

7 Steps Toward Better CPP/QPP Claiming Decisions

Shifting the paradigm on how we help Canadians

Step #2: Making a Case for Secure Pension Income

STEP
2



June 2024

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Paper Series Background: 7 Steps Toward Better CPP/QPP Claiming Decisions



Paper Series Overview:

Shifting the Paradigm on How We Help Canadians.



Introduction:

Opportunities and Obstacles to Shifting the Paradigm.



Step #1.

Educate the public about the Canadian retirement income system.



Step #2.

Help retirees understand the advantages of secure pension income.



Step #3.

Improve mainstream practices, perspectives and narratives.



Step #4.

Explain the mechanics of delaying CPP/QPP benefits.



Step #5.

Help Canadians overcome the systemic cognitive biases and motivational barriers associated with this decision.



Step #6.

Develop new approaches to better communicate the financial advantages of delaying claiming CPP/QPP benefits.



Step #7.

Offer additional insights and actions for policymakers, employers and industry professionals.

When to claim benefits from the Canada Pension Plan (CPP) — or its Quebec counterpart, the Quebec Pension Plan (QPP) — is one of the most important retirement financial decisions Canadians will make.

By waiting until age 70 to claim these benefits, Canadians can receive more than double (2.2 times) the monthly pension than if they had claimed them at age 60. These higher payments last for life and are indexed to inflation. That's why, for people who can afford to wait without hurting their lifestyle – either by drawing on personal savings or by working longer – choosing to wait is a safe and inexpensive strategy to increase their lifelong income.

Yet, although most people can afford to wait, an overwhelming majority (9 in 10) choose to take their CPP/QPP benefits by age 65, reducing the lifetime income security they say they want and will most likely need.

This paper series aims to shift the paradigm toward more informed decision-making. Its purpose is simple: to propose new ways that those in a position of influence – such as human resource leaders, policymakers and the financial services industry – could help Canadians understand and benefit from the value of delaying CPP/QPP benefits.

The solutions are aimed at retirees for whom delaying CPP/QPP benefits is in their best financial self-interest, but it also supports choosing not to delay CPP/QPP benefits where circumstances warrant it.

In either case, improving the clarity of the decision and helping people understand their choices – and the consequences of those choices over the short and long term – will lead to more informed and confident decisions, peace of mind and, ideally, better retirement outcomes for all.

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Paper in Brief

Ageing Canadians say they value retirement financial security above all other financial priorities. Yet the choices they make – including when to start their Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) benefits – don’t align with that desire. How can we “boost” individual understanding of this choice and its consequences? Do Canadians understand that the risks they are assuming could derail their retirement income security?

Academic literature has established that the lack of understanding of consequences when making high-stakes, complex financial decisions drives a wedge between what people say that they want and need, and what they actually choose to do. This paper (Step #2) aims to address this gap by supporting and empowering financial advisors, employers, government agencies, professional organizations, financial institutions and others who guide Canadians in their financial planning choices. First, we systematically review the post-retirement financial risks faced by older individuals. Next, we explain the financial and other advantages of greater automatic, inflation-indexed pension income for life from the perspective of individual Canadians, helping set the stage for later papers in the series that continue to explore

how better framing of financial decisions can help Canadians make more informed choices.

While the focus of this paper series is on the CPP/QPP claiming choice, this is just one of the key decisions that could be improved by a better understanding of post-retirement risks and the value of secure, lifelong pension income. Others include deferring Old Age Security (OAS) benefits, purchasing an annuity and electing to join a workplace defined benefit (DB) pension plan.

Canadians encounter various financial risks during their post-employment years – particularly from investments, inflation, health and longevity. Although these risks are present while they are working and accumulating retirement savings, they become more impactful during retirement. Unlike active workers, retirees are generally less able to return to the workforce, so they have limited opportunities to reverse poor financial decisions or recover from negative financial shocks. They also can’t wait for a market reversal when financial markets fail, as the necessity of withdrawals to finance current spending forces them to lock in bad returns. Pension plans like the CPP/QPP mitigate these financial risks, but communicating the consequences of the risks and the value of secure pension income to the public can be challenging.

Having more secure, lifelong retirement income can help mitigate financial risks, and the benefits extend well beyond how much money you'll have to spend.

Here are six key advantages:



1 Reliable income stream.

Greater lifelong pension income ensures additional steady inflows to cover your living expenses despite the volatility of the financial markets, no matter how long you live. The income is there when you need it, for as long as you need it.



2 Freedom to spend. With a secure income, you'll have the freedom to spend based on a monthly budget, with the comfort

of knowing you'll have the same ongoing income to get you through retirement. Without this protection, people often live an unnecessarily reduced lifestyle out of fear of outliving their savings.



3 Freedom to invest. With a secure income, you'll have the freedom to invest for greater returns over a longer time

horizon, knowing you won't be forced to sell investments during dips in the markets.



4 Peace of mind and better health.

Knowing that your income is secure not only promises greater financial independence as you get older, but it's also good for your health and general well-being. Having stable, predictable income can help ease financial worries and anxiety. You can be less preoccupied with the ups and downs of any self-managed wealth and more focused on making the most out of your golden years.



5 Lighter burden.

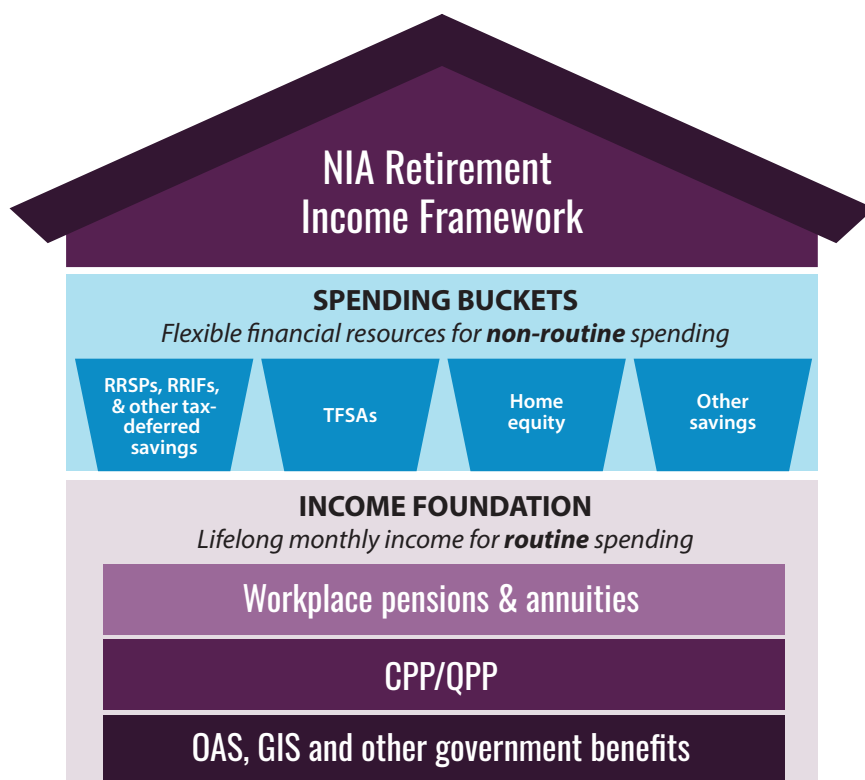
Over time, you may find the responsibility of managing your wealth burdensome, especially if you begin to suffer from a cognitive decline that can impair your ability to make sound financial decisions. Having a secure automatic income stream lessens this responsibility for you and your family.



6 Protection against exploitation.

Converting your savings into fixed automatic pension income can reduce your risk of being a victim of bad advice – or even fraud. It's an uncomfortable truth, but holding large amounts of savings can invite conflicts within your family and, even worse, scammers and swindlers. Choices may be made by others that are not in your best interest, which is especially detrimental if you don't already have a sufficient steady stream of automated income to cover your needs.

NIA Retirement Income Framework



These discussion points are intended to complement the NIA’s reframed retirement income system (detailed in Step #1 of this paper series), solidifying and building on the economic argument for securing appropriate lifelong monthly income levels. By “boosting” individual competencies and abilities to understand the consequences of their choices, including when to claim CPP/QPP benefits, this more targeted education can help those advising Canadians to bridge the gap between intention and action – whether it is to increase or decrease their income foundation.

A key message is that waiting to start CPP/QPP benefits – by working longer or drawing on savings during the delay period – can lock in greater lifelong, inflation-indexed monthly income and mitigate risk. This strategy

addresses many risks Canadians face during their post-employment years, including three major areas of financial risk – investment, inflation and longevity – bringing greater peace of mind to older Canadians and their families, along with a license to spend and invest more freely and joyfully in retirement.

Educating people on the financial value of delaying claiming their CPP/QPP benefits alone is unlikely to motivate action (see the paper “Introduction” (MacDonald, 2024)). Clearly articulating the value of a secure pension from the perspective of retiring Canadians, and highlighting the financial risks and consequences they will face as they age, will help them overcome psychological and social biases and will have a stronger, more lasting impact on informing decision-makers than traditional, generic financial education.

Introduction

“Protection is the first necessity of opulence and luxury.”

- Joseph Conrad (Conrad, 1907, p.9)

As they contemplate their future, ageing Canadians report that they value retirement financial security above all else (see Box A)¹. However, the financial choices they make – including when to start claiming their CPP/QPP pension – do not correspond with that desire, as discussed in the first paper in this series (MacDonald, 2024). Waiting to collect CPP/QPP benefits is an inexpensive and safe approach to getting additional secure lifetime income. Yet 9 out of 10 Canadians claim their CPP/QPP benefits by age 65, even though most of them can afford to wait (MacDonald, 2020). Research in psychology and behavioural economics finds the complexity of high-stakes decisions creates a disconnect between stated preferences and actions, including those related to retirement financial planning².

The Step #1 paper in this series (MacDonald, Chandler & Hodder, 2024) redefines Canada's retirement income system in a way that distinguishes savings from lifelong income. Within this framework, a retiree can convert savings into lifelong retirement income by drawing on the former so as to delay claiming CPP/QPP benefits. The consequences of this choice can be severe. As an aid for financial advisors, employers and others who help guide Canadians through their retirement

choices, this paper reviews the value of stable, predictable and secure lifelong retirement income. It begins by discussing the key financial risks faced by retirees. It then reviews the advantages of greater automatic, inflation-indexed retirement income for life that delaying CPP/QPP payments can bring.

The decision on when to claim a CPP/QPP retirement pension is just one of the choices that could benefit from greater understanding of post-retirement risks. Others include deferring Old Age Security (OAS) benefits, purchasing an annuity, electing to join a workplace defined benefit (DB) pension plan or to accept a lump sum settlement, investing in a longevity-pooled mutual fund and the uptake of emerging innovations that aim to make affordable, lifelong pension income more accessible to retiring Canadians (MacDonald et al., 2021).



¹ As discussed in the introduction paper in this series, survey and focus group evidence has consistently found that income security (i.e., steady, safe lifetime income) is valued over high returns and access or control over money when it comes to retirement finances (MacDonald, 2024; Retirement Research Center, 2022; Society of Actuaries, 2021; and Baldwin, 2017).

² For a review of this topic, see the introduction paper of this series, MacDonald (2024).

Box A: 2023 NIA Ageing in Canada Survey Spotlight

We asked Canadians ages 50 and older, *In thinking about your own personal situation, which of the following priorities is the most important to you as you get older?*

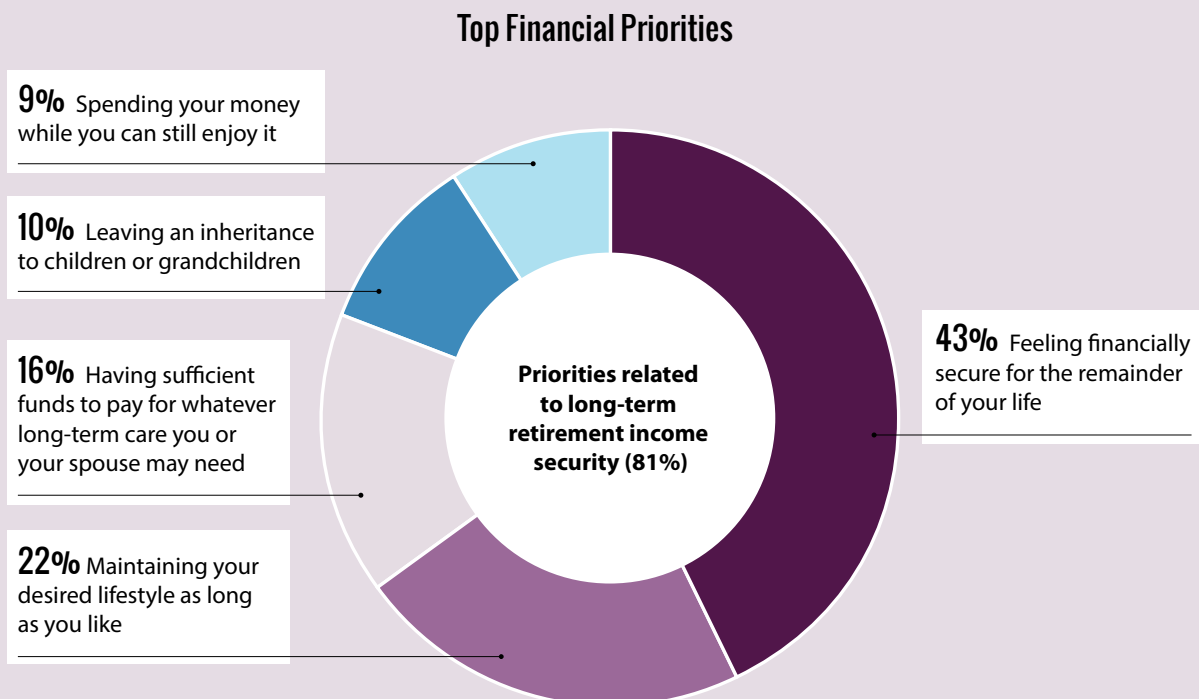
The results?

8 out of 10 chose priorities related to long-term retirement income security:

- Feeling financially secure for the remainder of your life (43%);
- Maintaining your desired lifestyle as long as you like (22%); and
- Having sufficient funds to pay for whatever long-term care you or your spouse may need (16%).

Only 2 out of 10 chose other priorities:

- Leaving an inheritance to children or grandchildren (10%); and
- Spending your money while you can still enjoy it (9%).



Source: 2023 NIA Ageing in Canada Survey. These results report the distribution of responses among the 79% of the sample who were able to choose a single priority (of the remainder, 17% responded "All equally important," 2% responded "None are important," 2% responded "Cannot say," and 1% responded "Other").

The Decumulation Dilemma and the Consequences of Financial Risk

Determining how to draw down your savings in retirement – the “decumulation dilemma” – isn’t just difficult. For the average Canadian, it’s borderline impossible. The unknowns over this potentially long phase of life are almost endless: unknown investment returns over an unknown time horizon, as well as uncertainties around health, personal circumstances, longevity and the cost of products and services that might be needed in the future.

As discussed in the introduction and Step #1 papers in this series, the **financial risks in retirement are different from those while working**, and retirees will need to adjust their mindset accordingly. While workers are exposed to labour market risks, such as unemployment, these particular risks disappear after retirement. But other risks persist and can expand thereafter, especially as people advance in age, such as:

- Poor investment returns;
- Living longer than anticipated;
- Poor financial decisions due to bad advice, behavioural factors or cognitive decline;
- Illiquidity of savings (e.g., to cover unanticipated expenses);
- Default by financial institutions where the person has savings;
- Unexpected inflation;
- Political risks (such as increases in taxes and retractions in social benefits for older adults);
- Separation, divorce or death of a spouse;
- Less financial and non-financial support from family and friends;
- Health conditions that require out-of-pocket expenditures;
- Unanticipated expenses (such as home repairs); and
- Financial exploitation.

These risks become more impactful during the decumulation years – particularly since **Canadians who have left the workforce have fewer opportunities to react to financial downturns or reverse financial decisions.**

Facing health issues and a lack of employment options, older Canadians simply do not have the human capital of younger Canadians. They quickly lose the ability to return to the workforce to make up for any financial shortfalls and are limited in how much additional debt they can assume without steady employment income. What’s more, they can’t always wait for a reversal when financial markets fail: required withdrawals to finance ongoing expenses can force them to lock in bad returns. This is especially damaging when there are major unanticipated expenses that can’t be postponed.

Shifts in cultural norms and socioeconomic practices are also limiting the ability of older Canadians to respond to financial downturns. For example, family has traditionally acted as a form of financial protection for older adults, providing care and support when necessary (see Box E). However, this protection is much less available than in the past, given the reduction in the number of adult children as a result of lower fertility rates since the 1960s, combined with a greater likelihood that those adult children are geographically separated from their parents (MacDonald et al., 2019).

Fortunately, pension plans like the CPP/QPP mitigate the three major financial risks of investment, inflation and longevity, as explained in Box B. They enable workers and

their employers to pool their money together to efficiently deliver secure lifetime income to the entire group, including those who live to advanced ages.

Box B: Helping Retirees Understand Inflation, Longevity and Investment Risks

What are these risks, and how can they derail a person's retirement? Here is an overview of these three key risks and their impact on retirees.

Investment Risk

The economic shocks of COVID-19 were a grim reminder of financial market risks, with the Canadian stock index falling 22% over the first quarter of 2020, hitting single-day percentage drops that hadn't been seen since the day Germany invaded France in 1940³.

Older Canadians who rely on selling investments in the capital markets to support them through retirement are **more vulnerable to financial market risks than working-age Canadians**. Without the necessary time or resources to recover from an economic downturn, **the only option left for them is to curb their spending and scale back their living standards** – meaning the implications of downturns can be long-lasting or even permanent. In the U.S., for example, the proportion of older persons filing for bankruptcy has doubled since the 2008-09 downturn, while it has fallen for younger age groups (Thorne et al., 2020).

Variations in investment prices usually work to the advantage of individuals while retirement funds are accumulating but **to their disadvantage while funds are decumulating** (known as "sequence of returns risk"). For example, a temporary decline in market prices – like the one that began in 2008 – is a buying opportunity for a worker saving for retirement but a permanent blow for a retiree who is selling funds every year to support spending.

An emerging risk is that **even those retirees with seemingly adequate savings, based on historical rates of return, will not achieve the investment returns needed to sustain their living standards in the future**. Starting from a much lower initial long-term interest rate environment, investors (especially fixed-income investors) will be challenged to obtain the returns that were achieved starting in the 1980s. Additionally, historical equity risk premiums – the higher return investors expect from the stock market, relative to the guaranteed returns offered by the bond market – are not a good indicator of the future (Siegel, 2005). This means even retirees who are open to taking on additional investment risk in their retirement years can't count on the risk/return dynamics of the past.

Taking on investment risk in the pursuit of higher returns is a personal choice. Just as for larger pension funds like CPP/QPP, an individual's overall portfolio investment risk and

³ Source: Authors' calculations based on the S&P/TSX Composite Index historical data.

expected return are mostly determined by their asset allocation. However, individual investors are at a significant disadvantage compared to large pension plans like the CPP/QPP when it comes to implementing trade-offs between risk and return. Larger pension funds have:

- a longer investing time horizon, which results in a better capacity to access illiquid asset classes and to tolerate fluctuations in market price;
- the ability to invest in specialized financial instruments that better hedge risk and higher yielding private market investments; and
- economies of scale, which generate substantially reduced fees for asset management and administration relative to those available in the retail market.

In contrast, individuals have:

- relatively minimal research capabilities or access to data needed to make good investment decisions⁴;
- a greater tendency to respond emotionally to market swings and make poor market timing decisions;
- a much higher risk of making bad decisions on their own or being badly advised by investment salespeople, who may have conflicts of interest or may not be much better equipped than their clients (Linnainmaa et al., 2020); and
- the risk of experiencing cognitive decline as they age, which can increasingly impair decisions. Research finds that financial literacy declines with age, but unfortunately, confidence in financial decision-making does not (Finke et al., 2017). Older adults can easily become vulnerable to decision-making mistakes, overestimating their abilities to make financial decisions and not seeking appropriate help (ibid).

Inflation Risk

Inflation is a serious concern for older people since they often do not have the flexibility to return to work and earn wages that keep pace with the costs of goods and services. Many retirees rely on private pensions and annuities whose payments are fixed (i.e., not indexed to inflation), resulting in a gradual erosion of their purchasing power year after year, with significant accumulated losses after decades of retirement. While inflation is a matter that older adults need to plan for, “inflation risk” is the added concern that prices might accelerate even more quickly than planned.

From a retirement financial-planning perspective, there are several considerations related to inflation rate risk that are particularly relevant to older Canadians, as outlined below.

⁴ Insight on the “asymmetric information” challenges for individual investors was provided by Canadian investment expert Keith Ambachtsheer via personal correspondence, April 11, 2020.

Spikes in inflation: When economists and politicians talk about inflation, they generally mean the rate of increase in the consumer price index (CPI). This statistical measure tracks the change in a basket of goods and services from month to month, with periodic changes in the composition of the basket to reflect changes in typical spending patterns. During the 20th century, CPI increases varied widely – from negative rates of increase (deflation) in the 1930s to double-digit annual increases in the 1970s. In 1992, the Bank of Canada adopted inflation targeting as its objective and, since then, inflation has remained close to its 2% target. Average inflation during the 29 years from 1992 through 2020 was 1.76% per year, and annual inflation only rarely and slightly deviated from the Bank of Canada target range of 1% to 3% (Statistics Canada, 2024)⁵.

However, with supply chain disruptions caused by the COVID-19 pandemic, monetary stimulus policies and other global events, Canadian inflation jumped to an average annual rate of 4.8% from 2021 through 2023 (ibid)⁶. Due to this recent spike in prices, older Canadians have begun to report inflation as a major financial concern. According to the 2023 NIA Ageing in Canada Survey, the rising cost of living is by far the most frequently reported concern (70%) among Canadians ages 50 years and older (Iciaszczyk et al., 2024). When asked to choose a single “top” financial concern when contemplating the financial implications of ageing, inflation was also ranked highest, capturing 37% of respondents (MacDonald, 2024).

Differential impacts across Canada’s older population: As with the general population, the impact of inflation varies within and across the older population. Individual retirees will have a basket of goods and services that is composed differently than that underlying the CPI, creating a mismatch between the increases in a person’s actual expenses and the increases in CPI. This mismatch is a challenge for older adults in maintaining their personal living standards since the CPI underlies the indexation of many retirement income payments, including social income support programs for older Canadians – namely, OAS and the Guaranteed Income Supplement (GIS).

Compared to the average person, low-income older Canadians are particularly exposed to the mismatch since they devote a greater portion of their total spending to essentials and a smaller portion to luxuries. Relative to lower-income older adults, a greater proportion of spending by middle- and upper-income retirees is likely non-essential, so they may be in a better position to make lifestyle choices that help manage the effects of inflation.

The general population CPI measure applied to older adults: A relevant concern from a retirement financial planning perspective is that the basket of goods and services consumed by the general population used to determine the CPI is not representative of the spending patterns of older Canadians. For example, retirees are thought to spend less on work-related expenses (such as professional development fees, commuting to work and special

⁵ Statistics Canada reported CPI (all items) grew from 82.9 in December 1991, to 137.4 in December 2020, a compound annual growth rate of 1.76%.

⁶ Statistics Canada reported CPI (all items) grew from 137.4 in December 2020 to 158.3 in December 2023, a compound annual growth rate of 4.833%/yr.

clothing) and to have rising health-related expenses as they age. This means there may be a systematic mismatch between the increase in the income of older Canadians and their expenses. Although earlier studies have not found this to be the case (Chiru, 2005; Michaud, 2019), whether older Canadians need their own measure of inflation continues to be debated (Schrive, 2024).

Longevity Risk

Longevity risk is the uncertainty around how long a person will live. The risk is either:

- Dying earlier than anticipated, resulting in financial sacrifices during the early years of retirement that ultimately prove to be unnecessary; or
- Living longer than anticipated and being forced to curtail spending during the later retirement years.

When it comes to life expectancy, **people tend to underestimate how long they will live**. This phenomenon has been documented and dubbed “longevity pessimism” by Club Vita (an analytics centre for improving the understanding of human longevity with the largest and most current longevity dataset for Canadian pensioners with workplace pensions). Based on a 2021 survey across Canada, the U.S. and the U.K., Club Vita (2022) found **people underestimate their longevity by an average of 4.7 years**, compared to their longevity database and models. Similarly, a U.S. online survey by the Society of Actuaries (SOA) found 43% of retired respondents underestimated their life expectancy by at least five years, compared to life expectancy for the general population of their age and gender (Perlman & Fauquier, 2020).

Even when Canadians try to become better informed, **the life expectancy statistics used in retirement planning are often misleading**. This challenge is detailed in Appendix A (made possible by Club Vita), which presents the step-by-step pieces of longevity construction that are so often misrepresented. Beginning with the often-quoted longevity expectations from birth (males = 79.9, females = 84.0), it shows that once you have accounted for mortality improvements, current age, socioeconomic status and longevity risk, even as far as **age 100 is likely a more prudent benchmark for retirement financial planning** among those with sufficient savings to make delaying CPP/QPP benefits a viable option.

The impact of longevity expectations on a person's decumulation strategy is substantial. For example, if a 65-year-old has \$100,000 in RRSPs and draws it down assuming a 4% real rate of return (after inflation and fees), they would withdraw \$673/month if they assumed their life expectancy at birth (age 82). However, if they adopted the more conservative benchmark of age 100, they would withdraw \$438/month – 35% less.

Ultimately, experts need to be careful about the life expectancy statistics they use to ensure they are accurately communicating longevity risk. Moreover, it's even more critical that they properly communicate the range of outcomes that can result from this risk. As Appendix A

shows, advisors need to remember that people are highly unlikely to die exactly at their life expectancy, therefore treating that as a fixed assumption is dangerously misleading. Without communicating the range of outcomes, it's difficult to appreciate the important protection that shifting resources from financial savings "buckets" to lifelong, monthly "foundational" income provides Canadians over a potentially long retirement.

The reality of longevity risk was best summarized by the world's oldest person at the time, Bob Weighton, who said when he was 111 years old: "I have not lived my life avoiding being run over by buses or getting cancer or anything else. I've done nothing to deserve or achieve this age. I'm just one of the lucky ones" (BBC, 2020). When asked, he said the secret to his longevity was "to avoid dying."

The financial risk due to not knowing how long a person will live becomes dramatically smaller with a large group of people, such as those in a defined benefit (DB) pension plan like the CPP/QPP, because the actuary can rely on the law of large numbers to estimate mortality across the group. Simply put, with enough people, it can be assumed that everyone lives to approximately the average age when determining what the contributions and payouts should be. The losses to the plan's funding that occur when some people in the group live longer are offset by the gains

when others die earlier. By "pooling" people together, the DB pension structure frees retirees from needing to hold on to savings to cover the possibility of living beyond their life expectancy. It also frees them from needing to invest conservatively to ensure a secure income over a limited time horizon. Overall, it is the most cost-efficient way to mitigate the longevity risk. **As pension expert Stefan Lundberg once said, "If diversification (for retirement savings) is a free lunch, then longevity pooling is a free dinner"** (Pension Playpen, 2023).

Box C: Experts Weigh in on the Decumulation Dilemma in the Canadian and U.S. Retirement Income Systems

"We've done this way too much when it comes down to it. So much of the health system in the U.S., retirement, and various other systems, has been pushed on the individual – who is likely to be the least capable of making an immediate decision in their own benefit" (John, 2022).

- David C. John – U.S. public policy expert on pension and retirement savings issues

"The paradox is that we have deliberately put retirement financing in the hands of individuals when the best way to deal with it is through collective solutions. Wants and needs are very individual as is the sense of who is responsible for retirement saving. But the most effective means of meeting retirement income needs is through collective institutions."⁷

- Bob Baldwin – Canadian public policy expert on pension and retirement savings issues

⁷ Personal correspondence, June 2, 2023

The Value of Secure Retirement Income

Decisions made at retirement – such as when to claim CPP/QPP benefits – have long-lasting effects. This is especially true today when Canadians face longer retirements with less family support (see Box E). With insufficient pension income and greater reliance on personal savings, investment returns and longevity are more likely to determine a person’s retirement lifestyle and peace of mind than in the past. As Box C discusses, these post-retirement risks all have the potential to derail a retiree’s financial well-being.

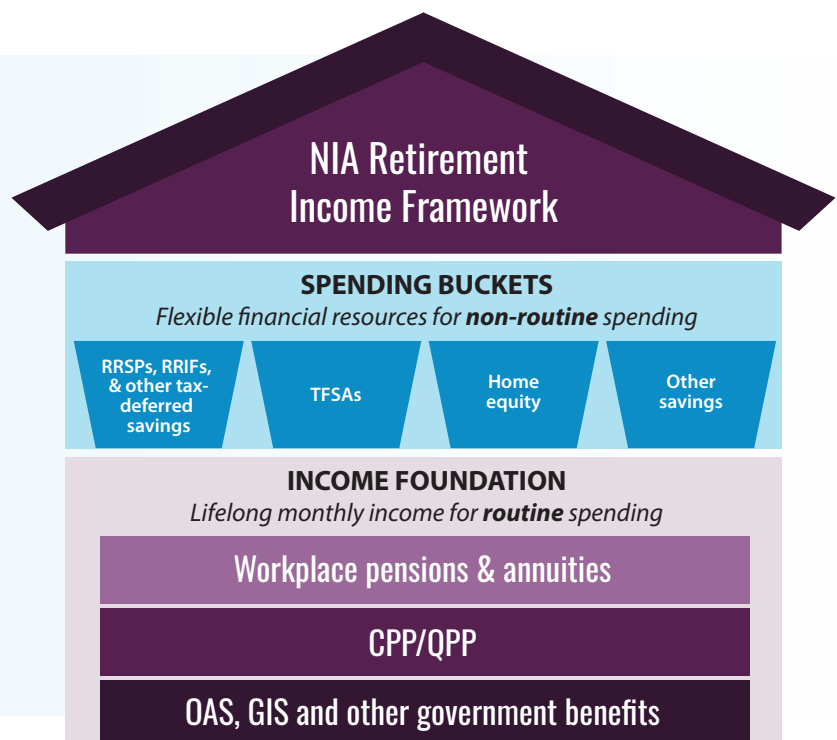
The opportunity provided by waiting to start CPP/QPP benefits is simple: turning accessible, variable wealth into secure lifelong income (as emphasized in the NIA’s Retirement Income Framework in Figure 1). As discussed in the first paper of this series, “Introduction” (MacDonald, 2024), this strategy not only delivers *safer* lifetime income, but it also delivers *higher* expected lifetime income. It is an inexpensive strategy for securing lifelong retirement income, relative to the “cost” of the payments forfeited during the deferral period (MacDonald, 2020).

Following are some of the key advantages of having secure, indexed lifelong retirement income from the perspective of retirees.

1 Reliable, ongoing income stream to cover living expenses when (and for as long as) it’s needed – If retirees can ensure their level of secure, inflation-indexed, lifetime income from CPP/QPP, OAS, workplace DB pension plans and annuities is high enough to cover essential expenses, such as housing, food and utilities, they can sustain their basic living standards into later life – despite the ups and downs of the financial markets and no matter how long they live (see Box D). An income foundation also mitigates the psychological and behavioural biases discussed in the first paper of this series (MacDonald, 2024), such as underestimating life expectancy and being overly optimistic regarding future investment returns and inflation. Lastly, a steady flow of lifelong income protects a person’s ability to finance long-term care expenses if and when they are needed (see Box E).

Figure 1: NIA’s Redefined Visual of the Canadian Retirement Income System

Source: Figure 1 (MacDonald, Chandler, & Hodder, 2024).



Box D: How CPP/QPP Benefits Safeguard a Retiree's Spendable Income

While it's clear that lifelong income from CPP/QPP and OAS mitigates longevity risk, these benefits are also extremely important in protecting the living standards of Canadian retirees against financial market volatility. Using a sophisticated microsimulation model of the Canadian population, MacDonald & Osberg (2014) found that when income from personal savings drops on account of unfavourable investment returns, the decline in net income is substantially mitigated by stable fixed income sources (such as the CPP/QPP) and an offsetting rise in income-tested social transfers like OAS/GIS and a decrease in personal income tax⁸.

"Canadian research has long recognized that the Canadian social pension system protects poorer Canadian seniors from destitution. Our results indicate that it also helps shield the Canadian elderly population as a whole from financial market risk." (ibid, p.315).

2 Licence to spend more freely and joyfully in retirement – Risk-free income simplifies and stabilizes a person's financial life, allowing them to comfortably spend a yearly budget while knowing they can rely on future income to get them through their retirement. Without this security, older adults are required to exercise their judgment. And it's a fine balance: too little caution will hurt their quality of life later by running down their savings too quickly, while too much caution will hurt their quality of life now, needlessly depriving them of experiences that can bring happiness and fulfillment. While the focus tends to be on the first risk (running down savings too quickly), the second risk may be equally problematic.

A U.S. study by Washington, D.C. think tank Employee Benefit Research Institute and asset manager BlackRock found that, on average, retirees drew 1% of assets per

year and had more than 80% of assets even after two decades of retirement (Wolfe & Brazier, 2017). In fact, account balances grew for over a third of retirees over that period (ibid)⁹. Similarly, a government-commissioned report for Australia found that "most people die with the bulk of the wealth they had at retirement intact. It appears they see superannuation (retirement savings) as mainly about accumulating capital and living off the return on this capital, rather than as an asset they can draw down to support their standard of living in retirement" (p. 36, Australia Government, 2020). Surveys and focus groups in various countries found this behaviour is attributable to fear of what the future will bring – particularly when it comes to unknown health and long-term care expenditures – rather than the desire to leave an inheritance (Alonso-Garcia et al., 2022; SOA, 2016). In Canada, fears

⁸ The study found out that, in an environment of continued low financial market returns, even if the annual income from private savings of a typical older Canadian drops by over half, net income drops only by just over one fifth.

⁹ Other studies that came to similar conclusions include De Nardi et al. (2006), Love et al. (2009), Poterba et al. (2011) and Smith et al. (2009).

about the need to personally finance later life health and long-term care needs are legitimate (see Box E).

Blanchett and Finke (2021) took this one step further, explaining that secure income effectively gives retirees a “licence to spend,” without which they tend to hold onto their retirement savings. Their study

found that **retirees spend twice as much each year in retirement if the income is coming from a secure lifelong pension rather than from a savings account.**

Overall, having greater pension income means more steady and predictable retirement income while alive, along with the confidence to spend that income.

Box E: Ageing in the Right Place – An Important Consideration When Discussing the Value of Lifelong Pension Income

“When I make a diagnosis of dementia, one of the first questions I ask myself is whether my patient has a supportive family and/or money. These are the two greatest determinants of how well they will navigate their future journey living with dementia.”

- Dr. Samir Sinha, leading Canadian geriatrician and Director of Health Policy Research at the NIA

There are very few universal truths when it comes to retirement financial planning, but one is the desire to age in place. According to an NIA survey, nearly all Canadians ages 65 and older intend to live independently in their own home for as long as they can do so safely (NIA & Telus Health, 2020). They would do everything they could to avoid going into a long-term care home (NIA, 2021). This preference was amplified by the fallout from the COVID-19 pandemic in long-term care and nursing homes across Canada (NIA & Telus Health, 2020; NIA, 2021).

So, **it’s clear what Canadians want: to age at home for as long as possible.** What’s not clear is how that’s going to be possible from a financial perspective.

As discussed earlier, developing a health condition that generates out-of-pocket expenses is an important post-retirement financial risk in Canada. Canadians may not know that the **Canada Health Act does not cover the delivery of long-term care**, since it was not considered an essential health service when this act was created in 1984. Furthermore, the provision of long-term care isn’t administered as a single national program but through a patchwork of federal, provincial and territorial spending programs that partially cover the delivery of health care and social services by a mix of private and public providers. These programs and services have varying costs, subsidies and eligibility criteria, and are delivered in a variety of settings. The system is complex and difficult to navigate. Understanding what the provincial governments will provide and what older people and their families will need to do for themselves is challenging today, let alone when predicting a future when care is needed.

Public funding for the provision of long-term care in general – and home care in particular – is very limited¹⁰.

In 2021, it was estimated that more than 52,000 Canadians were on waiting lists for placement in a long-term care home (Segel-Brown, 2021). More than 430,000 Canadian adults had unmet home care needs, with nearly 40% ages 65 and older (Gilmour, 2018).

These pressures will only intensify going forward. The ability to age at home has traditionally been made possible by family, which has been the backbone of home care in Canada. Even now, 75% of care for older adults receiving publicly funded home care services within their homes is provided on an unpaid basis by family members (MacDonald et al., 2019). But smaller family sizes resulting from reduced fertility rates since the 1960s have dramatically reduced the availability of adult children for baby boomers now moving into retirement. This demographic shift – together with greater geographical mobility of family members, higher divorce rates, dramatic growth in the participation of women in the labour force (who have traditionally acted as caregivers) and changing expectations of care within the family – has created a new reality of care for older adults in Canada. For the first time in history, it is very unlikely that older Canadians will get the support they need from adult children, leading to a greater reliance on paid care.

Canada's ageing population will amplify this shift as more people enter into old age with longer life expectancies and longer periods of impaired health (Bushnik et al., 2018). MacDonald's 2019 NIA research paper with Michael Wolfson and John Hirdes employed a large-scale microsimulation of the Canadian population and found that, if Canada continues on its current track, the cost of publicly funded long-term care for older Canadians is expected to more than triple over the coming three decades – rising from \$22 billion to \$71 billion in today's dollars (MacDonald et al., 2019). If unpaid hours of family care had to be paid publicly, this would add \$27 billion to government costs by 2050, increasing the projected cost from \$71 billion to \$98 billion and **representing more than one-quarter of all projected provincial and federal personal income tax revenue in 2050 (ibid).**

The unsustainability of Canada's long-term care systems is a pressing national concern. **Only a minority of Canadian retirees would have the funds necessary to pay privately** should the two primary sources of care (public programs and family support) begin to fail. For example, in 2019 only two-thirds of Canadian households nearing retirement (where the major income earner was between ages 55 and 70) held registered savings in individual accounts (such as RRSPs, RRIFs and DC pension plans), and the median balance among those two-thirds was \$100,000.¹¹ Most households would soon find their retirement savings drained by privately financing the potentially large ongoing costs associated with meeting their long-term care needs, meaning reduced living standards, being unable to cover costs and, potentially, falling into poverty.

¹⁰ See NIA (2022) for a review of existing programs and services that federal, provincial and territorial Canadian governments deliver to support older Canadians to age in place. For further background, see also a recent paper by CD Howe Institute, which reviews the gaps in policies and practices with regards to LTC in Canada, and solutions for solving them (Wyonch, 2024).

¹¹ Custom tabulation in MacDonald et al. (2021) based on the Survey of Financial Security, 2019, Statistics Canada.

One last consideration is that the **psychology of the human brain works against retirees in properly planning to age in place**. As discussed in the introduction paper of this series, people are overly confident regarding their financial futures and unrealistically optimistic in believing that negative events, such as becoming frail and dependent, only happen to other people (Sharot, 2012). This “optimism bias” has been extensively studied and is well established in academic literature. This bias can lead people not to take precautionary measures – such as financially planning for their future, more vulnerable self. The disconnect is illustrated in the NIA’s 2023 Ageing in Canada survey, which found that more than 9 in 10 Canadians aged 50 years and older who still live in their own homes and plan to continue doing so feel confident that they can for as long as they want to (Iciaszczyk et al., 2024).

Those in a position to influence CPP/QPP claiming decisions are strategically positioned to help rewire a retiree’s thinking on this critical issue. It is important that those advising retiring Canadians clearly and intentionally bring the reality of ageing in place into the decision-making process. Greater levels of steady, reliable income at advanced ages will help finance the care needed to protect independent living at home for as long as possible.

3 Peace of mind and better health – Financial insecurity means not knowing whether the money will be there when you need it, and the consequences of this uncertainty are extensive. **Worrying about the future can reduce day-to-day happiness and well-being, and it has also proven to be detrimental to both mental and physical health** – not just for the poor but for anyone facing the prospect of potentially inadequate income (Akanni et al., 2022; Osberg, 2021; Rohde et al., 2017).

Surveys have found that people with secure and stable pension income from their employers enjoy positive outcomes beyond the more obvious financial ones. For example, a 2020 report developed for OMERS by the Canadian Centre for Economic Analysis found that retirees with an employer-based DB pension have more satisfaction with life than their peers who do not participate in a pension plan. They benefit from enhanced

feelings of financial security, better satisfaction with physical and mental health, less stress, more community involvement and more leisure time (Smetanin & Stiff, 2021). These results held at all ages, genders, regions and, most significantly, all household income levels.

Without sufficient stable income, older Canadians relying on investments are extensively exposed to the ups and downs of financial markets (see Box B). Their future income will be determined by a fluctuating stock of wealth, which has negative mental and physical consequences. **Research has established that when someone is facing income instability, they face both the actual experience of having inadequate confidence in their ability to spend their income today and the stress of potentially inadequate income tomorrow. Both of these stressors impact their overall health.**¹²

¹² See Brydges et al. (2023) for a review of the literature on the relationship between income levels, income stability and economic security (defined as the perceptions of one’s current or future financial circumstances) on health.

For example, a drop in income *today* can lead to a loss of social networks, unhealthy behaviours – such as smoking and lack of exercise – and a reduction in necessary spending, including spending on health-care needs (for discussion and supporting literature, see Elfassy et al. (2019)). These consequences are especially detrimental to older Canadians who are already living with a chronic disease. The worry of income insecurity *tomorrow* also worsens physical and mental health, which leads to a greater risk of future disease – including depression (Prause et al., 2009), worsening cognitive function (Grasset et al., 2019) and cardiovascular disease (Elfassy et al., 2019).¹³ Financial wellness expert Janice Holman explains: “Retirees often think they’ll do better by leaving personal savings invested in the financial markets instead of converting it into lifelong pension income. They then watch the markets daily, and research tells us that they psychologically feel losses twice as much as they feel gains. They end up subjecting themselves to a lifelong emotional roller coaster.”¹⁴

As a Canadian economist and expert in economic well-being, Lars Osberg wrote, “Greater peace of mind is a direct benefit of greater economic security” (2021, p. 6). Stable, predictable income delivers financial independence and better health at advanced ages. It eases financial worries and anxiety, allowing individuals to be less preoccupied with the status of any self-managed wealth (such as short-term financial performance and ability to sustain them for their lifetime) and more focused on making the most of their older years.

4 Less burden and responsibility on the shoulders of older Canadians and their families – Over time, retirees may find the responsibility of managing their wealth increasingly burdensome, even if they are in relatively good health. Having a secure income stream lifts the burden of managing investments at advanced ages, when the greater risk of cognitive decline can impair an older person’s ability to make good financial decisions (Finke et al., 2017; Keane & Thorp, 2016) – a reality that even the most capable experts appreciate (see Box F). As life expectancy increases, more people will experience cognitive decline and impairment. According to the Alzheimer Society of Canada, by 2030, the number of Canadians living with dementia could increase 65% compared to 2020, and the increase could nearly double (187%) by 2050.

Families will also benefit from the retirement income security of older relatives. Financial planning is difficult for yourself, let alone for another person. Outside of the time and energy involved, stress and conflict can arise when family members must take on the financial decision-making responsibilities of dependent older relatives. The entrusted family member risks investing and spending too conservatively, out of fear of being criticized for running down the wealth too quickly – or spending extravagantly out of fear that, as a potential beneficiary, not spending the money could be viewed as self-serving.

¹³ For additional evidence on the negative relationship between income volatility with health and well-being, see Adeline et al. (2019), Bania & Leete (2022), and Vanzella-Yang & Veenstra (2021).

¹⁴ Personal communications, May 6, 2024.

Box F: THINKADVISOR Asks: What's a Critical Key to Retirement Planning?

Response by Retirement Financial Expert Prof. Moshe Milevsky (Rusoff, 2022)

"As you get older, you should make fewer financial decisions. You want those to be on automatic pilot. This goal is even more important than not running out of money in retirement.

"I'm in my early 50s chronologically, and I really enjoy the investment and portfolio construction process. I enjoy optimization. I hope to be doing all that a decade from now.

"But in two decades, at 70, I'm not so sure. At 80, I'm not certain I'll have the financial or technical acumen to deal with whatever investment vehicle will be around then.

And at 90, I won't want to make these decisions.

"I can assure you that if I ever reach 95, there's no way I plan to log on to Vanguard or Fidelity anymore or check P/E ratios or payout rates.

"If I'm alive then, I'll be happy with a decent bowel movement!

"So, as I age, I want to make fewer financial decisions. I want to set my finances on automatic pilot at retirement and live off the cash flow."

As pension expert and actuary René Beaudry comments: "As someone responsible for the finances of a 90-year-old mother, I can't help but believe that a system that allows retirees to choose less pension income was designed by people with no experience in helping the elderly to manage their savings."¹⁵

5 Barriers against financial exploitation

– Choosing to hold large levels of savings at advanced ages in lieu of fixed, automatic income can expose older adults to bad advice or even fraud. In many cases, when their

health fails, the responsibility for financial affairs falls to their children or the public trustee, and decisions about how much to spend and how to invest – even when well-intentioned – are not always what the individual would have intended. Holding significant amounts of accessible savings at advanced ages can invite conflicts within families – and, even worse, attract scammers and swindlers. In fact, financial elder abuse is expected to become one of the biggest crimes of the 21st century (Roberto & Teaster, 2011).

¹⁵ Personal communications, April 6, 2023.

Box G: An Uncomfortable Truth

“As someone who has owned and run privately owned nursing homes, I could usually tell which residents had a DB pension plan that covered their fees relative to the ones who were drawing from their savings, just from the attitudes of the family members. Families of those who were drawing from their savings often complained about not getting their money’s worth and that a publicly funded (i.e., free) nursing home would be better. Residents with DB pensions generally did not leave, and it seemed (anecdotally) that the pension income was generally regarded by their families as being the older person’s income, budgeted for their care.

“Over time, it became clear to me that families of residents without DB pensions were more likely to have a proprietary view of their parent's assets. It is an uncomfortable truth, but there is an inherent conflict of interest in having the ultimate beneficiary of the assets control the funding decisions of the parent. By comparison, the family of residents with a DB pension did not have the same desire to preserve the asset for the future, which they could do by not spending the DB pension income as it came in. It was viewed merely as an income stream to cover the costs of care.”

- Anonymous – personal communications, May 10, 2021.

Conclusion

Delaying claiming CPP/QPP benefits can address three major areas of financial risk in retirement: investment, inflation and longevity. Reducing these risks not only increases financial security in retirement, but also brings greater peace of mind, less burden and responsibility on the shoulders of older Canadians and their families, a license to spend more freely and joyfully in retirement, and a barrier against financial exploitation of the elderly.

Explaining the financial value of choices like deferring CPP/QPP benefits is insufficient. This paper supports and empowers financial

advisors, employers, government agencies, professional organizations, financial institutions and others in a position of influence. It offers a more holistic approach to explaining the risks Canadians will face in retirement and the **key advantages of having more secure, lifelong retirement income, which extend far beyond how much money can be spent.** This targeted education – combined with the behavioural interventions discussed in forthcoming papers in the series – can have a profound and lasting impact on financial decision-making, now and in the future.

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Appendix A: Club Vita Explains Longevity Misconceptions and Risks

By Bonnie-Jeanne MacDonald and Erik Pickett

Life expectancy statistics can be very misleading for Canadians planning their retirement, as the following incremental errors are often made:

1. Using the wrong starting age. Life expectancy statistics are routinely reported from birth. While it is true that life expectancy has gone up significantly over the past 70 years (from age 68 in 1950, to age 82 in 2016) (Human Mortality Database, 2020), these statistics include deaths before retirement. In other words, for Canadians who have survived long enough to retire, their life expectancy is quite a bit longer. For example, according to Statistics Canada, the period life expectancy based on 2016-2018 data for Canadians at birth versus at age 65 shows approximately a three- to four-year differential (Statistics Canada, 2022):

- Period life expectancy from birth:
males = 79.9, females = 84.0
- Period life expectancy from age 65:
males = 84.4, females = 87.1

2. Ignoring critical characteristics. No two Canadians are the same, and Canadians who rely on life expectancy statistics should attempt to make them as personalized as possible. For example, Club Vita's analysis shows an 11-year spectrum in life expectancy, depending on individual characteristics such as gender, wealth and lifestyle.

With personalized data, life expectancies can vary widely relative to group data. At the extreme, provided with perfect granular individual information, a person's life expectancy could range from a few months (for those with a terminal illness) to more than 30 years (such as a non-smoking, wealthy female in excellent health with exceptional genetics living in an optimal environment).

Canadians who can contemplate delaying CPP/QPP benefits generally have the cash flow to fund the delay – as well as some anticipation of normal to good health – and are therefore likely to be on the longer-lived end of the spectrum. Figure A.1 shows how period life expectancy changes for different individual characteristics. Period life expectancy based on 2016-2018 defined benefit pensioner data for healthy individuals, with high affluence in long-living postal codes, is 87.7 for men and 91.5 for women.

Figure A.1: Impact of personalized characteristics on life expectancy

Longevity characteristic	Impact on life expectancy from age 65 for men	Impact on life expectancy from age 65 for women
Females vs. males	3.1 years	
Pensioner vs. surviving spouse	1.4 years	1.4 years
Regular vs. disabled retirement	4.7 years	4.0 years
Longest vs. shortest-lived lifestyle group	3.4 years	3.6 years
Highest vs. lowest salary band	3.4 years	1.8 years
Highest vs. lowest pension band	2.8 years	1.4 years
Non-manual vs. manual occupations	1.9 years	1.7 years
Joint vs. single pension form	1.2 years	0.6 years
Considering all factors	10.8 years	

Source: Club Vita analysis based on CV20 model calibrated to 2016-2018 DB pensioner mortality data

3. Ignoring mortality improvements.

Commonly reported life expectancy figures are known as “period life expectancy”, meaning they assume new pensioners today will have the same levels of health, lifestyle and medical support as those from the previous generation. However, actuaries and other experts expect life expectancy to continue to increase over time (as it has for centuries), based on known cohort-specific and cause-specific improvements that have not yet fully taken hold. For example, life expectancy among those with high socioeconomic conditions from age 65 in 2022 with mortality improvement (MI-2017) is age 89.4 for males and 92.9 for females.

4. Reporting only averages.

Most importantly, life expectancy is an average figure – and most people are far from average. Even with a more appropriate life expectancy figure, there is a significant risk that a person will die either much sooner or much later (as emphasized in Figure A.2, which shows the range of ages of death). Someone is much more likely to die before or after their life expectancy than at the age itself. In fact, on account of the distribution being skewed to the right, people are more likely to die after their life expectancy: the “typical” age of death (the median) is higher than the average. (Figure A.3 vividly illustrates this point.)

Figure A.2: Distribution of age of death for a 65-year-old, by sex

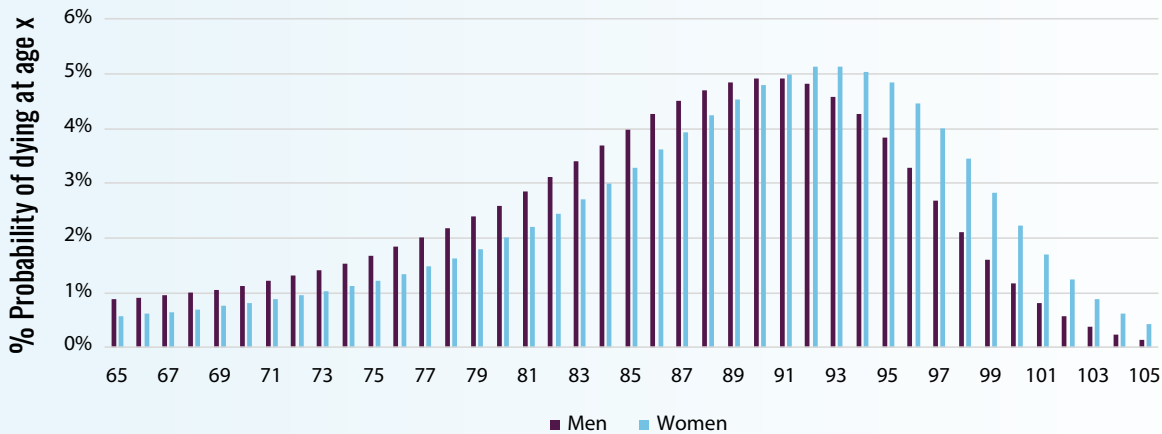
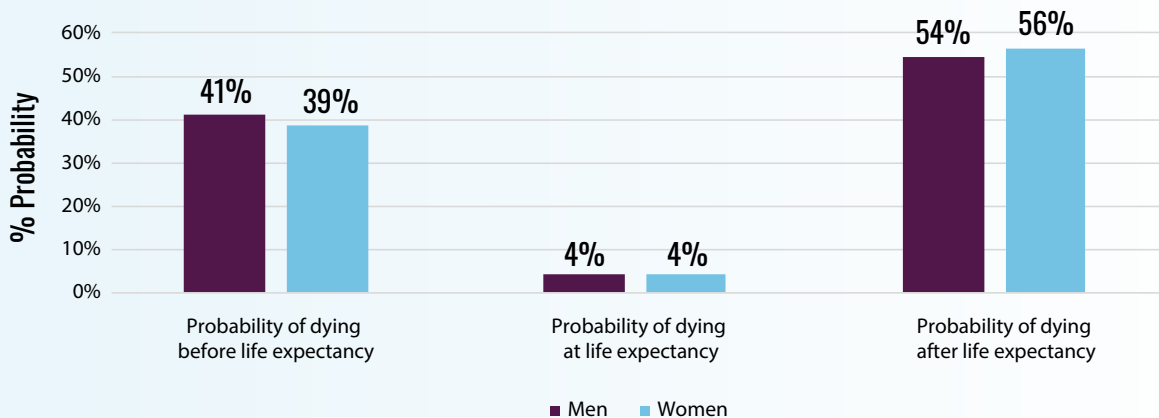


Figure A.3: Probability of dying before, at, or after life expectancy for a 65-year-old, by sex



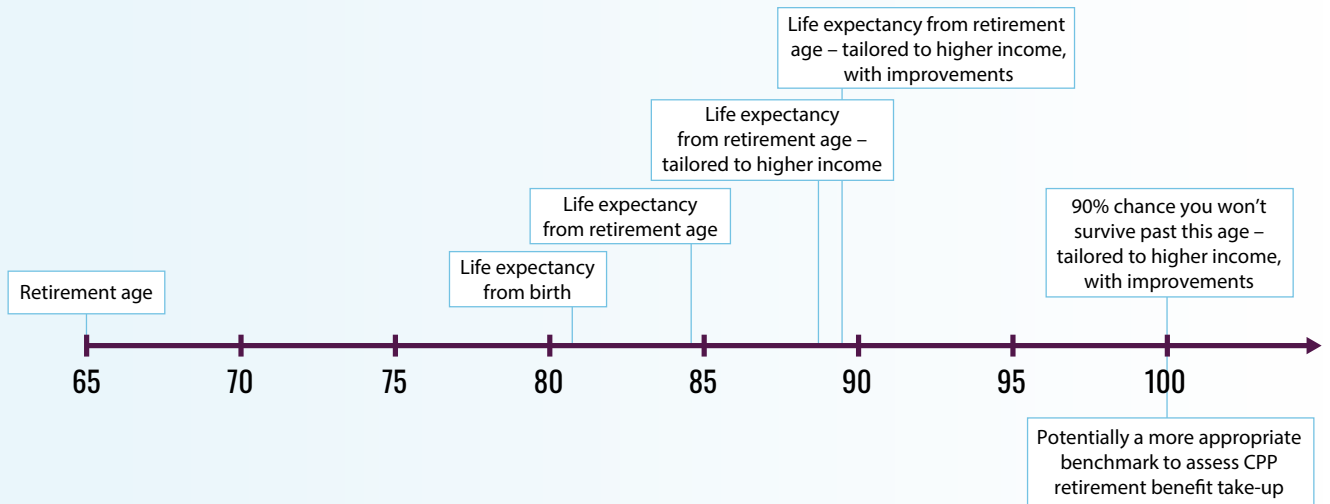
Source: Club Vita analysis for a 65-year-old in 2020 assuming the Canadian Pensioner Mortality (CPM 2014) Private base mortality table with the CPM-B improvement scale (Club Vita, 2020).

Once accounting for a 65-year-old’s current age, mortality improvements – and the reality that those who can afford to delay CPP/QPP benefits tend to have higher socioeconomic conditions – there is a:

- 25% chance of living to age 96 for men, and age 99 for women;
- 10% chance of living to age 100 for men, and age 103 for women; and
- 5% chance of living to age 102 for men, and 105 for women.

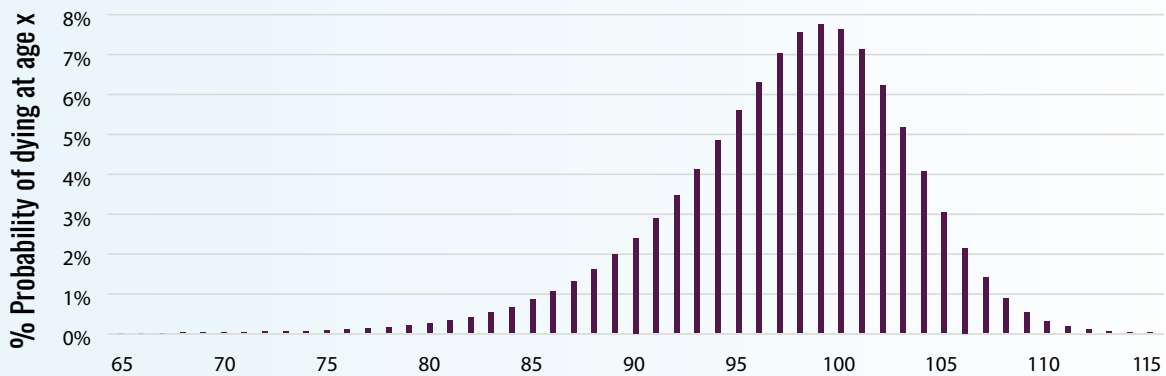
Figure A.4 captures the full picture of subjective versus objective financial planning timeline for males with higher socioeconomic conditions (the equivalent female values are shifted to the right by two to four years). It points to age 100 as a reasonably prudent benchmark for retirement financial planning among those with sufficient savings to make delaying CPP/QPP a viable option.

Figure A.4: Subjective versus objective timeline for retirement financial planning for male with higher socioeconomic conditions



Finally, couples have to be particularly aware of longevity risk, because they are planning the lifespan of not just one but two individuals. For example, there’s a one in 10 chance that one of a 65-year-old couple will live past age 103.

Figure A.5: Probability of last survivor of a 65 year old couple dying at a given age



Probability	Age at death of last survivor of Male-Female household retiring at 65
90%	89
75%	93
50%	97
25%	100
10%	103

Source: Club Vita calculations using CV21 base tables, MI-2017 mortality improvement scale, assuming a male/female couple, both 65 years old in 2023.

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