Together, for a healthier retirement

Harnessing the collective power of physicians for a successful group retirement plan.

By Alex Mazer and Jonathan Weisstub, Common Wealth

This feature article is the second of three in a series on physicians and retirement security. In response to OMA members’ needs for greater financial security after full-time work, OMA Insurance will soon launch the Advantages Retirement Plan™ for physicians and their spouses. This article, authored by the team at Common Wealth, the retirement security company helping OMA Insurance create and deliver the plan, features the advantages behind the new group plan that will help OMA members receive more retirement “bang for their buck.” Learn more and sign up for a pre-registration package at www.omainsurance.com/retire.
We got an expert opinion

Teaming up with Common Wealth to create and implement the Advantages Retirement Plan™

Common Wealth is privileged to be collaborating with OMA Insurance in creating and delivering the Advantages Retirement Plan™, a new group retirement income plan for Ontario’s physicians and their spouses. Together, we are striving to incorporate the value drivers of traditional collective retirement plans into a model that meets the unique needs of Ontario physicians. OMA Insurance has used the “profit-for-members” model for years, a model that has also created considerable member value in the pensions and retirement world, so together we’re looking forward to launching a plan that helps Ontario physicians achieve greater value for money in their retirement savings, and greater financial security in retirement.

• Since retirement is one of the biggest “expenses” people face, a value-for-money approach to retirement can generate significant savings. Fee savings alone can be worth over $1.5 million over a lifetime in a case example of a physician earning $200,000 before tax and after expenses.

• The five main factors that drive value for money in retirement are: saving, investment management fees, investment returns, tax and government benefits, and longevity risk management to reduce the risk of outliving your savings.

• Evidence shows that by combining multiple value drivers, collective approaches to retirement, including a group plan sponsored by an association, tend to be much more efficient than individual approaches, such as investing your Tax-Free Savings Account (TFSA) or Registered Retirement Savings Plan (RRSP) savings on your own.

Retirement is expensive. As Canadians live longer, we are spending more years in retirement. According to some studies, these retirement years can be among the happiest of a person’s life. But enjoying a comfortable retirement requires income, and the more years retired, the more income needed. And that means more savings. Value for money in retirement is especially important in an era of stagnant wages and rising costs for major items such as housing, post-secondary education, and out-of-pocket health care costs.

Think about the pre-funding of your retirement as a purchase like a house or a car. Retirement is one of life’s biggest investments, often requiring you to save 10-15% of your income over 30-40 working years to build a nest egg.

American economist and Nobel Laureate William Sharpe has referred to retirement preparation as “The nastiest, hardest problem in finance.”

And yet, at its essence, the problem is simple: how do you convert today’s savings into regular income in the future?
The five advantages that drive value in retirement

1. **Savings**
   When a person starts saving early and saves an adequate amount on a regular and consistent basis, financing retirement becomes much more cost-effective. Waiting until one’s late 30s or 40s to start saving means your money has less time to compound, and therefore means you need to save a larger amount to achieve the same level of retirement income.

2. **Fees**
   Each dollar in investment management fees you pay means you have fewer investment returns to fund your retirement. Further, higher fees have a negative compounding effect over time — what investing legend and Vanguard Group founder Jack Bogle called the “tyranny of compounding.” Over a 40-year period, a fee of 2% — typical in the Canadian retail investing industry — can consume well over half of a person’s investment returns.

3. **Investment Returns**
   Net (i.e., after-fee) investment returns are among the most important drivers of retirement efficiency. In a value-for-money retirement arrangement, the large majority of your retirement should be derived from investment returns earned over time, rather than simply from the dollars contributed to the plan. Remember that preparing for retirement is a marathon, not a sprint.

4. **Tax & Government Benefits**
   The government provides very favourable tax treatment for retirement savings, through programs such as RRSPs and TFSAs. You also need to make the most of your Canada Pension Plan and Old Age Security, including accessing these programs at the right time and understanding how they interact with your private savings.

5. **Longevity Risk Management**
   It’s hard to save for something when you don’t know how much that thing will cost. Planning for a short retirement creates a risk that you will live longer than expected and run out of money, but planning for a very long retirement creates a danger of oversaving, missing out on opportunities you could enjoy today.

REFERENCES

5. A study by Robert Brown, former president of the International Actuarial Association, found that workplace retirement plans with collective features (e.g., lower fees, longevity risk pooling) generate 2.2 times as much retirement income for every dollar of contribution.
6. A recent report by a former head of research for the Australian pensions regulator cited that “inefficient, profit-seeking operations, with excessive choices, high indirect costs, and conflicted governance” cost retail pension plan members AUD $1 million (roughly $900,000 Canadian) on average. This shows that there is a significant difference in efficiency between for-profit retirement plans and industry plans with a non-profit governance structure.

REFERENCES

The characteristics of well-run, collective retirement plans:

Automated Approaches to Savings
Automated approaches to savings, including mandatory contributions, default contribution rates, and behavioural nudges such as “auto-escalation,” which increases members’ contribution rates over time to increase saving, help to overcome the human tendency to “save later” and inconsistently.

Economies of Scale
Collective retirement plans use economies of scale to drive lower costs for members, taking advantage of their bulk purchasing power to access investment and administrative services at a lower cost.

“Profit-for-Members” Structure
Many collective retirement plans have a “profit-for-members” structure, rather than a “profit-for-shareholders” structure. This creates both an obligation and an incentive to serve the best interests of plan members. Retirement expert and Director Emeritus of the Rotman International Centre for Pension Management, Keith Ambachtsheer, has estimated that this type of governance structure where plan members’ interests are put first, if combined with the right expertise, can add 1-2% of extra retirement income value per year for plan members.⁸

Pooled Longevity Risk
Collective retirement arrangements can pool longevity risk across a group, so that the risk of outliving one’s money is shared. Our research with HOOPP and the National Institute on Ageing found that risk pooling was the single biggest driver of the greater efficiency of collective retirement arrangements relative to individual approaches, accounting for about 45% of the efficiency advantage.⁹

Opportunities to create value for money in retirement savings

<table>
<thead>
<tr>
<th>Retirement Value Drivers</th>
<th>Potential lifetime value in a case example of a physician earning $200K¹⁰</th>
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<tbody>
<tr>
<td>Lower fees</td>
<td>$1,500,000+</td>
</tr>
<tr>
<td>Saving earlier</td>
<td>$800,000+</td>
</tr>
<tr>
<td>Avoiding common investment mistakes</td>
<td>$800,000+</td>
</tr>
</tbody>
</table>

¹⁰ See Ambachtsheer, Capelle & Lum, “Pension Fund Governance Today: Strengths, Weaknesses, and Opportunities for Improvement” (International Centre for Pension Management, 2006).


A good collective retirement plan can provide 2 to 4 times more “bang for the buck” than a typical individual approach.
MAKE your money work harder than you do

Achieving value for money in retirement planning can make a huge impact over a lifetime. Starting to save early is always the best, but there are other ways to get more bang for your buck. Avoiding investment mistakes and understanding how investment management fees work can be significant drivers when it comes to being and feeling retirement ready.

The impact of fees.

The difference between paying average fees and low fees for investment management and plan administration could cost over $1.5 million in retirement income in a case example of a physician earning $200,000 before tax and after expenses. As illustrated below, the physician paying low fees ends up with over $800,000 more than the physician paying average fees by age 70, and over $1.5 million more by age 85.

Illustrative example: 11

• Physician with earnings of $200K before tax and after expenses
• Saves 15% of earnings from age 34-65
• Works part time from age 66-69 before fully retiring, and retires at age 70 12
• In retirement, draws down enough from their account to replace 60% of their pre-retirement earnings13
• Gross returns of 5% per year14

<table>
<thead>
<tr>
<th>LOW FEES</th>
<th>AVERAGE FEES</th>
<th>DIFFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee structure</td>
<td>0.6% of assets plus $120 per year (similar to the cost of a large pension plan)15</td>
<td>2.1% of assets (the cost of an average Canadian mutual fund)16</td>
</tr>
<tr>
<td>Projected nest egg size at age 70</td>
<td>$3,028,587</td>
<td>$2,187,063</td>
</tr>
<tr>
<td>Projected retirement assets left at age 85</td>
<td>$1,527,270</td>
<td>$0 (money runs out at approx. age 83)</td>
</tr>
<tr>
<td>Projected retirement assets left at age 90</td>
<td>$509,683</td>
<td>$0 (money runs out approx. age 83)</td>
</tr>
</tbody>
</table>

11 These numbers are for illustrative purposes only and are based on a limited number of assumptions as stated. Other assumptions include the following: 1) Physician defers CPP until age 70; 2) Does not receive OAS; 3) 2% annual inflation; 4) Annual earnings growth without any other earnings increase/increase that physician can save a portion of; 5) Annual contributions are made regularly throughout the year.
12 Data from the Ontario Medical Association indicates that the median physician retirement age is 69.
13 The 60% replacement ratio is calculated based on a replacement ratio of 66% of the user’s pre-tax, pre retirement income. The 5% figure is based on a study that economist Keith Horner conducted for the federal government, which found that higher-income individuals such as physicians require a lower replacement rate than the oft-cited 70% figure. While this study recommended a slightly lower replacement ratio of 53% for higher-income Canadians, it did not factor in out-of-pocket health care costs such as home care and long-term care, so for conservatism we assume a slightly higher number. See Keith Horner, “Retirement Saving by Canadian Households” (Finance Canada, Report of the Research Working Group on Retirement Income Adequacy, December 2009).
15 The mutual fund’s industry association reports that the average total cost of ownership for actively managed mutual funds in Canada is 2.14%. See Investment Funds Institute of Canada, “Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios” (2017).
Saving earlier.

Through the study of behavioural finance which explores how people make financial decisions, we have learned that most of us tend to put off saving for the future.\textsuperscript{17}

While it might be hard to see the effects of such a delay at the time, deferring retirement savings can cost you a great deal. In the example below, starting to save six years earlier – at age 34 rather than age 40 – means a difference of over $800,000 by age 85.

For example, if you subtract the additional $189,000 the earlier saver contributes to their retirement plan, this is still a difference of nearly $695,000 of retirement income for no additional cost.

Illustrative example: \textsuperscript{18}

- Physician with earnings of $200K before tax and after expenses
- Saves 15% of earnings from the beginning of savings until age 65
- Works part time from age 66-69 before fully retiring, and retires at age 70
- In retirement, draws down enough from their account to replace 60% of their pre-retirement earnings
- Gross returns of 5% per year
- Fees of 1% of assets

<table>
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<tr>
<th>Starts saving at</th>
<th>Total contributions</th>
<th>Projected nest egg size at age 70</th>
<th>Projected retirement assets left at age 85</th>
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<tr>
<td>Age 34</td>
<td>$1,326,811</td>
<td>$2,780,612</td>
<td>$884,003 (plus approx. 2 years of retirement income)</td>
</tr>
<tr>
<td>Age 40</td>
<td>$1,137,567</td>
<td>$2,095,529</td>
<td>$0 (money runs out at age 83)</td>
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\textbf{DIFFERENCE} 6 years

Avoiding common investment mistakes is another way that a physician can achieve greater retirement value for money. Such mistakes can consist of inappropriate asset allocation, attempting to time the market, and making suboptimal fund or stock selection decisions.

One way to measure the impact of such investment mistakes is to compare the performance of investment funds to that of the individual investors whose money is invested in those funds, taking into account factors such as the timing of when investors bought and sold funds. A recent study by Morningstar examined just this over a five-year period from 2011 to 2016.\textsuperscript{19} The study found that the average mutual fund investor underperformed the funds they were invested in by 1.09% per year. One reason for this was “performance chasing”: the tendency of investors to purchase funds that have performed well in recent years, even though recent outperformance is often an indicator of future underperformance. The example below illustrates the powerful impact of avoiding common mistakes. Note that, in this scenario, the mistake-avoiding physician is not “beating the market.” The returns are generally tracking the market, but this individual is avoiding the kind of mistakes that cause many investors to underperform the market. Not committing these mistakes can create $884,000 in additional retirement assets plus approximately two years of retirement income by age 85.

Illustrative example: \textsuperscript{20}

- Physician with earnings of $200K before tax and after expenses
- Starting at age 34, saves 15% of earnings from the beginning of savings until age 65
- Works part time from age 66-69 before fully retiring, and retires at age 70
- In retirement, draws down enough from their account to replace 60% of their pre-retirement earnings
- Gross returns of 5% per year
- Fees of 1% of assets

Assumes common investment mistakes reduce returns by 1% per year (slightly less than the Morningstar study cited above)

<table>
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<tr>
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<th>MAKES COMMON INVESTMENT MISTAKES</th>
<th>DIFFERENCE</th>
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You probably have QUESTIONS

This is your retirement plan, and you need to feel comfortable with it. So if you have any questions, feel free to reach out to us at retire@omainsurance.com.

Visit the Advantages Retirement Plan™ website to calculate your retirement readiness and pre-register for the plan at www.omainsurance.com/retire.