

## CHAPTER ONE

# My Quest for a Solution



*When you fail to plan, you plan to fail.*

—Rev. Dr. Robert Schuller

In the spring of 1987, my parents made a decision. Their house was paid for, they had good jobs, but they were missing out on the terrific gains being made in the stock market. Friends and co-workers were telling them how easy it was to make money with mutual funds. They feared they were being left behind.

My parents discussed it very seriously, finally calling my sister and me into the living room to tell us the big news. They somberly explained to a very young Melissa and Andrew that they were in their mid-forties, had no pension plan, and that if they didn't do something soon, it would be too late.

By the fall of 1987, it was evident to both my sister and me that something was wrong in the Springett household. My parents, nice people who'd never read the business section in their lives, were suddenly poring over stock tables on a daily basis. The atmosphere during these reading sessions became more intense with each passing day. My father started to have trouble sleeping, and by early November, we became used to hearing the TV being turned on in the small hours of the night. Soon it was time for another family meeting.

The meeting started and ended quickly. "We can't afford to lose any more money," my father said without preamble. "If we sell the mutual funds now, we can afford to make the mortgage payments. If they go down anymore, we'll have to sell the house."

After that articulate explanation, my father proceeded to pick up the phone and give the instructions required to keep a roof over our heads.

After the family meeting was over, I cornered my mother. She was obviously upset, but like any mother, she had trouble putting off a son asking well-intentioned questions. The details of our situation quickly emerged. The mutual fund salesperson my parents had been referred to thought we had too much equity in the house. He'd explained the considerable tax advantages of borrowing against the house to fund a retirement plan and had put together a strategy for my parents whereby they'd borrow against the full value of the house to buy mutual funds. The payments on our new mortgage would come from the earnings produced by the mutual funds.

The plan was simple and it worked well for a few months. Then the markets dropped, dragging with them the value of many mutual funds. Within a month of the crash, my parents had to make a choice: sell the mutual funds and begin making payments on a new mortgage at the tender age of forty-two or hold on and risk having to sell the house if the markets declined further. They chose the former.

A one-income family with two teenagers had mortgage payments to make once again. Like millions of other Canadians, my parents managed, but sacrifices had to be made. The retirement plan, such a cause of excitement a few short months earlier, was the first casualty of the new mortgage. A second casualty quickly emerged in the form of university tuition for my sister and me.

This experience affected my life and direction in a profound way. My parents are smart people; they look both ways before crossing the street. How could this have happened to them?

I've dedicated the majority of my professional life to understanding what happened to my family and to helping families avoid this and the myriad other financial pitfalls that exist in Canada. Now, years later, I understand how these events transpired and how they could have been avoided, as well as how

things should have turned out. I'd like to show you the proper way to achieve that which eluded my parents: a secure pension.

Historically, most people fail to meet their investment goals. Actually, only about 11% of individuals manage to achieve the objectives of their investment program. On the other hand, large investors, such as pension funds, manage to meet their investment goals about 90% of the time. That's a huge difference!

My parents failed to meet their financial goals, and in spectacular fashion I might add, but they're not alone. Literally millions of Canadians have had or will have the same experience. It's a sorry state of affairs, made even worse because it's entirely preventable. Thus began my quest to understand why pension plans have more than eight times the success rate of individuals.

What I uncovered during the course of my investigation surprised me. Pensions are managed by regular people, not brain surgeons or rocket scientists. Pension managers don't spend all day glued to investment reports or reading research on stocks. What is it, then, that they do? Pension managers follow a simple but disciplined process. That's it. They don't work to reinvent the wheel. The managers of the greatest Canadian pension funds simply know what works and that's what they do.

So why didn't my parents succeed?

When my parents borrowed against their home to buy mutual funds, that's what they got. Not a pension plan, but a portfolio of mutual funds.

Think of the people you know who have a strong secure pension plan, perhaps a teacher, or a friend or relative who chose to serve our great country through public service. Do they ever worry about their pension suddenly disappearing? I don't think they do. They may not be wealthy when they retire, but they don't lose too many nights' sleep either. That, in a nutshell, is the great benefit of a sound pension plan: peace of mind. People who have a good pension in place don't worry about what the stock market is doing and they don't check their statements every month. In fact, I'd bet that the vast majority don't even know the liquidation

value of their pensions. They don't care. All they know—all they need to know—is that as long as their contributions are made every year, they'll be well taken care of when that magical retirement day finally comes. Every plan is different, but for the most part, the beneficiaries of these plans can count on 60% to 70% of their income to continue for the rest of their lives. I choose to refer to these fantastic vehicles as “the great pension plans.”

Now I'm not suggesting that you should consider a career change. I just want to make a point: for many people, a good pension plan can bring peace of mind. I think we all deserve the simplicity, peace, and security that a good pension can supply. In this book, I'm going to show you how to create your own personal pension plan. Perhaps just as important, I'm going to show you how to integrate your financial values, priorities, and goals into that pension plan. If you're willing to invest a few hours to read this book and two or three hours per year after that, you can have a pension plan built just for you and your peace of mind. Your own private pension will also offer you unparalleled flexibility.

What do flexibility, peace of mind, and security add up to? In a word: freedom. The freedom to do the work that ignites your passions; the freedom to retire a little earlier, or perhaps a lot earlier, than you ever thought possible. Freedom is all about working by choice, not out of necessity.

### **Summary**

- Most Canadians desire a secure pension to provide security for their family; they just don't want to know about the details.
- Behaviour is an important component of any investment plan. Bad investor behaviour can be more dangerous than bad investments.
- Financial mistakes can have devastating and unexpected effects on family life.
- Being educated doesn't protect you from costly investment mistakes. Intelligent well-educated people make potentially

devastating investment decisions every day in Canada.

Historically, most people fail to meet their investment goals.

- Only 11% of individuals manage to achieve their objectives, while large investors, such as pension funds, successfully meet their investment goals about 90% of the time.
- Pension funds are managed by regular people who follow simple but disciplined procedures. They know what works and that's what they do.
- In a nutshell, the great benefit of a sound pension plan is peace of mind.
- The beneficiaries of the best pension plans are typically free from financial worry. They can count on 60% to 70% of their employment income to continue for the rest of their lives. I choose to refer to these fantastic vehicles as "the great pension plans."
- In this book, I'm going to show you how, in just two or three hours per year, you can build and manage your own personal pension plan. Your own pension will offer you flexibility, peace of mind, and security—or, in a word, freedom.



## CHAPTER TWO

# What Is a Pension Plan?



*Waste neither time nor money, but make the best use of both.*  
—Benjamin Franklin

A pension is a lifetime payment commencing after retirement that lasts until the death of the beneficiary or their spouse. The pension plan itself is nothing more than the mechanism for managing the pool of money required to make good on promised payments.

Public pensions have existed since the eleventh century, originally introduced in China under Emperor Wang An-shih. Life expectancy wasn't very long, so these plans were, and for that matter still are, very simple. Either the company or the worker would contribute a portion of wages to the government every month. In exchange, the government agreed to pay the worker a fixed amount each month once the person was too old to continue working.

The essence of this type of plan is very basic. Money is being loaned to the government; the government has the use of this money for its own purposes. At the time of the pension owner's retirement, the money is repaid in small monthly payments. In this type of pension plan, there's no common pool of money. In fact, there's no separate pension money at all! The government simply adds the contributions to its treasury and uses them as it sees fit. When the time comes to make a pension payment, it simply takes that money out of the current treasury.

Why the history lesson? It's important to differentiate between a government pension and a pension plan. In today's

vernacular, there's a tendency for people to view these two distinct entities as the same. In a government pension scheme, there's no planning and no plan. Money contributed today, by a company or person, is used by the government today to meet current government obligations. Future pension payments are treated as current obligations of the government at the time they're paid.

Private pension plans, on the other hand, are relatively new. In 1874, the Grand Trunk Railway became the first Canadian company to offer a private pension plan to its employees. In 1875, the American Express Company followed suit, becoming the first American company with a private pension plan.

Private pension plans differ from public pensions in one very notable way: private plans pool the contributions made by employers and employees. This pool of money is put to work on behalf of its future beneficiaries. Since this pool of money is growing and compounding, the contributions required are significantly less than those required by a public plan.

Earlier, when I used the examples of a teacher and a government employee, I didn't highlight that the teacher belongs to a private pension plan, while the government employee is simply entitled to receive a pension payment from the government's regular budget. There was a reason for this. The main benefits to both types of plans are the same: peace of mind, simplicity, and security. Both government pensions and private pension plans deliver the same things to those fortunate enough to own them. How they go about delivering them is the only real difference. The government pension makes its pension payments from the regular budget of that government. The private pension plan, however, makes its pension payments from the earnings it's generating. Since the contributions made to a private pension plan are working for its members, the amount of contributions or savings required is significantly lower.

While there recently have been several rather public instances of private pension funds being unable to meet their obligations, it is important to note that in these cases the fault lies with compa-

nies failing to make the agreed-upon contributions, not with the investment returns of the private pension plans.

I'm sure you're familiar with many examples of great private pension plans. Teachers have great plans, as do federal, provincial, and municipal government workers, bank employees, tradespeople, and most unionized employees. The point I want to drive home is that these plans all have one thing in common, one underlying reason why they're so effective. I'll give you a hint: it's not that these plans are kept afloat with huge financial contributions; employers simply lack the will and the financial resources for huge contributions. The one thing all private pension plans have in common is that they make the pension money work for them. Actually, they work this money to the bone. Money in and of itself is neither good nor evil; money is neither safety nor comfort, and it certainly can't buy love. Money is what money does. I can't state it any more simply than that. Money is simply a tool to deliver those things we find important for ourselves and our families, such as security and peace of mind. If you think I just contradicted myself, then I politely suggest you reread this paragraph because you've missed the point. Private pension funds simply use contributed money as the tool it is. They use this tool to build a bright, secure, and comfortable future for their owners, and from the owners' perspectives, they do it in the simplest way possible. The members of the plan make their contribution, and when they're ready to retire, they receive a safe and steady income that increases with inflation for the rest of their lives.

Unfortunately, most private pension plans are designed for people who earn average amounts of money. If you earn an above-average living and want to continue that lifestyle into retirement, or if you're not fortunate enough to belong to one of the "great pension plans," then it's time to put together one of your own.

The purpose of this book is not to concentrate on what these great pension plans do, but rather to concentrate on how they do it. There are over three thousand private defined-benefit pension

plans in North America. Three thousand private pension plans and they're all managed the same way, although the exact technique can vary a little from plan to plan. Laws can differ, some plans are new and don't have any retired members yet, and some have an older membership, but the management strategy never wavers. The basic tenets that cover the teachers' plan are the same as those that govern the bank employees' plan or the cops' plan or the plan that belongs to the nice man who fixed your broken pipe last year. The one thing that all private pension plans have in common is, simply put, a plan. And the name of that plan is the same for all three thousand or so pensions out there. It's called modern portfolio theory.

### Summary

- A pension is a lifetime payment, commencing after retirement, that lasts until the death of the beneficiary or their spouse.
- The pension plan itself is nothing more than the mechanism for managing the pool of money required to make good on the promised payments.
- Public pensions have existed since the eleventh century. Either the company or the worker would contribute a portion of wages to the government every month. In exchange, the government agreed to pay a fixed amount each month once the person was too old to continue working.
- It's important to differentiate between a government pension and a private pension plan. In a government pension scheme, there's no planning and no plan. Private plans pool the contributions made by employers and employees.
- Private pension plans put the pool of contributions to work on behalf of future beneficiaries. Since the pool of money is growing and compounding, the contributions required are significantly less than those required by a public plan.
- All private pension funds have in common is the fact that they make the pension money work for them.
- Most private pension plans are designed for people who earn

average amounts of money. If you earn more than that, or if you're not fortunate enough to belong to a pension plan, then it's time to put together one of your own.

- All private pensions are based on the tenets of modern portfolio theory.