Enhanced CPP & OAS

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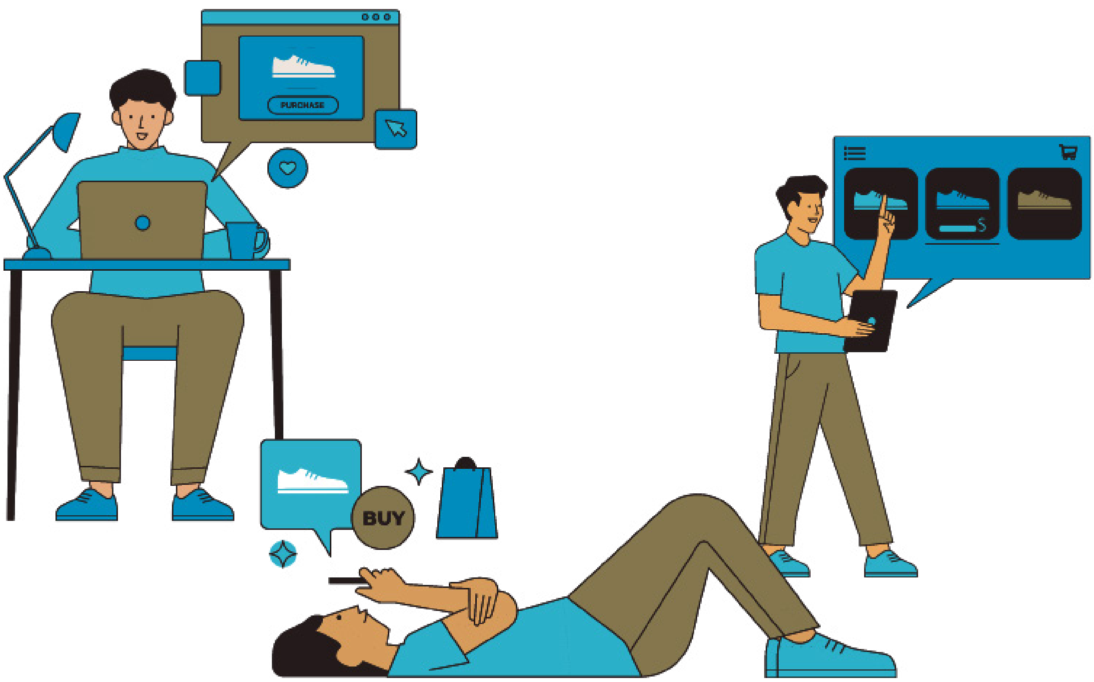
A Not-So-Hidden Secret

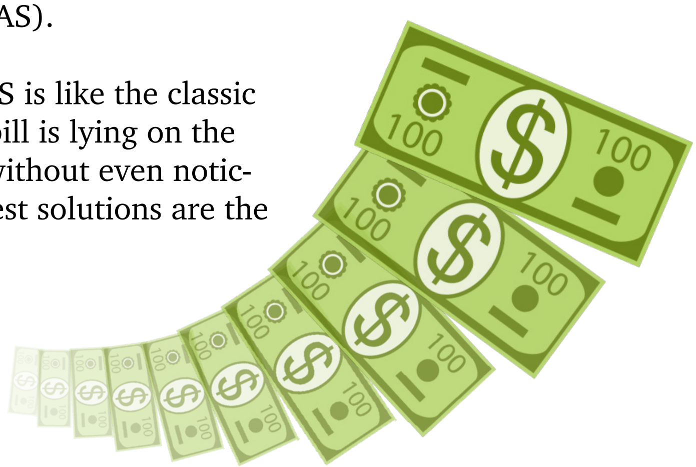
In a world where every dollar counts, it's no wonder that people are always searching for a good bargain. Occasionally, a devotion to saving money can sometimes become an obsession. When searching for a new pair of sneakers, I'll spend weeks checking out different stores and websites to find the best price, even if it means waiting longer for shipping. Dividend investors will scour stock screeners for days, seeking to eke out an extra 0.25% yield.

We're all guilty of trying to squeeze water from a rock to save or make a little extra money. But at what cost?



Interestingly, the best-guaranteed returns often lie in plain sight, overlooked in favour of more complex strategies. As investment counsellors, we aim to optimize clients' accounts to maximize their after-tax income in retirement. We consider projections on rates of returns, time horizons, risk, lifestyle, and many other factors. But the difference is tiny when we compare these efforts to the best-guaranteed returns available through programs like the Canada Pension Plan (CPP) and Old Age Security (OAS).

In fact, the under-planning for CPP & OAS is like the classic economics joke where a hundred-dollar bill is lying on the ground, and an economist walks past it without even noticing. It's a reminder that sometimes the best solutions are the simplest ones.



The changes to CPP introduced in 2019 and enhancements to OAS in 2022 should be addressed. The gist is that even more of your retirement income is guaranteed! You only have to see it lying there and pick it up.

We've previously reviewed the mechanics of CPP. If you could use a reminder of the ins and outs of CPP, read our prior Qub[Ed] article.

Change in CPP Contributions

Before the 2019 reforms, CPP was meant to replace only a quarter of your income. The goal now is for CPP to replace one third of your average income post-2019. CPP changes occur in two phases:

Phase 1—2019 to 2023: Contribution rate increases on Yearly Maximum Pensionable Earnings (YMPE)

Employers and employees will be contributing 1% more to CPP on earnings. For reference, in 2018, the rate was 4.95%. In 2023, employees contribute 5.95% of earnings up to $66,600 (2023 YMPE), a maximum of $3,963. Self-employed individuals taking T4 income would contribute a total of $7,926.

Phase 1 is the first unnoticed guarantee lying around. The contribution is increasing by 1%, while the benefit for your contribution is increasing by 8.3%!

Phase 2—Begins 2024: Tier two CPP contributions for amounts above the YMPE

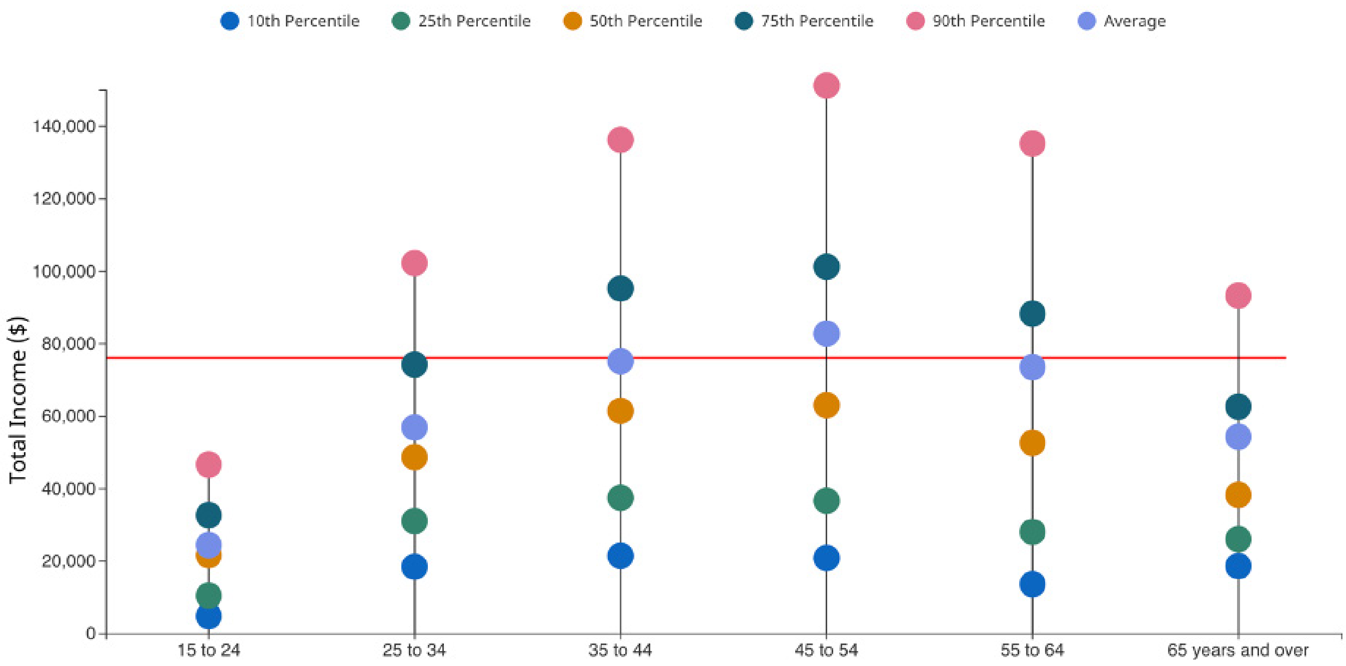
The new second earnings ceiling is the Years Additional Maximum Pensionable Earnings (YAMPE). In 2024, this limit will be a set amount that is 7% higher than the first earnings ceiling. In 2025, it will jump to 14% above the YMPE.

The second earnings ceiling will increase after 2025, just like the YMPE based on inflation-adjusted wage growth. The second ceiling contribution is 4% for employers and employees and 8% for self-employed individuals.

Using the 2023 YMPE of $66,600, we can illustrate the second ceiling for contributions:

Second Ceiling Percentage		YAMPE	Est. Maximum Contribution Employer/Employee
2024	7%	$4,662	$186.48
2025	Onward 14%	$9,324	$372.96

Phase 2 is another opportunity hidden in plain sight! As of 2021, the average income for 35 to 64-year-olds in Alberta is higher than the CPP max. The new second ceiling CPP will provide more guaranteed income benefits to many Albertans in retirement.



The Phase 2 benefit will replace one third of income that falls under the second ceiling. How does that compare with the first ceiling? Contributions are smaller—4% compared with 5.95%—while still covering one third of income in that tier. Another opportunity to guarantee more retirement income!

With any guarantee in life, there is always the fine print. With CPP, this is where the benefits are more geared toward the younger generations.

Substantial Benefit Changes... Eventually

Of course, there's always fine print. With these CPP changes, the benefits are not retroactive to years of contributions. Although pension is in the name, CPP isn't a defined benefit pension using your best five years of contributions.

Rather, the enhancements are on a going-forward basis. For a 60-year-old in 2023, if they take CPP at 65, they'll only experience contributions with Phase 1 and 2 enhancements for three years.

A contributor to CPP will need to pay into it **until 2065** to reap the full benefits. To determine your benefits, CRA has created another lengthy acronym: RTR-FBC—meaning Retirement for Benefit Calculation.

The calculation consists of three parts:

1. The Basic Component -Available on [MyCRA]

This follows the five-step calculation in our previous [CPP Qub[Ed].] And this was the formula used for CPP before the enhancement was introduced.

Essentially, the calculation is your best 32 years of CPP contributions up to the CPP maximum earnings. In 2023, the average Canadian collecting CPP receives 62% of the CPP maximum.

2. First Additional Component -Based on the new, higher contribution rate of 5.95%

This calculation determines the additional CPP benefits gradually increasing from 25% of the YMPE to 33.3%. Between 2019 to 2023, the increases are prorated.

The prorating is based on:

- 2019 – 15% of increased CPP benefits (1.25% of 8.3% CPP increase)
- 2020 – 30% of increased CPP benefits (2.5% of 8.3% CPP increase)
- 2021 – 50% of increased CPP benefits (4.15% of 8.3% CPP increase)
- 2022 – 75% of increased CPP benefits (6.23% of 8.3% CPP increase)
- 2023 – 100% of increased CPP benefits (8.3% of 8.3% CPP increase)

As with many government programs, it seems complex when written out. Put simply, between 2019 and 2023; you only received part of the CPP enhancement. From 2023 onward, you will receive the total CPP enhancement. We love doing these calculations; if you don't, we recommend checking your CPP benefit on MyCRA or reaching out to the Qube team.

3. Second Additional Component

The 2024 and 2025 tier 2 income contributions will replace one third of income that falls under the second ceiling. The second additional adjusted pensionable earnings (SAAPE) will be totalled for all years and averaged over forty years.

Let's look at these calculations in action.

1. Baseline CPP

Yearly Maximum Pensionable Earnings

2019 — $57,400
2020 — $58,700
2021 — $61,600
2022 — $64,900
2023 — $66,600

5-Year Average YMPE = $61,840 X Average lifetime credit of max CPP. For example, 80%. X 25% CPP income replacement = **Starting Annual CPP $12,368**

2. First CPP Enhancement

Yearly Maximum Pensionable Earnings	First Additional Adjusted Pensionable Earnings
2019 — $57,400	x 0.15 = $8,610
2020 — $58,700	x 0.30 = $17,610
2021 — $61,600	x 0.50 = $30,800
2022 — $64,900	x 0.75 = $46,200
2023 — $66,600	x 1.00 = $66,600

5-Year Average FAAPE = $33,964/40 (Years for CPP) X 8.33% CPP Enhancement to get to 1/3 benefit = **$56.68 additional starting annual benefit**

3. Second CPP Enhancement

Assuming income is above YMPE, using 2% inflation

Yearly Maximum Pensionable Earnings

2024 — $67,932 — 7% above = $4,755 /480 x 1/3= **$3.30/year accrued**
2025 — $69,291 — 14% above= $9,700/480 x 1/3= **$6.73/year accrued**
2026 — $70,676 — 14% above= $9,894/480 x 1/3= **$6.80/year accrued**

If you are nearing retirement, the introduction of tier 1 and tier 2 CPP enhancements between 2019 and 2025 results in a guaranteed annual benefit increase of 1.3%. It might not seem like much, but as investors, we would love a guarantee of 1.3%! Then moving forward each month of contributions will gradually increase CPP benefits until 2065. When fully implemented, the 8.33% increase in CPP tier 1 and the addition of tier 2 benefits results in a total increase of over 50% in CPP. All it takes to bolster guaranteed retirement income is patience and continued contributions.

With CPP, contribution changes are what provide the enhanced return. However, the new OAS enhancement is a guarantee with no explicit costs; you only need to live to age 75 to experience its benefit.

OAS Enhancement: When Patience Pays Off

Now, let's turn our attention to the changes made to Old Age Security. When thinking about OAS, imagine it as the valuable collector's item you never knew you had; the vinyl record you forgot about in the basement that turned out to be a first pressing. It wasn't valuable when you bought it, but time was on your side. Now it would fetch a handsome sum if sold!

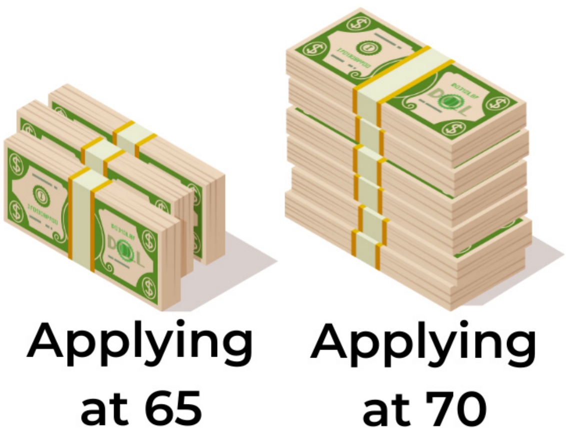
For Canadians, July 2022 marked the first time **since 1973** that a permanent increase to OAS was made. At age 75, OAS payments increase by 10%. All you need to do is wait. That's it.

Free Money?

There is no such thing as a free lunch. But, with OAS, we're close; there is no explicit cost. The **implicit cost** is that taxes pay for OAS in the aggregate. Though, that argument can be used with many government programs and benefits. OAS differs from CPP in that OAS is not based on earnings. Instead, it is based on time in Canada after age 18 divided by 40. After 40 years, the benefit reaches its maximum.

OAS is also **income tested.** For every dollar of income above the threshold amount, 15 cents is clawed back. In 2023, the minimum income recovery threshold is $86,912, and the maximum is $142,124. For example, an individual with a gross income of $90,000 will lose $463.20 of OAS. Conversely, someone who made $85,000 (and therefore did not hit the minimum threshold) will have no lost benefit.

The application to start receiving OAS can begin at age 65. In 2022, the payment was $691 per month. For each month after age 65, OAS benefits increase by 0.6% for a total of 36% by age 70. Waiting until age 70 to receive the benefit increases it to $939.76 monthly. For a 75-year-old, deferring by five years will have made the 10% increase total $93.98 instead of $69.10. Just like CPP, these small differences can add up, culminating in lifetime loss.



Leaving $100 Bills on the Ground

Lifetime loss calculates how much an individual loses by taking government benefits at an earlier age. Each year of deferral can make a big difference.

In Canada, there is a 50% probability of living to age 85. Assuming an individual survives to age 85, the lifetime loss of taking OAS at 65 versus deferring with the new 10% increase at 75 is:

- $4,155 at 66
- $7,990 at 67
- $11,440 at 68
- $14,430 at 69
- $16,873 at 70

An additional $16,873 over retirement is nothing to scoff at. For individuals who reach age 90, the lifetime loss of taking OAS at 65 instead of 70 grows to just under $30,000! A lot of retirement income is left on the table; again, all it takes is patience to receive it.

Decisions, Decisions

As you decide when to take CPP and OAS, it is important to consider your total income and your life expectancy, since taxes are what pays for OAS. Naturally, you want to maximize what you get from the program. And CPP calculations can be overwhelming. When working with clients, we consider all angles. We'll help get the easy wins with CPP & OAS, then work strategically to gather marginal improvements through proper tax planning.

Qube is committed to looking at the larger picture and analyzing your retirement planning with your specific set of circumstances in mind. Contact our team by email at info@qubeinvest.ca, or call us at (780) 463-2688 to get the most out of your retirement planning.

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