

Pension Reform in Canada In Canada — An Actuarial Perspective

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Abstract

This paper is written in two parts. In the first section, we give background material on the existing Canadian Income Security system, including both government-sponsored systems and private sector supplements. This is to give the rest of the paper its proper context.

Part two of the paper is the report from the Canadian Institute of Actuaries' Task Force on Government-Facilitated Retirement Income Plans, published in March 2010 to provide a response from the Canadian actuarial profession on the continuing pension reform debate in Canada. I was the chair of this task force.

The Canadian Context

We will describe the Canadian Retirement Income Security system as being composed of three Pillars (as defined by the World Bank).

We will refer to the Guaranteed Income Supplement and Old Age Security as Pillar 0. Pillar 1 will refer to the government-sponsored contributory and earnings based Canada-Quebec Pension Plans. Pillar 2 will refer to employer-sponsored registered pension plans. Finally, Pillar 3 will refer to voluntary savings (some of which are tax incented) such as registered retirement savings plans (RRSPs) and tax-free savings accounts (TFSA's).

Readers should consider \$1 CAD to be equal to \$1 USD.

The Guaranteed Income Supplement (GIS)

The government-sponsored portion of the Canadian Retirement Income Security system is highly targeted with the clear purpose of alleviating poverty in retirement.

The first tier of these benefits is welfare benefits called the Guaranteed Income Supplement (GIS). The maximum GIS benefit as of July 2010 was \$658.40 (single) or \$7,901 per annum.

GIS benefits are clawed back at a 50 percent rate for every dollar the individual has of their own source, except for the Old Age Security benefit. This means that it is often not wise to expect or to force low-income workers to save for retirement since they will lose 50 percent of every retirement income dollar they produce. In many provinces, there are additional provincial programs (e.g., the Guaranteed Annual Income System, or GAINS program, in Ontario) that effectively create a 100 percent clawback rate. This clawback becomes extremely important in designing any alternative program.

GIS benefits are not taxable (not a big deal given the very low income of the recipients) and the system is funded from general tax revenues. It is thus a pay-as-you-go plan. One-third of Canadian retirees today receive at least a partial GIS.

Old Age Security (OAS)

Old Age Security (OAS) benefits are paid to all Canadians 65 and older who have lived for 40 years in Canada (pro-rata payments are made to those with less residency). The OAS benefit as of July 2010 was \$521.62 a month or \$6,259 per annum. Thus, a recipient of a full GIS plus OAS benefit would receive \$14,160 per annum (or about 30 percent of average yearly earnings).

OAS is funded by general tax revenues. OAS benefits are taxable income. Both OAS and GIS benefits increase quarterly based on the consumer price index (not a wage index).

OAS also has a clawback but not as severe as for the GIS. OAS benefits are clawed back at a marginal rate of 15 percent once your own personal income exceeds \$62,000. Thus, recipients with their own source retirement income of \$104,000 receive no OAS at all.

The Canada/Quebec Pension Plans (C/QPP)

The Canada Pension Plan and the Quebec Pension Plan are virtually identical and workers have full portability between plans.

C/QPP are earnings related contributory pension plans. Participation for those earning more than \$3,500 per annum is mandatory. The contribution rate is 9.9 percent split equally between the worker and the employer (the self-employed pay the full 9.9 percent). There is a tax credit for these contributions (i.e., a tax deduction but at the tax rate of an average Canadian). Benefits are taxable income.

Actuarial reports of the CPP show that it is sustainable over 75 years at the contribution rate of 9.9 percent. The QPP requires a rate of contribution slightly in excess of 9.9 percent to achieve long-term sustainability.

Contributions and benefit accruals stop at the year's maximum pensionable earnings (YMPE). In 2010, the YMPE was \$47,200. This is approximately the average yearly earnings in Canada.

The benefit accrual rate is 25 percent of wages up to the YMPE. The maximum CPP benefit in 2010 was \$934.17 monthly or \$11,210 per annum. Thus, a person with a maximum OAS plus a maximum CPP would receive \$25,370 or about 37 percent of average earnings. Thus, we can see there is still a lot of room for Canadians to save for retirement in other vehicles.

Private Sector Employer Registered Pension Plans (RPPs)

Similar to the U.S., Canada has seen a measurable shift in employer-sponsored registered pension plans (RPPs) from defined benefits (D.B.) to defined contribution (D.C.) plans. Most of the D.B. RPPs cover public employees. In total, D.B. RPP plans cover 35 percent of the work force but only 22 percent of the private sector work force. And, both of these numbers are in decline.

Thus, there is a growing concern that the next generation of workers may not retire with adequate income. Research has shown this is especially true for those now earning between \$40,000 and \$80,000.

Within defined limits, contributions to both D.B. and D.C. plans are tax-deductible for both the employer and employees. Plans with employee contributions are the norm.

This, then, is the context upon which the CIA produced its task force report on government-facilitated retirement income plans.