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The Rise of TFSAs: Trends in Savings Vehicle Usage in Canada

Summary
A savings plan has two main parts: the setting aside of sufficient funds and investing them efficiently. To save effectively, tax-preferred savings vehicles are key to achieving high returns on savings over time. In most instances, Canadians must choose to place their savings into either RRSPs or TFSAs, both of which have distinct rules and tax advantages. Using Statistics Canada's Survey of Financial Security, this RSI Brief investigates trends in TFSA and RRSP use since TFSAs were introduced in 2009. It finds that TFSAs have become especially popular among older Canadians who are drawing down their retirement savings as well as among younger savers. However, the introduction of TFSAs has increased the complexity of savings decisions, hence public and private decision-makers need to continue to find ways to improve financial literacy and design effective educational interventions.

Résumé
Un plan d'épargne comporte deux volets principaux : mettre de côté suffisamment de fonds et les investir efficacement. Pour épargner de manière optimale, les comptes d'épargne enregistrés sont essentiels pour obtenir des rendements élevés sur l'épargne au fil du temps. Dans la plupart des cas, les Canadiens doivent choisir de placer leur épargne dans un REER ou un CELI, qui comportent tous deux des règles et des avantages fiscaux distincts. À l'aide de l'Enquête sur la sécurité financière de Statistique Canada, cette Note IRE examine les tendances en matière d'utilisation des CELI et des REER depuis la création des CELI en 2009. Elle révèle que les CELI sont devenus particulièrement populaires auprès des Canadiens plus âgés qui retirent leur épargne-retraite ainsi que parmi les jeunes épargnants. Cependant, l'introduction des CELI a accru la complexité des décisions d'épargne. Les décideurs publics et privés doivent donc continuer de trouver des moyens d'améliorer la littératie financière et de concevoir des interventions éducatives efficaces.

Retirement and Savings Institute
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INTRODUCTION

In a prior RSI Brief, Busby, LoRiggio and Michaud (2023) explored trends in how much Canadians are saving – in other words, how much savings they have accumulated at the time of retiring. But a successful savings plan is the product of both how much is saved and the returns on those savings, which one could call saving efficiency. This second aspect of savings decisions is often overlooked. One key factor determining efficiency is taxation. This Brief looks more closely at decisions regarding the efficiency of savings choices and, in particular, how Canadians exploit tax-preferred saving vehicles.

We zoom in on the use of Tax-Free Savings Accounts (TFSA), which were introduced in 2009 as an alternative to Registered Retirement Savings Plans (RRSP). TFSAs offer Canadians the option to save on a tax-prepaid basis, with no taxes paid on investment income upon withdrawal. Deposits into RRSPs, in contrast, are tax-deductible (they reduce taxable income in the year they are made) but require tax to be paid upon the withdrawal of funds. Hence, marginal effective tax rates at the time of contributing and withdrawing funds can severely impact the effective return on a dollar of savings. In particular, RRSP withdrawals count as taxable income and may reduce income-tested government benefits – such as Old Age Security/Guaranteed Income Supplement (OAS/GIS), Child Benefits, etc. – whereas TFSA withdrawals do not affect income-tested benefits.[1] Contributions into the "wrong" savings vehicle can lower one's effective returns on savings – potentially increasing taxes owing and/or lowering eligible government benefits – which in turn require more savings to meet retirement spending goals (Boyer, d'Astous and Michaud 2022).

In this RSI Brief, we assess the rise in TFSA usage against the main objectives set out in the 2008 Federal Budget (Canada 2008). In addition to savers broadly speaking, TFSAs were intended principally to benefit older Canadians and low-income earners who were expected to benefit from a long-term savings vehicle that offered more flexibility around withdrawals. For example, TFSAs provide older Canadians a viable tax-sheltered savings vehicle during the decumulation phase of their retirement. As well, TFSAs provide low-income earners an effective retirement savings vehicle that avoids clawbacks which reduce retirement benefits when savings are withdrawn at older ages. We analyse TFSA usage by both age and income to assess their success against these objectives.

[1] One important difference between these two vehicles is how withdrawals can affect cumulative savings contribution room. Withdrawals from TFSAs do not affect the cumulative contribution room in the following year – people are allowed to add back those withdrawn amounts in future years. Withdrawals from RRSPs, on the other hand, cannot be replaced. In addition, TFSA contribution room is cumulative and grows at around $6,500 per year for all Canadians (as of 2023), whereas RRSP cumulative contribution room grows according to 18% of the prior year's earnings.

We find that TFSAs have enjoyed tremendous growth since their inception. The pace of growth is such that annual median contributions into TFSAs already outstrip RRSPs',[2] and the total value of savings in them may end up surpassing those in RRSPs in the foreseeable future. Older households, especially those drawing down their retirement savings, are more likely than other age groups to have a TFSA and have the least room available relative to their contribution limit. We also find that low-income Canadians are starting to take advantage of TFSAs, but perhaps not as fast as expected given the steep GIS clawbacks they may face at older ages. Given that 36% of Canadian households have both an RRSP and TFSA, and must therefore make a complex decision on where to place their next dollar of savings, educational and other policy interventions will be important to ensure that Canadians make optimal choices that maximize their savings (Boyer, d'Astous and Michaud 2022; Laurin, Messacar and Michaud 2023).

DATA AND SAMPLE

This Brief uses Statistics Canada's Survey of Financial Security (SFS) from 2005 to 2019. The SFS collects information on the value of financial and non-financial assets and debts of households across Canada. Net worth is constructed as total assets minus total debt. Income and demographic information are also collected for the main (highest) income earner. We use the Public Use Microdata File (PUMF) data of the SFS which contains information at the economic family level. Economic families are similar to households except they exclude those at the same address who do not share family resources. Housemates, for example, each have unique family IDs and thus appear as separate observations in the sample. As such, economic families can also comprise individuals. For simplicity we refer to the unit of observation as a 'household'.

The SFS is a cross-sectional survey that consists of five waves collected in 1999, 2005, 2012, 2016 and 2019. Each wave contains around 12,000 responses except for 2005 which drew 5,000 responses (see Baldwin 2019). The survey collects information from those aged 18 and older. We focus on households where the main income earner is aged between 20 and 79. Given our age range extends past age 71 – the age at which Canadians must convert their RRSPs into Registered Retirement Income Funds (RRIFs) – we combine RRSPs and RRIFs into a single variable. Because RRSPs account for almost 90% of the combined value of the two, and 96% for those younger than 70, we refer to the aggregated asset as an RRSP for the remainder of the analysis.

The data are adjusted for inflation, outliers, and family size.[3] All values are reported in 2019 dollars

[2] See Statistics Canada's 2021 Census summary at https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=9810008501

[3] We adjust for outliers by winsorising at the 99th percentile (and the 1st percentile for variables with negative values). Values are equivalised by dividing them by the square root of family size. For example, wealth is divided by 2

and have been weighted using the weights provided by the SFS. Unless otherwise mentioned, averages include households with zero values.[4] For ease of comparison, we exclude from the analysis non-TFSA and non-RRSP employer-based forms of retirement saving (i.e., DB or DC registered pension plans; voluntary retirement savings plans; or pooled retirement pension plans).

RESULTS

One-third of households owned a TFSA in 2012, just three years following its introduction in 2009. In the ten years since, that proportion has grown to almost half or 46% (Figure 1). In the coming decade it is likely, given recent growth rates, that there will be as many households with a TFSA as those with an RRSP.[5]

The decision to own one, both or neither vehicle has also changed dramatically (Figure 2). In 2019, 10% of households owned a TFSA only, replacing the share that owned neither vehicle. Owning both vehicles was also common, replacing the share of households that owned an RRSP only. By 2019, more households had both an RRSP and a TFSA than those with neither.

The share of household financial assets invested in TFSAs has also grown substantially. TFSAs increased from 5% of financial assets in 2012 to 11% in 2019 (Figure 3). All other investments fell as a proportion of financial assets. In the following sections, we break down these trends by age and income to understand which groups are driving these changes.

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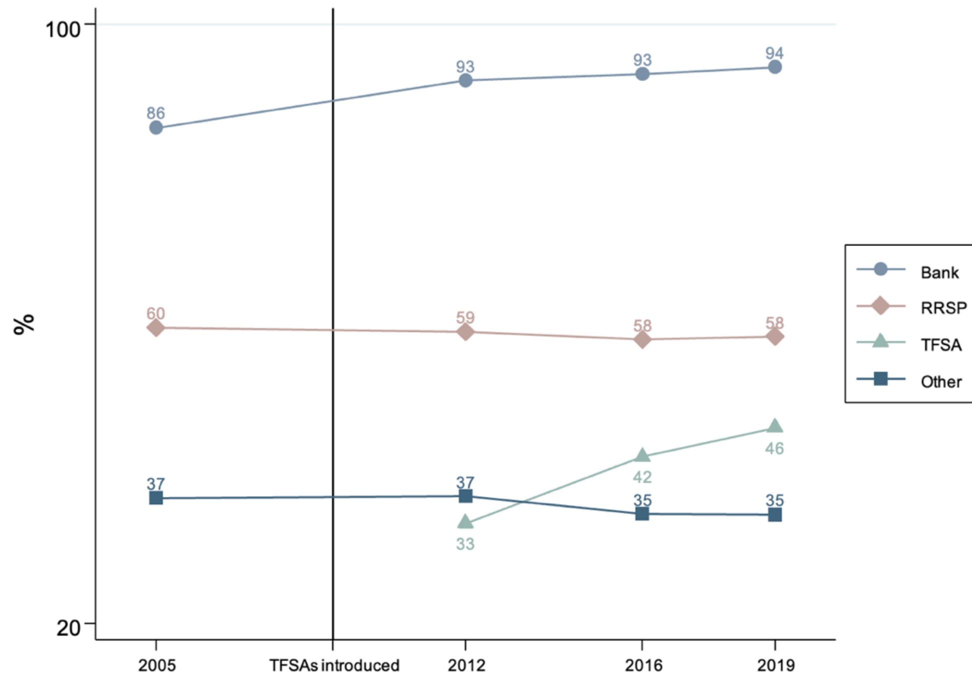
when family size is 4, or divided by 1 (i.e., unadjusted) when family size is 1. This allows for a fairer comparison of wealth across different family sizes.

[4] For example, house values are set to zero for those who do not own a home and are included in the calculation of the average.

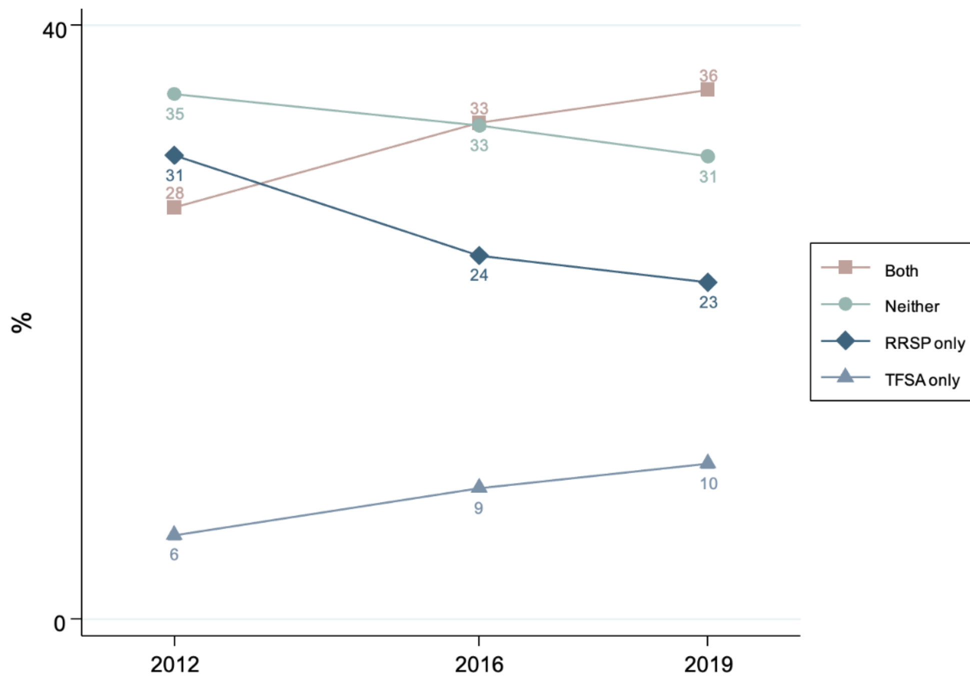
[5] The data do not allow us to identify group TFSA and RRSP holdings from individual ones. Therefore, we show all data for both vehicles.

Figure 1: Share with Private Savings Accounts, 2005 - 2019



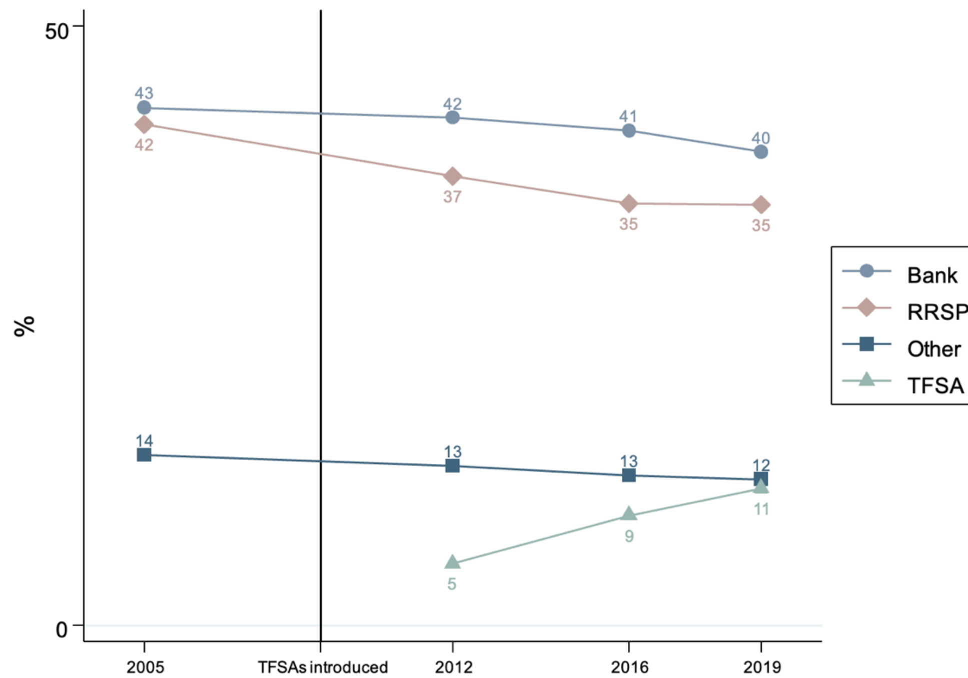
Notes: Bank assets include bank deposits, term deposits and treasury bills. "Other" financial assets include unregistered mutual funds, stocks & bonds, registered educational savings plans (RESP), loans to others, other money held in trust, asset-backed securities, and any other investments or financial assets not included elsewhere.

Figure 2: Share with RRSPs, TFSAs, Both or Neither, 2012 - 2019



Notes: See Figure 1.

Figure 3: Share of Household Financial Assets, 2005 – 2019



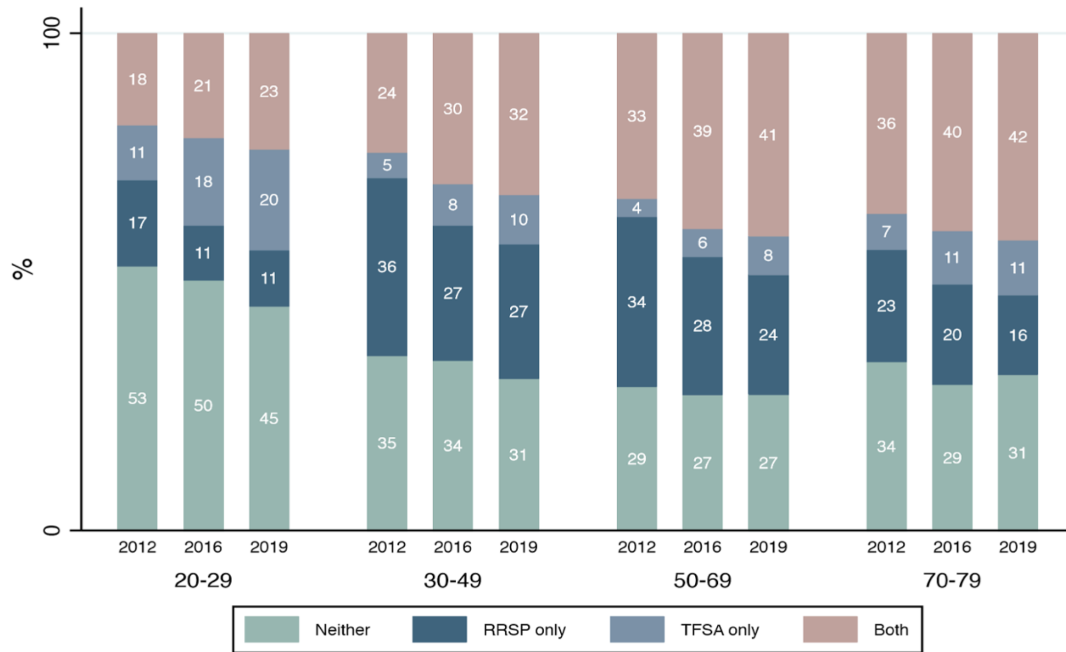
Notes: See Figure 1.

USE OF SAVINGS VEHICLES BY AGE

In 2019, younger households were slightly more likely to not have either savings vehicle compared to the other age groups, and middle-aged households were slightly more likely to have both vehicles (Figure 4). Over time, the proportion of Canadian households with only a TFSA increased across all age groups. This is especially true for the youngest and oldest households. Those with RRSPs only were most prevalent among middle-aged households.

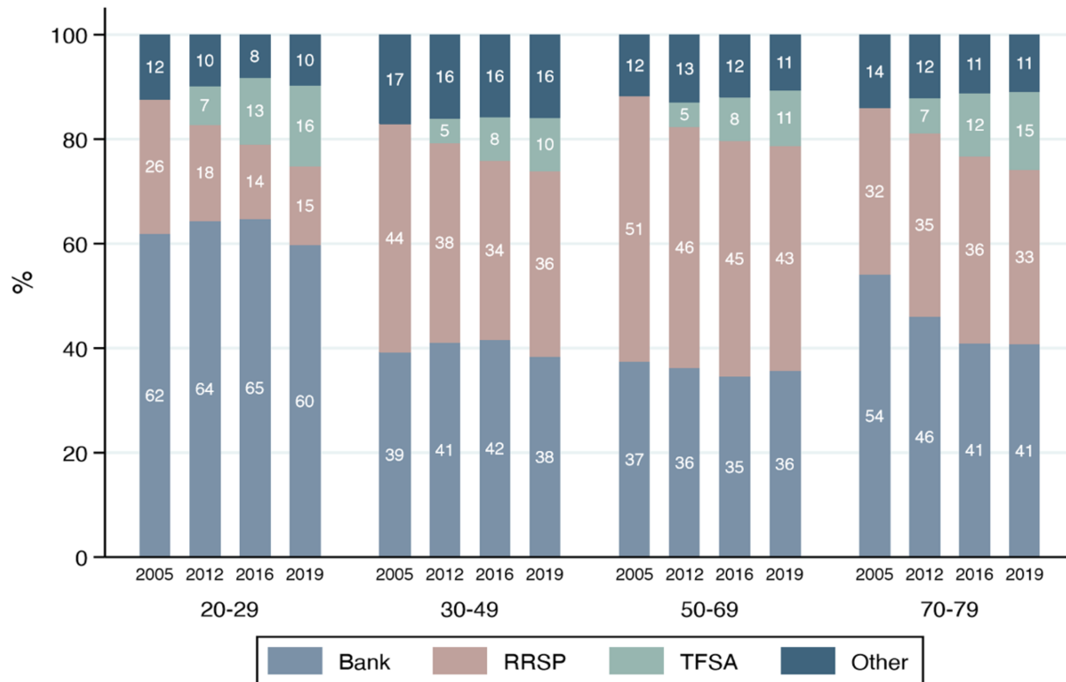
The share of household financial assets across age groups in (Figure 5) shows the relative decline in the stock of RRSP savings across all ages. In contrast, the share of financial assets invested in TFSAs increased sharply over the period across all ages. The youngest and eldest households increased their share of TFSAs the most over the period, to 15% and 16%, respectively, by 2019. In particular, younger households (aged 20-29) reduced their share of RRSPs and shifted quite heavily towards TFSAs. This may be due to the greater flexibility of TFSAs as a tool for short- and medium- term savings goals. For instance, it could be in response to higher house prices over the period which required more savings to fund house purchases or other medium-term purchases. It could also reflect intergenerational wealth transfers within families, among other things.

Figure 4: Share with RRSPs, TFSAs, Both or Neither by Age Group, 2012 - 2019



Notes: See Figure 1.

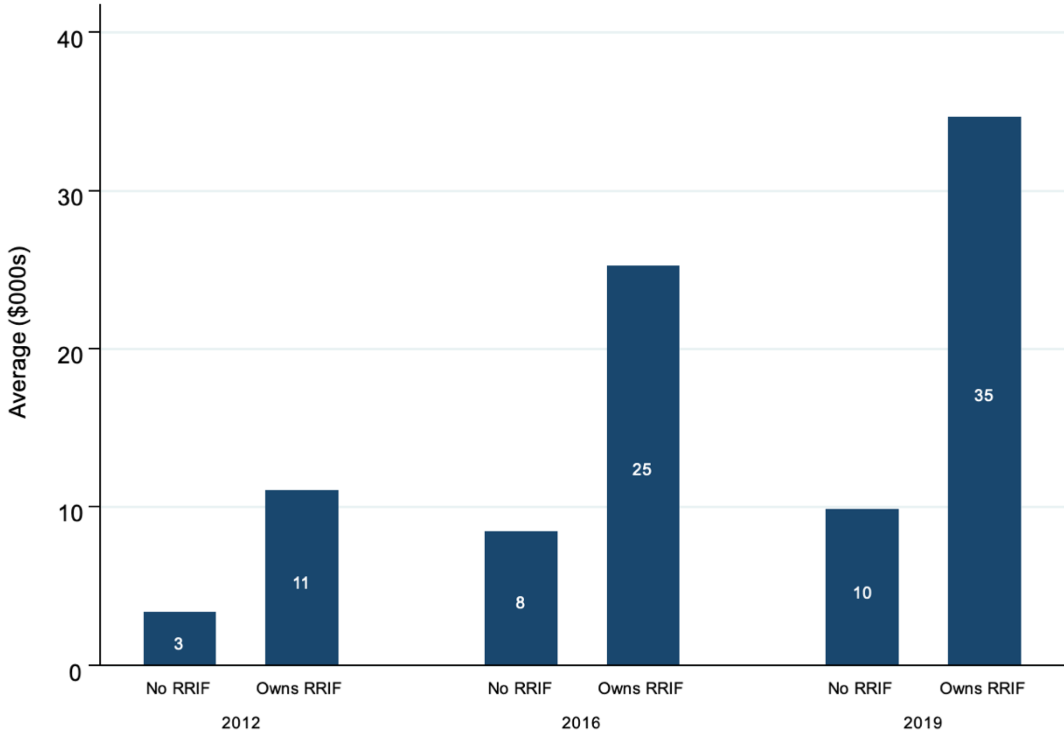
Figure 5: Share of Household Financial Assets by Age Group, 2005 - 2019



Notes: See Figure 1.

Older households also show a major shift in TFSA usage, especially among those in the so-called decumulation phase of retirement. Households aged 70-79 that have RRIFs, which require minimum annual withdrawals,[6] appear to make significant deposits into their TFSAs. In addition, they have the least contribution room available relative to other households.[7] RRIFs have been criticized for potentially forcing some Canadians to withdraw more funds than they would like, raising concerns about ultimately outliving their savings (Robson and Laurin, 2023). Regardless, the data suggest that Canadians with RRIFs are much more likely to deposit excess savings into their TFSAs each year, demonstrated by the TFSA balances among households with RRIFs relative to those without RRIFs (Figure 6).

Figure 6: TFSA Balance by RRIF Ownership Among 70-79 Age Group, 2012 - 2019



Notes: See Figure 1.

Data from the Canada Revenue Agency reveals that older and younger households use TFSAs quite differently.[8] Younger households tend to make deposits into, and withdrawals from, them more

[6] Canadians are required to convert their RRSPs into RRIFs by the end of the year in which they turn 71. RRIFs have minimum withdrawal requirements each year that compel Canadians to draw down on their savings whether they would like to or not.

[7] The SFS data indicates that households aged 70-79 had used 31% of their TFSA contribution room by 2019, double that of households in other age groups, which had used 16% on average.

[8] See https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/income-statistics-gst-hst-statistics/tax-free-savings-account-statistics/tax-free-savings-account-statistics-2019-tax-year.html

frequently in smaller amounts, while older households deposit and withdraw large amounts every so often.[9]

USE OF SAVINGS VEHICLES BY INCOME

The uptake of TFSAs differs across the income distribution. Low-income households are much more likely to own neither vehicle while high-income households are much more likely to own both (Figure 7). Over time, however, TFSAs have grown in popularity among low-income households. Moreover, TFSA-only ownership is most prevalent among the two lowest income quartiles, where RRSP use is also stagnating, indicating that low-income households have been attracted more to TFSAs than RRSPs – in line with the objectives outlined in the 2008 Federal Budget.

As a share of households' financial assets, TFSA balances are similar across the income distribution, growing by a similar magnitude across all income quartiles (Figure 8). Low-income and high-income households shifted their savings differently, however, as they increased their TFSA shares. It appears that low-income households replaced bank assets and other financial assets while high-income households replaced RRSPs.

Although take up of TFSAs has been slow relative to other income groups, there has been notable growth in the share of TFSA savings by lower-income households. This is encouraging as low-income earners have the most to gain from using TFSAs over RRSPs for retirement savings, as TFSA withdrawals do not reduce income-tested government benefits such as the GIS. This was one of the primary objectives of introducing TFSAs. That said, the households in the SFS show a persistently high share of savings in RRSPs among low-income households since inception, despite RRSPs potentially being most disadvantageous to this group, especially when savings are intended for retirement purposes.[10]

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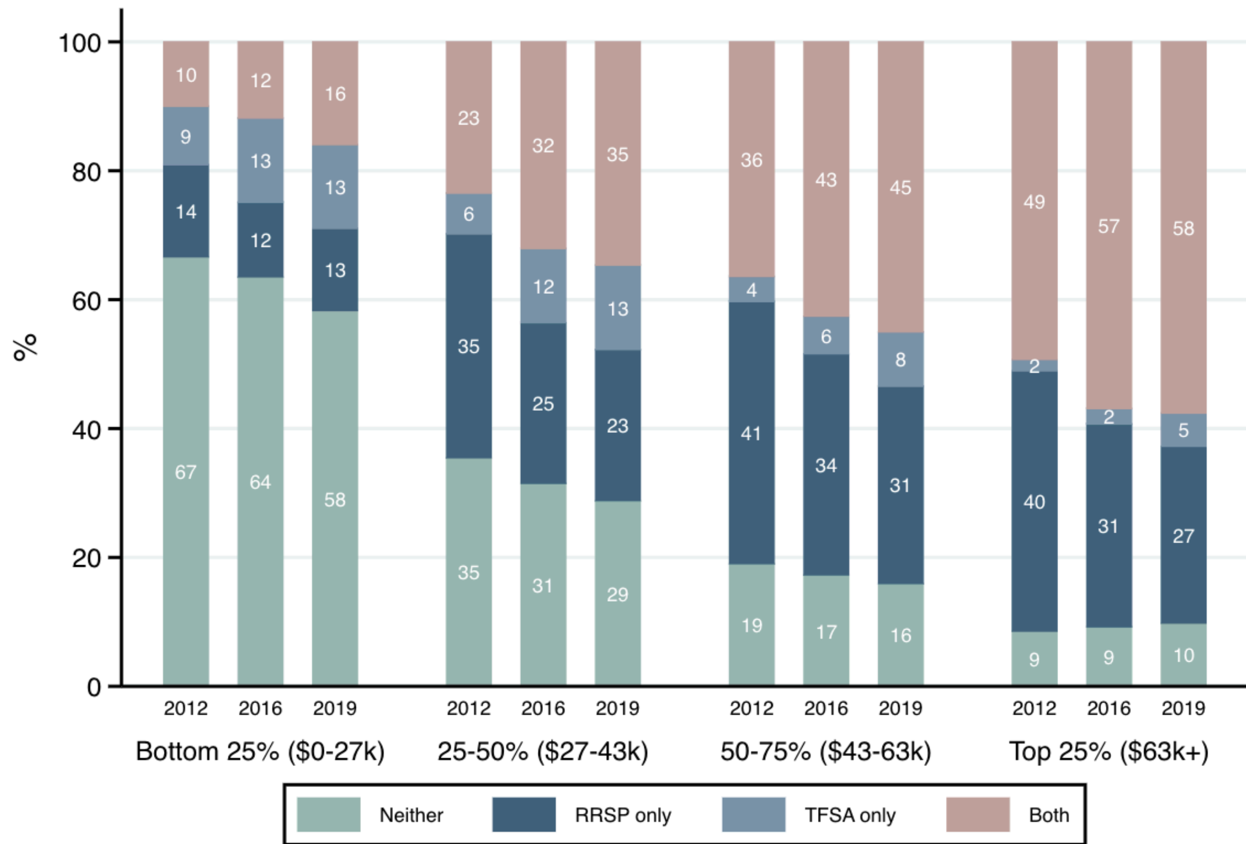
[9] In 2019, Canadians aged 20-29 made 22 deposits and just 8 withdrawals per year, averaging in size around $5,000. In contrast, Canadians aged 70-74 made 6 deposits and 3 withdrawals per year, averaging in size around $9,700.

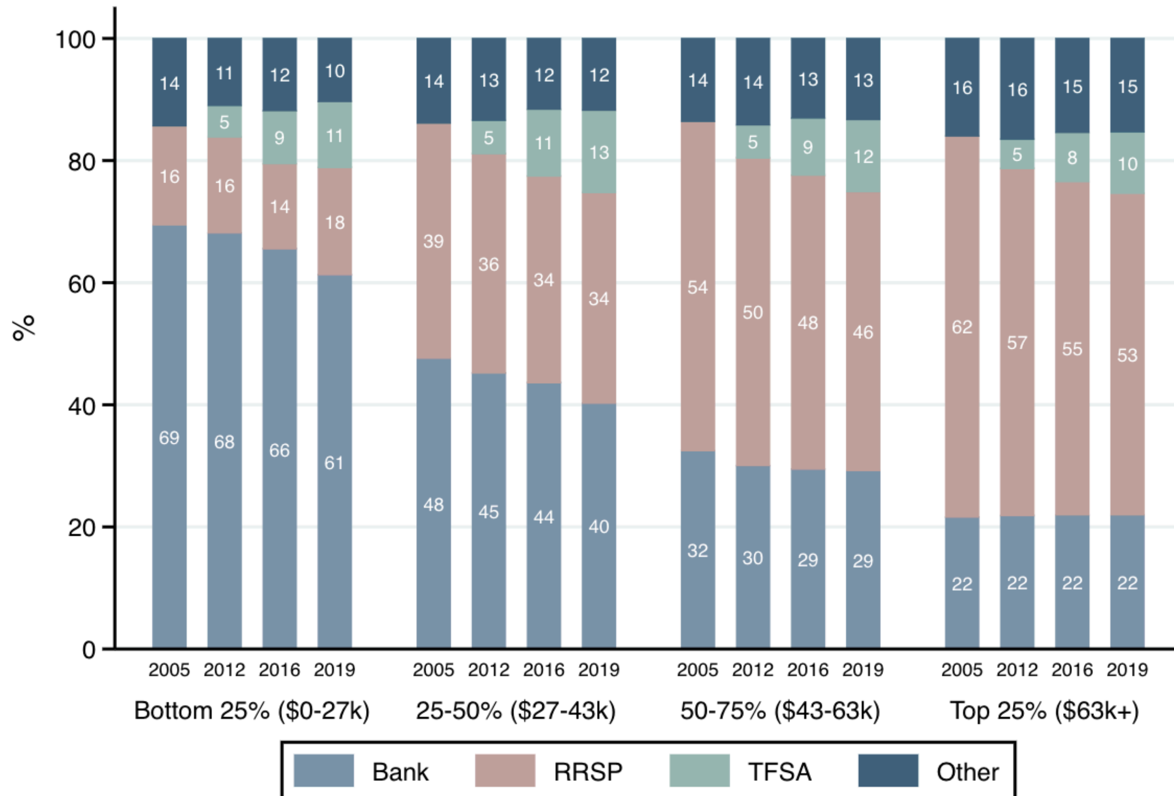
[10] One limitation of the SFS data is that they provide only a snapshot of households the year the survey is administered – the data are not longitudinal and therefore do not follow specific low-income households over time. As a result, some households that get collected in the data may only have a temporary drop in income for one year as opposed to a persistently low income over time.

Figure 7: Share with RRSPs, TFSAs, Both or Neither by Income Quartile, 2012 - 2019



Notes: See Figure 1.

Figure 8: Share of Household Financial Assets by Income Quartile, 2005 - 2019



Notes: See Figure 1.

CONCLUSION AND POLICY CONSIDERATIONS

The 2008 Federal Budget, which announced the introduction of TFSAs, stated several objectives and advantages for these accounts. Beyond the flexibility of TFSAs, such as allowing withdrawals and re-contributions without affecting contribution room, the explicit aims of TFSAs included: 1) their potential use as a viable savings account for Canadians once they begin to draw down on retirement savings; and, 2) improved savings opportunities for low- and-middle income earners as they avoid the income-tested clawbacks of GIS benefits.

Since their introduction in 2009, TFSAs have transformed the savings landscape in Canada. At current rates of growth, it is likely that TFSAs will become as popular as RRSPs in the foreseeable future. Encouragingly, the results show that TFSAs are making significant progress towards the stated objectives. Among all age groups in Canada, TFSAs are used the most by those above the age of 70. Usage is particularly high during the decumulation phase of retirement, as demonstrated by households with RRIFs. In these circumstances, it is likely that TFSAs are used to deposit excess withdrawals of pension income, and stored for large purchases or consumption smoothing.

Somewhat surprisingly, younger Canadian households are also big TFSA users. Many young Canadians may not see the value in using RRSPs for long-term savings goals and may prefer the flexibility that TFSAs offer in the short- and medium-term. There is, however, more to explore here to understand why this age group finds TFSAs more attractive than RRSPs.

TFSA usage among those with low to moderate incomes is also growing over time. Upon introduction, TFSA ownership and growth was somewhat muted among these groups, especially surprising given the advantages they offer low-income earners in retirement. Nonetheless, the trends over the last decade are somewhat reassuring.

At the same time, the introduction of TFSAs has increased the complexity of savings decisions for many Canadians, who must choose how much and where to save. Finding ways to improve financial literacy is imperative to ensure that Canadians are making good choices (Laurin, Messacar and Michaud 2023). For many savers, the reality is that the decision for whether to put a dollar of savings into a TFSA or an RRSP is simply a guess. However, educational interventions can improve the savings decisions of Canadians who do not know where to put their next dollar of savings (Boyer, d'Astous and Michaud 2022). Hence, educational support and interventions should get a significant amount of attention by public and private sector decision-makers. Despite promising growth in usage among low- to middle-income households, there is a lot of work to do still to educate Canadians on how to make the best use of these vehicles (Shillington 2019).

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