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Canadians' Wealth Around Retirement: What Decades of Change Mean for Retirement Income Adequacy

Summary
Most Canadians must save enough during their working lives – beyond contributions to Canada/Quebec Pension Plans – to maintain their standard of living in retirement. Using Statistics Canada's Survey of Financial Security, this RSI Brief investigates trends in household wealth among older Canadians from 1999 to 2019. On one hand, it finds that there has been a notable increase in wealth over time, especially due to rising values of primary residences. On the other, this increase in wealth does not suggest a higher expected standard of living in retirement as people are living longer, interest rates have trended downwards, and principal residences are complex to use to finance consumption later in life. Hence, policy-makers should expect that many Canadians around retirement age will have financial concerns.

Résumé
La plupart des Canadiens doivent épargner suffisamment durant leur vie active pour maintenir leur niveau de vie à la retraite – au-delà des cotisations aux régimes publics de pensions du Canada (RPC) et du Québec (RRQ). À l'aide de l'Enquête sur la sécurité financière de Statistique Canada, cette Note IRE examine les tendances, de 1999 à 2019, du patrimoine des ménages parmi des Canadiens âgés. D'une part, nous observons une augmentation notable de la richesse au fil du temps, en particulier en raison de la hausse de valeur des résidences principales. D'autre part, cette augmentation de la richesse ne suggère pas un niveau de vie attendu plus élevé à la retraite; en effet, les gens vivent plus longtemps, les taux d'intérêt ont connu une tendance à la baisse, et l'utilisation d'une résidence principale pour financer la consommation durant cette période est complexe. Par conséquent, les gouvernements doivent s'attendre à ce que de nombreux Canadiens autour de l'âge de la retraite aient des soucis financiers.

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INTRODUCTION

The first two pillars of Canada's retirement income system provide the foundation for Canadians' standard of living in retirement. Old-Age Security (OAS) and the Guaranteed Income Supplement (GIS) are tax-financed benefit that aim to ensure that basic needs – food, clothing, shelter, etc. – can be met. The Canada/Quebec Pension Plans (C/QPP) pay out benefits according to the mandatory contributions of workers during their careers[1]. Most Canadians, however, top up their public pensions to maintain their standard of living in retirement and therefore need to accumulate sufficient private wealth and savings while they are working (Messacar and Morissette, 2015). This is especially the case for middle- and high-income earners, for whom relying solely on public pensions would result in a significant drop in their standard of living (Boisclair et al., 2020). Over the last few decades, the decline in employer defined-benefit pension plans and the rising share of defined-contribution pension plans (Glenzer, Michaud and Staubli, 2022) underscores the need for policy-makers to monitor the balance sheet of households nearing retirement.

In this note, we examine trends in wealth among older Canadian households using Statistics Canada's Survey of Financial Security (SFS) from 1999 to 2019. We highlight the retirement income value of private wealth – the value of wealth when converted into an annuity – and the value of housing in terms of potential consumption in retirement.

On average, we find that Canadians aged 55 to 74 have become wealthier over time, driven by housing equity and to a lesser extent by private retirement assets[2]. Wealth growth has occurred across the distribution, except for the bottom decile. While the least wealthy have not accumulated more wealth, rates of relative poverty have decreased inthe last 20 years.

Our analysis unveils challenges ahead. Despite large increases in wealth over time, the expected standard of living in retirement has not followed the rise in average wealth. Due to increases in longevity and to lower interest rates, the annuitized value of private wealth has increased only slightly.

[1]As at November 2022 the maximum monthly payment, if taken at age 65, for OAS is $686, $1,220 for GIS, and $1,254 for CPP/QPP.

[2]Retirement assets refer to Employer Pension Plans (EPPs/RPPs), Registered Retirement SavingsPlans (RRSPs), Registered Retirement Income Funds (RRIFs) and all other retirement funds.

As such, we find that wealth growth is not generating similar growth in income or consumption during retirement. Since housing cannot easily be used to fund consumption in retirement (Baldwin, 2022; Farooqui, 2022), it is unclear that growth in housing wealth improves standards of living. If these trends continue, standards of living in retirement may diverge from growth in private wealth.

DATA

The SFS provides insight into the accumulated private wealth of older households in Canada. The SFS collects information on incomes as well as the value of financial and non-financial assets and debts of households across Canada. Net worth, or wealth, is calculated within the survey as total assets minus total debt. These values are collected for economic families, which includes two-or-more-person households as well as individuals not in families. Demographic characteristics such as age are collected for the household's primary income earner. The survey is cross-sectional which means it does not follow households over time. Since the first survey was administered in 1999, subsequent surveys have taken place every 6 to 7 years, and only since 2016 has the survey been administered every three years (with one to be administered in 2022). The survey contains around 12,000 responses per year, except in 2005 which drew 5,000 responses (see Baldwin (2019) and Baldwin (2022) for a summary). The overall sample includes households whose primary earner is aged 18 and older. We focus on older households where the main income earner is aged between 55 and 74, as they capture those near or in retirement and reflect the near complete range of retirement ages.

We adjust values for inflation, outliers[3] and household size[4]. All values are reported in 2019 dollars. Statistics reported in this note are weighted using the SFS Public Use Microdata File (PUMF) to reflect population values at the household level. Unless otherwise mentioned, we include all households, including those which do not own the asset or debt items that we study[5].

[3]We apply winsorisation at the 99th percentile (and the 1st percentile for variables with negative values).

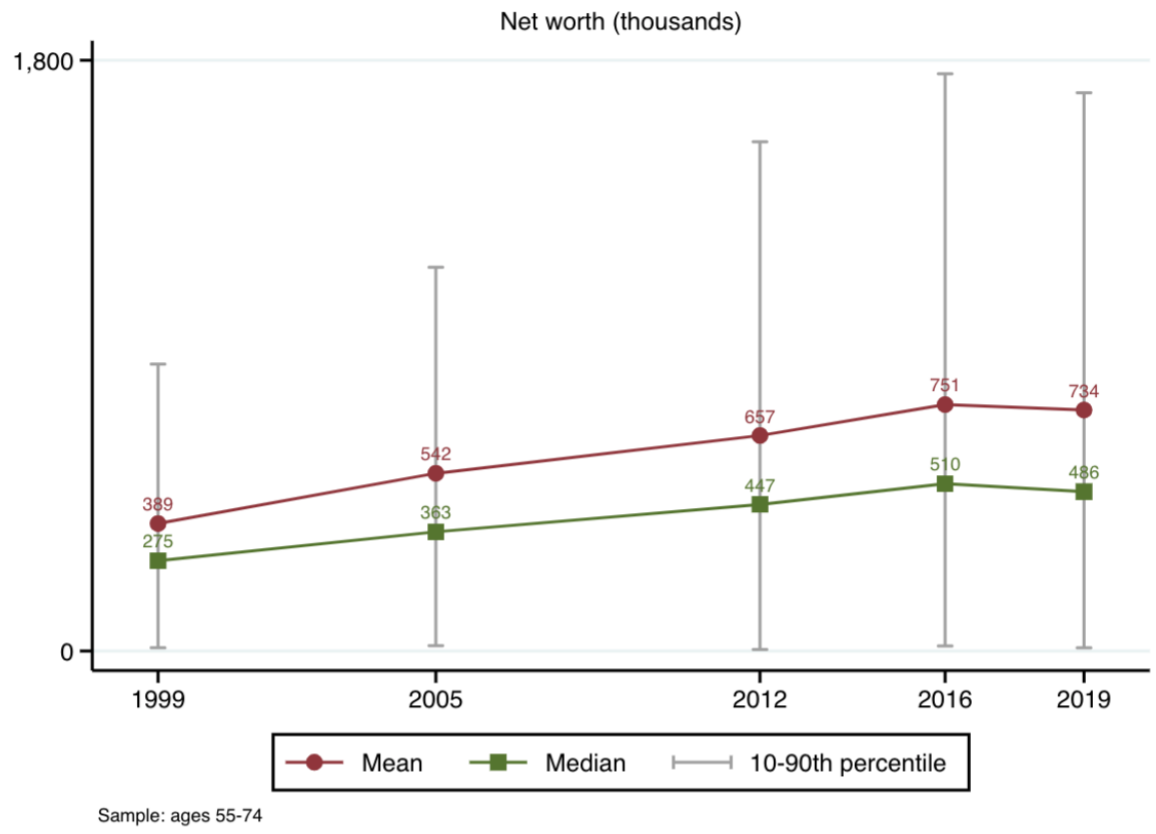
[4]Values are adjusted to make them comparable across all households regardless of size. Specifically, they are made comparable by standard technique of dividing them by the square root of household size. For example, net worth is divided by 2 for households with 4 family members and divided by 1 (unadjusted) for households with 1 member.

[5]The SFS PUMF does not include all items of private wealth, such as registered educational savings plan funds, deferred profit sharing plan, annuity investment funds, etc. which are predominantly held by high-income households

TRENDS IN RETIREES' WEALTH

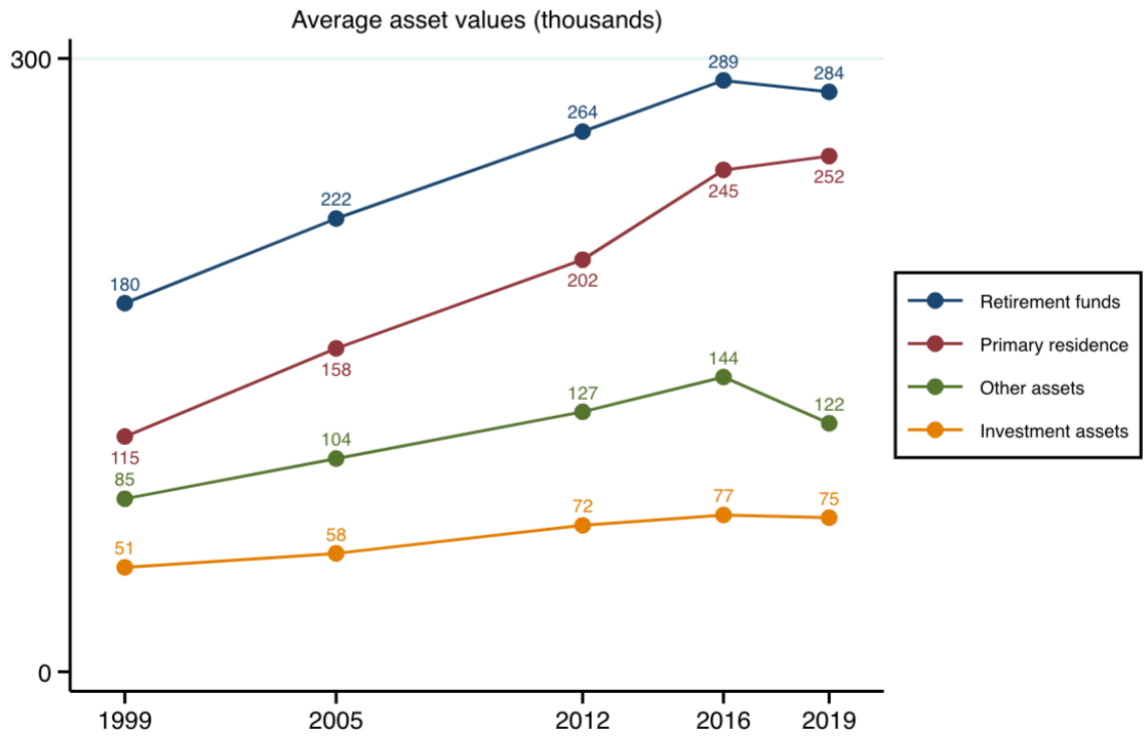
Since 1999, the real value of assets and net worth, on average, have been increasing over time among Canadian households (Figure 1). This is also true for those in the middle of the wealth distribution – the median Canadian household – and at the top of the wealth distribution. In dollar terms, retirement funds and primary residences have been the main drivers of wealth growth (Figure 2). The growth in wealth was dampened by the growth in debt, which was driven higher by mortgages and lines of credit (Figure 3) (see Bedard and Michaud (2021) for further analysis). As a result, leverage (the proportion of total debt to total assets) increased markedly on average, but not for the median household[6]. Overall, the decision to increase debt to finance housing has generated strong wealth growth for both the average and median retired household.

Figure 1: Growing mean and median net worth, and a widening distribution



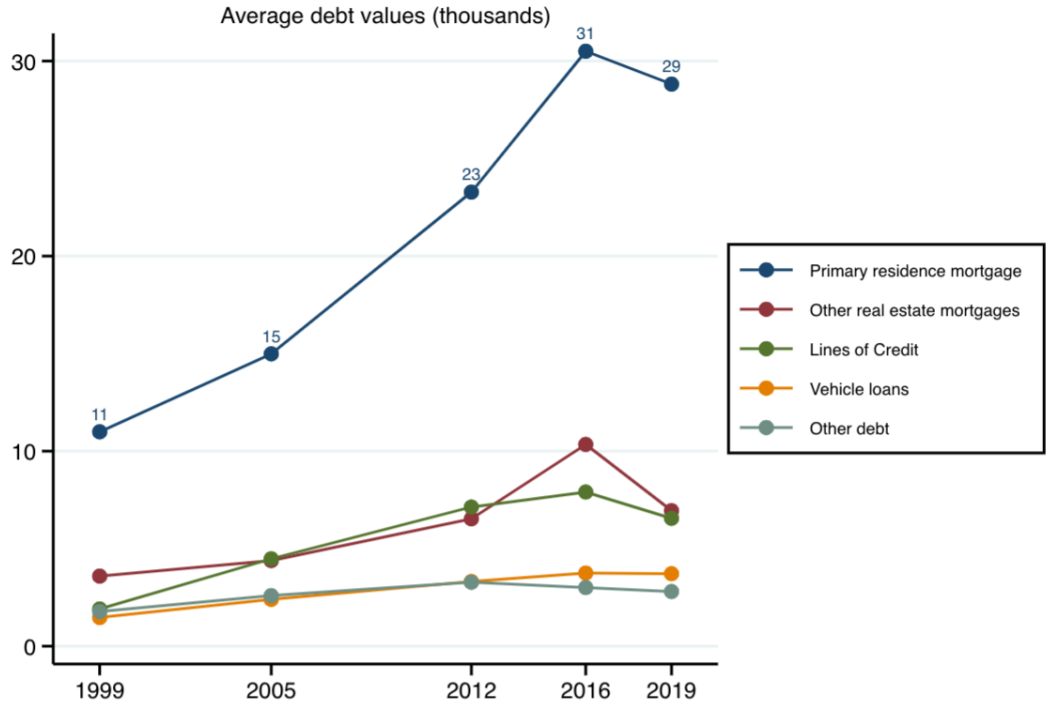
[6]Between 1999 and 2019, primary residence values grew 128% on average (93% for the median), wealth grew 89% on average (77% for the median) while debt grew the most at 168% on average (from $0 to $7000 for the median). Among debt, lines of credit had the largest growth at 255% on average with primary residence mortgages second largest at 162% on average. Together these two debt items amounted to $35,000 on average in 2019 for those aged 55-74. Leverage increased from 13% to 28% on average over the period, but for the median household leverage only increased from 0 to 2%.

Figure 2: Assets held mainly in the form of retirement funds and housing



Sample: ages 55-74
Retirement funds: EPPs, RRIFs, RRSPs and Other retirement funds.
Investment assets: deposits, mutual funds, stocks, bonds, TFSAs and other financial investments.
Other assets: Business equity, other real estate, vehicles, other non-financial assets.

Figure 3: Debt driven by primary residence mortgages



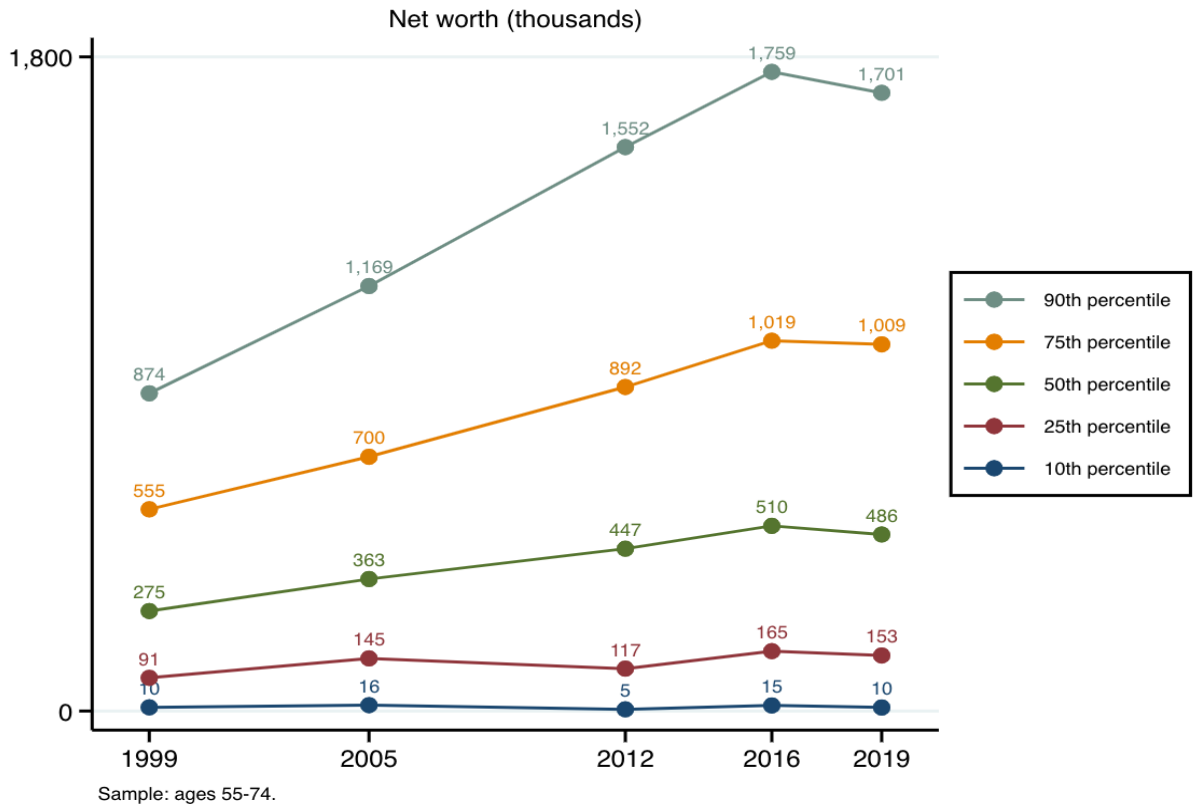
Sample: ages 55-74
Other debt: credit cards, student loans, other loans

Poverty and Wealth Accumulation Across Income Groups

Mean and median measures of financial well-being do not tell the full story, as they can mask changes to the tail ends of the distribution. While the wealth distribution has become wider over time due to wealthier households becoming wealthier, the poorest households have maintained a similar level of wealth over time (Figure 4).

The share of those in situations of relatively low-income among those aged 65 and over has fallen considerably over the last 20 years. We see this in our own measure of low-income[7] and in Statistics Canada's low-income measure (LICO-AT[8]) (Figure 5). Given that inflation-adjusted OAS/GIS pension benefits have only increased marginally over time, the decline in old-age income poverty may be driven by greater access to CPP/QPP or improved private wealth accumulation among low-income Canadians. Indeed, those who qualify for some GIS[9] have on average, increased their wealth from $160,000 to $250,000 over the period.

Figure 4: Wealth inequality has been driven by the wealthy getting wealthier

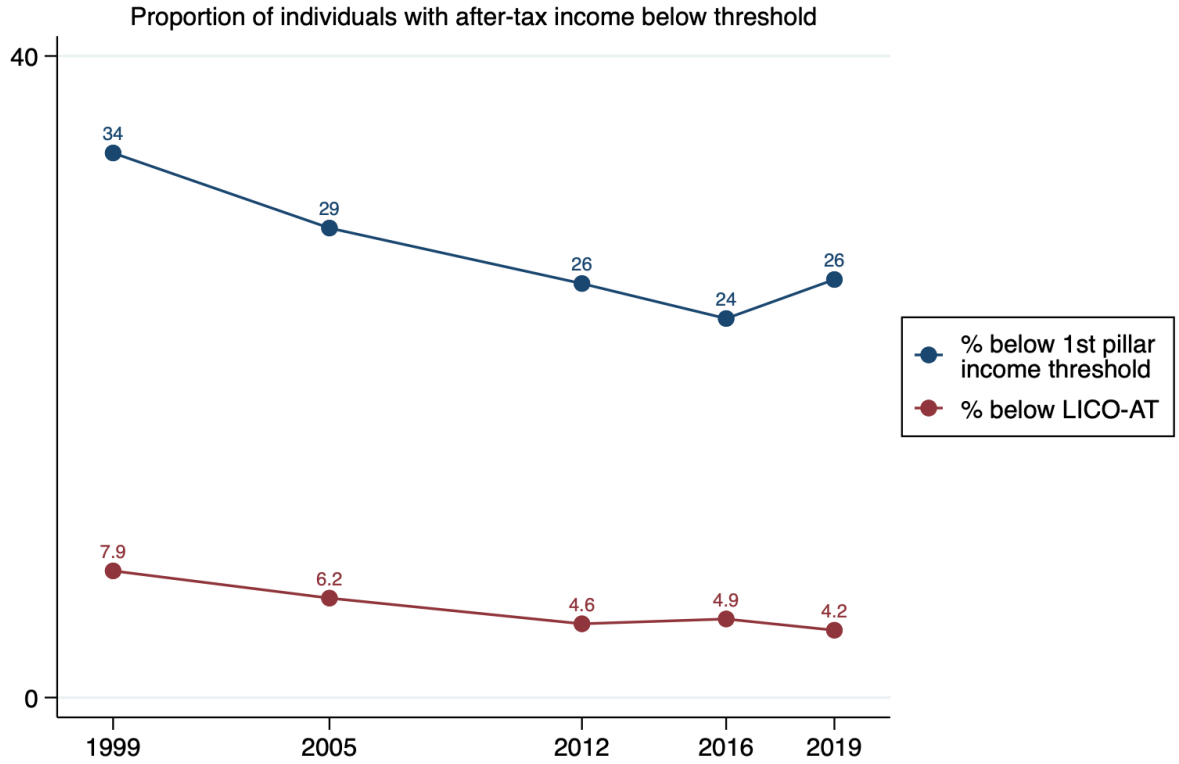


[7]We define low-income as anyone with income below the threshold at which they qualify for only a dollar of GIS benefits. Since OAS benefits do not affect GIS receipt, our low-income measure is the maximum OAS benefit plus this threshold at which one qualifies for some GIS benefits. We do this separately for couples and singles. In essence, this provides the maximum first-pillar benefit available.

[8]Low Income Cut Off After-Tax. This measure is most similar to Canada's main measure of poverty, the Basket Measure, except that the LICO-AT is available at the national level whereas the Market Based Measure is only available at a regional level.

[9]Those aged 65 and over with income below the GIS income threshold.

Figure 5: The proportion of individuals in low-income has fallen



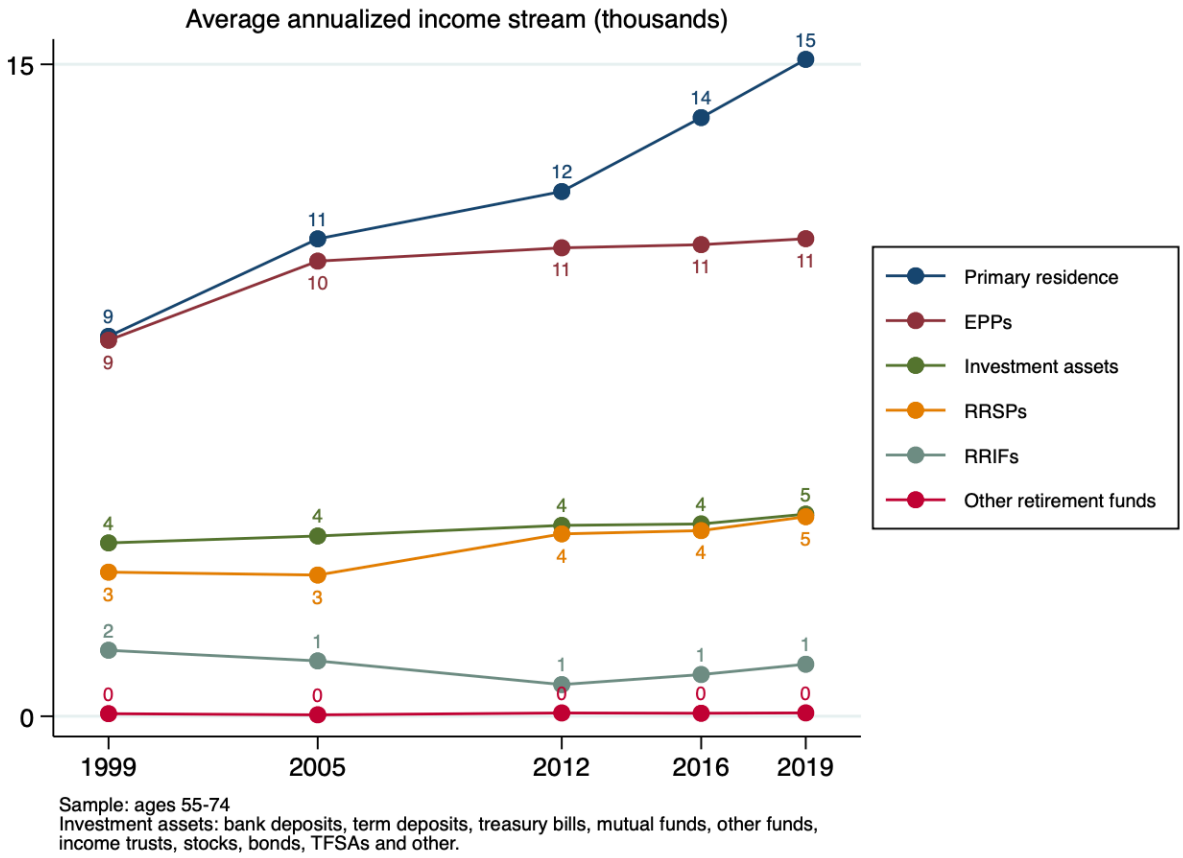
Sample: ages 65 and over.
Low-income rates are shown at the individual level i.e. households with 2 family members count for two individuals in low-income.
LICO-AT (Low Income Cut-Off After-Tax) rates are sourced from Statistics Canada.

The Implications of Private Wealth for Expected Retirement Incomes

At first glance these overarching trends appear to paint a very optimistic picture of trends in the private savings of retirees in Canada. This may lead some to believe that despite the ongoing shift away from defined benefit pension plans in Canada, private wealth is holding up. However, two competing developments over this time complicate the analysis – falling interest rates and longer life expectancies. Both factors have increased the amount of assets needed to buy a dollar of lifetime retirement income, which is reflected in the rising cost of purchasing annuities over time. In fact, the higher cost of purchasing annuity income for retirement increased so much that it almost fully offset the increase in asset values over the period, and this is especially true when housing is excluded (Figure 6[10]). These estimates reveal that if retirees exhaust their liquid assets (excluding housing) completely to fund their retirement, the income available for consumption has not improved over time.

[10]Figure 6 transforms different groups of assets into annuities, using historical annuity rates by gender and age for each survey year. For example, males aged 60-64 were offered a 5.8% yield in 2019 in the private annuity market, down from 6.9% in 1999, reflecting the decline in interest rates over the period. Males aged 70-74 were offered a higher rate of 7.8% in 2019, accounting for their lower life expectancy.

Figure 6: Excluding housing, increases to net worth do not translate to more retirementincome



Including housing in the analysis of private wealth and financial readiness for retirement is complex. For example, housing is not just an asset, but it is something that Canadians must consume[11]. Hence, if retirees choose to sell their house to convert it to income, those funds must be used to purchase another form of shelter, such as purchasing another home, renting, or entering a nursing home. We estimate that in 2019 home owners could generate $1,750 per month if they converted their home to an annuity, less than the national average rent across Canada in 2019 of $1,940 (Myers, 2022). This finding is not surprising in light of Boisclair et al. (2020), which shows that housing has little effect on retirement income adequacy. In sum, one must be careful when interpreting what the increase in household wealth means in terms of financial preparedness for retirement. Individual circumstances vary and there are many ways in which Canadians may perceive the role of their primary residence in their retirement plans[12].

[11]Statistics Canada's calculations for the consumer price index includes housing as a consumption good.

[12]For many, continuing to live in one's primary residence in retirement has financial and individual health advantages (Wolfson and MacDonald, 2016). For those with dementia, living in a home with familiar surroundings can reduce disorientation (Evans et al., 2019). In terms of personal finances, some may see their housing equity as the main bequeathment to their heirs and might not be interested in selling their primary residence. Others, however, may look at using reverse mortgages (or other financial options) as an avenue to remain in one's residence while converting equity to income.

CONCLUSION AND POLICY CONSIDERATIONS

The Canadian retirement system requires middle – and high-income earners to be responsible for accumulating enough savings – either through workplace pension plans or individual efforts – to top-up their income in retirement. The SFS provides insight into the accumulated private wealth of older households in Canada.

We find that despite increasing wealth inequality, income and wealth are improving among lower-income groups and poverty rates are falling. While wealth among older households around retirement has increased in the last 20 years, much of the increase has been driven by increasing values of their primary residence. Hence, the increase to net worth observed needs to be interpreted with caution, especially given that housing is rarely used to fund consumption in retirement. Accounting for the decline in interest rates and increased longevity over the period eliminates the growth in income from private wealth almost entirely, suggesting a stagnation in older households' standards of living.

Given that the considerable increase in the value of assets and net worth has not generated a similar increase in retirement income, policy-makers should expect that Canadians around retirement will have persistent financial concerns. This is especially true for households carrying high debt loads into retirement (Bedard and Michaud, 2021). As a result, many may look to work longer to further bolster their financial situation or make more aggressive investment decisions, among other things.

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