Simple Ideas to Boost Your Savings Plan

Talbot Stevens

Compliments of

Advisor Name

BA, CFP, RFP

ABC Financial Inc.

The Key to Your Success

The key to success in any area, including finances, is not what you know, it's what you do.

In my financial workshops, I point out that it's actually worse to know how to benefit, and not act on it, than to not be aware at all. If you know of an idea that can benefit you, and you choose not to act on it, there's only one person to blame ... your spouse!

Thus, the **key barrier to financial success is our behaviour**, both as a consumer and an investor. I offer the following simple ideas to help investors get closer to their retirement goals in a behaviourally effective manner - easily, automatically, and without any future thought or effort. Taking a few minutes to make a small change to how you save can produce a meaningful increase in your retirement fund.

Pay Yourself First (PYF)

Without question, the most valuable three words in all of financial planning are to "pay yourself first", now conveniently compressed to the three letter acronym PYF. To have a retirement that you can enjoy and feel secure about, you know you need to save, and you want to do it in the most painless way possible.

You've probably heard of the concept. You probably already understand that **paying yourself first by automatically investing 10% of your income is the simplest and most effective way to save** for retirement. Setting up a Pre-Authorized Contribution (PAC) plan to move funds from your chequing account into an RRSP or TFSA ensures that you save and benefit automatically. You probably also know that even small amounts invested monthly compound to a significant nest egg at retirement.

P.S. If you've made the financial mistake of having children, make sure your kids know about the benefits of establishing the PYF habit. It might be the most valuable (financial) thing you do for them.

A Better PYF Approach

Kim, who earns $50,000 a year, was investing using an "ad hoc" savings approach, where she invested whatever was available in the last few weeks of "RRSP season". Sometimes, if the winter was really cold that year, the money for Kim's RRSP contribution was diverted to a trip to the Caribbean instead.

Acknowledging that an "automatic savings" approach is easier and more effective for building the retirement fund she wanted, Kim started a PYF plan, investing 10% of her income each month, or $5,000 a year.

This worked great at the start, achieving her savings goals easily and automatically. However, a number of years later when Kim's income had grown to $60,000 through cost-of-living increases and a promotion, she was no longer saving 10% of her income. Without realizing it, the amount she was saving had fallen behind her intended commitment. She was still saving $5,000 a year, but her PYF 10% plan meant she should have been saving $6,000.

To maintain Kim's initial intention of saving 10% of her income, she needs to increase her savings as her income changes. Adjusting her savings plan could be done in an "ad hoc" way — where Kim must remember to, and take the time to implement changes as appropriate — but this approach is cumbersome at best.

A behaviourally more effective approach — where a simple, one-time decision automatically produces a long-term benefit without any additional thought or effort — is to **inflate your PYF plan to automatically increase each year.**

Default to Benefit Automatically

The minimum wage in each province is adjusted periodically to stay in line with inflation. Government benefits, like Old Age Security, are indexed with inflation to maintain seniors' purchasing power. Even our tax brackets are now indexed with inflation each year to avoid bracket creep. By default, your savings plan should increase to keep up with inflation too.

Since the inflation rate in Canada has averaged about 2.0% over the last two decades, it **makes sense to inflate your PYF plan by at least 2% each year, by default.** Anything less is falling behind. But even this tiny change to your PYF plan adds up over time.

> **Example:** Recognizing that her savings had fallen below 10% of her current $60,000 income, Kim immediately adjusted her PYF deposits to $6,000 a year. If her funds grow at 6%, 20 years later she would have $228,000. However, by increasing her contributions each year by 2% to automatically keep up with inflation, she would end up with about $267,000 — an extra $39,000, or 17% more.

If you have a group RRSP at work, and contribute a percentage of your income, the amount saved increases automatically as your income rises. But sadly, there hasn't been a way for individuals saving on their own to automatically have their contributions increase over time — until now.

Note that if your group RRSP contribution is a fixed amount and not a portion of your income, you or your advisor will need to manually inflate your savings each year to get the benefits.

> **Note:** The impact of inflating becomes more significant when investment returns are lower, as more of your retirement fund comes from what you contribute, and less from growth. This makes the decision to inflate more important for fixed-income investors, and even equity investors if future returns are lower than normal.

Commit to Benefit More

Fortunately, as you gain both experience and skills, promotions and job changes generally increase your income more than inflation. For most people, this means that increasing PYF contributions by only 2% each year won't maintain their initial savings commitment, and might not be the rate of increase that is most effective for their goals.

If your career path should result in your income growing faster than inflation, or you're behind in your retirement savings — because you're saving less than 10% of your income, started saving later, or due to poor market returns — you can **automatically get closer to your retirement goals by inflating your PYF plan by more than 2%.**

Example: If Kim increases her PYF plan by 5% instead of 2%, her retirement fund will be $343,000. This is a 50% increase and $115,000 more than she would have without inflating. In terms Kim can relate to, the *extra* $115,000 covers over 30 years of Caribbean getaways in retirement.

Before you decide on what inflating rate makes the most sense for you, have your advisor compare a few possibilities and note that increasing at 5% is an almost negligible difference beyond a commitment to keep pace with 2% inflation.

As we see here, even small, gradual changes over time can compound to big increases in your retirement fund, and thus retirement lifestyle.

The (Almost) Painless PYF Plan

Let's say that you want to lose some weight and get closer to having 6-pack abs by doing sit-ups. Noting that you haven't done any sit-ups since your high school gym class, which approach are you more likely to start: going from zero to 200 sit-ups a day, or starting with 20 per day for a while and then gradually increasing to 30, 50, 80, and eventually 200? Most of us will find the start-small-and-increase-slowly approach less intimidating, making it more likely that we start. Which approach are you more likely to stick to, and thus realize the long-term benefits?

For those who have not yet ACTed on the most valuable 3 letters in financial planning — PYF — perhaps because you think that saving 10% of your income would be too much of a strain, try this approach. Instead of PYF 10%, which means living on 90% of your income when you're used to 100%, save using a Painless PYF approach, where you initially invest only 5% of your income, and increase by 10% each year.

With the "PYF 5% and inflate 10%" plan, getting started is easy — almost painless, and the habit of saving automatically builds slowly over time. This approach starts off with a very modest savings commitment, and still generally produces a larger retirement fund than the conventional PYF 10% approach.

Note: Many economists predict that governments will resort to higher inflation rates to deal with the unsustainable global debt levels. This is another reason to increase at a higher rate than the 20-year average of 2.0% inflation.

It's Easier Than You Think

One of the big behavioural barriers to saving for retirement is that if the task seems too difficult in any way — too complicated, too much effort, or too much of a sacrifice — many people throw up their hands in discouragement and don't even try, thinking that it's not possible for them to succeed. An important additional benefit of appropriately including inflating in your PYF plan is the realization that **funding your retirement doesn't require saving as much of your income as we previously thought** based on assumptions that ignored inflated deposits.

In most cases, saving 8% of income and increasing deposits by 3% produces a larger retirement fund than the conventional guideline to PYF 10%, but is less intimidating and easier to commit to.

For everyone's benefit, perhaps the old mantra of "Pay Yourself First 10%" should be upgraded to the easier approach of "Pay Yourself First 8% and inflate 3%".

Action Plan Checklist

Remember that on its own, knowing how to read a map won't help you. You must follow it to get to your goal.

Check off each idea that you are currently ACTing on, and benefiting from. Either ACT on the other ideas right away, or add them to your calendar as an "A" priority. Check them off later, after you ACT on them. It feels good.

Action Plan Checklist

- ❑ Pay Yourself First 10% of your income, or easier: Pay Yourself First 8% and inflate deposits by 3%.
- ❑ If you already PYF, and haven't increased your contributions in a few years, immediately increase them to reflect your initial commitment level.
- ❑ Increase your PYF plan at least 2% each year, to keep up with inflation.
- ❑ Choose to inflate at a faster 5% rate, especially if you're saving less than 10% or are behind in your retirement savings.
- ❑ If needed, use the Painless PYF approach: PYF 5% and inflate 10%.

Next Steps

To understand which inflating approach is best to simply and automatically boost your savings plan, see your trusted financial advisor.

COMPLIMENTS OF

Advisor Name

ABC Financial Inc.

advisor@ABCFinancial.com

123-456-7890

"Help a Friend"

If you found this information valuable, please ***"Help a Friend"*** and share these ideas with those you care about.

Talbot Stevens is a financial educator, author, and industry consultant. To learn about other educational resources including seminars, pamphlets, booklets, books, analysis software, and more, visit www.TalbotStevens.com.