

## Little known facts about the Canada Pension Plan (CPP)

For Canadians at or nearing retirement, the Canada Pension Plan (CPP) remains a bit of a mystery. Many people realize they've been contributing to it for a good portion of their lives, but may not be sure how much they will receive at retirement. Furthermore, there is often some confusion as to whether it is a better strategy to begin drawing pension income early at age 60, or wait until age 65. What follows are some facts that shed some light into the "black hole" known as the CPP.

### **FACT # 1**

You can start collecting a CPP retirement pension as early as age 60 – if you have stopped working or have low earnings. To qualify for low earnings, you must earn less than the current CPP monthly maximum payment amount (\$801.25 in 2003), in the month prior

to the pension starting, and in the month it starts. Stopping work means that you are not working on the last day of the month prior to the pension starting, or in the same month the CPP payment is to start. For example, if you apply to have your pension start on November 1, you must not be working on October 31st, or during the month of November.

### **FACT # 2**

Once you begin to receive the CPP, you can work as much as you want without affecting your pension payment. And because you are receiving pension payments, you are no longer required (or allowed) to make CPP contributions, regardless of the type or amount of income you earn. This benefit can really add up. For example, if you started your own business after you left your regular employment, it could save you up to \$4,000 a year (in 2003) in contributions.





### FACT # 3

If you are turning 60 and plan on retiring early, you'll want to know which option is better: taking a reduced CPP pension at age 60, or waiting until age 65 to get the full amount (your CPP can also be delayed to age 70).

The monthly amount you would receive is based on your earnings, and a predefined contributory period, which may be longer than the period that you actually contributed. Also, if you decide to retire early, CPP benefits will be reduced 0.5% per month under age 65, or 30% at age 60.

In terms of a general overview, a pension benefit is calculated by dividing the CPP benefit rate, which is 25% of an individual's average earnings, by the contributory period. Adjustments are then made to reflect actual earnings to bring them in line with the growth in wages over the years. There is also a drop out period allowed for years where you reported low earnings, up to a maximum of 15% of the contributory period. Let's clarify these rules through an example.

Example: Sam turned 60 this year and decided to retire, and wanted to determine if he should start to collect his CPP at age 60 or 65. To show the difference between taking a pension at 60 versus 65, let's assume for benefit purposes that Sam's total earnings over his working life are \$1,211,500, which would make him eligible for the current maximum of \$801.25 per month.

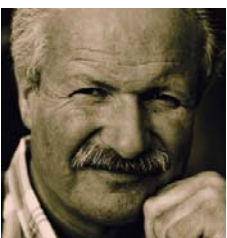
We can see from this example, Sam's average earnings are the same in both cases because he stopped contributing at age 60 when he retired. However, if Sam chose to start receiving his CPP benefit at 65, his average earnings would be divided by a higher number (five additional years) because the predefined contributory period includes all years until the pension starts. Therefore, the reduction from taking his pension early at age 60 is not really 30%. **He will only get 18% more by waiting to age 65, or \$140.29 extra per month.**

From a different perspective, because he is receiving the \$560.70 for an extra 60 months, or an extra \$33,642, **Sam would have to wait until age 84 to have received the same gross amount ( $33,642 \div 140.29 = 239$  months or 19.92 years).**

### FACT # 4

Even if you don't need the income benefits provided by the CPP, it's still a good idea to begin collecting them at age 60. The following are a few suggestions you can discuss with your advisor to determine which option may be right for you:

- You can pay the taxes now and invest the remainder in a growth oriented investment fund (your breakeven point is only slightly impacted).
- You can offset taxes with an interest deduction using a borrow to invest strategy.



## Sam at Age 60

A Sam's contribution period is from 1966 – 2003 = **37 years**

B The maximum drop-out period is  $37 \times 15\% =$  **5.5 years**

C Total earnings are **\$1,211,500**

D The CPP benefit rate is **25%**

E Since Sam is 60 years old, we need to reduce the payments by **30%**

Calculating Sam's CPP benefit at age 60 would look like this:  
 $\$1,211,500 \div 31.5 \times 25\% \div 12 \text{ months} =$  **\$801.25**

**The figure \$801.25 reduced by 30% = \$560.70**

## Sam at Age 65

A Sam's contribution period is from 1966 – 2008 = **42 years**

B The maximum drop-out period is  $42 \times 15\% =$  **6.3 years**

C Total earnings are **\$1,211,500**

D The CPP benefit rate is **25%**

Calculating Sam's CPP benefit at age 65 would look like this:  $\$1,211,500 \div 35.7 \times 25\% \div 12 \text{ months} =$  **\$706.99**

## GETTING ADVICE

If you qualify for a CPP pension, either because you have stopped working or have low earnings, you should ask for a quote. Begin by asking how much you will receive if you begin collecting at age 60, and how much you'll receive if you stop contributing, but wait until age 65 to start your pension. Once you receive your quotes, it should be an easy calculation to figure out which option makes the most sense. If you have questions, review the quotes with your financial advisor to get an expert opinion.

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