THE CASE FOR DELAYING CPP

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Should your clients consider delaying their Canada Pension Plan (CPP) and/or Quebec Pension Plan (QPP) benefits?

Description of the CPP/QPP

The CPP/QPP[1] is a compulsory public insurance plan for individuals aged 18 and over who are working and have an annual income over $3,500. It offers basic financial protection during retirement, after death or in the event of disability. The CPP/QPP aims to replace 25% of the average income in retirement.

Starting January 1, 2019, CPP/QPP was enhanced, aiming to increase income replacement to 33.33% from 25%. This improvement, which is being implemented gradually, may provide future generations with better financial protection in retirement. For these individuals, their CPP/QPP will increase based on the number of years they contribute to a new supplementary plan. The full effect on benefits may be achieved in about 40 years. Individuals who do not contribute to the supplementary plan because they stopped working before January 1, 2019, are not affected by these changes.

Contributions

CPP/QPP is financed by contributions from workers and employers in Canada. For 2020, the contribution rate to the basic plan is 9.9% of income for CPP and 10.8% for QPP, shared equally between the employee and the employer. This rate applies to the portion of the employee's income between the general exemption of $3,500 and the maximum annual pensionable earnings on which an employee can contribute, which is $58,700 in 2020. The maximum CPP contribution in 2020 is $5,796, shared equally between the employer and employee ($6,292.80 for the QPP).[2]

The supplementary plan is also financed by contributions from employees and employers. For 2020, the contribution rate to the additional plan is 0.6%, shared equally between the employee and the employer. Contributions will gradually increase each year between 2019 to 2025.[3]

[1] The Quebec Pension Plan apply only to persons who work in Quebec.

[2] https://www.canada.ca/en/services/benefits/publicpensions/cpp/contributions.html; https://www.rrq.gouv.qc.ca/fr/programmes/regime_rentes/travail_cotisations/Pages/calcul_cotisations.aspx [3] https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-enhancement.html

Should your clients consider delaying their CPP/QPP or take it earlier?

Canadians can take CPP/QPP earlier than age 65 in exchange for a 0.6% reduction in benefits per month (7.2% per year). For example, if the expected CPP/QPP pension at age 65 is $1,000 a month, an individual taking CPP/QPP at age 63 would see a reduction of 14.4% in their benefits, and would instead receive $856 each month. We calculate this as follows: 24 months X 0.6%/month X $1,000 = $144 reduction/month

Alternatively, individuals can choose to defer CPP/QPP up to age 70 in order to receive an increase in benefits equivalent to 0.7% per month, or 8.4% per year. For example, if the expected CPP/QPP pension at age 65 was $1,000 a month, an individual who deferred CPP/QPP to age 68 would see an increase in benefits by 25.2%, and would receive $1,252/month (36 months x 0.7% X $1,000 = $252 increase/month).

Note that deferred CPP/QPP benefits are also wage-indexed during the deferral period, further increasing the benefits of deferral.

The table below illustrates the effect of delaying or taking CPP/QPP early:

Age at start	2020 onward entitlement	CPP 2020 maximum monthly entitlement	QPP 2020 maximum monthly entitlement	Notional "breakeven age "
60	-36.0%	$752.53	$753.47	> 73.9
61	-28.8%	$837.19	$838.24	> 74.9
62	-21.6%	$921.85	$923.00	> 75.9
63	-14.4%	$1,006.51	$1,007.77	> 76.9
64	-7.2%	$1,091.17	$1,092.53	> 77.9
65	0.0%	$1,175.83	$1,177.30	0
66	8.4%	$1,274.60	$1,276.19	77.9 <
67	16.8%	$1,373.37	$1,375.08	78.9 <
68	25.2%	$1,472.14	$1,473.98	79.9 <
69	33.6%	$1,570.91	$1,572.87	80.9 <
70	42.0%	$1,669.68	$1,671.77	81.9 <

Less than 5% of Canadians defer CPP/QPP payments past age 65, and fewer than 2% choose to delay until age 70.[4]

[4] The CPP Take-Up Decision, Risk and Opportunities, Canadian Institute of Actuaries and Society of Actuaries, July 2020.

Is that an optimal choice?

One popular financial planning strategy is to take-up CPP/QPP payments as early as possible. This approach is based on investor behaviour (would you loan money to someone interest-free for 14 years?) and on the fact that retirees often have more income needs early in retirement.

Another approach is based on the "breakeven" age. This is the age where the cumulative CPP/QPP payouts received from taking CPP/QPP early are equal to the cumulative benefits received when deferring. It is possible to mix other factors into the equation, such as marital status, ability to split/share income with the spouse or common-law partner, RRSP contribution room available, access to other sources of income, state of health, family longevity trends, and more.

A new study by the Canadian Institute of Actuaries (CIA), called The CPP Take-Up Decision[5], sheds light on the benefits and downsides of choosing to take-up CPP early or to defer.

The study analyzed workers retiring at age 65 with sufficient savings to delay CPP payments for five years, until age 70. The analysis found that, for the majority of Canadians with sufficient RRSP/RRIF savings to bridge the gap between age 65 and 70, the decision to delay CPP payments should depend almost exclusively on investment returns and life expectancy:

> "...from a cashflow and savings perspective, the CPP timing decision is unaffected by those considerations that are normally key to retirement financial planning – such as Guaranteed Income Supplement (GIS) benefits, taxes, pension income, other savings, or even the level of the CPP benefit itself. Mortality expectations and financial market returns are the only direct factors affecting the financial trade-offs in terms of cashflow and savings."[6]

To arrive at this conclusion, the study compares two financial strategies:

- Option #1: Delay CPP payments from age 65 to 70, using a portion of RRSP/RRIF savings (the bridging funds) to provide for withdrawals during that five-year period that exactly match the income that the CPP pension (adjusted for inflation) will provide when an individual takes it up at age 70.
- Option #2: Claim CPP payments at age 65 and self-manage the portion of RRSP/RRIF savings (that would have otherwise been used to bridge the five-year gap in Option #1) over retirement so as to achieve the same net annual income (as in Option #1) throughout retirement (maintaining that level until death or the exhaustion of the bridging funds).

[5] The CPP Take-Up Decision, Risk and Opportunities, Canadian Institute of Actuaries and Society of Actuaries, July 2020.
[6] The CPP Take-Up Decision, Risk and Opportunities, Canadian Institute of Actuaries and Society of Actuaries, July 2020, p. 5

Here are some of their findings[7]:

	Age				
	75	80	85	90	95
Financial Market Risk: Income Security	**Probability that Option #2 (CCP at 65) will deliver less income than Option #1 (CPP at 70) by Age**				
Net Rate of Return					
4%	0%	25%	97%	100%	100%
6%	2%	28%	58%	76%	85%
Financial Market Risk: Bridging Funds	**Expected Proportion of Bridging Funds Remaining for Option #2 (CPP at 65) bt Age**				
Net Rate of Return					
4%	41%	10%	0%	0%	0%
6%	60%	39%	25%	18%	15%
Financial Market Risk: Income Security	**Probability that Option #2 (CCP at 65) will deliver less income than Option #1 (CPP at 70) by Age**				
Female					
High Longevity	93%	85%	73%	55%	30%
Low Longevity	89%	80%	67%	49%	25%
All	90%	82%	69%	50%	26%
Male					
High Longevity	89%	79%	64%	42%	19%
Low Longevity	83%	71%	55%	35%	15%
All	86%	75%	59%	38%	17%

A net rate of return of 4% and 6% was used for the purpose of this study. The rate of return of 6% represents an "optimistic" rate of return. The Financial Planning Standards Council of Canada uses more moderate assumptions for typical portfolios: 2.65% for a conservative portfolio, 3.35% for a balanced and 4% for a growth portfolio.[8]

The table above shows that a male has a 59% probability of survival to age 85. Should he live until 85, having chosen to delay CPP to age 70, and having invested in a "growth" portfolio, there is a 97% probability that delaying CPP would result in more retirement income than taking CPP at age 65. Additionally, in this scenario, there is 0% chance that the bridging funds saved by taking CPP early would still be remaining at age 85.

For a woman surviving to age 90 (a woman has a 50% chance of living until that age), there is a 100% probability she'll receive more income in retirement by delaying CPP until age 70 than by taking it at age 65 (assuming that she invests in a "growth" portfolio). There is a 0% chance that the bridging funds saved by taking CPP early would still be remaining at age 90.

Another major advantage of delaying CPP payments is that it promises additional secure, lifetime income that increases each year alongside the price of consumer goods. This helps protect seniors against the financial risks associated with inflation, financial market returns, and longevity.

[7] The CPP Take-Up Decision, Risk and Opportunities, Canadian Institute of Actuaries and Society of Actuaries, July 2020, p. 25.
[8] 2020 Projection Assumption Guidelines, Financial Planning Standards Council of Canada, 2020, available at https://fpcanada.ca/docs/default-source/standards/2020-pag---english.pdf

Takeaways

In matters of financial planning, it's difficult to generalize advice. The diversity of individual circumstances and the complexity of the Canadian retirement income system makes it difficult for you to provide the same advice to all your Clients. There may be individual situations where taking CPP/QPP early might make more financial sense. That's why it's beneficial for individuals to work with an advisor who can develop a tailored income plan specific to their retirement needs.

However, with less than 5% of Canadians delaying CPP/QPP benefits past age 65, there's a significant disconnect between the behaviour of the majority of Canadians and the findings of the CIA study. In a low yield world where longevity is increasing, Canadian retirees with average return expectations for their RRSP/RRIF portfolio, and an average life expectancy, could potentially benefit from delaying CPP past age 65. This is especially true for women and conservative investors.

Finally, realistically it would be very difficult for a retiree to "beat" the benefits of delaying CPP by increasing their investment returns.

According to the Canadian Institute of Actuaries, the reasons for an individual to consider...

...taking CPP/QPP early	...deferring CPP/QPP early
• If you project having a shorter life expectancy/have health problems. • You will be receiving the Guaranteed Income Supplement (GIS) (beneficiaries of the GIS have a shorter life expectancy than the average population). • You can generate "outsized" returns with your registered investment portfolio.	• If you project having an "average" life expectancy. • If you expect "normal" rate of return form your registered portfolio. • You want a stream of income that is inflation protected in retirement. • You want to avoid market risk with a portion of your portfolio.

CPP/QPP Benefits

In addition to the **retirement pension**, the basic CPP/QPP plan provides various pensions and benefits[9] to people who have contributed enough and, in some cases, to their family members:

- **Post-retirement benefit:** If an individual works while receiving a CPP/QPP retirement pension, they may increase their retirement income with a lifetime benefit. This is called the **post-retirement benefit**. An individual may be eligible if they are 60 to 70 years of age, working, contributing to the CPP, and receiving a retirement pension from the CPP or QPP.
- **Disability benefit and post-retirement disability benefit:** This is a monthly payment for individuals who: are under 65, have made enough contributions into the CPP/QPP, have a mental or physical disability that regularly stops them from performing any type of substantially gainful work, have a disability that is long-term and of indefinite duration, or is likely to result in death.
- **Survivor's pension benefit:** The CPP/QPP survivor's pension is paid to the legal spouse or common-law partner of the deceased contributor. If the surviving spouse is age 65 or older and not receiving other CPP benefits, they will receive 60% of the contributor's pension. If the surviving spouse is under 65 and not receiving other CPP benefits, they will receive a flat rate portion of $197.34 plus 37.5% of the contributor's pension.
- **Children's benefit:** provides monthly payments to the dependent children of disabled or deceased CPP/QPP contributors. The child must be either under age 18, or under age 25 and in full-time attendance at a recognized school or university.
- **Death benefit:** it is a one-time, lump-sum payment of $2,500 to the estate of the deceased CPP contributor.

[9] https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-benefit/other-benefits.html; https://www.rrq.gouv.qc.ca/en/programmes/regime_rentes/Pages/regime_rentes.aspx

Pension sharing and CPP/QPP

CPP/QPP benefits are not "eligible pension income" as defined under the Income Tax Act, and thus cannot be split with the spouse (married or common-law partner). However, the CPP/QPP retirement benefits can be "shared" with a spouse.

To qualify for CPP/QPP pension income sharing, **both** spouses:

- must be 60 years of age or over
- must be living together and must have lived together while contributing to CPP/QPP
- must be receiving the CPP/QPP pension. If only one contributed to CPP, the spouse who contributed to CPP must be receiving their pension

How does it work?

The portion of the CPP/QPP that can be shared is based on the number of months lived together during the "joint contributory period." The joint contributory period starts when the older of the spouses or common-law partner turns 18 and ends when both start receiving CPP/QPP pensions. CPP/QPP pension sharing does not change the total CPP/QPP that a couple can receive, but pension sharing can often result in an overall family tax savings.

Hypothetical example:

John and Jill are common-law partners and are both receiving their CPP retirement pensions. John is one year older than Jill and they both decided to take their CPP starting at age 65. Without CPP pension sharing, John's CPP retirement pension is $1,000 per month while Jill's is $500 per month. Since the joint contributory period began when John turned 18 and ended when Jill turned 65, their joint contributory period is 48 years. The amount of CPP that can be shared, depends on how many years John and Jill have lived together as a proportion of their joint contributory period. For example, if John and Jill had been living together for 38.4 years (80% of their joint contributory period) then $400 of their retirement pension can be shared ($500, representing the difference between John's and Jill's CPP/QPP retirement pensions x 80% = $400). Half of that amount, $200, can be subtracted from John's retirement pension and added to Jill's retirement pension.

Number of years lived together	% of joint contributory period	Monthly CPP/QPP after pension sharing	
		John	Jill
33.6	70%	$825.00	$675.00
38.4	80%	$800.00	$700.00
43.2	90%	$775.00	$725.00
48.0	100%	$750.00	$750.00

Pension sharing can be cancelled at any time by a request submitted by either spouse or common-law partner. It will also stop upon divorce, or the month when one of the spouses or common-law partner dies.

Delaying OAS payments

While it is not possible to take Old Age Security (OAS) before age 65, it is now possible to delay the start of OAS benefits until age 70. Deferring OAS past age 65 may be less beneficial than deferring CPP/QPP, as OAS benefits increase by 0.6% for every month delayed after 65 (7.2%/year). Also, unlike CPP/QPP, OAS is not wage-indexed during the deferral period. Finally, OAS does not provide a survivor pension once the original beneficiary dies, thus offering less of an incentive to defer the OAS benefit past age 65.

The long-term viability of CPP/QPP benefits

The 30th Actuarial Report on the Canada Pension Plan confirms that the actual legislated contribution rate is sufficient to finance the base CPP over the long term. The most recent report (2019) projected that CPP contributions to base CPP and additional CPP will exceed annual benefits paid until 2057.[10]

The Actuarial Valuation of the Quebec Pension Plan of December 31, 2018 presents a projection of the inflows and outflows of the Quebec Pension Plan for the next 50 years, from 2019 to 2068. According to this report, the inflows are sufficient to finance the outflows for the next 50 years of projection.[11]

[10] 30th Actuarial Report, Canada Pension Plan as at 31 December 2018 (2019).
[11] Évaluation actuarielle du Régime de rentes du Québec au 31 décembre 2018, Retraite Québec, Régime des rentes du Québec (2019).

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