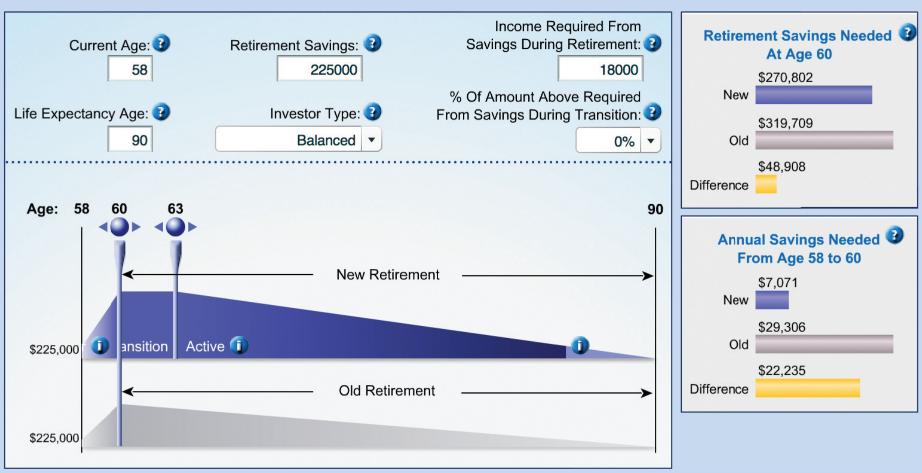
Five reasons why Canadians might consider working longer:

1. Decline in confidence: How much is enough?
2. Insufficient savings and inadequate planning
3. Longevity and fear of outliving capital
4. Corporate pension and healthcare concerns
5. Higher earning potential

How much? How long?

Susan is 58 years old with retirement savings of $320,000 invested in a balanced portfolio. She had planned to retire at age 60 and begin to withdraw $1,500 per month, or $18,000 annually from her savings to supplement CPP/QPP, OAS and her company pension until age 90. However, her portfolio is now worth $225,000 and she is considering revisiting her "retire by" date.

One option is to continue to work at her current job until age 60 and then work part time until age 63. If she earns enough with her part-time job (i.e. from age 60-63) and does not have to withdraw money from her current retirement savings until she stops working entirely, she needs to save approximately $7,071 annually while she's working full time with no additional savings needed from her part-time work to meet her retirement goals.



The BMO Retirement Transition Illustrator was designed by BMO Financial Group to help future retirees calculate the impact working longer will have on their retirement savings. Visit **www.retirementyourway.com** – Resources & Calculators.

[3] Statistics Canada, Pension and Wealth Research Paper Series, The Wealth of Canadians: An overview of the Results of the Survey of Financial Security, 2005

[4/5] BMO Retirement Trends Omnibus, BMO Financial Group, October 2006

Benefits Research Institute (EBRI) pointed out that only two out of five American workers have attempted to do a retirement savings needs calculation, and one-third of those who have can't remember the result. What's more, 70% of workers polled say they do not have a formal, written financial plan.[6]

Without knowing what their savings needs are, it is virtually impossible to determine if they are on track or how far off track they may be and whether significant changes are needed now and/or during retirement years.

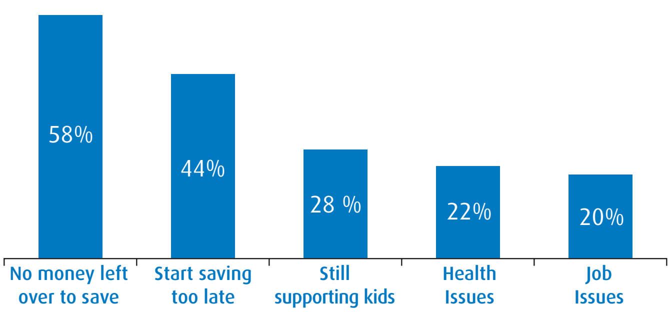
A lack of confidence is natural if one does not have a plan or is unaware of the options available to help eliminate a savings gap. Speaking to a financial advisor can provide answers which can help restore confidence, yet according to the 2009 BMO Working Longer Omni survey, among those considering delaying retirement or returning to the workforce, over 50% said they had not and do not plan to speak with a financial advisor about the potential impact of their decision on their financial plan.[7]

Insufficient savings and inadequate planning

Why are Canadians not saving enough?

58% of Canadians have no money left over to save

Five Reasons for Insufficient Retirement Savings



Source: 2006 BMO Retirement Trends Study

Many Boomers have enjoyed the opportunity to spend a greater percentage of their disposable income on leisure and luxury items. The trend towards using debt to afford this lifestyle has become more common and acceptable by the Boomer generation. Adding further financial strain, many Boomers are sandwiched between aging parents requiring expensive healthcare and dependent children.

More than ever before, the big question on the mind of Canadians is "How do we get there?" Most of us recognize that government retirement programs by themselves will simply not be sufficient. Instead, a blend of government and company pensions, personal savings, home equity, and insurance products will be required. Over the years, more of the burden of funding retirement has shifted onto the individual and away from governments and employers.

And after over 50 years of hearing about the benefits of an RRSP, contributions have definitely grown over time, but the average taxpayer's contribution is far less than the allowable limit. According to Statistics Canada, RRSP contributions in 2007 represented only about six percent of the total contribution room available, down from 7.0% in 2006.[8] Nevertheless, the introduction of the Tax-Free Savings Account in 2009 may provide further incentive for Canadians to save more for retirement as income and withdrawals are tax-free.

Nonetheless, while some pre-retirees expect to reduce their discretionary spending or relocate to reduce housing expenses, a McKinsey study shows less than ten percent of recent retirees in the U.S. have done these things.[9] In contrast, over 50% of Canadian pre-retirees polled are either planning to or are considering delaying their retirement date, according to the January 2009 BMO Working Longer Omnibus survey. Similarly, 45% of those already retired stated that they will probably return to work within the next year.[10]

Like many other things in life, saving for retirement takes higher priority the closer it becomes to reality. Many Boomers are now realizing they may need to consider their retirement savings and income needs and find themselves looking for options. Instead of simply reducing their expectations for their planned retirement, working longer or returning to paid work is a potential solution.

[6] The 2007 Retirement Confidence Survey, Employee Benefit Research Institute, Issue Brief, No. 304, April 2007
[7/10] January 2009 BMO Working Longer Omnibus Survey
[8] Statistics Canada, Registered retirement savings plan contributions, The Daily, November 2008
[9] McKinsey and Company, what US Workers Don't Know About Retirement, January 2007

Longevity and fear of outliving capital

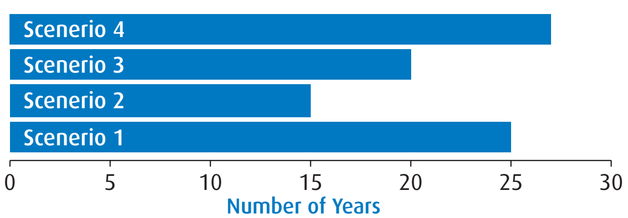
With life expectancy around the 80-year mark, retirement can now stretch over as many as three decades, putting more pressure on Boomers to save more in order to maintain their lifestyles. Living longer is associated with other financial risks, too. Inflation rates can vary, making it difficult to gauge how much of an impact the cost of living will have on one's capital. Even a moderately low inflation rate of 3% has the effect of significantly eroding purchasing power over a 20 or 30 year period. And, as one's health can deteriorate with age, health care costs can bring an additional unknown into the mix.

Entering retirement and making withdrawals from retirement savings during a bear market (a period of negative investment returns) places significant stress on those savings which increases the chance of running out of money during a lifetime. As illustrated in the example below, working longer may alleviate that stress by delaying or reducing required withdrawals from accumulated savings and providing additional years to continue to rebuild assets.

Example: Extend portfolio life by delaying withdrawals during bear markets

How long will retirement savings of $225,000 last?

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Rate of return	+7% per year	Negative 7% first 2 years and +7% for remaining years	Negative 7% in first 2 years, then +7% annually	Negative 7% in first 2 years, then +7% annually
Annual withdrawals	$18,000 beginning immediately	$18,000 beginning immediately	$18,000 beginning in 2 years	$18,000 beginning in 4 years
Duration of savings	25 years	15 years	20 years	28 years



Note: For the purposes of this illustration, income taxes and inflation are not included.

If the portfolio has negative returns occur only during the first two years of retirement, making withdrawals in those years can reduce the duration that retirement savings will last by 10 years (Scenario 2). Eliminating withdrawals in those first two years, as a result of working longer, can result in the savings lasting 20 years (Scenario 3) and if no withdrawals are made during the first four years, the duration of the savings can actually be extended to 28 years (Scenario 4).

Corporate pension and healthcare concerns

Previously, Canadians believed that their corporate benefits would provide sufficient income and health care coverage to see them through their retirement years, but it is becoming clearer that this is not the case. As more Canadian companies replace defined benefit (DB) pensions with market-exposed defined contribution (DC) plans, employees must now assume more responsibility for building retirement reserves. Given recent market volatility, the result is that those with DC plans have seen their retirement savings diminish significantly which means less pension income available during retirement unless additional contributions are made. To provide employers with more flexibility in offering phased retirement to employees, the Canadian federal government introduced legislation in the 2007 budget that allows an employee to receive pension benefits from a DB plan and simultaneously build up further benefits while continuing to work. Unfortunately, not all provinces have amended their pension acts to allow phased retirement, so it may take some time before all Canadians will fully reap the benefits across the country.

In addition, many employers are changing their attitude towards the provision of retiree healthcare. According to Mercer's 2008 Post-Retirement Trends survey, one-third of Canadian companies surveyed have made reductions to the benefits they provide for retired employees in the last three years.[11]

[11] 2008 Post-Retirement Trends Study, Mercers

Benefits are changing south of the border as well. In the U.S., a significant number of organizations are eliminating health care coverage altogether. There is a general lack of awareness of these benefit changes and contrary to reality, two in five workers still expect employer-provided health care coverage and as much as 44% expect an employer sponsored retirement plan to be a major source of income in retirement, according to a 2007 EBRI Retirement Confidence Survey.[12]

Many future retirees have not yet realized the gap between their expectations and reality and do not have sufficient retirement reserves set aside to offset rising healthcare costs. Those concerned with healthcare costs, may choose to remain active in the workforce to ensure their healthcare benefits continue and may seek organizations that offer comprehensive healthcare benefits as part of the total compensation package.

Higher earning potential

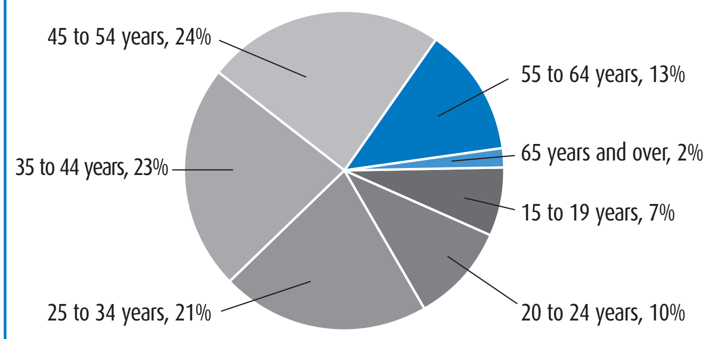
Another reason for working longer could be that Boomers, as a highly educated and experienced generation, generally earn more than their younger peers. With the mandatory retirement age lifted in many professions, more Boomers are staying active in the workforce to take advantage of what many now believe to be their peak earning years. Consistent with this theory, are the findings of a 2003 AARP Talent Study analyzing workforce demographics that found that workers aged 50 and over sustained productivity, creativity and motivation, and were also more likely to be engaged in their work than younger workers.[13]

Continuing to work in a current job rather than seeking part-time or temporary employment during retirement, may help Boomers to work only a few more years rather than making it a long-term solution. Not to mention the added benefit of continuing to build pension assets at higher income levels.

Is there still a workforce crisis?

As the largest generation ever poised to retire, Boomers' retirement decisions will have a considerable impact on the workforce. For years, the rapidly aging workforce has sparked concern amongst analysts who believe the pool of skilled, experienced people in the workforce will be depleted as the Boomers retire.

Labour Force Characteristics by Age



Source: Statistics Canada, CANSIM, table 282-0002. Last modified: 2009-01-08.

These global numbers paint a compelling picture:

- The U.S. Census Bureau data states that by 2011 one Boomer will turn 65 every eight seconds.[14]
- Globally, the population of people over 60 is growing at a rate of 2.6% per year. In 2006, the number of persons age 60 years or over had surpassed 700 million. By 2050, 2 billion people 60+ are projected to be alive, implying that their number will once again triple over a span of 50 years.[15]
- In 2007, 21.5 percent of the Japanese population was over 65 years old. By 2055, it is projected to be 40.5 percent.[16]

And workers are aging as fast on the home-front:

- A 2006 Statistics Canada study projected that the number of Canadian seniors will increase from roughly 4.3 million to 8 million over the next two decades, with their share of the population exceeding 20% by that date.[17]

[12] The 2007 Retirement Confidence Survey, Employee Benefit Research Institute, Issue Brief, No. 304, April 2007
[13] 2003 AARP Global Work Force Study
[14] United States Census, 2000
[15] World Population Ageing 2007, United Nations Department of Economic and Social Affairs, Population Division
[16] East Asian Institute, Declining Fertility Rates in Japan: An Ageing Crisis Ahead, February 2009
[17] Statistics Canada, The Daily: A portrait of seniors, February 2007

- Canada's Urban Futures Institute predicts the number of Canadians retiring each year will reach 425,000 by 2020.[18]

What do these numbers mean? An aging population translates into increased demand for healthcare services, medical supplies, transportation, and geriatric support networks – so while a labour shortage seems imminent, demand for more comprehensive services is rising. Some of the sectors most affected by the aging workforce include farmers, teachers, healthcare providers, transit operators and aerospace and defence engineers.[19]

However, if non-retirement becomes the new normal, the so-called workforce crisis may diminish, or at the very least, be deferred. The latest market upheaval has compelled many Boomers to hold on to their jobs for as long as possible, and launched a significant amount of retirees back into an active search for employment. In fact, according to a January 2009 Statistic Canada survey, the unemployment rate of Canadians aged 55+ rose as a result of more people in this category looking for work.[20] This is a trend that is likely to continue based on the findings of the 2009 BMO Working Longer Omnibus survey where 57% of Canadian pre-retirees polled said they either plan to or are considering delaying their retirement date, and 45% of those polled who were already retired, plan to or will probably return to paid work within the next year.[21]

The ramifications of this trend may extend well beyond Boomer finances. As Boomers choose to postpone their retirement dates, multiple generations may be forced to compete for the same jobs, potentially causing a surge in unemployment across Canada.

But there is some promising news for Boomers who are planning to work longer. Some employers are making a considerable effort to attract and retain Boomers such as incorporating Return-to-Work programs into their schedule of benefits, or appealing to older workers who are looking to supplement their income and obtain some medical coverage at the same time. Others have adapted their workspace to fit the needs of older employees.[22] Interestingly, organizations that are providing alternative and flexible work arrangements that appeal to Boomers may at the same time create working environments that may be very attractive to Gen X and Gen Y employees.

Meanwhile, a new crop of recruitment agencies has surfaced with websites tailored to attract experienced workers over age 50. And for Boomers who wish to "give back" while enjoying some of the non-financial benefits associated with working, volunteer opportunities abound.

Regardless of whether there will be a shortage in the workforce or not, some major re-balancing will be required over the next few decades to accommodate for the shift in demographics. Considering that jobs losses in Canada continued for the fourth consecutive month in February 2009, pushing the current unemployment rate up to 7.7%[23], flexibility and creativity will be the order of the day. Boomers will likely see the demand for experienced workers translating into part-time, seasonal, consultant and contract positions. To partake in this trend, Boomers will need to consider continuing to develop their networks and keeping their skills current.

Conclusion

The latest economic setback will affect each Boomer differently, depending on their individual savings and circumstances. But for the most part, Canadians will have to return to the basics and fully understand their options, before they are able to retire on their own terms.

To achieve peace of mind and a more positive retirement outlook, it is vital that Boomers know where they stand both financially and professionally. Now is the time to review portfolio and savings strategies and face up to those difficult questions, such as "What are my needs versus what are my wants?", "How much do I need to earn and save?" and "How

[18] Canada's Urban Futures Institute, 2005
[19] Statistics Canada, Perspectives on Labour and Income, Retirement, May 2006
[20/23] Statistics Canada, Labour Survey, January, 2009
[21] January 2009 BMO Working Longer Omnibus Survey
[22] Richard Pimentel, Mid-Life: A Crisis for Baby Boomers or a Crisis for Industry?, 2001
Statistics Canada, Latest Release from the Labour Force Survey, March 2009

much longer will I need to work?" Boomers are advised to consult with their employers, accountants, tax specialists and financial advisors to get the full picture. Finally, it is important to keep things in perspective. Changes in the financial landscape may result in a change in values from consumption to savings not only for the Boomers but for other generations as well. When and if retirement must be put on hold, life doesn't have to be, making it more important than ever to have a documented retirement plan and to review it regularly.