Fondation pour la recherche FP Canada™/MC Research Foundation

CPP/QPP Timing Decisions

- Executive Summary

July 2021

Research conducted by:

NATIONAL INSTITUTE ON AGEING

Research into timing decisions for the Canada and Quebec Pension Plans (CPP/QPP) was carried out to help Canadians and their advisors think objectively about their approach to retirement income planning based on evidence. The research was conducted by Dr. Bonnie-Jeanne MacDonald, PhD FCIA FSA, Director of Financial Security at the National Institute on Ageing at Ryerson University and funded by FP Canada Research Foundation. While we refer to CPP throughout these practice notes, the guidance is generally relevant for both CPP and QPP decision making.

The research shows that delaying CPP benefits for as long as possible is the safest, most inexpensive approach to get secure retirement income that lasts for life and keeps up with inflation. Yet 95% of Canadians claim their CPP benefits by age 65.

The research finds that, from the actuarial age-adjustment factors alone, a Canadian with the median CPP income and average life expectancy is losing out on over $100,000 worth of secure lifetime income, in current dollars, by taking CPP benefits at age 60 rather than age 70.

Here is how the math works out:

A 60-year-old who takes CPP immediately can expect to receive annual payments of $6,773 starting at age 60 for their life expectancy – 25.9 years for males or 28.5 years for females – or a total of $175,400 in current dollars (males) and $193,000 (females).

The same 60-year-old who decides to delay CPP benefits to age 70 can expect to receive annual payments of $16,726 for their life expectancy – 15.9 years (males) and 18.5 years (females) – or a total of $265,900 in current dollars (males) and $309,400 (females).

Therefore, the Lifetime Loss from taking CPP at age 60 is as follows:

- **For men:**
  $265,900 (CPP at age 70) - $175,400 (CPP at age 60) = $90,500
- **For women:**
  $309,400 (CPP at age 70) - $193,000 (CPP at age 60) = $116,400

Average Lifetime Loss: $103,500

Put another way, delaying benefits can provide over 50% more lifetime income over the course of retirement ($90,500/$175,400 = 52% for men, and $116,400/$193,000 = 60% for women).

Further, an average female Canadian retiring in 2020 with the maximum CPP benefit can expect to lose $155,000 in lifetime income by taking CPP at age 60 in 2020, rather than at age 70 in 2030 (in current dollars). If she falls into the category of better longevity, there is a 25% risk that she will be giving up nearly $300,000 of secure lifetime income (in current dollars) by taking CPP benefits at age 60 versus age 70.

As financial planners, you have a key role in providing advice to help retiring Canadians decide when to begin to receive CPP – a ***critical*** retirement decision that may affect your clients' financial well-being for the rest of their lives. Improving the quality of the claiming age decision is the single most effective tool to directly improve the long-term financial security of Canada's ageing population.

Background

Therefore, the Lifetime Loss from taking CPP at age 60 is as follows:

- A clear trend away from collective workplace pension plans that Canadians can rely on for predictable and secure income;
- A low interest rate environment creating relative low investment returns on savings;
- Uncertainty in financial markets;
- Out of pocket costs of retirement are going up (including transportation, daily care, meal preparation, support services) as family who traditionally support the elderly are fewer in number and often more geographically dispersed than in earlier years; and
- Life expectancy is at a historical high creating a longer time horizon to be financed.

Challenges with Current Advisory Approach

Those in a position to provide advice to Canadians on the choice to delay CPP almost universally encourage early take-up, often by taking an approach that urges people to essentially take a gamble on their life expectancy. The common approach is to use a break-even analysis to calculate the age when the cumulative benefits of taking CPP later exceed those of taking CPP earlier and then using statements like "you'll be ahead financially if you take CPP at age 60 and don't live past age 80".

> Advisors should be aware that the research and evidence are clear: a break-even approach is powerfully misleading and (inadvertently or not) forcefully promotes early claiming behavior.

1. **The value of delaying CPP is greatly misunderstood:** Delaying CPP effectively increases pension levels beyond the statutory amounts (.6% reduction each month between age 60 and 65 (or 36% over five years) and .7% increase each month between age 65 and 70 (or 42% over five years). The actual financial incentives of delaying benefits are often higher due to the role of national wage growth, which generally exceeds inflation, in determining benefit levels. Between 2012 and 2019, for example, the average financial penalty for taking CPP at age 60 versus age 65 grew from 36.0% to 38.8%, and the incentive to delay to age 70 increased from 42.0% to 45.4%.
2. **Taking CPP early typically means giving up a significant level of secure income:** Canadians receiving the median CPP income who choose to take benefits at age 60 rather than age 70 are forfeiting over $100,000 (in current dollars) worth of secure lifetime income. From a lifetime perspective, the total amount of CPP income that an average Canadian will receive over the course of their retirement is over 50% greater by delaying CPP from age 60 to age 70.
3. **Delaying by even a single year, from age 60 to 61 delivers high value:** Based on the official age-adjustment factors alone, a one-year delay is equivalent to investing a single year's CPP benefit at age 60 and getting lifetime pension income of 11.25% of that initial investment, indexed by inflation year after year. A guaranteed risk-free return of 11.25%/year is hard to beat by investing it yourself!
4. **People tend to underestimate how long they will live:** Life expectancy statistics are routinely reported for the year a person is born (80.7 for males and 85.6 for females in 2019). However, for Canadians who have lived long enough to retire, their life expectancy is quite a bit longer (at age 60, it is 85.9 for males and 88.5 for females as of 2019). However, no two Canadians are the same. Therefore, we should attempt to personalize the life expectancy statistics as much as possible. As well, we cannot ignore the constant improvements in mortality over time, based on lifestyle and improvements in medicine.
5. **CPP is arguably one of the most secure pension plans in the world:** Anecdotal commentary in popular media suggests there is an unfounded belief that CPP is not sustainable. This belief is likely fueled by the challenges facing the U.S.'s Social Security system, which is under substantial financial scrutiny. CPP, on the other hand, is proven to be sustainable based on a combination of a dedicated income stream from employers and employees and a globally diversified investment fund managed by the CPP Investment Board (CPPIB). For most Canadians, CPP is likely their most dependable source of income in retirement. A 2016 federal-provincial agreement was reached to enhance CPP benefits from 25% of the YMPE to 33% of a higher YMPE beginning in 2019 and phasing in over the next 6 years based on increased employer and employee contributions. This was a response to inadequate levels of individual savings, rather than a response to the sustainability of CPP benefits.

Deferring Does Not Benefit in All Cases

Of course, every client situation needs to be considered individually as deferring is not the best choice for all.

- **Those who cannot afford to wait to take CPP** - Without other income streams or savings to cover necessary living expenses, delaying CPP may not be a viable option.
- **Those who would face a reduction in pensionable earnings for having deferred CPP -** Some Canadians could face a reduction in their CPP benefits by deferring where they will have several years of low (or zero) earnings between age 60 and 65 and insufficient drop-out room.
- **Those facing shortened life expectancy.**
- **Those who already have sufficient lifetime secure retirement income -** Secure income enables Canadians to sustain their living standards into later life, despite the ups and downs of the financial market.
- **Those eligible for the GIS or other income tested benefits -** Canada's tax and transfer system features strong financial disincentives for low-income seniors to increase taxable income past age 65 – including CPP benefits, employment earnings, RRSP/ RRIF withdrawals and workplace pension benefits.
- **Those who are on the threshold of GIS phase out, OAS claw back or other income support reduction -** where income supports may be decreased due to income testing and approaches to manage reductions such as splitting RRIF and RPP income and CPP pension sharing to manage reductions are not available or sufficient.

Deferring Does Not Benefit in All Cases

- Those who make extra contributions without a corresponding increase their benefits;
- Those who continue working and accumulate CPP post-retirement benefits;
- Those receiving a CPP survivor pension. It is not true that individuals should take their own CPP retirement pension when it reaches an amount that when added to the CPP survivor pension equals the maximum.

In these cases, the specifics of each situation should be considered to inform CPP timing decisions.

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