The Merits of Starting CPP at the Age of 70

by | **Frederick Vettese**

Delaying the start of a Canada Pension Plan (CPP) pension can increase its value by 8.4% a year, yet few Canadians realize the financial advantages of waiting until the age of 70 to begin their pensions. Employers that want to increase retirement income security for employees should consider providing education on the deferral of CPP.

One would be hard-pressed to find people who would prefer to have less income, especially if they don't have an excessive amount of it in the first place. Yet so few workers make the most of the retirement savings that they have accumulated. One reason is simply not knowing what strategies work best to convert savings into income that will last a lifetime. The way workers manage their Canada Pension Plan (CPP) benefits is a case in point.

Everyone knows that the normal retirement age under CPP is 65. Almost everyone knows they can start their CPP pension as early as the age of 60, though with a penalty. Fewer people are aware that they can wait until the age of 70 to start CPP. Most importantly, almost no one realizes that waiting can be advantageous.

This explains why fewer than 1% of all workers wait until the age of 70 to start their CPP pension. Even that 1% are not necessarily doing it because they are more knowledgeable; the slim data that is available suggests the late start in CPP is more often the result of procrastination rather than careful deliberation. The benefits of starting CPP late therefore remain one of Canada's best-kept secrets.

The best way to show why it could make sense to start CPP late is with an example. Consider a married couple, Jack (who is 65) and Martha (62), who are on the verge of retirement. They have no defined benefit (DB) pension from a workplace plan, but they did participate in defined contribution (DC) pension plans and also contributed to personal Registered Retirement Savings Plans (RRSPs). Between the two of them, they have accumulated $500,000 in tax-sheltered savings by the time they retire. They decide they want total retirement income of $55,000 a year (plus inflationary adjustments). Some of this income will come from CPP and Old Age Security (OAS), and the rest will come from their savings.

We will consider two scenarios. In both scenarios, Jack and Martha invest in a 50/50 stock/bond asset mix and incur investment fees of 1.8% a year, including what their financial planner charges. And in both scenarios, future investment performance turns out to be terrible. Finally, we will assume for now that both Jack and Martha live into their 90s; we will revisit the implications of earlier death later on. Other assumptions used in these scenarios are given in the sidebar.

Given these scenarios, we can test whether the starting age for receiving CPP makes a difference. In the first scenario, the CPP pension is started immediately, which means at the age of 62 for Martha and 65 for Jack. Jack is eligible for his OAS pension at that point, but Martha will have to wait another three years for hers. The rest of their $55,000 income will have to come from drawing down their $500,000 in savings.

As it turns out, drawing $55,000 of income (plus inflationary increases) is not sustainable given the poor investment results they get, or at least that is the conclusion if they start receiving CPP immediately. The couple's savings run out by the time Jack is 83 and Martha is 80. This is shown in Figure 1. All they have left at that point are their CPP and OAS pensions. This type of situation represents the worst nightmare for many retirees.

In the second scenario, everything is the same except that both Jack and Martha wait until the age of 70 to start drawing their CPP pension. At first blush, this would appear to make matters worse. After all, if they aren't receiving CPP before the age of 70, they will have to draw down their own savings that much faster in their 60s in order to generate $55,000 in income. They do indeed draw down their savings more quickly—but only until the age of 70. After that, the drawdown slows down dramatically because they are receiving a much bigger CPP pension than if they had started payments sooner. The net result is that their money now lasts a lifetime, as shown in Figure 2.

Waiting until the age of 70 to draw CPP made all the difference in the world for Jack and Martha. The reason this works so well is that the CPP pension is much bigger if it starts at the age of 70 rather than 65. The guaranteed increase is 8.4% a year, or 42% in total. There is no way plan members can match this result by taking their income early and investing the money, at least not without taking some major risk.

Another way to think about it is that by deferring CPP

Assumptions Used in Scenarios for Jack and Martha

Future inflation rate:	2.2% a year
How income increases:	With price inflation until the age of 70, then more slowly
Amount of CPP payable:	90% of the maximum for Jack, 75% for Martha
Investment returns:	At the fifth percentile, based on a Monte Carlo simulation
Year of retirement:	2017

until the age of 70, workers can transfer investment risk and longevity risk back to the government. It is up to the government to find a way to generate enough investment income to justify providing people an 8.4% a year increase in CPP pension.

It is worth noting that the actual increase can be even greater than 42%. That is because the CPP pension is calculated based on the CPP earnings ceiling in the year of retirement and the four preceding years. The CPP ceiling rises with wage inflation rather than general price inflation, and wage inflation outstrips price inflation, at least over the long term. In the above example, the assumption is that wages outstrip price inflation by 1% a year, in which case CPP at the age of 70 is actually 49% more (in real terms) than it is at the age of 65.

FIGURE 1

Jack and Martha Come Up Short

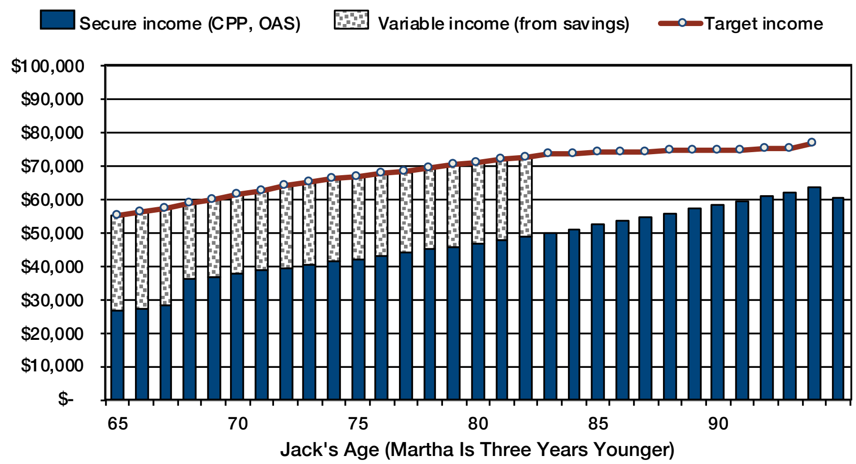
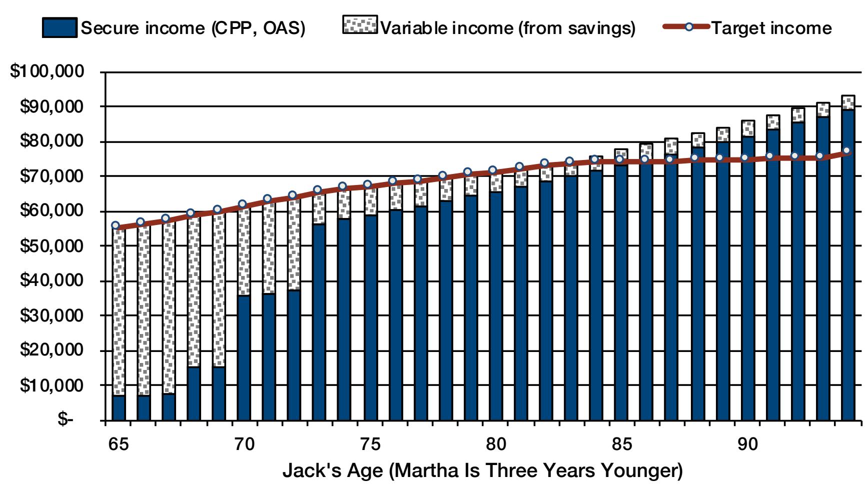


FIGURE 2

Deferring CPP to the Age of 70 Helps a Lot



Objections

Even armed with the above example of Jack and Martha, plan administrators may find their members have widespread resistance to the idea of starting CPP late. The concept of deferring CPP has appeared a number of times in national newspapers. Based on numerous reader comments, there is stiff resistance to the idea of starting CPP late. The same objections tend to crop up each time.

One of the concerns is that CPP is not going to be there when people retire, so they want to get as much as they can as soon as they can. Long-term projections, however, show that CPP is undoubtedly sustainable, not only for the rest of our lives but also for the lives of our children.

Another concern is that people do not want to wait to spend their money. There is agreement that people should not have to wait to enjoy their retirement, but deferring CPP does not have to mean spending less before the age of 70. Rather, the income in early retirement can come from savings instead of from CPP.

The biggest objection by far is the bird-in-the-hand argument. People want to get their money while they can because they don't know (1) what the government might do to CPP or (2) how long they'll live. Governments can do many stupid things, but taking away CPP is highly unlikely to be one of them. For one thing, contributions to CPP are made by workers and their employers, not the government. For another, gray power is a formidable force. The proportion of voters who are retired is growing, and it would be a foolish politician indeed to take something away from seniors without good reason.

If both Jack and Martha have good reason to think they will die young (i.e., before the age of 80), then they would have a valid reason for taking CPP early. In the vast majority of cases, though, at least one of them can expect to live well into their 80s or even their 90s. People tend to underestimate their own life spans.

There also is one scenario in which it may be better to take CPP at the age of 65. If a worker has already earned the maximum CPP by the age of 65 and continues to have employment earnings after turning 65, a funny quirk in CPP rules makes waiting until the age of 70 much less attractive. Under this set of circumstances, workers must continue to contribute to CPP even though it won't improve their CPP pension one iota. This scenario doesn't apply to very many people, though.

The bottom line is that deferring the start of CPP pensions until the age of 70 is, in effect, replacing uncertain income (the amount a person can draw from savings in the long term) with income that is much more secure (the amount the government will pay a person).

Why Employers Should Get Involved

Larger employers have generally done a good job of helping their employees to save for retirement. They offer pension plans and group RRSPs and make matching contributions. They provide ongoing education about investment options and the need to save, and they use economies of scale to keep fees low.

However, this support tends to end at the point of retirement. This can be unfortunate since the *decumulation phase* (i.e., drawing down one's savings) is even more fraught with pitfalls than the *accumulation phase* (i.e., saving).

Employers that want to boost the retirement income security of their employees should consider an educational program to explain concepts such as starting CPP late. If they don't do so, the odds are that no one else is going to do so. The merits of starting CPP late are well understood by researchers within the actuarial profession and by academics who specialize in retirement matters. They are not well understood by others, not even by financial advisors, for the most part.

Even financial advisors who accept the case for starting CPP late face conflicts in advising their clients to do so. That is because this advice gets in the way of their remuneration. The famous quote by Upton Sinclair comes to mind: "It is difficult to get a man to understand something when his sal-

Takeaways

- Not many people are aware that it can be financially advantageous to delay the start of Canada Pension Plan (CPP) benefits. In fact, fewer than 1% of all workers wait until the age of 70 to start their CPP pension.
- Delaying the start of a CPP pension can increase its value by a guaranteed 8.4% a year, or 42% in total.
- By deferring CPP, workers can transfer investment risk and longevity risk to the government.
- Workers may express objections to the idea of delaying CPP for reasons such as not wanting to wait to spend their money.
- Employers that want to increase retirement income security for their employees should consider an education program that explains the concept and benefits of deferring CPP.

Learn More

Education

37th Annual ISCEBS Employee Benefits Symposium

August 26-29, Boston, Massachusetts
Visit *www.ifebp.org/symposium* for more information.

From the Bookstore

The Essential Retirement Guide: A Contrarian's Perspective
Frederick Vettese.
Wiley. 2016.
Visit *www.ifebp.org/books.asp?9070* for more information.

Morneau Shepell Handbook of Canadian Pension and Benefit Plans, 15th Edition

Bethune Whiston and J. Gregory Clooney.
LexisNexis. 2016.
Visit *www.ifebp.org/books.asp?9077* for more information.

ary depends on his not understanding it." Most advisors are paid a percentage of assets. Therefore, the faster people draw down their assets, the faster they reduce what their advisor gets.

By contrast, employers and other plan sponsors have no conflict of interest in giving the best advice to their retiring employees. Moreover, they have access to retirement planning experts who can remain objective because they are paid on a fee-for-service basis.

BIO

Frederick Vettese is a partner at Morneau Shepell in Toronto, Ontario. He has spent his career providing retirement consulting and actuarial services in respect of workplace pension plans. Much of Vettese's professional time is currently spent in the public eye, speaking at industry conferences, writing on retirement issues for Canada's national newspapers and academic journals, and giving TV and radio interviews. He is the author of several retirement books, including *Retirement Income for Life: Getting More Without Saving More*.