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- Practice Notes

Approaches to Helping Clients with CPP Timing Decisions

This study, conducted by researchers Jodi Letkiewicz, Chris Robinson and Dale This section proposes four distinct perspectives to help Canadians better appreciate the value of augmenting risk-free lifetime retirement income by delaying CPP pension benefits where they can afford to.

Perspective #1

– Focus on the Short-Term (one year at a time)

The major value of delaying CPP retirement benefits is it delivers a secure source of income over a future of unknown length and protects against risky financial markets and other future risks. However, when it

comes to deciding when to take CPP, retirees often focus on short-term risks and return and lack concern over lifetime consumption. It can be difficult for Canadians to project into the future and contemplate all the potential risks to their retirement lifestyles, including possible changes in family composition (such as divorce or widowhood), the corrosive effects of inflation on fixed income purchasing power, and the possible impacts of deteriorating health on their lifestyle and consequently their income needs.

You can help your clients by suggesting they consider the decision one year at a time.

Each year, ask your retiring or retired clients the following questions:

- Do you need additional income this year?
- Do you have other savings to draw on to bridge an income gap, such as RRSP or TFSA savings?
- Do you feel confident that you can achieve more than a 11.25% annual return on the CPP income if taken early?
- What does the prospect of secure income in retirement mean to you?

Over the span of retirement, much can change. The Covid-19 pandemic provides a strong reminder of the value of secure income when financial markets and health impacts become increasingly uncertain.

This approach to focus on one year at a time responds to the natural psychological tendencies of people to think short term.

Perspective #2

– Delaying CPP is the equivalent of buying a defined benefit (DB) pension or annuity at a bargain price

This approach to explaining the value of delaying CPP can be powerful as it uses a “real-world” view that Canadians may relate to – that is, comparing delaying CPP to purchasing an annuity in the retail market.

Delaying CPP is like buying an annuity, but at a much better price.

As an example, using annuity price quotes as of October 6, 2020 (provided by CANNEX Financial Exchanges Limited), a 70-year-old man with registered savings of \$100,000 could purchase an annuity with indexing of 2% (for inflation) which would provide payments of approximately \$5,299/year. That compares to \$9,080 that a delay in CPP would deliver for an equivalent \$100,000 of premium – making it 71% more expensive to purchase a retail annuity that matches the additional payout stream that delaying CPP provides. For a woman, the retail annuity payments would be \$4,688, making it 94% more expensive.

This approach responds to the natural inclination of people to seek bargains or good value in their purchases.

Perspective #3

– Protecting your Future is Worth its Weight in Gold

Though hard to do at the time of retirement, it is critical to try to appreciate the “known unknowns” of the financial markets, future health needs, and future expenses based on lifestyle and longevity. Lacking secure pension income, the financial markets and longevity will together determine a person’s retirement wealth, lifestyle, and peace of mind. Unfortunately, both financial markets and longevity are very difficult to predict and can derail retirement financial well-being.

Financial Market Risk

The economic fallout of COVID-19 is a grim reminder of the risks of the financial markets. COVID-19 was declared a pandemic on the same day the stock market officially entered a bear market, with the S&P/TSX Composite Index falling 22% over the first quarter of 2020, hitting daily percentage drops that had not been seen in 30 years. Government of Canada bond rates also dropped to historic lows.

Older Canadians who are relying on their investments to support them through retirement are more vulnerable to financial markets than working-aged Canadians. Facing health issues or a lack of employment options, older Canadians simply do not have the human capital of younger Canadians. That is, they are not able to return to work to make up losses from market declines. As a result, the implications of market downturns can be long-lasting and even permanent.

If the goal is to securely increase lifelong income in retirement, then most Canadians with RRSP/RRIF savings are much better off using a portion of those savings early in retirement as a bridge to a delayed, but increased, CPP benefit, rather than stretching out their RRSP/RRIF withdrawals over retirement. The two strategies generate the same tax and GIS/OAS eligibility implications, and survivor benefits are unaffected. However, delaying CPP offers greater reward and minimal risk.

Longevity Risk

When it comes to life expectancy, the first reason for concern is, left to their own judgment, people tend to underestimate how long they might live. A survey by the Society of Actuaries found that 43% of retired respondents underestimated their life expectancy by at least five years (when comparing to the life expectancy for someone of their age and gender) (Perlman and Fauquier, 2020).

CPP's Promise Against Retirement's Financial Risks

The combination of CPP and OAS benefits provides a solid income base for Canadians as they age. They are the safest and most secure income sources that most retirees have. Because both provide income for life and automatically keep up with inflation, waiting to commence benefits means having higher, inflation-protected monthly income for as long as they live, protecting against the "known unknowns" of retirement financial planning.

It is also important to note that survivor benefits are unaffected by the CPP take-up decision – they are calculated based on the reference "age 65" retirement pension, and not when it actually begins.

The Value of Delaying on Protecting Clients' Legacies and Tax Position

Most Canadians will get more over their lifetimes from delaying CPP retirement benefits than they would by taking it early. If leaving an estate is a priority, the legacy is more likely to be higher by saving a portion of the income from a higher, delayed CPP benefit rather than taking it early and trying to hold onto existing savings. As well, unneeded income from higher CPP payments could be put into a TFSA account, and therefore not be subject to taxation on death.

If the priority is to have more savings available to the spouse in the case of an early death, then the better solution is to purchase life insurance with the higher CPP payments.

A further compelling advantage is that delaying protects the retiree as well as their intended heirs. Without the protection of secure income in later life, intended heirs may ultimately need to financially support their anticipated benefactor if financial markets are poor, the retiree lives longer than budgeted for and/or wealth is inadequately managed. When retirees outlive their savings, they often become dependent on their spouse and children, especially for helping with care needs and paying for services. Dependency is the opposite of a bequest.

An argument that is sometimes raised in support of earlier CPP benefit take-up is what is called "political risk", in that retiring Canadians fear that income tax rates will increase in the future, thereby triggering a heavier tax burden on any taxable income. If this is a concern, then it may be optimal to exhaust taxable income sources quicker than one would do if tax rates were assumed to be constant (in current dollars). This concern, however, does not change the thrust of the research paper. A deferred CPP benefit is most likely to deliver higher returns at lower risk than RRSP/RRIF savings, and therefore RRSP/RRIF withdrawals should be used as bridging income from both a pre-tax and after-tax perspective. If higher future income tax rates are a concern, the better approach is to smooth the drawdown of RRSPs/RRIFs by taking withdrawals earlier than required.

This approach responds to addressing future risks that are often difficult to contemplate at the point of retirement, but that are important to consider.

Perspective #4

– Help Your Future Self

As discussed in Perspective #1, the brain can struggle with rewards or risks that are too far in the future. People often lack a psychological connectedness to their future selves – and this connection declines the further into the future they go. As a result of this disconnect, encouraging people to financially help themselves in the future using messages of self-interest are not effective while people continue to think of their future self almost as another person.

This is particularly unfortunate since the “future self” of a retiring Canadian is also very likely a much more financially vulnerable self.

When retiring, it is not the initial foreseeable retirement years that create the most concern in terms of financial security. Of concern are the unknown later years when a person is more likely to experience financial shocks such as widowhood and/or the onset of a long-term health condition. Such events are unpredictable. Declines in cognitive abilities among the very elderly can impair their ability to make good financial decisions concerning their savings, allowing them to become victims of bad advice.

All of these vulnerabilities point to the importance and value of risk-free retirement income, particularly at advanced ages.

You can help your clients to contemplate their future selves by asking them to:

- Imagine their futures, and how possible future risks may impact their future selves.
- Consider how they can mitigate that risk to protect their future selves.
- Consider what happens if they delay CPP? What happens if they don't?

This approach addresses the natural challenges associated with envisioning ourselves in the future and empathizing with our future selves.

Other Advisory Approaches to Help your Clients make Informed Decisions

As QAFP and CFP professionals, you can also help your clients more effectively and prudently make this important decision by applying the following:

- Long lead times: Financial planners can protect Canadians by helping them to understand their options well before it becomes time to make this permanent decision. Research suggests that individuals may “become more impulsive as retirement draws near, so one obvious remedy to future retirees' potentially impulsive behavior is to urge them to start thinking about the retirement decision earlier.”
- Use Testimonials: People tend to be overly optimistic when it comes to the future. Unfortunately, reminding them of the things that can go wrong has been found to be ineffective on account of an attitude that bad things happen to other people, and the desire to avoid triggering negative emotions. Without using names or sharing confidential information, you can share your experiences with other clients who have experienced unexpected challenges later in life which was or would have been helped by having a higher secure income.

- Framing is critical: Currently, the adjustment factors are described using age 65 as the default age to receive CPP – with reductions (or losses) in benefits when take-up is before age 65 and increases (or gains) for take-up after age 65. In actual fact, however, this reference point is arbitrary. One simple approach to helping Canadians better contemplate the full 10-year menu of take-up retirement benefit choices is by simply moving the reference point to age 70, rather than age 65 (i.e., a 55% loss by taking CPP at 60 vs. 70 or 30% by taking CPP at 65 vs. 70).
- Avoid anchors: U.S. Social Security has major take-up spikes at age 62 (the “earliest age to claim”) and age 65 (the “normal retirement age”). Research suggests that these titles are “anchoring” Americans to these ages, giving them particular significance however arbitrary they are. The same appears to be true in Canada, where the spikes at ages 60 and 65 significantly dominate the other take-up ages. Service Canada currently frames the take-up decision around age 65, calling it the “standard age”. As well, some financial planning software defaults to age 65 as the “standard age”. Adjusting verbiage to avoid “specialness” to any particular age is one way to help to neutralize the decision.

In Conclusion

The majority of Canadians near or at retirement age do not understand that delaying the receipt of CPP increases the payment levels. Today’s retirees need to plan to live longer with fewer sources of predictable income and a good deal of uncertainty about the future. Knowledge is power. You are in a position to equip your clients with knowledge, help them to make sense of it and effectively weigh this critical timing decision that can affect their financial wellbeing for the rest of their lives.

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