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Registered education savings plan investments by family income and liquid wealth

By Marc Frenette

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Registered Education Savings Plans (RESPs) are an important vehicle to help families save for postsecondary education. Several financial incentives have existed for many years to encourage low- and middle-income families to open RESP accounts and contribute to them. Despite these targeted incentives, large differences in RESP savings persist between families of different income levels. Among families with children, those in the top 20% of the after-tax income distribution held $22,052 in RESP investments in 2019, compared with $3,295 among their counterparts in the bottom 20% (Frenette 2022).[1]

Why do such differences remain? The answer is not fully known, but a recent study did investigate the role of several parental factors, including wealth; education; and literacy, numeracy and financial literacy (Bonikowska and Frenette 2020). The main factor identified by the study was wealth (net worth), which accounted for 50% to 79% of the total gap in RESP participation between families in the top and bottom income quartiles, depending on the method and dataset used. These results were perhaps not surprising, since investing in RESPs requires available funds or assets to borrow against, both of which may be more available from one's stock reserves (i.e., wealth) as opposed one's flow of funds (i.e., income).

Wealth can take two forms: liquid or illiquid. Illiquid wealth, such as a residence or certain registered investments—namely Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), or Deferred Profit Sharing Plans (DPSPs)—cannot be accessed without significant transaction costs and may be less relevant than liquid wealth when it comes to gauging a family's ability to invest in RESPs. Liquid wealth (including chequing and savings accounts, investment funds and trusts, stocks and shares, bonds and debentures, and Tax-Free Savings Accounts—TFSAs,[2] minus credit card and installment debt[3]) is easily convertible to accessible funds that may be more readily used for RESP contributions.

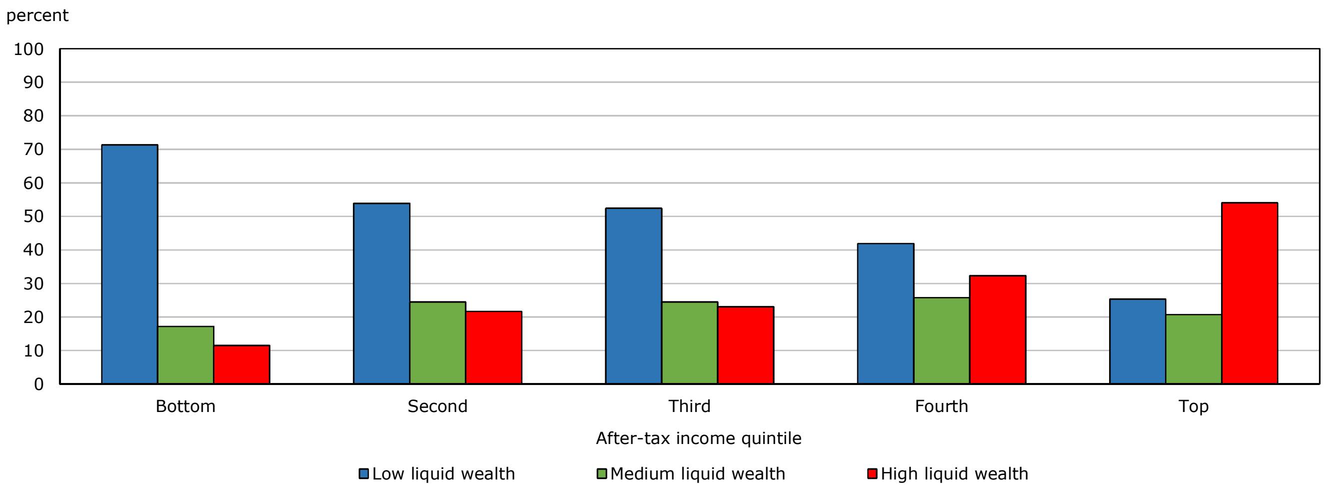
Do families targeted by the income-based RESP incentives all have low levels of liquid wealth, and do families excluded from these incentives all have significant liquid wealth? The answer is no, as shown in Chart 1. In 2019, 11.5% of families in the bottom 20% (or lowest income quintile) of the income distribution had high liquid wealth (at least $20,000 for a family of four), while 25.3% of families in the top income quintile had low liquid wealth (below $5,000 for a family of four).

1. These values include families with no RESP investments.
2. TFSAs are also registered investments since earnings are tax-free. However, there are no penalties or tax implications associated with removing funds from a TFSA, unlike RRSP, RRIF, and DPSP withdrawals (which are all taxable).
3. This definition of liquid wealth follows that of Kaplan et al. (2014), who also used the Survey of Financial Security. Cash holdings are not available in the data and thus are excluded from the definition of liquid wealth.

Importantly, families within the same income bracket (or quintile), but with different levels of liquid wealth, made very different RESP investment decisions. For example, Chart 2 indicates that among families in the middle (or third) income quintile, mean RESP investments were $15,085 among those with high liquid wealth—almost three times more than families with low liquid wealth ($5,504). Similar trends were evident in all other income quintiles.[4]

In summary, despite the existence of several financial incentives for low- and middle-income families to open and contribute to an RESP account, large differences in RESP investments persist across the income distribution. Another important factor is liquid wealth—high-liquid-wealth families tend to hold considerably more RESP investments than low-liquid-wealth families, even when both are in the same income group.

Chart 1
Distribution of liquid wealth by after-tax income quintile, 2019

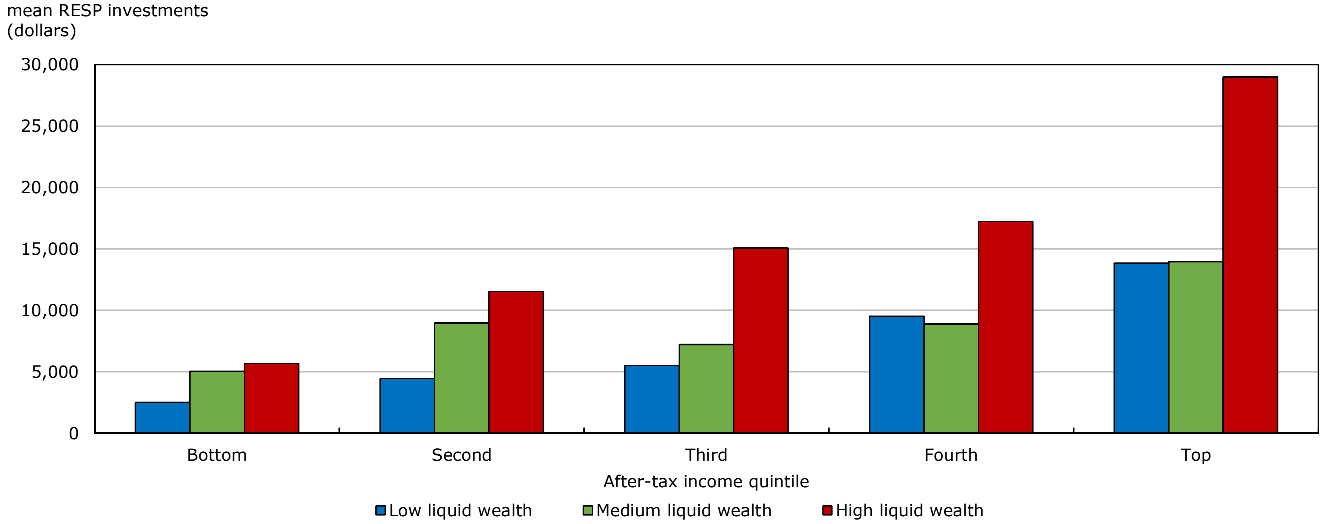


Notes: The sample consists of economic families with at least one child younger than 18. All variables are measured at the economic family level. Dollar figures are expressed in 2019 constant dollars. Families are classified as having low, medium or high liquid wealth based on equivalent dollars, which are obtained by dividing by the square root of the number of family members. Median equivalent wealth in the sample was $2,500, or $5,000 in actual te family of four.

Source: Statistics Canada, Survey of Financial Security.

4. Ideally, one would have access to liquid wealth information prior to when families made the decision of whether to invest in RESPs, because funds for RESP investments may have been drawn from liquid assets (rather than through income that would have otherwise been spent on consumables). Assuming the funds were all drawn from liquid assets, one could simply add RESP investments to the definition of liquid wealth to obtain an alternative measure of pre-RESP investment liquid wealth. When this is done, the differences in RESP investments by this alternative measure of liquid wealth become larger, because many families with low liquid wealth move up to medium or high liquid wealth after RESPs are factored in. Thus, the results presented in Chart 2 may represent lower bounds on the differences in RESP investments by level of liquid wealth within income quintiles. Results based on the alternative measure of liquid wealth are available upon request.

Chart 2
Registered Education Savings Plan investments by after-tax income quintile and liquid wealth level, 2019



Notes: RESP = Registered Education Savings Plan. The sample consists of economic families with at least one child younger than 18. All variables are measured at the economic family level. Dollar figures are expressed in 2019 constant dollars. Families are classified as having low, medium or high liquid wealth based on equivalent dollars, which are obtained by dividing by the square root of the number of family members. Median equivalent wealth in the sample was $2,500, or $5,000 in actual terms for a family of four.

Source: Statistics Canada, Survey of Financial Security.

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