SOCIETY OF ACTUARIES

Article from

International News

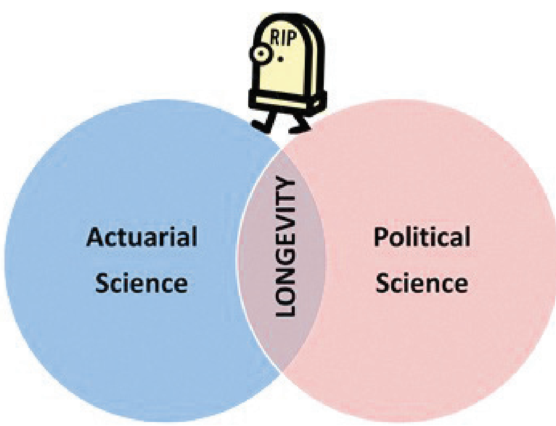
September 2016
Issue 69

Retirement Readiness: A Rocky Road in Canada

By Geoffrey Melbourne

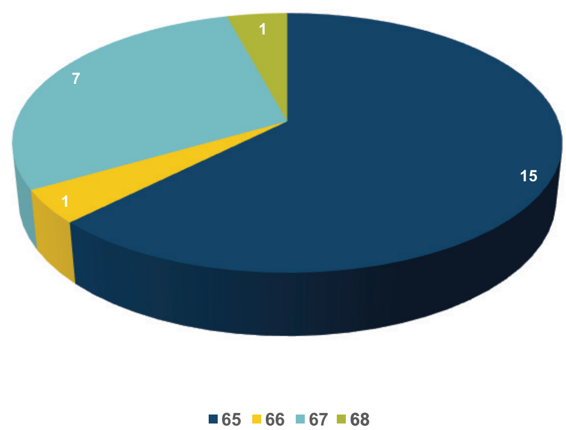
Politics and pensions make strange bedfellows. I was reminded of this recently as I read of a call[1] by U.S. President Obama for Social Security to be expanded. I was fascinated, not because of any merits or otherwise of the position, rather the position—which seems to represent a change in outlook—comes in the twilight of his presidency.

However, this article is not about U.S. politics or pension challenges, but those north of our (still friendly) border in Canada. In my entry to the 2012 Country Feature Competition (which I observe was published in the first digital edition of *International News*!), I wrote about planned changes to Canada's Old Age Security (OAS) program. The main changes would see the eligibility age for the residence-based OAS and its companion means-tested Guaranteed Income Supplement (GIS) gradually increasing from age 65 to age 67 over six years starting in 2023.



Whatever misgivings one may have, I would suspect that an audience of actuaries would find an increase in the eligibility age to be logical in light of longevity trends. According to World Bank Pensions Data,[2] 15 of 24 high-income OECD countries (including Canada) had a statutory retirement age for males of 65 as of Q2 2013, meaning 37.5 percent of these countries had a higher retirement age as shown in Chart 1.

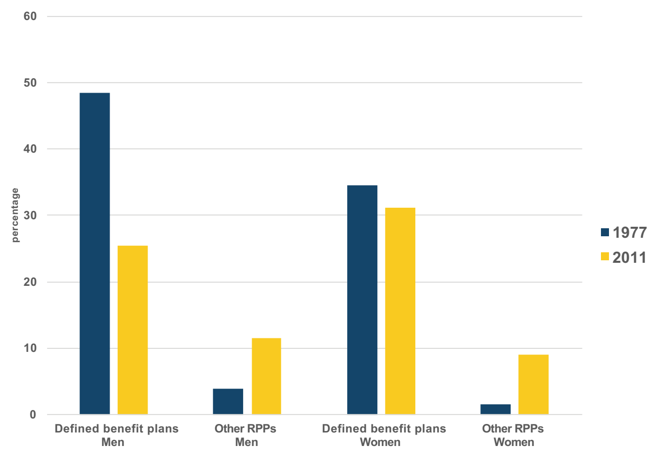
Chart 1: Statutory Retirement Age for Males in OECD Countries (Q2 2013)



Fast forward to 2016 in Canada and we have a new Prime Minister, Justin Trudeau, representing the Liberal Party of Canada. You may read of his "bromance" with President Obama elsewhere, but one of his pre-election promises was to cancel the scheduled increases in the OAS eligibility age, and this was made manifest in his government's first federal budget:[3]

Well love it or hate it, that's one plus for future seniors. What else is in store for future generations of retirees? After all, the OAS has a target replacement ratio of only 15 percent of national average income, leaving most Canadians reliant on other sources of income for their financial security in retirement. The Canada Pension Plan (CPP), the other main social security pillar, is based on employment earnings and has a 25 percent target replacement ratio. Even the combined social security program is considered to leave significant room for workplace retirement programs and personal savings to bridge the gap to retirement readiness for many Canadians. As in much of the industrialized world, workplace retirement programs have been in decline in Canada and, particularly outside of the public sector, there has been a trend[4] towards defined contribution rather than defined benefit coverage as seen in Chart 2.

Chart 2: Percentage of employees with a registered pension plan (RPP) through their job, by gender and pension type. 1977 and 2011



RPP: registered pension plan

Sources: Statistics Canada, Pension Plans in Canada and Labour Force Survey, 1977 and 2011.

The government of Ontario (Canada's most populous province) has long advocated a CPP expansion to address the retirement readiness issue. It faced resistance from the previous federal government that was generally opposed to such an expansion, but has found more favor with the Trudeau regime. Changes to the CPP require the support of at least seven provinces holding two-thirds of the population of the country—given the different state of provincial economies and other local considerations, achieving consensus on this front is non-trivial.

Ontario had therefore forged ahead with the Ontario Retirement Pension Plan ("ORPP").[5]

"A pension plan designed to help Ontario workers retire with greater financial security."

"Restoring the eligibility age for Old Age Security and Guaranteed Income Supplement benefits to 65 will put thousands of dollars back in the pockets of Canadians as they become seniors. These benefits are an important part of the retirement income of Canadians, particularly for lower-income seniors. Vulnerable seniors depend on this support, and without it, face a much higher risk of living in poverty."

Key features of the ORPP included:

- Mandatory for employees without a "comparable workplace pension plan"
- Employees would contribute up to 1.9 percent of their annual earnings up to $90,000—matched by employers
- Normal retirement eligibility age of 65, with options to receive adjusted retirement income as early as age 60 or as late as age 71
- Designed to provide a 15 percent income replacement rate after contributing to the plan over 40 years
- Pensions would be indexed to inflation
- Phased implementation depending on the number of employees and whether a non-comparable registered workplace pension plan is in place

The comparability test had been one of the more controversial features of the ORPP:

- For earnings-based Defined Benefit (DB) pension plans, the annual benefit accrual rate must be at least 0.5 percent to be considered comparable
- For Defined Contribution (DC) pension plans, the minimum total contribution must be at least 8 percent of earnings, with employers contributing at least 50 percent of the total minimum contribution, or at least 4 percent

One actuarial conundrum had been how a 0.5 percent DB accrual rate and an 8 percent DC contribution rate could be considered to be equivalent. Suffice it to say that there are arguments that a DC contribution rate would need to be higher to cover risks and features such as longevity, indexation, survivor benefits and institutional investment returns and fees that are better addressed under a DB arrangement.

Another concern, especially among DC providers such as insurance companies, was that DC plans, which are not structured as registered pension plans (and therefore allow easier access to the funds saved before retirement), would not be comparable. In addition, some DC plans have contribution designs that would not meet the comparability test, in some cases because contributions may be optional for employees with a match from employers rather than being mandatory. In contrast, most DB plans would be expected to satisfy the comparability test.

There were also viewpoints that:

- The ORPP would be solving a problem that doesn't exist
- ORPP contributions would represent an unjustified payroll tax
- Employers (especially small employers) and/or employees couldn't afford the additional contributions
- The disruption to existing workplace retirement programs because of the comparability test would be unwarranted

The Canadian Institute of Actuaries (CIA) recently released a public position paper on the "Expansion of Public Pension

Plans."[6] While not advocating for any particular position on the merit or lack thereof of any program, the CIA suggested the following key design elements for consideration if governments agree that the key problem to be addressed is middle income workers without a pension plan and that the best solution is for public pension plans to be expanded:

- 15 percent pension target after a full career, based on earnings between 50 percent and 150 percent of CPP covered earnings
- Set equal employee and employer contributions and consider staggered contribution rates based on age to minimize generational transfers
- Fully fund new benefits by providing gradual pension accruals, and adjust indexing if necessary so that the new plan remains self-sufficient
- Use the existing structures (CPP and Quebec counterpart) for collecting contributions, administering benefits and investment functions
- Take more time to evaluate whether the retirement age under public plans should be adjusted

The 2016 Global Benefits Attitudes Survey[7] from Willis Towers Watson highlighted that Canadian employees generally desire retirement security and are willing to pay for it (with 65 percent of Canadian employees surveyed in 2015 being willing to have a higher pay deduction each month to ensure a guaranteed retirement benefit):

So we have employees concerned about retirement readiness, governments taking actions at different paces and employers needing to manage the different issues and influences in a way that makes sense in the contexts of their business operations. On the government side, Canada's finance ministers met in June 2016 to discuss ways to reform the CPP, following the federal budget indications[8] that the government would launch consultations to give Canadians an opportunity to share their views on enhancing the CPP. At the time of writing, it had just been announced[9] that the finance ministers have agreed in principle to work on a CPP enhancement starting January 1, 2019, with the following key features:

- Target replacement ratio increased from 25 percent to 33.3 percent
- Maximum amount of income subject to CPP ($54,900 in 2016) increased by 14 percent upon full implementation in 2025, when the new projected limit would be $82,700
- Gradual phase-in of contribution impacts over seven years starting on January 1, 2019 to allow more time for businesses and employees to adjust
- Offsetting the impact on low-income workers by enhancing federal tax benefits, and providing a tax deduction rather than a tax credit for employee contributions associated with the enhanced portion of CPP to mitigate the tax consequences in general

Eight provinces and the federal government have signed the agreement, with Quebec and Manitoba agreeing to remain part of the discussions moving forward. Ontario has confirmed that the ORPP will not be implemented, pending ratification of the CPP deal by mid-July 2016. Despite all the preparation work done on the ORPP, using a national platform is that much more efficient and averts further "checker-boarding" of pension provision in Canada. Those who viewed the ORPP as solving a non-existent problem and/or the ORPP contributions as an unjustified payroll tax may hold similar sentiments towards the CPP expansion. The proposed CPP changes don't go as far as the ORPP would have, and I expect that the road to retirement readiness in Canada will remain a long and rocky one. ■

The views expressed in this article are not necessarily the views of Willis Towers Watson

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ENDNOTES

1 *http://www.latimes.com/business/hiltzik/la-fi-hiltzik-obama-social-security-20160603-snap-story.html*

2 *http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALPROTECTION/EXTPENSIONS/0,,contentMDK:23231994~pagePK:148956~piPK:216618~theSitePK:396253,00.html*

3 *http://www.budget.gc.ca/2016/docs/plan/ch5-en.html*

4 *http://www.statcan.gc.ca/pub/75-006-x/2014001/article/14120-eng.htm#n10*

5 *https://www.ontario.ca/page/orpp-ontario-retirement-pension-plan*

6 *http://www.cia-ica.ca/docs/default-source/2016/216056e.pdf?sfvrsn=0&utm_source=May_19_Announcements&utm_medium=Email&utm_content=PP_Link_PUB_EN&utm_campaign=May_2016_ORPP_PP*

7 *https://www.willistowerswatson.com/en/insights/2016/02/global-benefit-attitudes-survey-2015-16*

8 *http://www.benefitscanada.com/pensions/governance-law/finance-ministers-schedule-meeting-for-cpp-reform-discussions-82105*

9 *http://www.fin.gc.ca/n16/16-081-eng.asp*