THE GLOBE AND MAIL

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TAX MATTERS

Changes to RRIF rules are necessary for the financial health of Canadian seniors

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED SEPTEMBER 25, 2024

My neighbour, Jack, turned 72 last weekend. He still has a ton of energy, and still works. “Retirement at 65 is crazy” Jack said. “When I was 65, I still had pimples” he joked, quoting the late George Burns. Truth be told, Jack still needs to work to make sure he doesn’t run out of money before running out of retirement years.

Jack is also concerned about the fact that he has to start making withdrawals from his registered retirement income fund (RRIF) this year. Thousands of Canadians are worried about outliving their RRIFs and the rules that require withdrawals starting in the year they reach 72. The government is aware of the concerns.

The report

On June 15, 2022, Parliament passed a motion that provided that the government should “undertake a study examining population aging, longevity, interest rates, and registered retirement income funds, and report its findings and recommendations to the House within 12 months.”

The report tabled by the government in response falls short of making specific recommendations about changes to the RRIF rules but does highlight proposals by stakeholders around the country – which I’ll get to in a minute.

The rules

Our current rules say that the life of an RRSP must come to an end by Dec. 31 of the year you reach age 71. The most common strategy is to convert the RRSP to a RRIF by that date, with mandatory withdrawals from the RRIF starting the following year.

The withdrawals required from a RRIF are calculated as a percentage of the assets in the RRIF on Jan. 1 each year. The older you get, the higher the percentage you’ve got to withdraw. These percentages were set by the government to allow you to preserve enough savings to provide a constant income stream, indexed to inflation, from age 72 to 100. The rules also assume that you can earn a 3-per cent real (after inflation) rate of return on your portfolio each year, and

that inflation is an average of 2 per cent annually.

The assumptions

One key issue is that folks are living longer, and longer. In the early 1990s, when registered plan reform took place, life expectancy at age 71 was 13.7 years. This has increased to 16.2 years as of 2020 (the most recent data available). The 2020 data shows that 14 per cent of the population will live to age 95 (the figure for women is 18 per cent), which has increased from 5.6 per cent in the early 1980s. And the proportion of people making it to 100 has nearly doubled over that time.

What about the assumption of a 3-per-cent real rate of return? The government report shows that, in order to achieve this return, based on average historical data, you'd have to invest about 30 per cent of your portfolio in equities for 25 years (basically, from 70 to 95 years) – or perhaps invest more in equities to begin with, reducing this percentage as you age.

What the report fails to address is the impact of portfolio volatility on the psychological well-being of seniors. The more equities they hold in a portfolio, the more nervous some get, particularly as they get older. I've met many seniors who would not be comfortable with having as much as 30 per cent in equities at age 80. This issue has been entirely ignored when commenting on the equity percentages required to achieve the assumed 3-per-cent real return.

As for the assumption of inflation at 2 per cent over the 28 years from age 72 to 100, well, there's no shortage of experts who would suggest this isn't reasonable notwithstanding that it's the Bank of Canada's target inflation rate. As of today, the average annual inflation rate over the past 25 years is 2.54 per cent, over 30 years it has been 2.39 per cent, and over 50 years it has been 3.79 per cent.

More seniors than ever are finding it necessary to work beyond 70. Labour force participation for folks over 70 has grown from 4.9 per cent in 1978 to 8 per cent in 2022, an increase of 63 per cent. If folks are having trouble making ends meet in retirement, it hardly seems appropriate that they should be forced to withdraw as much as they are from their RRIFs.

The suggestions

The government report highlighted several suggestions made by different organizations and individuals on this issue of RRIF withdrawals. Common themes emerged, including:

- There should be an increase in the age at which RRIF withdrawals must start – perhaps to age 75;
- The minimum required RRIF withdrawal schedule should be reduced; and
- RRIFs under a certain amount should be exempt from minimum withdrawals.

One thing is for sure: We need to make sure our seniors enjoy a dignified retirement free from worry. The next federal budget should make changes to the RRIF rules.

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