TRANSACTIONS OF SOCIETY OF ACTUARIES
1964 VOL. 16 PT. 1 NO. 44 AB

REPORTS ON TOPICS OF PARTICULAR INTEREST—CHICAGO REGIONAL MEETING

CANADA PENSION PLAN

The Canada Pension Plan has been called a political football and, in very truth, the struggle during the past few years between the various contestants has had all the excitement and drama of a football game in which we find five or six teams participating at the same time.

To properly understand the background of what has been happening in Canada, it must be remembered that, under our Constitution, which is sometimes called the British North America Act, the field of pensions can be occupied by the Federal Government with respect to any province only if that province does not already occupy it; and the field of benefits for widows, orphans, and disabled persons belongs in the provincial sphere unless all the provinces agree to relinquish this responsibility to the Federal Government through a constitutional change.

For some years, since 1952 in fact, our basic system of old-age security has taken the form of a statutory flat rate benefit—not related to wages and not means-tested—available to every individual who has lived in Canada for ten years on attainment of age 70. In the beginning this benefit amounted to $40 per month. If a man and his wife both qualified, they would get $80 a month between the two of them.

During the past six or seven years the monthly benefit rate has been increased from time to time, first to $46 a month, then to $55 a month, then to $65 a month, and, finally, toward the end of last year, to $75 a month.

The cost of these benefits has been met by a three-part tax, on personal incomes up to $3,000 a year, on corporate profits, and on sales. The rate of tax in each case started out at 2 per cent and was subsequently increased to 3 per cent. The rate of tax on personal incomes was increased further, to 4 per cent, at the time the benefit rate was raised to $75 a month, and this increase is effective in 1964.

Over the years there has been some dissatisfaction with this flat rate benefit program, and I think it was in 1957, when the Conservative Government was in power, that a Commission was appointed to investigate the whole problem of economic security for the aged. In particular, the Commission was asked to find out why the people of the United States can have higher benefits than we have in Canada, and at lower cost. The

Chairman and sole member of this Commission was Dr. R. M. Clark, an economist with the University of British Columbia.

In due course it came out that neither of the original assumptions with regard to the United States plan was entirely correct. However, Dr. Clark, after a couple of years, produced an excellent and monumental report on the whole question of old-age pensions, although he did not make any specific recommendations. Subsequently, he has stated publicly on a number of occasions that he is not personally in favor of a supplementary wage-related plan in Canada.

The Government of the day did not take any immediate action on the Clark report, so at this point, I think in 1960, the Government of Ontario grabbed the football and appointed a Committee, called the Ontario Committee on Portable Pensions, to look into the possibility of all pension plans in the province being made portable, and also to look into the possibility of providing better supervision over private plans. This Committee reported in due course and, as a result of its report, the Ontario Pension Benefits Act was passed. This was in the spring of 1963, so you will see that we are quickly getting up to date.

There were three main provisions in the Ontario Pension Benefits Act. The first was that every employer with fifteen or more employees must establish a private pension plan providing benefits not less than a prescribed minimum. There were three alternative benefit formulas but the basic idea was to build up a pension of about $80 a month by age 70. The second was that all pension plans, even voluntary supplementary plans, must be made portable subject to certain minimum service requirements. The third was that all pension plans would be supervised by a Pension Commission to be established.

About this time, in the spring of 1963, our Conservative Government was defeated in the House of Commons and an election was called. The Liberal Party, as part of its platform on which it appealed for votes, promised that, if elected, it would establish a pension plan for all Canadians providing pensions of one-third of average lifetime earnings up to a ceiling of $6,000 a year, commencing at age 70. In other words, the maximum pension would be $2,000 a year or $166 a month, over and above the existing flat rate benefit which was to be increased from $65 to $75 a month. The election pamphlets asserted that this plan could be financed by contributions of 1 per cent of covered earnings, that is, one-half of 1 per cent by an employee and the same amount by the employer.

In due course the Liberal Party won the election, although with only a plurality and not a majority of the seats in the House. Having promised a pension plan, the new government felt obligated to implement its illadvised promise, although it quickly became apparent that the figures used in the election campaign were completely unrealistic.

In July 1963 a resolution regarding the Canada Pension Plan was introduced in the House. We now call it the first Canada Pension Plan because it did not survive but has gone through two subsequent transformations. It provided for pensions of 30 per cent of average earnings up to $4,000, in other words, a maximum of $100 a month which was 40 per cent less than had been promised. It also provided for contributions at the rate of 2 per cent—1 per cent from the employee and 1 per cent from the employer. This was an increase of 100 per cent over what had been forecast during the election campaign. In addition to this, a Government actuary prepared a forecast of what the ultimate cost might be—as this was a pay-as-you-go plan—and he estimated that the required contributions might some day reach a minimum of $3\frac{1}{2}$ per cent or a maximum of 8 per cent. When the cost of the basic flat rate pension, expressed in terms of covered earnings, is added in, the ultimate cost might range from 8 per cent to 13 per cent.

It was at this stage that the Government did, in fact, put through an increase in the flat rate benefit from $65 to $75 per month. This is the only part of the first Canada Pension Plan that was enacted.

The other features of the first Canada Pension Plan also deserve to be mentioned. One of these was that there would be a ten-year transition period during which the full rate of pension, with a maximum of $100 a month, would be reached. Persons now age 69 would retire in one year at $10 a month; those at age 68 would retire in two years at $20 a month, and so on. The other feature was an escalator clause under which the earnings ceiling of $4,000 a year would gradually work up over the years ahead to keep pace with the contributors' average earnings.

There was a great hue and cry about all this, particularly on the part of the Province of Ontario, so it was not very long before the Government brought in a revised Bill to provide what we might call the second Canada Pension Plan. Under this plan, instead of $100 a month, the maximum pension would have been $75 a month. This was arrived at as 20 per cent of average earnings up to $4,500 a year, which would be $900 a year or $75 a month. This pension would start at age 65, subject to a retirement test until age 70. Contributions and everything else were to be substantially the same as under the first plan.

In this football game there was still another team, representing the Province of Quebec. The people of Quebec have been relatively unhappy about a number of things during the past few years and, at the outset, their Premier announced that they would not participate in the Canada

Pension Plan but would establish their own plan. This was to be a fully funded plan, and it was generally understood that one of its purposes would be to build up a large fund in the hands of the Government which could be used to stimulate the economy of the province. The plan was never fully described, but the general principle was to provide pensions of 25 per cent of earnings up to $6,000 a year, which works out to $125 a month. Contributions were to be at the rate of 4 per cent on earnings in excess of $1,000 and up to $6,000. The transition period, during which pensions would be built up to the full rate, would be 20 years. There were also to be benefits for widows, orphans, and the disabled.

The Premier of Ontario expressed an interest in the proposed Quebec Plan, and the Prime Minister of Canada sensed that a compromise could be effected. This resulted in the third Canada Pension Plan being announced. Even yet it has not appeared in Bill form, and all that we know about it has been learned from the newspapers and from a copy of a telegram from the Prime Minister of Canada to the Provincial Premiers which was made public. In general, the proposed benefits are based on the Quebec Plan, but, instead of 25 per cent of earnings up to $6,000, the plan would provide 25 per cent of earnings up to $5,000, which works out to $104 a month. The contribution rate is to be 3.6 per cent on the excess of earnings over $600 a year up to $5,000, evenly split between the employee and employer. The transition period is back to ten years. There is also to be an escalator clause, whereby the earnings ceiling will be adjusted to keep pace with average earnings in Canada. In addition, there is to be provision for cost-of-living adjustments in pensions in the course of payment. Finally, for the first time, pensions for widows, orphans, and the disabled would be provided, on the assumption that this would be agreed to by the provinces.

The third Canada Pension Plan is essentially a funded plan, and each province is to have the right to invest its own share of the fund. It has been estimated that the total fund might reach three billion dollars, exclusive of interest earnings, in less than ten years.

Perhaps you would be interested to know how the proposed benefits compare with those you have in the United States. Under your Social Security Plan an individual earning $100 a month would receive $59 a month. In Canada he would receive a total of $76 a month if he took the discounted value of his flat rate benefit at age 65, or, if he waits until age 70 to get the flat rate benefit, he would get $100 a month. A person earning $416 a month, the earnings ceiling in Canada, would get $127 a month in the United States. In Canada he would get $155 a month at age 65 or $179 a month at age 70. A married person in the United States would get 50 per cent more, or $190 a month. In Canada if both man and wife qualified for the flat rate benefit, they would get $206 a month at age 65 or $254 a month at age 70. This would be over 60 per cent of their average earnings.

In considering the foregoing comparisons it should be realized that average consumer spending in the United States is approximately $320 a month per couple, but in Canada only $230 a month.

Some of us who think we know a little more than the average about pensions, and feel in our hearts that we have a sense of social responsibility, view these developments with deep misgiving. For one thing, there has been no real study of the needs of the aged and the problems of priority in our whole social security structure. Benefits under the proposed plans have ranged from $166 a month down to $100 a month, then down to $75 a month and up to $125 a month, and have finally settled at $104 a month, in addition to the flat rate benefits, all on the basis of political expediency. Social security in Canada is estimated to cost some four billion dollars a year at the present time or about 12½ per cent of our total national income, a ratio which is approximately 50 per cent more than the corresponding ratio in the United States. We think that flat rate benefits are better in the Canadian picture, and we think that the proposed benefits are too high by any standard. We also question the ten-for-one subsidies which will be paid during the transition period for those who have not contributed the full cost of their pensions, and particularly to the fact that those with larger incomes would receive larger subsidies than others in more need. Furthermore, there is nothing in the plan for those who have already retired on the basic $75 a month. Another point is that the escalator clause and the cost-of-living adjustment seem inappropriate in a Government plan, as they are likely to breed indifference to inflation. Finally, we think that it is undesirable to accumulate such a large fund in Government hands rather than in the private sector of the economy.

In closing, I would like to tell you a little personal anecdote. About a month ago I took my wife to a Chinese restaurant. It has been my practice for several years to base my actuarial forecasts on a study of the fortune cookies. On this occasion one of the cookies contained a slip that said "A change for the better which will happen *against* you." This perturbed me. I thought for a while that it might mean that the National Life of Canada was about to get a new president. However, since coming to this meeting, it has occurred to me that the inscrutable but nevertheless demmed clever Chinese who wrote this message might have had the Canadian people in mind. If the Canada Pension Plan is a change for the better, which most of our politicians, and most of our newspapers, and most of our citizens seem to agree, then, Mr. President, I am afraid that a change for the better is about to happen against us.

HAROLD R. LAWSON

FINANCING OF MEDICAL CARE FOR THE AGED

As you are aware, there are many bills in Congress which are concerned with the financing of the medical care of our aged. For the purpose of this discussion, I have attempted to classify them in three different groups:

Those providing coverage for all over 65 and financed through social security taxes.

Those which would subsidize premiums for some of the aged through tax credits or scrip, the funds being supplied through general revenues.

The direct purchase of care from the vendors, that is, doctors, hospitals, by a government organization. Financing under these proposals has been through federal-state matching of funds.

The best known of the proposals utilizing a social security tax for funding is the King-Anderson bill. This is primarily a hospital program, and, although it includes some options, the example most frequently employed in describing the bill includes 90 days of service type benefits in the hospital with a deductible provision of $10 a day for the first nine days of care. In addition, this bill provides for some nursing home benefits and home health care service as well as out-patient diagnostic benefit.

The proposed financing is through a tax of $\frac{1}{4}$ of 1 per cent to be paid by both the employer and the employee on the first $5,200 of annual wages. The self-employed would pay $\frac{4}{10}$ of 1 per cent on the same wage base.

Another bill introduced earlier this year by Senator Javits of New York also would use social security financing. This bill includes benefits quite similar to those of the King-Anderson proposal and, in addition, provides enabling legislation for the formation of an association of insurance companies, the idea being that the members of the association would issue policies to provide benefits supplementing the King-Anderson bill. The enabling legislation would be similar to that under which the State 65 programs were established in the sense that it would exempt the association from the anti-trust laws of the federal and state governments and, in addition, relieve the association members of the obligation of paying federal income tax or state premium tax on policies provided under the rules of the association.

All individuals eligible for benefits under social security and who are over 65 would be covered by King-Anderson. In addition, those over 65 who are not eligible for social security benefits would be provided similar coverage, the funds being obtained from general revenue.

Other proposals which would use the social security tax as the financing mechanism are in many respects similar in the benefits provided but vary with respect to those who are eligible. As an example, one would provide benefits not only for those over 65 who are eligible for social security benefits but also for those under that age who are receiving social security benefits under the disability provisions of OASDI and for those who are survivors of deceased beneficiaries. There are, of course, many other variations as well.

The second type of bill would provide a substantial part of all the premium that some individuals over 65 would pay to private carriers for hospital-medical insurance. The best-known example is the bill introduced by Representative Bow of Ohio. This bill would provide a tax credit for those individuals whose income is $4,000 or less and for couples with incomes of $8,000 or less. The amount of the tax credit would be $150 per person. For those who were not paying sufficient taxes to take advantage of the $150 tax credit, the bill would provide that these individuals would be supplied scrip to make up the difference. This scrip would be redeemable only through an insurance carrier.

The Bow bill contains descriptions of two insurance plans which would provide minimum standards under the law: one is a major medical type program, while the other provides basic first-dollar benefits.

Again, there are bills introduced by other congressmen which have the same essential character as the Bow bill but with slight variations. For example, the subsidy might be limited to $125 rather than the $150 of the Bow bill. Others contain a sliding scale with respect to the amount of tax credit, the amount of subsidy being a function of income.

Finally, there are the proposals which are financed through matching funds of the federal and state governments. The Kerr-Mills legislation which was passed several years ago is financed in this way. Under this law the federal government will contribute between 50 and 80 per cent of the total cost of the program, depending upon the average income of the people in the state as compared with the average income of the nation as a whole. The purpose of this bill is to provide for the medically indigent over 65. By medically indigent is meant those individuals who are assumed to be able to provide their ordinary living expenses but for whom a serious illness could be a financial catastrophe. Under this program, the vendors are reimbursed directly by the state—there is no insurance vehicle. Most states have found it necessary to pass enabling legislation in order to take advantage of the Kerr-Mills bill. At the present time, some forty states have passed such legislation, although a few have not yet passed appropriate accompanying appropriation bills.

Independent of the positions of the various people who have been debating the question of how the financing of medical care for the aged should be provided, there is general agreement that legislation of the form of Kerr-Mills will be necessary no matter what else is done.

WALTER M. FOODY, JR.*

* Mr. Foody is Vice-President of the Continental Casualty Company and a member of the National Advisory Committee for the White House Conference on Aging.

INDEPENDENT PUBLIC ACCOUNTANTS

In recent years actuaries have come in closer contact with independent public accountants.

For example, actuaries in the pension field have become involved in discussions with accountants regarding the way in which pension costs are handled in the employer's Annual Statement. The question here involves the proper charge to be made against a particular year's earnings. To deal with this problem, the Society of Actuaries has a special Committee on Pension Accounting chaired by Frank Griffin. This committee has been conducting discussions on this problem with representatives of the American Institute of CPAs.

But more basic than this are the differences of opinion and attitudes arising in the audits of insurance companies by certified public accountants. These accountants find it necessary to comment in their audit report on the difference between N.A.I.C. insurance accounting and the CPAs' "generally accepted accounting principle."

Some of the differences mentioned by the CPAs include:

a) Comments regarding the valuation of assets.
b) Comments regarding the handling of expenses over the lifetime of the policies.
c) Comments regarding "not admitted assets."
d) Some accountants have even made comments regarding the valuation bases of reserves.

The Society has no committee working in this area. You might be interested to know, however, that an informal technical subcommittee representing the life insurance business and the property and casualty business has been formed to discuss the problems involved with a similar subcommittee of the CPAs. It is hoped that discussions at a technical level may be helpful in dealing with this very sensitive problem.

GATHINGS STEWART