Eliminating Mandatory RRIF Withdrawals

RRIF rules undermine retirement security

Canadians are not saving enough for their own retirement and there is growing concern that many will face considerable income insecurity in retirement.[i] Current rules mandating minimum yearly withdrawals from Registered Retirement Income Funds (RRIFs) compound the problem[ii] since Canadians who have retirement savings in Registered Retirement Savings Plans (RRSPs) are compelled under the current rules to drawdown their savings starting at age 71 - when RRSPs must be converted to Registered Retirement Income Funds (RRIFs). These rules are designed to virtually empty out the RRIF by age 92, thereby placing many Canadians at risk of outliving their retirement savings given today's longevity rates.

RRIF rules have not kept pace with increasing lifespans and time spent in retirement, declines in personal savings rates, and reduced access to workplace pension plans. When the original RRIF rules and withdrawal rates were introduced in 1978 and then increased in 1992, lifespans and time spent in retirement were much shorter than today and Canadians on average spent less time in retirement. RRIF holders now face considerable likelihood of running out of money in late stages of retirement.

CARP calling for an elimination of mandatory RRIF withdrawals

The recession took a heavy toll on retirement savings and investment. These losses were magnified by the RRIF rules that forced RRIF account holders to not only withdraw and pay tax on the mandated amounts but almost double the amount of tax deferral room in their RRIFs, room that was sorely needed if they were to rebuild their savings after the crash. At the time, CARP successfully advocated for a reduction on mandated RRIF withdrawals to help those affected by the 2008 recession. The federal government allowed a 25 percent reduction for 2008 only. While the temporary relief helped a considerable number of Canadians get breathing room, the reprieve was limited in duration and amount.

CARP is now calling on the federal government to completely eliminate mandated minimum RRIF withdrawals.

The erosive effect of RRIF rules on retirement savings

Tax-deferred Registered Retirement Savings Plans (RRSPs) were originally created by the federal government with the goal of promoting and helping people save for their own retirement. But since RRSPs must be converted to RRIFs or an annuity by age 71, the mandated RRIF withdrawals effectively remove personal choice and control over one's own finances in retirement and undermine the goal of RRSPs as a personal retirement savings vehicle. RRIF rules are designed to deplete retirement savings by age 91, only twenty years after conversion *(See appendix for full withdrawal rates by age).* Federal tax rules force people with RRIFs to withdraw prescribed yearly amounts from their accounts based on an

age-linked formula that starts at about 7 percent of savings the first year and increases yearly until reaching a minimum withdrawal of 20 percent. Prescribed, mandated RRIF withdrawal rates allow the government to recoup taxes that were deferred when individuals contributed to RRSPs.

The federal government was in a deficit position and in need of a steady inflow of tax revenue when the withdrawal amounts were increased in 1992.[iii] As of November 2014, the federal government is claiming a surplus for this year and for the years ahead. The federal government can no longer justify forcing retirees to withdraw and pay tax on RRIF funds to garner immediate tax revenues.

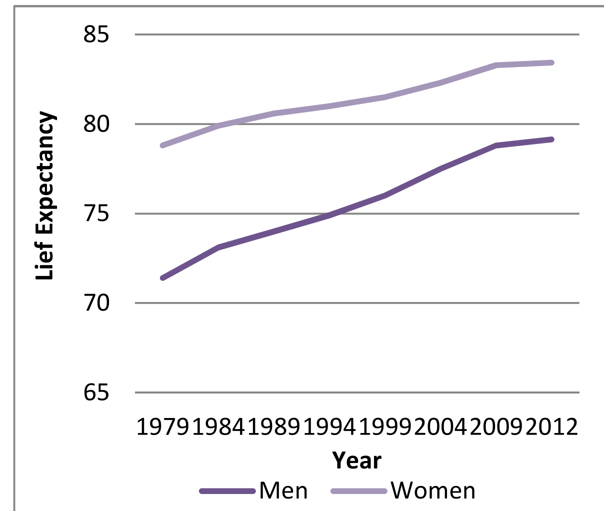
When RRIFs withdrawal rates were increased in 1992, they didn't have quite the negative effect they have now since life spans were shorter and people tended to live in retirement for a shorter period of time. Canadians now more than ever need the added flexibility and control in deciding how and when to withdraw their own money, all of which would still be subject to taxation upon any point of withdrawal.

Canadians at risk of outliving retirement savings

Current RRIF rules ignore changing demographics. Canadians are living longer now than ever before and spending a longer amount of time in retirement. RRIF rules mandating minimum yearly withdrawals at prescribed rates ignore these demographic realities.

- In 1992, a Canadian starting to withdraw funds from a RRIF could expect to live an additional 13 years, for a lifespan of approximately 82.[iv]
- Today, an average 71 year old can expect to live approximately 16 years more, for an expected lifespan of 85, three years more than in 1992.[v] It is projected for the near future that many Canadians will live past 90 years of age.[vi]
- The probability today of a 71 year old female reaching age 94 has almost doubled compared to 1992 and the probability of a 71 year old male reaching that age has more than tripled.[vii]
- There are about 200,000 Canadians currently over 90 years of age.[viii]

Chart 1. Canadian life expectancy at birth, 1979-2012[ix]



As the chart shows, in the time since RRIF rules were first implemented in the late 1970s, men on average have realized about 8 years of increased longevity and women have gained on average 5 years of longevity. Much of the respective gains in longevity occurred since the minimum withdrawal rates were increased in 1992.

Increased longevity and time spent in retirement requires that Canadians have more control of access to their retirement funds. The status quo increases both real and perceived financial insecurity.

Recession, low savings rates, and disappearance of pension plans compound the erosive effects of RRIF rules

The recession took a heavy toll on retirement savings, especially affecting people near or in retirement. Many RRIF account holders during the recession were hit financially multiple times: by the biggest market crash since the Great Depression that caused a loss of one third or more of investments; by mandated RRIF withdrawals that further depleted investments that were poised to rebound in the months and years following the crash; and by paying taxes on the money the RRIF rules forced people to withdraw regardless of personal timing and need.

Had RRIF holders been able to keep their money invested in 2008/9, the effects of the crash would not have hit as hard and would have allowed RRIF holders to recover more of their losses in the market recovery following the recession.

Even before the recession, however, Canadians were underprepared for retirement and at real risk of outliving their savings. Two-thirds of all working Canadians now also do not belong to a pension plan and those who do are more likely now than in the past to belong to defined contribution plans rather than the more robust defined benefit plans.[x]

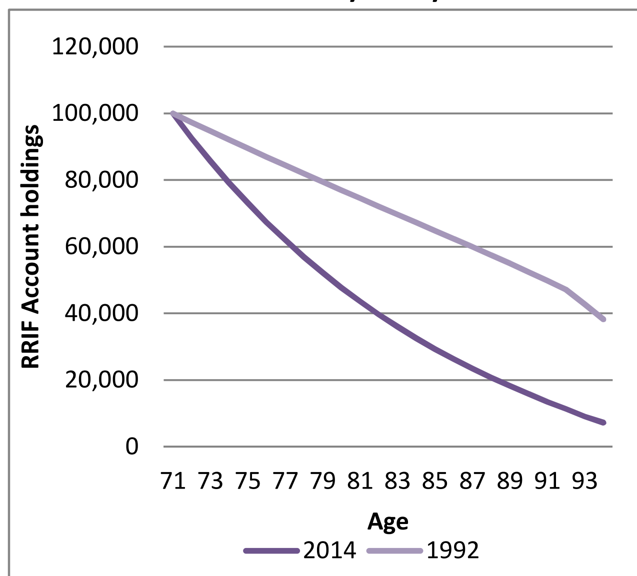
Most Canadians do not have alternatives to private savings for retirement besides CPP, OAS, and GIS. When RRIF rules were first put in place in the late 1970s, Canadian households saved about 15 percent of income. By 2011, the household savings rate plummeted by a factor of five to just above 3 percent of income.[xi]

At the time of retirement, a typical middle-income Canadian family will require roughly $500,000 to $1,000,000 to retire securely without a drop in standard of living, depending on pre-retirement income, retirement needs, and age of retirement.[xii] The Canadian median RRSP value in 2005 was only $30,000, far short of even the lower range of expected savings needs.[xiii]

Canadians between the ages of 65 to 69 today hold only an average of $40,000 dollars in RRSPs.[xiv] Many Canadians will not have saved sufficiently for retirement and mandated minimum withdrawal rules put people at risk of untimely erosion of personal savings in RRIFs.

Taking as an example a RRIF account with holdings of $100,000 and applying 1992 RRIF rates with the rates applied today shows the erosive effects of RRIF rules.

Chart 2. Effect of Mandatory Yearly Minimum



Withdrawal Amounts from a $100,000 RRIF Account, 1992 vs 2014[xv]:

The chart above shows that the current mandated withdrawal rates combined with increase longevity results in a precipitous decline in savings that erode substantially by age 91.

For an increasing number of Canadians, savings will dwindle or run out before death. By contrast, if the same $100,000 investment remained intact and grew at a conservative rate of 2 percent each year, by 76 an account holder would have $111,000 - $44,000 more than would be in the account under the current rules.

Some financial experts have suggested that RRIF account holders are free to reinvest funds

withdrawn from RRIF accounts. But this approach ignores the effect of taxation on each withdrawal and the loss of investment scale that occurs when funds are diverted from a larger pool of investments into smaller accounts. It also ignores the impossibility of market timing. Successfully withdrawing funds from a RRIF account for reinvestment purposes would require individual to time the withdrawals and reinvestments with daily, monthly, or yearly market cycles, which is a skill and level of risk most common retail investors and retirees do not possess.

66% of CARP members call for complete elimination of mandatory RRIF withdrawals.

CARP members want an end to mandatory RRIF withdrawals[xvi]

RRIFs play a significant role in the retirement income of CARP members. Almost all (87%) of CARP members are RRIF holders or will be when they reach age 71 and almost two-thirds (61%) of CARP's members hold half or more of their retirement savings in a RRIF account. One in five CARP members polled hold all of their retirement savings in RRIF accounts.

Not surprisingly, more than half (54%) of CARP members are worried about outliving their savings, with 48 percent saying that only careful planning and spending will they have enough to last as long as they live. More than one-quarter of CARP members don't expect their savings to last a lifetime. Only 17 percent say they have enough savings to last a lifetime.

CARP members confirm that their own expectations for longevity have changed over the past two decades. Half (48%) of members expect now to live longer than they expected twenty years ago. Almost 10 percent expect to live much longer. The reality of longer lifespans has seeped into the planning and thinking of retirement age Canadians, but the RRIF rules have not. Seventy-two percent of CARP members think that RRIF rules have not kept up with demographic changes. Only 55 percent report that RRIF rules match current demographic facts and trends.

RRIF rules play a direct role in the members' retirement well-being outlook. Forty-one percent say that eliminating mandatory RRIF withdrawals would improve their outlook in retirement.

CARP members see personal control over retirement savings withdrawals as key to ensuring savings last. Having control over RRIF withdrawals is seen as the most important way to ensure savings last through retirement.

The vast majority of CARP members (78%) say that offering retirees complete control over their RRIFs is a more important goal than government recouping deferred taxes through mandatory withdrawals.

Conclusion

Mandatory minimum RRIF withdrawals reduce financial security by compelling individuals to withdraw and pay tax on savings regardless of need and despite the fact that saving adequately, planning, and managing finances for retirement is increasingly difficult for many Canadians. People are also living longer and spending more time in retirement than in past decades. Canadians now require more control and flexibility in determining how best to use the money they saved for their own retirement. Laws that directly undermine their efforts to secure their retirement should be removed.

The federal government acknowledged during the recession that RRIF rules can have adverse effects on retirement income security. They did so with a one-time 25 percent reduction in withdrawal rates. It's time now that the government acts to eliminate all mandatory minimum withdrawal rules affecting Canadians with RRIF accounts.

Appendix

Minimum Yearly RRIF Withdrawal Rates for 2014 by Age

Age at Start of Year	Minimum Withdrawal Percentage
71	7.38
72	7.48
73	7.59
74	7.71
75	7.85
76	7.99
77	8.15
78	8.33
79	8.53
80	8.75
81	8.99
82	9.27
83	9.58
84	9.93
85	10.33
86	10.79
87	11.33
88	11.96
89	12.71
90	13.62
91	14.73
92	16.12
93	17.92
94+	20.00

References

[i] Wolfson, Michael C., *Projecting the Adequacy of Canadians' Retirement Incomes*, IRPP April 2011: www.irpp.org/assets/Uploads/Wolfson-No17.pdf
[ii] *CARP's Vision for Pension Reform*: http://www.carp.ca/wp-content/uploads/2014/10/Pension-Brief-Oct-2014.pdf
[iii] Robson, William B.P., Laurin, Alexandre, *Outliving Our Savings: Registered Retirement Income Funds Need a Big Update.* CD Howe Institute: http://www.cdhowe.org/pdf/e-brief_175.pdf
[iv] Ibid.
[v] Ibid.
[vi] Office of the Superintendent of Financial Institutions: http://www.osfi-bsif.gc.ca/eng/oca-bac/as-ea/Pages/mpsspc.aspx#TOC-I
[vii] CD Howe, *Outliving Our Savings*: http://www.cdhowe.org/pdf/e-brief_175.pdftriclosan
[viii] Ibid.
[ix] Employment and Social Development Canada, *Life Expectancy at Birth*: http://www4.hrsdc.gc.ca/.3ndic.1t.4r@-eng.jsp?iid=3
[x] Statistics Canada: www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/famil117a-eng.htm
[xi] Statistics Canada: http://www.statcan.gc.ca/pub/13-605-x/2012002/c-g/c-g04-eng.htm
[xii] Based on a recommended income replacement rate of 70% of pre-retirement earnings
[xiii] Statistics Canada: http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/famil100c-eng.htm
[xiv] Statistics Canada: http://www.statcan.gc.ca/pub/75-001-x/2008102/pdf/10520-eng.pdf
[xv] Based on 1992 and 2014 RRIF withdrawal rates.
[xvi] The CARP Poll, RRIFs, July 29, 2014: http://www.carp.ca/2014/07/30/carp-poll-report-rrif-poll/