Canada: Building a Sustainable Pension System

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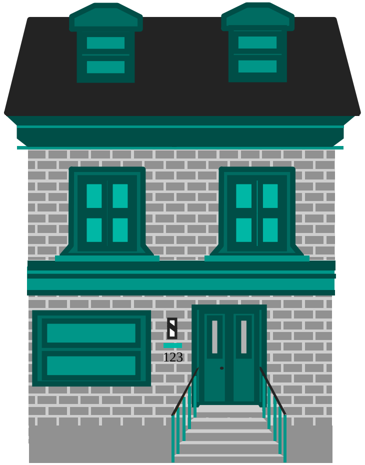
OSFI BSIF

Canada

Canadian Retirement Income System is based on a diversified approach to savings

- Canadian retirement system is a three-tiered system with mixed funding approaches
  - Old Age Security Program – a universal basic pension/supplement aimed at poverty reduction (PAYG)
  - Canada / Québec Pension Plan – mandatory earnings - related DB plans aimed at providing basic retirement income (partially funded)
  - Occupational Pension Plans and tax-favoured individual savings – voluntary schemes aimed at providing adequate retirement income (fully funded)

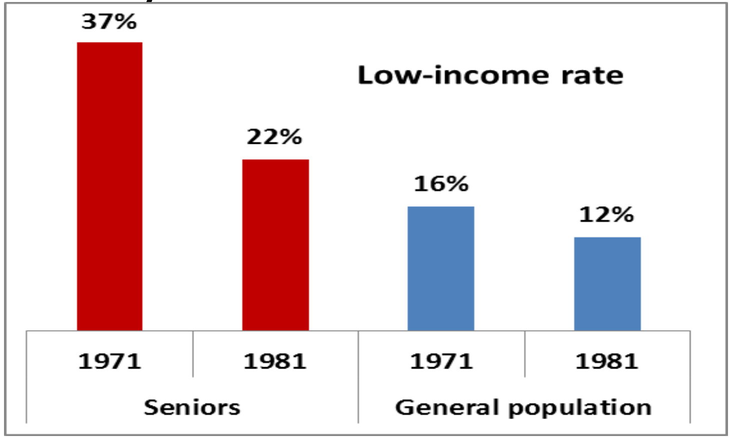


40% replacement rate from Pillars 1 and 2

Canadian retirement income system is well recognized in the world for its capacity to adapt rapidly to changing conditions.

1966 *The introduction of the Canada Pension Plan*

- A result of extensive political and societal discussions
- The CPP was established as a pay-as-you-go plan with small reserve fund
- Focus on both current and future generations
- Meaningful for people close to retirement at inception
  - Full retirement pension was available after 10 years
  - Low combined employer-employee contribution rate of 3.6%
    - Despite 1964 projections predicting that the contribution rate necessary to maintain the Plan will be between 4.3% and 5.2% by 2010.



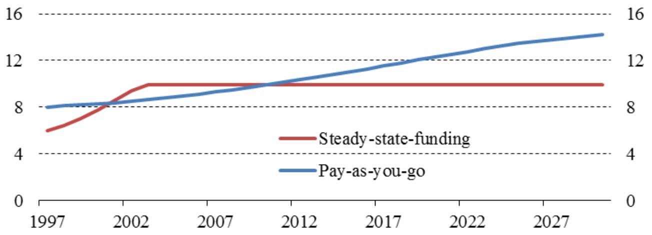
1996 *Solving long-term sustainability issues and improving equity across generations*

- Due to ageing and lower productivity contribution rate of 5.6% needed to increase to 14.0%

Younger generations were losing confidence in the CPP

- Governments and public agreed on nine principles for the reform
- Main reform points:
  - Increase in the contribution rate to 9.9% by 2003
  - Reduction in the growth of benefits
  - Creation of the CPPIB
  - Introduction of self-adjustment mechanism
  - Strengthening governance.

CPP Contribution rate under the pay-as-you and steady-state funding models
1997 to 2030; %



Source: Office of the Chief Actuary; Canada Pension Plan 16th Actuarial Report (September 1997)
Note: Certain data points are interpolated

2015 *CPP27: the Plan is expected to be able to meet its obligations over long term*

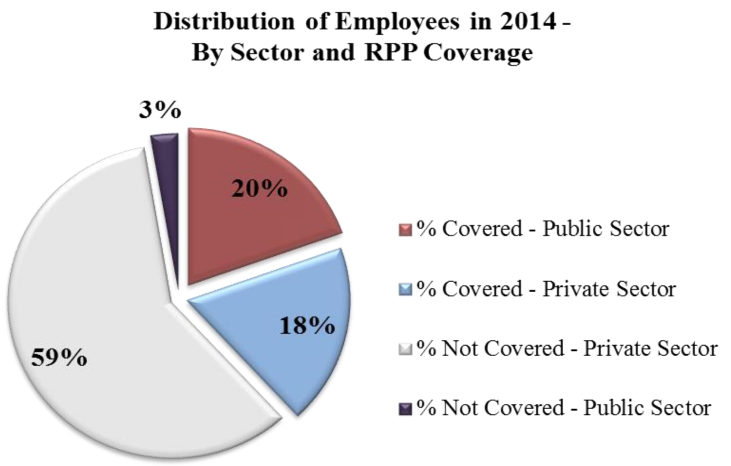
- The minimum contribution rate to sustain the Plan is **9.79%** of contributory earnings for the year 2019 and thereafter

- <u>Under the **9.9%** legislated contribution rate:</u>
  – contributions are projected to be more than sufficient to cover the expenditures over the period 2016 to 2020
  – Total assets are expected to grow from $285 billion at the end of 2015 to $476 billion by the end of 2025

Source: the 27th Actuarial Report on the Canada Pension Plan as at 31 December 2015 tabled in Parliament on 27 September 2016

2016 *A need to strengthen system for younger generations*

- Decline in the coverage by the employer-sponsored pension plans (especially in private sector)
- Changing labour market – increased employment mobility
- 2008-2009 financial crisis



Stewards of the CPP agreed on expansion parameters:
<u>modest</u>, <u>gradual</u> and <u>fully-funded</u>

2016 *Historical agreement on the CPP expansion*

- Increase in covered earnings to 114% of average wage
- Increase in replacement rate from 25% to 33.33%
- Contribution rates to finance expansion are 2%/8%
- Phase-in over 7 years to mitigate impact on businesses and workers (from 2019 to 2025)
- The financing objective of expansion:
  - Future revenues should fully cover future expenditures
  - No past service liability is created.

Current young workers benefit the most from the expansion

What is an efficient retirement system?

- **Diversified** system:
  - Mixture of public / private and voluntary / mandatory pensions
  - Mixture of funding approaches
- **Affordable** and **sustainable** system
- Respects intergenerational **equity**
- Has **solidarity** elements: reduction of poverty among seniors
- Based on **responsibility and societal dialogue**: retirement income security is a shared responsibility between the government, society, employers and individuals
- Maintains **standard of living** after retirement
- Properly interacts with **labour market**: incentives to remain in the labour force and flexibility in work-to-retirement transition.

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Thank you

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Appendix

Canada Pension Plan is jointly governed by federal, provincial and territorial ministers of finance

- CPP - the second tier of the Canadian retirement income system
- CPP and QPP are earnings-related plans providing indexed retirement, disability and survivor benefits to working Canadians
  - Came into effect in 1966
  - CPP/QPP cover all working population of Canada
  - Cover earnings up to Canadian average wage
  - CPP contributions are paid in equal part by employer and employees at the combined rate of 9.9%
  - Provide retirement replacement rate of 25% of wage-indexed career average earnings.

Principles to Guide Federal-Provincial Decisions on the Canada Pension Plan, 1996

1. The CPP is a key pillar of Canada's retirement income system that is worth saving.
2. The CPP is an earnings-related program. Its fundamental role is to help replace earnings upon retirement or disability, or the death of a spouse - not to redistribute income. The income redistribution role is the responsibility of the income tax system, the Old Age Security/Guaranteed Income Supplement/Seniors Benefit, and other income-tested programs paid from general tax revenues.
3. The solutions to the CPP's problems must be fair across generations and between men and women.
4. The CPP must be affordable and sustainable for future generations. This requires fuller funding and a contribution rate no higher than the already legislated future rate of 10.1 per cent. In deciding how quickly to move to this rate, governments must take economic and fiscal impacts into account.
5. Governments must tighten administration as the first step towards controlling costs.

Principles to Guide Federal-Provincial Decisions on the Canada Pension Plan, 1996

6. Disability and survivor benefits are important features of the CPP. However, they must be designed and administered in a way that does not jeopardize the security of retirement pensions.
7. Any further benefit improvements must be fully funded.
8. CPP funds must be invested in the best interests of plan members, and maintain a proper balance between returns and investment risk. Governance structures must be created to ensure sound fund management.
9. Governments must monitor changing economic, demographic, and other circumstances which can affect the CPP, and act to respond to these changing conditions. Annually, Ministers of Finance should provide Canadians with the appropriate information so they can judge for themselves that the integrity and security of the CPP is being protected.

2016 *For the additional CPP, investment income is the major source of revenues*

- Under 2%/8% contribution rates contributions will exceed benefits up to the year 2058.
  - This will result in the accumulation of sizable assets