When to begin your CPP retirement pension

aviso wealth

The case for taking Canada Pension Plan at age 70

While playing charades over the holidays, my youngest son stumbled with "a bird in the hand is worth two in the bush." Eventually we guessed it, and then explained to him that it means accepting a sure thing now rather than holding out for something potentially bigger later.

Coincidentally, that adage also featured prominently in an item on my holiday reading list — a research paper[1] about delaying Canada Pension Plan (CPP) retirement benefits, released in late 2020 by the National Institute on Ageing and the FP Canada Foundation.

My long-held opinion has been to take CPP no earlier than age 65, unless there are compelling personal characteristics or surrounding circumstances that support starting at a younger age. After reading this paper, I'm now leaning toward 70 as the default position.

When we're starting CPP, and why

The majority of Canadians — seven out of 10 — take their CPP retirement pension at either age 60 or 65. Less than 5% take it after age 65, and only 1% wait until age 70. The research paper's author, Bonnie-Jeanne MacDonald, attributes this pattern of early uptake to a combination of lack of advice, bad advice, and "bad-good" advice.

The bad advice includes the emotional pull of the bird-in-the-hand: If you die early (so the argument goes), you'll leave money on the table, so you should take CPP as soon as you can. However, the only guarantee here is that your payments will start sooner, not that you will receive more. And ironically, the early uptake may in fact increase the likelihood that you will receive less, as we will see further down.

The "bad-good" advice is the mainstream practice of using a breakeven age. It compares two starting ages, for example 60 and 65, focusing attention on whether you will reach the age when the cumulative payment receipts are the same. This speaks to our behavioural tendency to favour the near-term (from first age to second age to breakeven age), thereby undervaluing the lifetime income security that CPP offers. On top of that, academic research shows we tend to underestimate our life expectancy, making it even more likely to choose the earlier start.

According to Canada's chief actuary, life expectancy at age 60 is 85.9 for men and 88.5 for women. In my own experience, I've never seen a suggested breakeven/crossover age much over 80. This has long been my discomfort with this approach, as you are betting on being in the "dies-before" half of the cohort population. You lose (statistically) simply by being average, and it gets worse the longer you live.

Measuring the dollar difference

Early uptake would not be a concern if it leads to a better financial outcome. To test this, MacDonald departs from the breakeven approach, favouring a calculation of the current dollar value of the expected loss, or "lifetime loss."

The model incorporates the annual drawdown of RRSP/RRIF savings equal to the foregone CPP pension each year, until the pension actually begins. Though taking CPP earlier may allow RRSP/RRIF savings to last longer, the model shows that most people will maximize lifetime income from the two combined sources by deferring CPP to age 70.

Notably, among the scenarios canvassed in the paper, for someone entitled to the maximum CPP pension who lives close to age 100 (a 25% probability from age 60 according to the dataset used), the current dollar loss can exceed a quarter of a million dollars.

[1] https://bit.ly/3a3hszx

Sorting through contributing factors and fielding options

To be clear, lifetime loss is not intended to be applied without consideration of individual circumstances. There are many situations where it would make sense to begin early, such as when there is a known life-limiting health condition, or when someone is trying to preserve income-tested benefits or shield against the Old Age Security clawback.

For most people, it's a challenge just to identify all the contributing factors in making such a decision, let alone evaluate the trade-offs among them. It's both technically complicated and emotionally charged, which together can be overwhelming.

In addition to being a dependable information source, financial advisors can offer guidance on how to apply some of the lessons of behavioural finance:

- ***Loss aversion*** holds that we feel the pain of loss twice as much as the joy of gain, which is what lifetime loss illustrates in concrete terms.
- It also ***frames*** the discussion on the more-likely scenario of longevity, as opposed to early death.
- Lastly, by ***anchoring*** the thinking on age 70 as the default option, the ultimate decision is more likely to end up near that age, to one's own benefit.

Ultimately, the decision should be informed by individual particulars and reliable evidence as part of the conversations between advisors and clients.

For more information, please consult your advisor and tax professional.