



September 11, 2014

PENSION POLICY

## The Overlooked Option for Boosting Retirement Savings: Higher Limits for RRSPs

by

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- Government policymakers should not overlook enhancing RRSPs as another way to boost retirement savings by Canadians. They can easily neglect this option after considering broad data showing low uptake of the product by a majority of Canadians. Hence, it can appear that governments need to set up an obligatory retirement savings solution targeted to those not already participating in a workplace pension plan.
- Yet, more relevant data, focusing on those who need private saving to achieve a realistic retirement income, tell a more subtle story. They show RRSPs are mostly beneficial to \$50,000-plus income earners not covered by a workplace pension plan. Nearly one-in-two with the greatest need to participate in an RRSP made a contribution in 2013, contributing more than 10 percent of earnings on average. Further, relatively low income earners appear to be well covered with respect to their retirement savings needs.
- The case for remedial action, in the form of supplemental forced savings plans, is weaker than widely assumed. Likewise, the data suggest that policymakers should not dismiss the option of higher or more flexible contribution limits, since there are many Canadians who would be well placed to take advantage of them.

If one primarily listened to media and mainstream government reports on household retirement savings, one would likely conclude that Canadians are poor retirement savers, particularly in their Registered Retirement Savings Plans (RRSPs). Reported figures, however, often fail to show the extent to which those who should be privately saving for their retirement actually do so.

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The author would like to thank members of the C.D. Howe Institute's Pension Policy Council and other reviewers for their advice. Not all those who reviewed and commented on previous drafts will agree with the views expressed here: responsibility for any errors and the conclusions are the author's alone.

Low perceived levels of RRSP utilization may influence government policy in two ways. First, since it seems, on the face of it, that workers fail to willingly save enough for retirement on their own, it is sometimes argued that governments need to set up an obligatory retirement savings solution targeted to those not already participating in a workplace pension plan. Ontario's proposed new mandatory pension plan – the Ontario Retirement Pension Plan – is justified along these lines (Ontario 2014). Second, potential reforms to RRSP rules themselves, such as contribution room enhancement or increased flexibility, are outright discarded in large part because of the general – albeit incorrect – perception that no one needs more contribution room or flexibility because RRSP usage measured in aggregate seems low.

Every year, mostly around tax filing season, we hear that the stock of unused RRSP contribution room is staggeringly high, and growing. For example, the most recent Ontario budget reported that “in 2012, there was about \$730 billion in unused RRSP room in Canada, including \$280 billion in Ontario alone (Ontario 2014).” And although rising slowly, total annual contributions to RRSPs represent only a small fraction (4 percent) of available RRSP room.<sup>1</sup> As one financial reporter put it: “the RRSP savings pool gets deeper, but not wider” (Carrick 2014).

But are RRSP participation and contribution rates really that low? As evidenced by Vettese (2014), estimated participation rates would be much greater if we excluded from the statistic Canadians “who are not and should not be RRSP contributors.” People one might exclude, for example, are low and moderate income earners for which pension income from government sources will suffice to replace a significant portion of yearly income they earned when working. There are also those who are already covered by a workplace pension plan and, of course, students as well as older tax filers who are retired or in receipt of a pension.

As this paper shows, nearly half of employed workers who potentially should at least be contributing to an RRSP did so in 2013, and they contributed more than 10 percent of earnings on average, a much higher figure than broad average statistics would lead us to believe.<sup>2</sup> And both RRSP average participation rates and contribution rates increase with age, such that more than 60 percent of average- to high-income earners aged 45 and older contributed to their RRSP, at average contribution rates in various income groups ranging from 8 to 17 percent of earnings for RRSP-only contributors. Therefore, RRSP utilization may still be lower than some would consider socially optimal, but not to the extent widely believed, and not to the point of establishing a strong case for a major public-pensions overhaul. There are options available to encourage more private savings among those most in need of it.<sup>3</sup>

## The Role of Pension Income from Government Sources

Retirement income adequacy is often defined in terms of retirees' ability to maintain their living standards in retirement. Because expenses such as taxes, savings, household items, clothing, and transportation are usually higher while working than in retirement, the level of income retirees will need to maintain their living standards when moving into retirement is usually less than their average earnings over their work life. Because gross

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1 Statistics Canada's CANSIM Tables 111-0039 and 111-0040.

2 After peaking in the late 1990s at around 15 percent, the RRSP contribution rate of above-average earners who are not members of a contributory workplace pension plan has averaged around 11 percent annually since 2002.

3 In particular, workers experiencing uneven career earnings, delayed labour participation, workforce absences and partial careers in Canada, all of which reduce RRSP room potentially below savings levels required to meet retirement aspirations (Pierlot and Siddiqi 2011).

earnings are easily observable, financial planning for retirement is often based on a targeted fraction of the annual earnings a person wishes to replace in retirement, with targeted replacement ratios usually varying from 50 to 75 percent of gross earnings.

Moore et al. (2010) go a step further in approximating standards of living and consider, on top of gross earnings while working, value derived from home ownership versus renting, government benefits minus tax payable, registered retirement savings, and housing equity accumulation, to estimate consumption replacement ratios. They consider a 75 percent consumption replacement threshold sufficient since not all employment expenses and savings can be reliably estimated at an individual level.<sup>4</sup> For many low- to moderate-income earners, pension and other income support from government sources will bring them to that consumption replacement threshold – a welcome feature of Canada’s income support system given that low-income households are those who can least afford to save for retirement.

Consider for example a single senior individual in 2013. He or she would be entitled to receive from the federal government an Old Age Security (OAS) pension, a Guaranteed Income Supplement (GIS), and the GST Tax Credit amount, for a total of \$15,904. On top of this, he or she would be eligible for provincial GIS top-up amounts<sup>5</sup> and other provincial transfer benefits. In Ontario, the GIS top-up, Trillium benefits and the property tax grant would add \$2,871.<sup>6</sup> In total, an Ontarian senior individual with no other sources of income would be entitled to about \$18,775 annually (and indexed to inflation) in government transfers (Table 1).

In addition to this basic amount, workers will be entitled to Canada Pension Plan (CPP) benefits. The CPP pension yields 25 percent of a worker’s average career employment income, up to a maximum amount.<sup>7</sup> To keep things simple, consider an Ontario “low-income” worker retiring with a CPP pension of \$6,250 – which corresponds to real constant lifetime annual earnings of \$25,000 – and another “average-income” worker retiring with a CPP pension of \$12,500 – which corresponds to real constant lifetime annual earnings of \$50,000 (Table 2).

While working, the low-income earner is left with a disposable income of \$22,070 after taxes and benefits, while the average-income earner is left with \$38,250. In retirement, CPP income leads to GIS benefit reductions – or Guaranteed Annual Income System (GAINS) in Ontario – which means retirees’ disposable incomes over the basic amount calculated in Table 1 increase by less than their CPP income.

Overall, the hypothetical “low-income” earner is able to replace in retirement up to 92 percent of his/her working-life disposable income, while the “average-income” worker can still replace more than 60 percent of his or her working-life disposable income in retirement. Considering that some people may have equity accumulated in their homes, small businesses, or farms, this suggests that a fair number of workers will be able to maintain their standards of living in retirement exclusively from government-source income, without, or with very little need for, private retirement savings such as RRSPs, pension plans, non-registered savings or tax-free savings accounts (TFsas).

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4 A 75 percent consumption replacement ratio would likely correspond to a gross earnings replacement ratio closer to 50 percent for many workers because of the effect of housing equity accumulation, lower taxes, and generous government benefits in retirement.

5 Amounts range from \$3,970 in Saskatchewan to \$100 in PEI.

6 About half of very low income single seniors in Ontario pays property taxes and thus are eligible for the seniors’ property tax grant.

7 About \$12,775 in 2013, or 25 percent of yearly maximum pensionable earnings of \$51,100.

**Table 1: Basic Unreduced Government Income Transfers for Single Seniors, Ontario, 2013**

<b>Federal</b>	<b>\$</b>
OAS benefits	6,580
GIS benefits	8,920
GST credit	404
<b>Total Federal</b>	<b>15,904</b>
<b>Ontario</b>	<b>\$</b>
GIS Top-up (GAINS)	996
Trillium Benefit	1,375
Senior Homeowners' Property Tax Grant	500
<b>Total Ontario</b>	<b>2,871</b>
<b>Total Amounts</b>	<b>18,775</b>

Source: Statistics Canada's Social Policy Simulation Database and Model, version 21.0. See Box 1 for more details on data source.

### RRSP Participation for Middle- to High-Income Earners

A meaningful study of participation in RRSPs would exclude lower-income earners who, as shown in Table 2, can count on government programs to replace a sizable portion of working-life earnings in retirement. They also have a lower ability to save after spending on non-discretionary items is taken into account. Finally, excluding low-wage earners from the analysis also provides for the exclusion of student and senior tax filers, for whom RRSP contributions (if eligible) can be ill-advised.

Of all tax filers earning more than \$50,000 in 2013 – i.e., those with the greatest need for private savings – more than half participated in a pension plan sponsored by their employer (Registered Pension Plan, or RPP). Nearly another quarter without pension plan coverage contributed to their RRSP. In total, 75 percent participated either to an RPP, RRSP, or both. Participation in pension plans increases with income, so that 88 percent of those earning more than \$125,000 contributed to a retirement program (Table 3).

One would expect the incidence of RRSP contributors to increase with age, as younger workers may give priority to paying off student debt, buying their first home or raising a young family (Vettese 2014). Of all tax filers earning more than \$50,000, more than half contributed to an RRSP. The proportion varies with age, with 39 percent of the under-30 age category having contributed compared to 65 percent of those aged 60-plus. In the highest income category, the vast majority (84 percent) of tax filers in their prime working years (45 to 59 years old) contributed to an RRSP (Table 4).

**Table 2: Net Replacement Rate Calculations for Senior Retired Workers, No Private Savings, Ontario, 2013 Constant Dollars**

	Scenario 1 – Low-Income Worker	Scenario 2 – Average-Income Worker
<b>While Working...</b>	<b>\$</b>	
Gross Employment Income	<b>25,000</b>	<b>50,000</b>
GST Credit	404	0
Ontario Trillium Benefit	899	265
<i>Less:</i>		
CPP Contributions	1,064	2,302
EI Contributions	470	891
Federal Income Tax	1,697	5,649
Ontario Health Premium	300	600
Provincial Income Tax	702	2,303
<b>Disposable Income</b>	<b>22,070</b>	<b>38,520</b>
<b>In Retirement...</b>	<b>\$</b>	
CPP benefits	6,250	12,500
OAS benefits	6,580	6,580
GIS benefits	5,190	2,066
GST credit	404	404
Ontario GIS Top-up (GAINS)	0	0
Ontario Trillium Benefit	1,375	1,375
Senior Homeowners' Property Tax Grant	500	500
<b>Disposable Income</b>	<b>20,299</b>	<b>23,425</b>
<b>Net Income Replacement Rate in Retirement</b>	<b>92%</b>	<b>61%</b>

Source: Statistics Canada's Social Policy Simulation Database and Model, version 21.0. See Box 1 for more details on data source.

**Table 3: RPP and RRSP Participation Rates, by Employment Income Groups, 2013**

Earnings from Employment <sup>(1)</sup>	Number of Tax Filers (thousands)	RPP Participants <sup>(2)</sup> (percent)	RRSP-only Participants (percent)	RPP +/-or RRSP Participants (percent)	Proportion of RRSP Participants among Non-RPP Participants (percent)
\$50,001 to \$75,000	3,286	48	22	70	43
\$75,001 to \$125,000	2,439	55	23	78	51
More than \$125,000	769	60	28	88	70
<b>All</b>	<b>6,494</b>	<b>52</b>	<b>23</b>	<b>75</b>	<b>48</b>

Notes:

<sup>(1)</sup> Includes self-employment income.

<sup>(2)</sup> Includes a rough adjustment to the data to reflect members of non-contributory RPPs – who represent 15 percent of all RPP participants – in the tax data, allocated based on industry and income distributions, and assumed to contribute to RRSPs at the same frequency as members of contributory RPPs.

Source: Statistics Canada's Social Policy Simulation Database and Model, version 21.0. See Box 1 for more details on data source.

### RRSP Contribution Rates for Middle- to High-Income Earners

Average RRSP contribution rates for above-average earners who did not contribute to an RPP (i.e., those not participating in a workplace contributory pension plan) are quite high.<sup>8</sup> Workers earning more than \$50,000 contributed about 10.5 percent of their earnings to RRSPs, but contribution rates increase sharply with age. Average contribution rates reach 11.4 and 14.6 percent respectively for the 45-59 and 60+ age categories. At younger ages, average contribution rates are lower than 10 percent. The highest average contribution rate, at nearly 17 percent, is reached for contributors aged 60+ and earning between \$50,000 and \$75,000. This pattern of contribution rates increasing with age but generally declining with income is consistent with younger workers in lower-income categories delaying their participation in RRSPs or skipping years of contribution at younger age, but catching up later in life by contributing higher amounts (Table 5).<sup>9</sup>

8 The data on RRSP-only contributions include members of non-contributory pension plans. However, at about only 9 percent of all RRSP-only contributors, their influence on RRSP-only contribution rates is likely very small. In addition, since one would expect the average RRSP contribution rate of members of non-contributory plans to be lower than that of those without any coverage, their inclusion likely leads to lower average contribution rates.

9 Many workers have a spouse or a common-law partner, whose income or savings level may influence their own RRSPs. For example, some couples may decide to bunch up their RRSP contributions into the hands of the higher-earning spouse to take advantage of a more generous tax deferral on contributions. This would tend to weigh upwards on individual contribution rates and downwards on individual participation rates. We can think of many other situations where family interactions would push individual contribution rates either up or down. However, average RRSP savings rates for couples in which at least one of the spouses contribute exclusively to RRSPs show the same pattern as individual saving rates; i.e., saving rates increasing as workers get older and generally decreasing with income.

Table 4: RRSP Participation Rate, by Employment Income Groups and Age, 2013

Earnings from Employment <sup>(1)</sup>	Age Group				
	Under 30	30 to 44	45 to 59	60+	All
	<i>percent</i>				
\$50,001 to \$75,000	35	42	49	57	45
\$75,001 to \$125,000	43	50	59	59	54
More than \$125,000	70	72	84	88	80
All	39	48	58	65	52

Notes:

<sup>(1)</sup> Includes self-employment income.

Source: Statistics Canada's Social Policy Simulation Database and Model, version 21.0. See Box 1 for more details on data source.

Table 5: Average RRSP Contribution Rate for RRSP-only Contributors,<sup>(1)</sup> by Employment Income Groups and Age, 2013

Earnings from Employment <sup>(2)</sup>	Age Group				
	Under 30	30 to 44	45 to 59	60+	All
	<i>percent</i>				
\$50,001 to \$75,000	7.5	8.7	12.1	16.9	10.6
\$75,001 to \$125,000	8.3	10.9	11.8	14.8	11.4
More than \$125,000	6.3	6.9	8.8	7.9	7.9
All	7.7	9.3	11.4	14.6	10.5

Notes:

<sup>(1)</sup> Includes members of non-contributory pension plans, representing about 9 percent of all RRSP-only contributors included here. However, due their relatively small number, their influence on average contribution rates is likely small. In addition, since we can reasonably expect lower average RRSP contribution rates on the part of members of non-contributory pension plans as opposed to RRSP-only contributors without any pension coverage, their inclusion likely result in lower average contribution rates overall.<sup>(2)</sup> Includes self-employment income.

Source: Statistics Canada's Social Policy Simulation Database and Model, version 21.0. See Box 1 for more details on data source.

**Table 6: Low- to Average-Income Earners' RRSP Participation Rate, by Employment Income Groups, 2013**

Earnings from Employment <sup>(1)</sup>	Number of Tax Filers (thousands)	RPP Participants <sup>(2)</sup> (percent)	RRSP-only Participants (percent)	RPP +/-or RRSP Participants (percent)	Proportion of RRSP Participants among Non-RPP Participants (percent)
Less than \$25,000	8,210	10	5	15	6
\$25,000 to \$50,000	5,238	31	19	50	27
All	13,448	18	11	29	13

Notes:

<sup>(1)</sup> Positive earnings only. Includes self-employment income.

<sup>(2)</sup> Includes a rough adjustment to the data to reflect members of non-contributory RPPs – who represent 15 percent of all RPP participants – in the tax data, allocated based on industry and income distributions, and assumed to contribute to RRSPs at the same frequency as members of contributory RPPs.

Source: Statistics Canada's Social Policy Simulation Database and Model, version 21.0. See Box 1 for more details on data source.

## What about Low- to Average-Income Workers?

Only about 6 percent of earners who are not in a workplace pension plan and who earned less than \$25,000 contributed to an RRSP in 2013, and 27 percent of those earning between \$25,000 and \$50,000. This low participation rate is not alarming given the ability of government programs, as shown in Table 2, to maintain lower-income workers' standards of living as they move into retirement, as well as the higher frequency of students in the lowest income group. Overall, about 15 percent of those earning less than \$25,000, and half of those earning between \$25,000 and \$50,000, participated in either an RPP or an RRSP, or both (Table 6).

## How Canadians Score on Retirement Preparedness

Annual data on RRSP contributions in any given year do not yield sufficient information to fully assess financial preparedness for retirement. To do so would require the ability to track a large and representative sample of individual workers throughout their working life, as well as additional data on spending, housing equity and other forms of wealth.

In a study of retirement income adequacy prepared for Finance Canada, Horner (2009) uses a simple model of consumption and savings over the life cycle to find that about 78 percent of households saved in RPPs and RRSPs at rates sufficient to maintain at least 90 percent of their living standards in retirement. Based on a survey of Canadian households, McKinsey & Company (2012) found that there are significant variations in retirement readiness, with the majority of households appearing financially well-prepared and a minority – close to a quarter of households – likely on the wrong track.

### Box 1: Data Source for the Analysis of RRSP Contributions

Data on individual tax filers are from Statistics Canada's Social Policy Simulation Database and Model (SPSD/M), version 21.0. The SPSP/M database is a sophisticated and statistically representative database of individual taxpayers and their households. Data on each individual captures a wide range of income, saving, expenditures, family, and demographic patterns – a rich dataset of personal information to enable the micro-simulation of taxes paid to, and cash transfers received from, government at the greatest level of detail.

The database was constructed primarily from four major sources of microdata: Statistics Canada's Survey of Labour and Income Dynamics (SLID), personal income tax return data, Employment Insurance (EI) claim histories, and Statistics Canada's Survey of Household Spending. Registered Pension Plan (RPP) and Registered Retirement Savings Plan (RRSP) contributions are stochastically imputed in the database from a sample of approximately two million personal income tax (T1) returns selected from Statistics Canada's T1 Family File.

The analysis of RRSP contributions in this E-Brief is based on SPSP/M. The assumptions and calculations underlying the simulation results were prepared by the author of this report and the responsibility for the use and interpretation of these data is entirely his.

Source: SPSP/M Online Documentation Version 21.0.

Moore et al. (2010) use a sophisticated simulation tool developed at Statistics Canada (LifePath), which integrates a large amount of data on Canadians, to project consumption before and after retirement for Canadians who have not yet reached retirement age. They find that if existing trends and behaviour persist, the number of working Canadians at risk of a significant drop in their living standards in retirement will rise over time, with over 40 percent of the younger generation of workers at risk, mostly at higher income levels.

Another factor to consider is the growing popularity of TFSAs. Since 2008, Canadians have been able to save up to \$5,000<sup>11</sup> per year in TFSAs, in which eligible investment income is exempt from personal income tax. Money saved in a TFSA can be withdrawn at any time without penalty and thus may be used for various expenses other than retirement needs. In its first few years of existence, more than 10 million Canadians opened up a TFSA account and total assets now exceed \$65 billion. This fast-growing popularity is certainly not unrelated to the fact that many below-average income earners are better off in TFSAs than RRSPs for fiscal reasons alone.<sup>12</sup> Although we don't know the extent to which Canadian savers are opting for TFSAs rather than making RRSP contributions,

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11 Indexed to inflation in \$500 tranches.

12 Since low- to moderate-income earners' tax rate is often relatively low while their future RRSP withdrawals may trigger clawbacks of government benefit payments in retirement by more than 50 cents per dollar withdrawn, there are many situations where it is (at least retroactively) more tax efficient to save in TFSAs rather than RRSPs. See for example Laurin and Poschmann (2010) and Pierlot and Laurin (2012) for more on the tax efficiency implications of TFSAs versus RRSPs.

it appears likely that at least a portion of new contributions and investment income accumulating yearly in TFSAs will be available to Canadians as they move into retirement.

## Conclusion

Nearly one-in-two workers with the greatest need to participate in an RRSP made a contribution in 2013, and about three-quarters of tax filers earning more than \$50,000 made a contribution to either an RPP or an RRSP, or both. Contributions on the part of average- to high-income, RRSP-only contributors averaged more than 10 percent of earnings.

Fairly good RRSP take-up rates, on the part of those for whom such savings are most beneficial, suggests that the case for remedial action, in the form of supplemental forced savings plans, is weaker than widely assumed. However, the data do suggest that higher contribution limits are an attractive option, since there are many Canadians who would be well placed to take advantage of them.

Further, to the extent that patterns of earnings and savings differ among individuals throughout their careers and lifetimes, RRSP contribution limits better adapted to various individual circumstances – for example, a move to a “lifetime contribution limit” as advocated by Pierlot and Siddiqi (2011) – would likely be beneficial to those willing to catch up to their aspirations later in life because of low levels of earnings, employment setbacks, or meagre savings earlier in life.

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This E-Brief is a publication of the C.D. Howe Institute.

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