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Retirement Drawdown Choices

RRIF, TFSA and Non-registered Accounts

Practice Notes

October 2022

Research conducted by:
Doug Chandler, FSA, FCIA

Background

There are regular articles in mainstream press and finance publications on retirement drawdown strategies to help optimize income in retirement, specifically considering that individuals often reach retirement with different pools of assets, including both registered and non-registered investments.

Common asset drawdown strategies discussed in these articles include:

- drawing RRIF assets ahead of non-registered assets;
- drawing RRIF assets up to the top of the current tax bracket;
- proportionate withdrawals from registered and non-registered accounts;
- drawing registered assets to bridge the gap to deferred C/QPP benefits; and
- drawing down RRIF assets to maximize TFSA contributions.

Financial planners recently surveyed suggested that drawdown of RRIF assets up to the threshold of the client's current tax bracket each year was their top option for drawing down a client's retirement income to supplement their CPP and OAS income in the most tax-efficient way.

Research into asset drawdown strategies by Doug Chandler, an actuary specializing in Canadian retirement research and associate fellow of the National Institute on Ageing, provides clear evidence that the matter is more complex than is commonly understood. The research concludes that, "in general, the value of accelerated RRIF withdrawals may be overstated. Despite media stories highlighting opportunities to take advantage of differences in tax brackets, this research found that demonstrating added value can be quite difficult.[1] "

[1] *Retirement Drawdown Choices, RRIF, TFSA, Non-registered Accounts, Research by Doug Chandler, FSA, FCIA*

The key for financial planners is to consider each client's situation based on their specific circumstances, including their:

- Retirement and estate goals
- Spending
- Current and future effective tax rate(s) for an individual or couple
- Opportunities for income splitting
- Investment risks and returns
- Longevity
- TFSA room

While a recommendation for asset drawdown in a given year might be part of a multi-year drawdown strategy, it must be reviewed and reassessed annually. Changes in the above factors may lead to changes in recommended asset drawdown decisions year by year.

Based on the research by Mr. Chandler, it is important to exercise caution to help ensure that objectives like minimization of estate taxes or avoiding OAS recovery tax (clawback) does not trump the fundamental longevity of investment funds.

It is also key that you avoid rules of thumb and use your financial planning software to test and compare different scenarios based on your client's individual circumstances as they change from time to time.

Good Practice for Financial Planners

- Be aware of situations that may not require significant decumulation analysis due to their relative lack of complexity or flexibility for alternative actions, such as situations where the:
  - Client holds only non-registered assets
  - Client holds only locked-in pension assets
  - Client has significant surplus assets to meet their retirement and estate goals and cannot avoid being in the highest marginal tax brackets.
- Bemindful of situations that are complex, including situations where the:
  - Client has multiple pools of assets and sources of retirement income
  - Client will be subject to foreign taxation
  - Client is a current or potential future recipient of income-tested government benefits and can lose a federal or provincial credit or benefit by receiving additional income.

- Where your clients have multiple pools/sources of retirement income, take these steps:
  - Based on FP Canada Standards Council™ Standards of Professional Responsibility, Rules of Conduct, Rule 28, understand the functioning of your financial planning software and the assumptions built into the software that are key to your analysis of your client's retirement income situation
  - Determine the client's retirement and estate goals and expected longevity
  - Consider asset drawdown strategies to test, including some of the more common drawdown strategies referred to above
  - For each asset drawdown strategy, test the sensitivity of the strategy to different assumptions (i.e., mortality, variability of returns) and consider the impact of the strategy on the client's current effective tax rate, projected effective tax rate over the planning period, estate taxes and any potential impacts on income tested benefits.
  - Compare different asset drawdown strategies to assess which fits best with the client goals (given your client's situation) and optimizes the client's tax position over the planning period
  - Review and reassess the recommended strategy annually

As documented in Mr. Chandler's research, a single tax-optimized withdrawal strategy that may appear to add value for the client (i.e., results in a larger after-tax estate), may have the opposite outcome if the expected returns are lower than expected or if the client lives longer than expected. For this reason, Mr. Chandler's research used an actuarial approach which combined a stochastic model (Monte Carlo) on the expected returns and applied mortality tables to estimate the likelihood of death at every possible age. When you combine ALL of these possibilities and weight the average value of the after-tax estate by the probability of each age at death, you end up with an outcome inclusive of all return and longevity outcomes.

All software tools may not have this level of sophistication or these features may be avoided due to their complexity or the challenge of explaining what it means to clients.

For these reasons, it is incumbent on the financial planner to understand the features and any limitations of the software they are using. If planners are performing more traditional forecasts based on an expected return and life expectancy, scenario testing is required (as provided in the steps above).

Reminder:

FP Canada Standards Council™ Standards of Professional Responsibility

Rule 28 – Use of Technology

When relying of or using technology in the financial planning process, a Certificant:

a) Must take reasonable proactive steps to gain a general understanding of the methodologies underlying the technology that have a direct impact on financial planning projections and recommendations

b) Must have an understanding of the financial assumptions underlying the technology that have a direct impact on financial planning projections and recommendations

c) Must validate that the inputs and assumptions used are reasonable and appropriate based on the client's circumstances

d) Must validate that the outputs generated are reasonable and appropriate for the client before relying on them, or presenting the
final recommendations or strategies to the client. impact on financial planning projections and recommendations

Mr. Chandler and representatives from two financial planning software firms participated in a further discussion of this research and implications for practice in a video conversation. This video can be accessed at the following link: https://youtu.be/xzie-h5WvHc.

Want more information?

Additional materials on this topic and other research projects are available for you to download at:

www.canadianfoundationforfinancialplanning.ca

Executive Summary

Research Paper

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