CPP Supplement – An advanced guide to your CPP benefits

Matthew Karam CFA, CFP®, TEP, CIM® - Investment Advisor – TD Wealth Private Investment Advice

The purpose of this document is to offer some advanced commentary on CPP benefits. A summary of the recommendations in this guide are the following:

1) **If you are unsure of when to commence your CPP benefits, reference the CPP decision tree on page 6.**

2) **As explored in the proceeding case study, the CPP break-even point between taking CPP early at age 60 vs. delaying to age 70 can be as late as age 85 and beyond.**
    - In other words, it may take decades before delaying your CPP benefits is mathematically optimal compared to taking your CPP benefits early.
    - The case study also excludes considerations such as the CPP dropout provisions and Post-Retirement Supplement which would favor taking CPP early.
    - Many financial planning assumptions factor into this calculation including investment rate of return, marginal tax rates, inflation, and other retirement income.

3) **Upon marriage breakdown, it is recommended that you consult with a financial advisor prior to signing a CPP pension splitting agreement to review your CPP contribution history.**
    - Under some circumstances, it is possible that both parties will reduce their CPP benefits by signing a CPP pension splitting agreement.

How are your CPP benefits determined?

To better understand the guide recommendations, it is useful to know how your CPP benefits are calculated[i]:

1) First, obtain your most recent CPP statement of contributions via your My Service Canada Account.
    - If you do not have your My Service Canada information, there is a link available through your CRA Login.
    - The statement of contributions should look like the following:

Year	Your contributions	Your pensionable earnings	Notes
2011	$2,217.60	$48,300.00	M
2012	$2,306.70	$50,100.00	M
2013	$2,356.20	$51,099.00	
2014	$2,425.50	$52,500.00	M

2) Calculate your total number of CPP contributory months.
    - Your contributory period begins the month after you turn 18, and ends on the earlier of:
        i. The month you turn 70, or 65 if you retire prior.
        ii. The month before your CPP retirement starts.
        iii. Upon death.
    - The contributory period excludes any months in which you receive CPP disability benefits.

3) For each year, calculate the ratio between 'Your pensionable earnings' found in your statement of contributions and the Yearly Maximum Pensionable Earnings (YMPE) for that year.

4) Multiply the ratio from step #3 by the current years YMPE.
    - This figure provides a current dollar representation of your previous years CPP contributions.

5) Determine and remove your dropout periods. These dropout periods will be excluded from your CPP benefit calculation. The two most common include:
    - The general dropout provision affects 17% for CPP or 15% for QPP of your base contributory period, when your earnings were at their lowest, allowing up to 8 years of your lowest earnings to be dropped from the calculation[ii].
    - The child-rearing provision can apply where you had lower earnings because you were the primary caregiver of a dependent child under the age of 7[iii].

6) Sum the annual figures from step #4 (excluding the dropout years from step #5) and multiply by 25% to determine your CPP benefits at age 65.

7) Apply any applicable actuarial age adjustment factor.
    - ***Prior to age 65****:* reduce benefit by 0.6% per month.
    - ***After age 65****:* increase benefit by 0.7% per month.

Should you delay receiving your CPP benefits?

In short, it depends. The answer to this question ultimately depends on your financial situation and personal preferences. The following are items to consider when making the decision to start your CPP benefits:

- What is your life expectancy?
- Is there a risk of depleting your investment assets during retirement?
- Are you a risk-averse investor?
- What are your future retirement expenses?
- What is your current and future marginal tax rate?
- What is a reasonable future rate of return on your investment portfolio?
- What is a reasonable future rate of inflation?

Can delaying your CPP income reduce your base CPP benefits?

Yes. A reduction of your benefits most commonly affects individuals who retire prior to age 65 and decide to defer their benefits to age 65 and beyond.

This reduction can be attributed to the way the CPP formula includes your total number of contributory months (see step #2 above). The CPP formula will include all months from age 18 up until the earlier of:

- The month you turn 70, or 65 if you retire prior.
- The month before your CPP retirement starts.
- Upon death.

For example, should you decide to retire at age 55 but delay your CPP income until age 65, the 10-year gap will continue to be included as contributory months in your CPP calculation. The general dropout provision (see step #5 above) can help reduce some, but not all, of the negative impact on the calculation.

As a result, it may make more financial sense to take CPP benefits the earlier of age 60, or the year after retirement so the general dropout provision can be used for other low-income earning years.

What is the Post-Retirement Benefit (PRB) or Retirement Pension Supplement?

Once you have commenced your CPP/QPP payments, you may still be working, or you may decide to return to work. Should that occur, the CPP & QPP programs approach this aspect slightly differently. The CPP offers the PRB which is a program you may opt in or out of, whereas the QPP offers an automatic enrolment to the Retirement Pension Supplement[iv]. For both programs, additional payments begin the year following any additional contributions.

An individual is eligible for the PRB if you are:

- 60-70 years of age.
- Working and contributing to the CPP, and:
- Receiving a retirement pension from CPP/QPP.

The amount of the PRB you receive will depend on your age, earnings, and contribution amounts made during the previous year. It is approximately 1/40 of your annual CPP. The PRB is paid as a separate amount in addition to your regular CPP or QPP.

Should you elect to receive the Post-Retirement Benefit (PRB) supplement?

Electing to receive the PRB supplement can greatly benefit individuals who have maximized their lifetime CPP contributions while continuing to earn employment income beyond age 60. Given they gain no benefit from extra CPP contributions, the individual can elect to start receiving CPP benefits immediately, while accumulating benefits from the PRB supplement.

Should you take your CPP benefits at age 60 or 70? A CPP break-even case study.

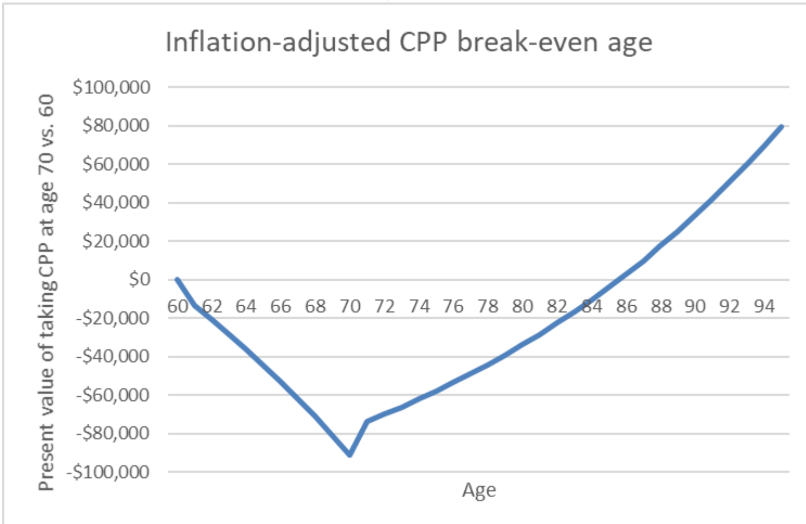
Assuming the previously mentioned CPP formula (page 2) and post-retirement benefit scenarios (page 4) are excluded from the case study, we can better isolate the decision to take CPP benefits by examining a typical retirement scenario.

Take a retiree aged 60 who qualifies for full CPP benefits and can earn an after-tax and management fee rate of return of 4.5% on their investment portfolio. The tax rate on their CPP income is initially 25% but increases to 35% once minimum RRIF payments commence at age 72.

If the retiree qualifies for full CPP benefits, they can elect to take CPP income at age 60 and receive an inflation-adjusted monthly income of $679.16 (for 2019), or $1639.50 at age 70. In each scenario, I will assume the retiree deposits the after-tax portion of this monthly income into their investment account earning an after tax and management fee of 4.5% in perpetuity.

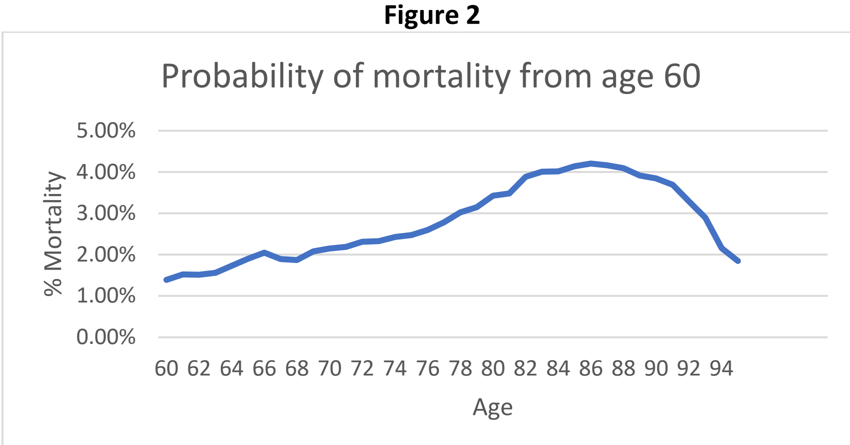
To best compare the two scenarios, we must calculate the present value (today's dollar value) of these cash flows. The model illustrates an inflation-adjusted CPP break-even point of age 85 (Figure 1). ***In other words, in this example, the retiree should delay their CPP benefits only if their life expectancy is greater than age 85.***

Figure 1



An important factor to consider is the probability of mortality of an average Canadian for each given age. As shown in Figure 2, an individual who is currently aged 60 has a 1.4% probability of passing away in that same year. In contrast, the age with the highest probability of mortality is age 86 at 4.21%.

Figure 2

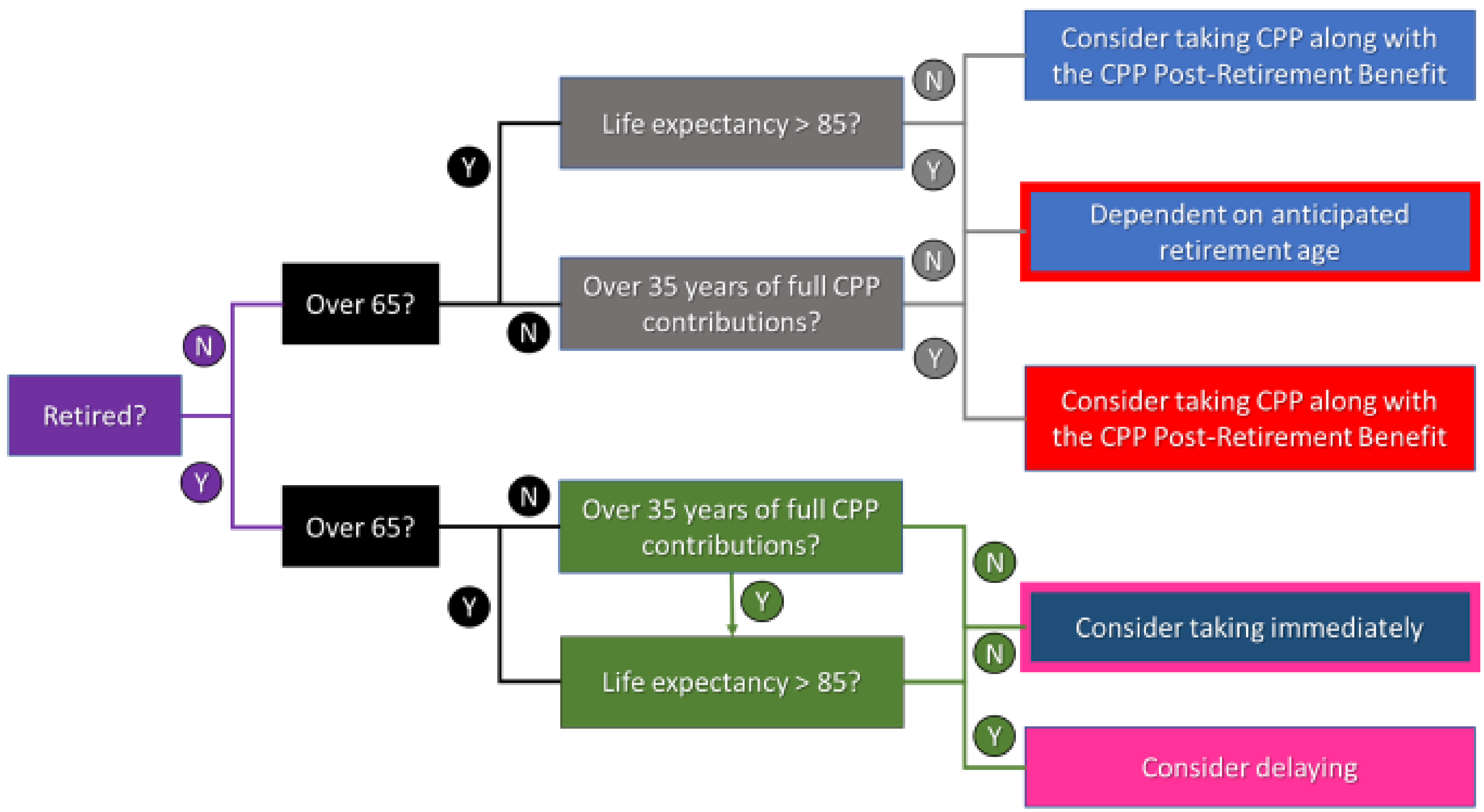


Source: Statistics Canada, Canadian Vital Statistics, Deaths Database, 2013, Survey 3233.

Although this example demonstrates a break-even age of 85, the case study assumptions exclude some of the CPP formula considerations mentioned previously such as the calculation of contributory months and the post-retirement benefit supplement. **If either of these exceptions applied to this case study, the CPP break-even point would have been greater than age 85.**

CPP Decision Tree

Use this guide to help make your decision whether to immediately take or delay your CPP benefits.



Is CPP pension splitting upon marriage breakdown a good idea?

The CPP contributions you and your spouse or common-law partner make during the time you live together can be equally divided after a divorce or separation. This is called credit splitting. Credits can be divided even if one spouse or common-law partner did not make contributions to the CPP[v]. To request a CPP split, complete the CPP Credit Split form (ISP1901), and include certified true copies of the required documentation.

In some cases, CPP pension splitting can be disadvantageous to both parties. The following table shows two individuals CPP pensionable earnings before and after a CPP credit split. Of note, Person B made higher CPP contributions than Person A from 2001-05, and then took 6 years off work from 2006-11 to care for their child.

Before		Year	After	
Person A	Person B		Person A	Person B
$15,000	$38,300	2001	$26,650	$26,650
$15,000	$39,100	2002	$26,650	$26,650
$15,000	$39,900	2003	$7,500	$7,500
$15,000	$40,500	2004	$7,500	$7,500
$15,000	$41,100	2005	$7,500	$7,500
$42,100	$0	2006	$21,050	$21,050
$43,700	$0	2007	$21,850	$21,850
$44,900	$0	2008	$22,450	$22,450
$46,300	$0	2009	$23,150	$23,150
$47,200	$0	2010	$23,600	$23,600
$48,300	$0	2011	$24,150	$24,150
$50,100	$50,100	2012	$50,100	$50,100
$51,100	$51,100	2013	$51,100	$51,100
$52,500	$52,500	2014	$52,500	$52,500
$53,600	$53,600	2015	$53,600	$53,600
$54,900	$54,900	2016	$54,900	$54,900
$55,300	$55,300	2017	$55,300	$55,300
$55,900	$55,900	2018	$55,900	$55,900
$57,400	$57,400	2019	$57,400	$57,400

Before the pension split, Persons A and B were on pace to receive almost 100% of the maximum CPP benefit since Person B could exclude 2006-11 from their CPP calculation under the child rearing provision.

After the split, both Persons A and B are now on track to receive about 70% of the maximum CPP benefit since Person A will split their credits from 2006-11, while Person B will split their credits from 2001-05. <u>Both individuals are negatively affected due to the sharing of credits for years that would qualify under the dropout provision (2006-11)</u>.

As a result, it is important to take a closer look at your CPP contribution history prior to applying to split CPP income.

[i] https://retirehappy.ca/how-to-calculate-your-cpp-retirement-pension/

[ii] https://mediahandler.broadridgeadvisor.com/media/286021/Government_Benefits_EN_Final.pdf?MediaVersion=1&optimize=false

[iii] https://www.canada.ca/en/services/benefits/publicpensions/cpp/child-rearing.html

[iv] https://mediahandler.broadridgeadvisor.com/media/286021/Government_Benefits_EN_Final.pdf?MediaVersion=1&optimize=false

[v] https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-split-credits.html