Canadian Labour Market and Skills Researcher Network

Working Paper No. 120

The Retirement Income System and the Risks Faced by Canadian Seniors

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April 2013

CLSRN is funded by the Social Sciences and Humanities Research Council of Canada (SSHRC) under its Strategic Knowledge Clusters Program. Research activities of CLSRN are carried out with support of Human Resources and Skills Development Canada (HRSDC). All opinions are those of the authors and do not reflect the views of HRSDC or the SSHRC.

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This paper was prepared as the final synthesis report for the Canadian Labour Market and Skills Researcher Network's Challenges to Canada's Retirement Income System Research Program. The CLSRN Research Program received financial support from Human Resources and Skills Development Canada. The views expressed in this paper are those of the authors and do not necessarily reflect the views of Human Resources and Skills Development Canada or the federal government. Without implication, the authors would like to thank Alex Grey, Chris Poole, John Rietschlin, and all participants of the research program for their comments, suggestions, and contributions to this research.

Executive Summary

A team of CLSRN researchers were tasked with investigating the challenges to Canada's Retirement Income System (RIS). Researchers examined various aspects of the composition and adequacy of seniors' income in retirement, the importance of demographic factors for retirement income, the impact of business cycle fluctuations on retirement income, the importance of policy complexity for retirement planning, and expectations for future retirement incomes. The research conducted has helped us clarify those areas in which Canada's RIS has been quite successful and also those areas where challenges remain.

The results of the CLSRN research program form the foundation of this paper. In this paper we use a risk framework to analyze the risks seniors face and discuss the success of Canada's retirement income system in insuring against these risks. We focus on four types of risk:

(i) the risk of low income at the onset of retirement – if retirees find themselves with low income at the onset of retirement, they are likely to remain in that state for the rest of their lives,

(ii) the risk of longevity and loss of a spouse – if one lives longer than they planned for or if the loss of a spouse leads to lower than expected living standards,

(iii) the risk of recessions – which includes the financial return risk that can negatively affect the value of retirement assets and the risk of unemployment, and

(iv) the risks in decision making – whereby the average Canadian might not be well-equipped to fully understand the implications of portfolio choices.

We find that Canada's RIS is succeeding in mitigating the worst outcomes for those with low incomes entering retirement and those who have unexpected longevity, and this success largely depends on Guaranteed Income Supplement provisions. On the other hand, the current system is doing less well in helping families deal with the complexity of system. Furthermore, the current system is doing less well in helping families face the risks of recessions – especially with respect to uncertain returns on financial assets.

Several policy implications follow from the research program:

- As permanent income is significant for predicting the risk of low income at the onset of retirement, investments made over the entire life-course – particularly investments in education – are important in reducing this risk.
- Opportunities for less risky pension incomes are important for mitigating the risk of long recessions. The introduction of PRPPs is not expected to reduce risk.
- Governments need to ensure those nearing retirement have the information necessary to make good decisions. In particular, efforts are needed to ensure

that GIS recipients do not face large effective marginal tax rates against their investment income.

- While GIS prevents the most severe hardship associated with longevity risk, it is not designed to maintain many seniors' standards of living. Policy levers that improve the availability of annuities and other decumulation products are needed.