



You need to know how much you should be stashing away now to generate the income you want in retirement. JASON VERSCHOOR/ISTOCKPHOTO

A rule for funding golden years



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Let's interrupt the gloom-fest over whether Canadians are putting enough money away for retirement to look at some new guidance on how to save.

It's called the Retirement Rule of 20 and it says a financially secure retirement can be had if you have \$20 in savings for every \$1 in annual income you require after you leave the work force.

The Rule of 20 doesn't really address the concerns among federal and provincial politicians that too many Canadians are saving insufficiently for retirement and face a big drop in their standard of living. But it can help people better understand the gap between how much they've saved for retirement and how much they need.

While governments confer about on how best to deal with the retirement issue, remember an old adage. If you want something done right, do it yourself.

The Rule of 20 was developed by the Canadian office of the global financial firm Russell Investments. It's an alternative to existing retirement savings formulas, such as the replacement ratio, which targets a percentage of your working income. A general rule in financial planning is to use a replacement ratio of 70 per cent, but some experts say as little as 50 per cent will suffice.

Russell began with the idea

The retirement rule of 20

Russell Investments Canada has created a new rule that helps you decide how much you need to save for retirement. For every \$1 of annual income you need to live on, you should have \$20 saved when you retire. Here are some examples of how the rule works.

In your RRSP, on your retirement date you have...

\$300,000
\$400,000
\$500,000

The Rule of 20 says your portfolio will generate annual income of...

\$15,000
\$20,000
\$25,000

Remember to add \$25,000 annual income from CPP and OAS per couple, and to factor in any pension benefits that apply

Rule of 20 Assumptions

- your money lasts about 33 years
- annual inflation of 3 per cent
- annual investment returns of 5.95 per cent after fees
- asset mix of 65 per cent bonds, 35 per cent stocks

that there are three components of retirement saving, one for day-to-day living costs, one for discretionary costs like travel and another for your estate, or money you hope to leave behind. The Rule of 20 is designed to cover just your essential costs, leaving you to work out how much extra you want to save for things like trips and inheritances.

The point of the rule is to show how much you need to save to achieve \$1 in retirement income before taxes. "Based on reasonable economic assumptions, our view is that the number is \$20," said Irshaad Ahmad, Russell Canada's president.

Good news - you don't actually have to save \$20 yourself for every dollar you'll live on later. Mr. Ahmad said most people can count on funds from the Canada Pension Plan (CPP) and Old Age Security (OAS), as well as a company pension plan if they're lucky enough to be among the 25 per cent of people in the private sector who have a such benefit.

But let's say you don't have a company pension, and you've decided you and your spouse can live on \$50,000 in income in retirement. Mr. Ahmad said \$25,000 will come from the CPP and OAS, which leaves you to make up the additional \$25,000 a year. Using the Rule of 20, you'll need to have a combined \$500,000 in registered savings on the day you retire.

Does \$500,000 sound low? "By my perspective that's actually quite a lot of money, assuming you've paid off your mortgage and your kids are out of the house," Mr. Ahmad said. His data show that the average age at which your mortgage is paid off is 55, while the average retirement age is 62.

The analysis behind the Rule of 20 suggests that retirement savings should last 33 years. If you save at a 25:1 ratio (or save \$25 for every dollar of income you need), you should be able to draw on your savings for 45 years. Inflation has been estimated at 3 per cent, and returns have

been pegged at 5.95 per cent a year after fees.

The return estimate is based on conservative mix of 65 per cent bonds and 35 per cent stocks that is designed to withstand years like 2008. However, the annual projected returns of 9 per cent for stocks and 6 per cent for bonds do seem high in today's world.

Mr. Ahmad sees the Rule of 20 as a common-sense way of helping people get past the financial sector's sales hype about the need to save millions and contribute the maximum to registered retirement savings plans every year.

"A whole industry has worked on trying to tell people that if they haven't started saving from the time they're conceived, they're going to be eating cat food," he said.

In fact, polling commissioned by Russell has found that fears of not having enough money to last through retirement actually ease once people leave the work force. Ten years away from retirement, 60 per cent of respondents said they were worried they would run out of money; five years into retirement, the corresponding number was 20 per cent.

When you're at least 10 years away from your retirement, Mr. Ahmad suggests you evaluate where you stand with the various retirement building blocks - CPP, OAS, company pension and your own RRSPs - and then see how much retirement income you'll end up with.

"When you draw that picture, it will do one or two things," he said. "It will either make you feel better, or it will scare the crap out of you. But it will give you the answer, and you can then develop an action plan around it."