Many Canadian seniors continue to carry high levels of debt. How do recent world events change your risk profile? One couple took this time of change and uncertainty as an opportunity to review their financial plan.

ADJUSTING COURSE IN LIGHT OF THE PANDEMIC

Hassan and Marja Gupta* count themselves blessed that their family are safe and well during this time. That said, like them, you may also have concerns about the security of your retirement income as financial markets fall and the prospect of a global recession moves into view.

A CHANGED ENVIRONMENT

The Guptas, like most retirees, have relied on assumptions of steady economic conditions, stable house values, low interest rates and, indirectly, that Canadians will continue to pay income taxes to support government pension programs. But now that at least some of these assumptions cannot be relied on, what can or should they do?

There seem to be many options: harvesting home equity, returning to work to continue to support themselves and put aside further savings, or perhaps defer the income they expected to receive by selling portfolio assets, now that those assets have been devalued.

When Hassan and Marja sat down to review their finances, they felt uncomfortable with their level of debt. They are not alone. According to StatsCan, in 2016 Canadian senior families had doubled their mortgage debt while non-mortgage consumer debt (loans and credit cards) is up by more than 50% compared to 1999. Though interest rates have recently fallen, lower stock market levels and economic recession has spurred the Guptas to find ways to shed risk by reducing their debt, or at least making sure that they do not increase it.

The couple reviewed their spending patterns and were able to identify many discretionary expenses. One of the silver-linings of the pandemic is that changes to their daily routine had revealed a number of things they might easily reduce, including regular eating out, travel, and the costs of operating two vehicles (gas, insurance, parking and maintenance).

FIRST STEPS

They chose to restructure household finances, cutting spending on vacations and some other extras. They also put off a planned kitchen renovation. They were thankful they could manage without resorting to any more serious actions like downsizing their primary residence.

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** Names have been changed.*

PENSION AND RRIF INCOME

Hassan and Marja also had a careful look at the sources of their retirement income. With such economic uncertainty in the world they felt relieved that they could rely on the security of their pensions. The Canada Pension Plan (CPP) and Old Age Security (OAS) pensions are well funded and reliable government sponsored plans. Hassan's BC Teacher's Pension is also secure. A recent message from the Chair of the Teacher's Pension Board of Trustees on May 12th, assures "that [their] pension will be paid now and in the future."

While the Gupta's pensions would continue to provide a solid foundation of reliable income, they did worry about their RRIF and TFSA portfolios. These were invested in well-diversified balanced retirement income-oriented securities with a healthy allocation to global stock markets. These portfolios were down by at least 13% since the beginning of the year. They wondered if they should be doing something about that. Their advisor, Sheila, reminded them that a stock market decline may not mean that they should change their asset allocation or withdrawal plan. A review of their long-term need for growth, balanced with their comfort with risk, indicated that they had properly designed their portfolios to weather events like these. They decided that their current asset allocation will continue to serve them well.

NEW RRIF GUIDELINES

Sheila pointed out that a recent Federal government change allows them to reduce their required minimum RRIF withdrawals by 25% for the rest of 2020. While this would take some pressure off their depreciated portfolios, and slightly reduce their taxes, they chose to leave the payments unchanged. Their thinking was that future tax rates may rise in response to increased government debt.

The Guptas also had a joint open investment account from an inheritance from Hassan's late father. While they liked to receive income from it, they wanted to ensure that it would continue to be sustainable. Sheila cautioned that they should not withdraw more than 5% of the portfolio's value each year, so the current 4% should be maintained. Market capital returns generally in the 2-3% range combined with similar dividend yields and interest should be able to support this over the long-term, however it will be important to monitor this regularly. While less tax-efficient, Sheila suggested taking as much of their payments as possible from dividends and interest generated in the portfolio, which would leave more of the capital value in the plan to participate in a recovery when it comes.

A SPOUSE WITHOUT A PENSION

While Hassan has his teacher's pension, Marja has no guaranteed income source aside from her CPP and OAS. This made her nervous. Sheila suggested that Marja consider securing a portion of her market RRIF so that she too would have more guaranteed income. This would require moving a portion of the RRIF to a registered life annuity issued by an insurance company. Similar to a pension plan, these contracts guarantee an income for life based on long-term interest rates and the annuitant's mortality. Annuity rates have fallen over recent years making them less palatable, however they are seeing a resurgence in a time of negative economic and market outlook as a safe source of retirement income. Sheila reminded Marja, that while a life annuity may seem attractive, it is an irrevocable contract that cannot be undone. They are not appropriate for everyone and should be carefully considered before purchase.

A CHANCE TO REVIEW AND REVISE

In our new uncertain COVID-19 world it is important to question long-held assumptions about retirement income planning. Canadian seniors like the Guptas have been given an opportunity to re-evaluate their financial plan and reduce their levels of debt, adjust their spending habits, and ensure that their portfolios are set to continue meeting their long-term needs. Involving a financial planner in these discussions gave Hassan and Marja a court of second opinion.

In the end, retirement planning is a fluid, on-going exercise that requires regular revisiting and revision.