Office of the Superintendent of Financial Institutions Canada

Bureau du surintendant des institutions financières Canada

Office of the Chief Actuary

Bureau de l'actuaire en chef

Canada Pension Plan Enhancement

Conference on retirement, institutional investment and personal finances

by Jean-Claude Ménard, Chief Actuary, OCA, OSFI

November 8, 2016

OSFI
BSIF

Canada

Office of the Chief Actuary

- The OCA is an independent unit within OSFI.
  - The Chief Actuary reports to the Superintendent;
  - however, the accountability framework of the OCA makes it clear that the Chief Actuary is solely responsible for content and actuarial opinions in reports prepared by the OCA.

- Mandate: conduct statutory actuarial valuations on the
  - Canada Pension Plan (CPP) –19M members
  - Old Age Security Program (OAS) - 5M beneficiaries
  - Federal public sector pension and insurance plans – 0.8M members
  - Canada Student Loans Program – 0.5M loans
  - Employment Insurance Program – 17M workers

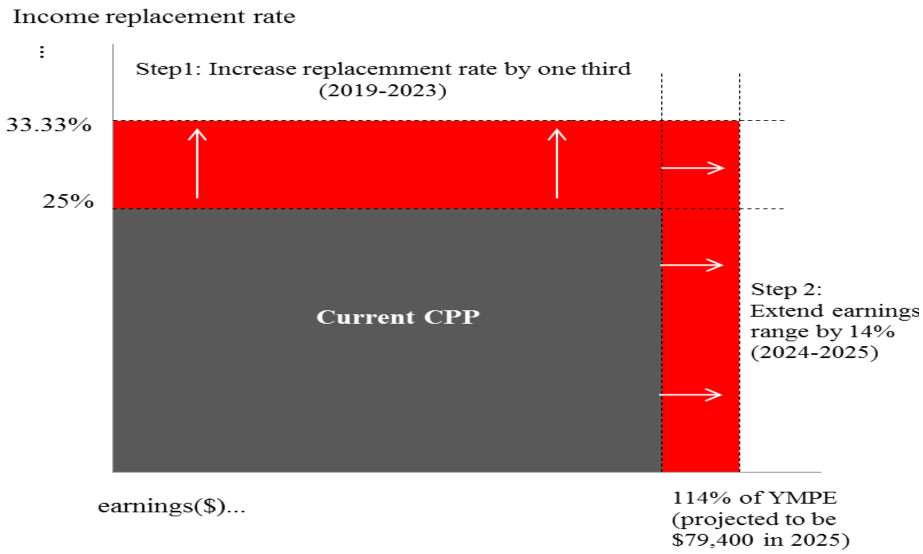
The following presentation reflects solely the views of the Office of the Chief Actuary

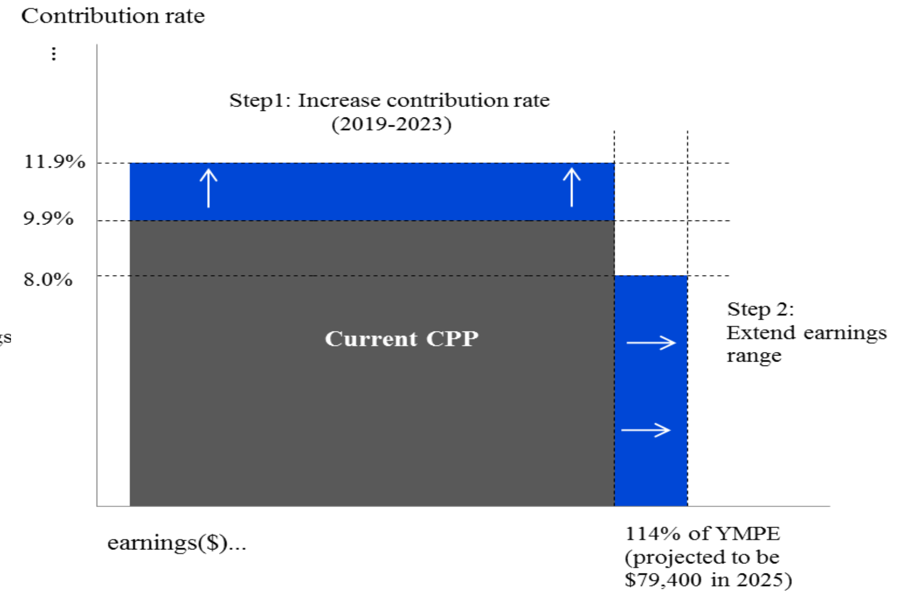
CPP27: the Plan is expected to be able to meet its obligations over long term

- 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
  - In 2050, it is projected that 26% of investment income will be required to pay for expenditures
  - In 2050, the contributions and investment income are projected to represent 67% and 33% of total revenues, respectively.

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

Bill C-26 amends the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act





- Bill C-26 includes provisions that both employee and employer contributions to the additional CPP would be tax deductible, and that the Working Income Tax Benefit would be increased to help offset CPP contributions for eligible low-income workers.

Source: Bill C-26 tabled in Parliament on 6 October 2016

Additional CPP strengthens link between contributions and benefits

- The financing objective of additional CPP:
  - To have constant contribution rates that result in projected contributions and investment income that are sufficient to fully pay the projected expenditures of the additional CPP over the long-term
- Each year of contributing to the enhanced CPP will allow workers to accrue partial additional benefits
  - Full enhanced CPP benefits will be available after 40 years of making contributions.
  - Partial benefits will be available sooner and will be based on years of contributions.

No past service liability is created

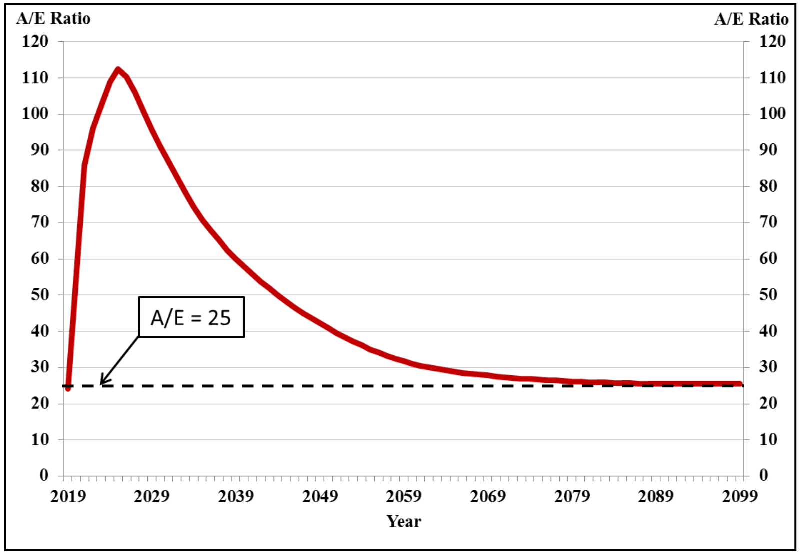
Insufficient rates provision of the current CPP serves as a safety net

- Insufficient rates provision of the base CPP is activated in the case its sustainability is jeopardised and its stewards (federal and provincial Ministers of Finance) do not agree on measures aimed at restoring the CPP sustainability
  - Neither contribution rate nor benefits are guaranteed

- For the additional CPP, if additional contribution rates fall outside prescribed ranges:
  - As for the base CPP, the first priority is given to the recommendations of Ministers
  - Prescribed ranges and actions with respect to the benefits and contributions will be defined in regulations.

The 28th CPP Report was tabled in Parliament on 28 October 2016

- The constant minimum first and second additional contribution rates that result in projected contributions and investment income being sufficient to fully pay projected expenditures of the additional CPP are respectively **1.93%** for the year 2023 and thereafter, and **7.72%** for the year 2024 and thereafter.

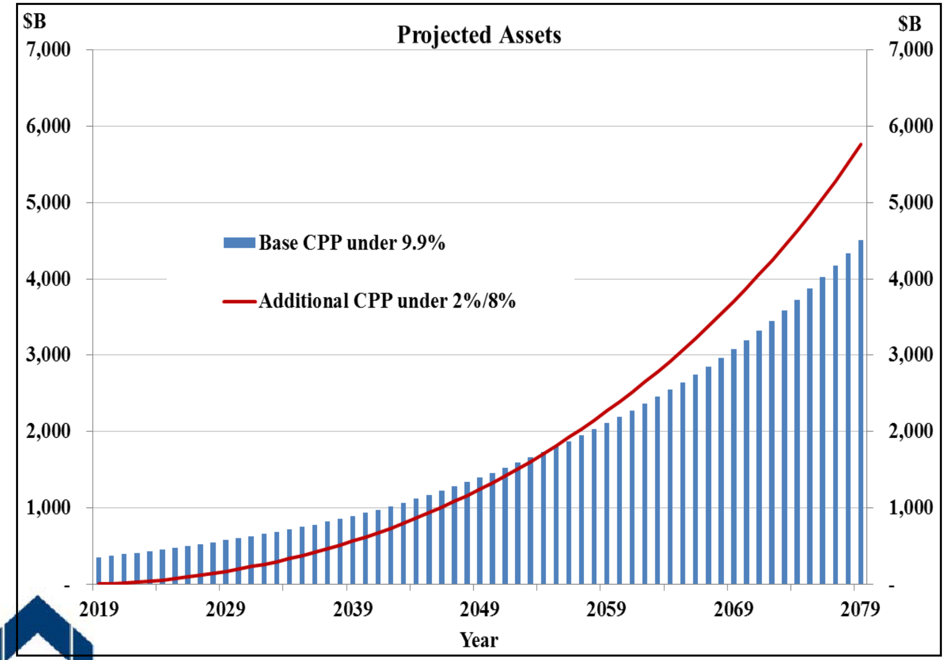


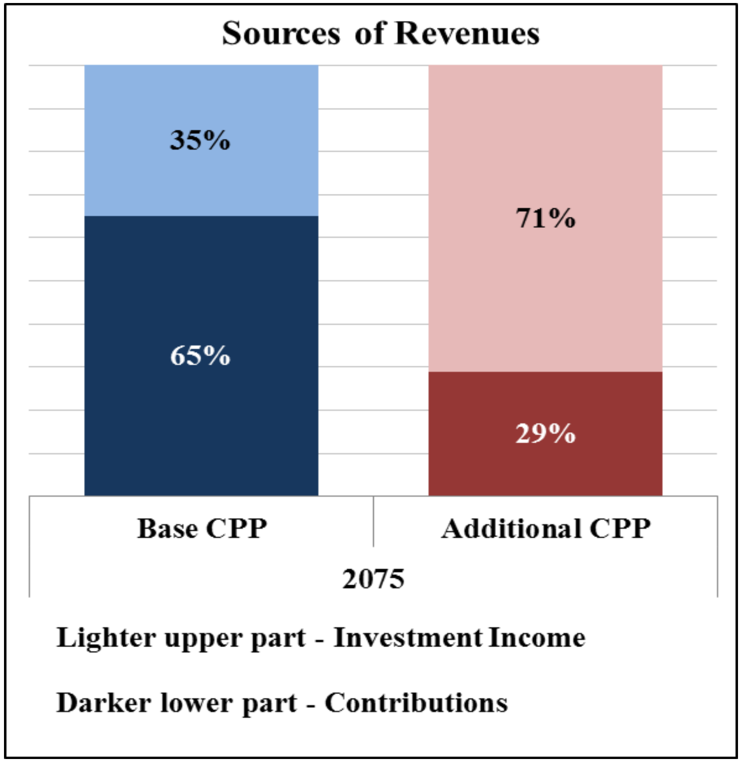
Open Group Balance Sheet - Additional CPP
January 1, 2019

	($billion)
Assets	
Current Assets	-
Future Contributions	674
Total Assets (a)	674
Actuarial Liability (b)	633
Asset Excess (Shortfall) (a) – (b)	40
Assets as percentage of Liability (a)/(b)	106.4%

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
- The major source of financing: Contributions for the base CPP, and investment income for the expansion.

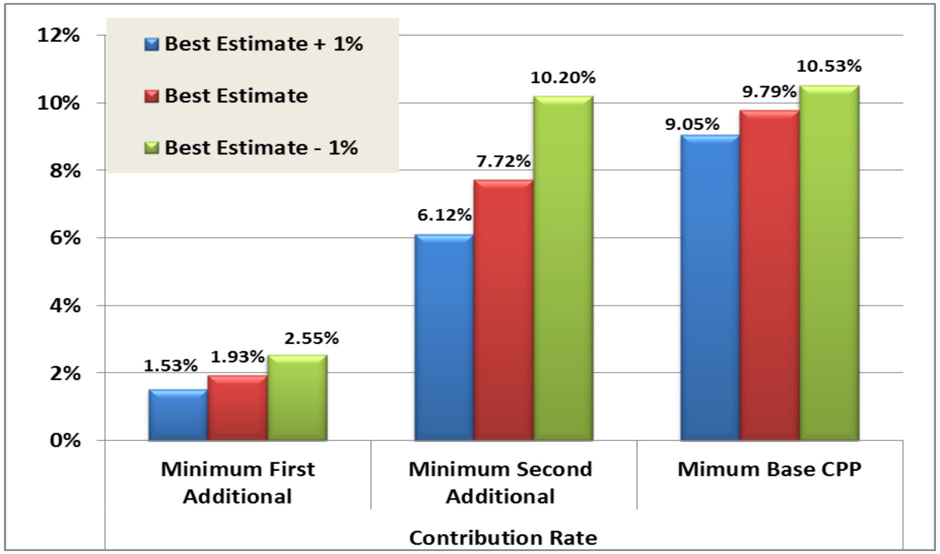




Additional CPP will be sensitive to investment environments

	Additional CPP (CPP 28)	Base CPP (CPP 27)
Assets Allocation	Fixed Income: 50% Equities: 50% Volatility: 9.2%	Fixed Income: 32.5% Equities: 67.5% Volatility: 11.4%
2025+ real rate of return (net of expenses)	3.63%	4.03%
Average real rate of return (net of expenses)		
- 2019-2023	2.51%	3.40%
- 2019-2028	3.03%	3.69%
- 2019-2093	3.55%	3.98%

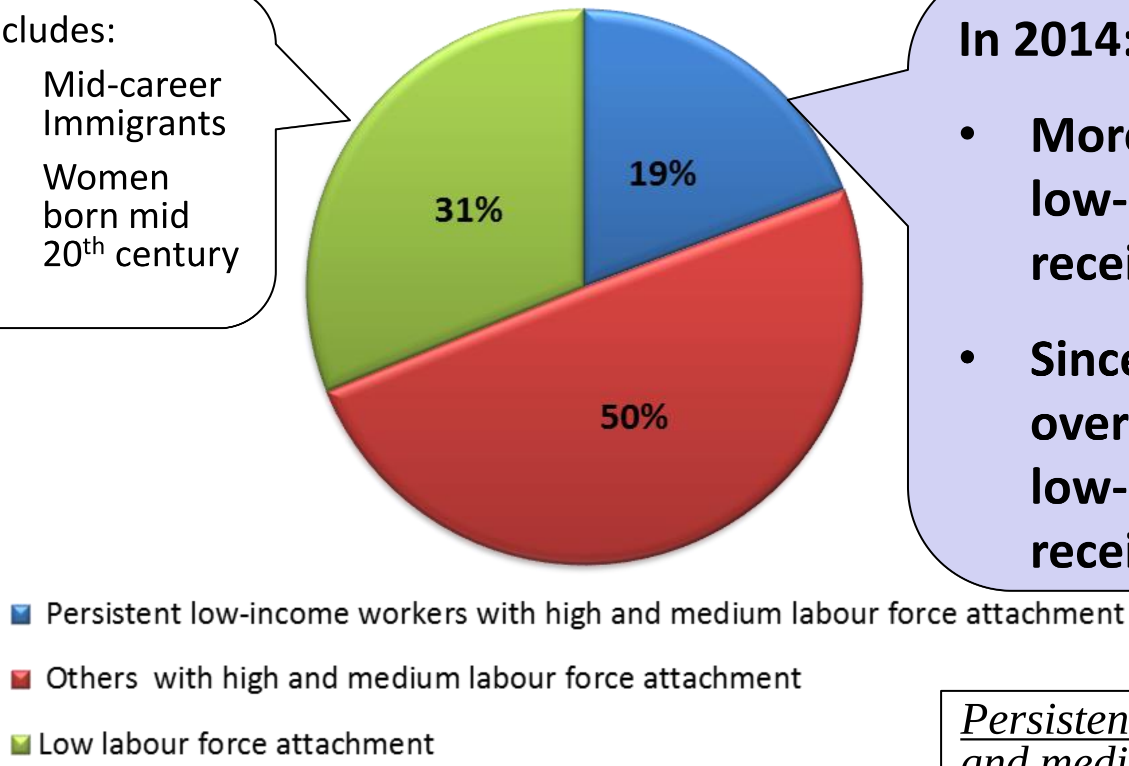
The decrease in the best-estimate rate of return of 1% results in about 30% increase in the minimum additional contribution rates compared to about 8% increase in the minimum contribution rate for the base CPP.



Do persistent low-income workers benefit from CPP enhancement?

Share of persistent low-income workers:
CPP contributors' cohort aged 65-69 in 2014 (1.4 million)

Includes:
- Mid-career Immigrants
- Women born mid 20th century

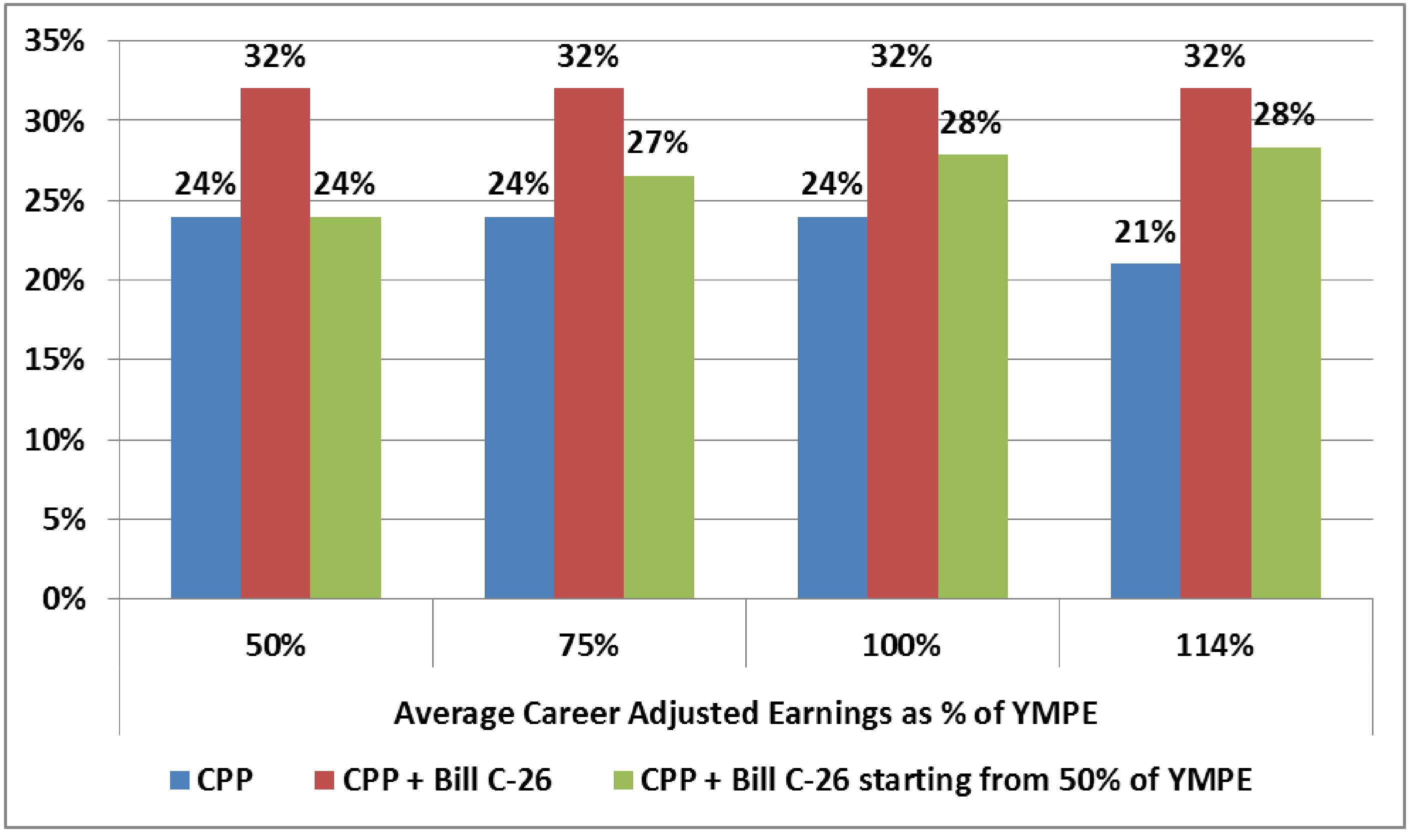


In 2014:
- **More than 75% of persistent low-income workers were not receiving GIS**
- **Since the GIS is a family benefit, over 80% of female persistent low-income workers do not receive GIS**

Persistent low-income worker with high and medium labour force attachment:
1. More than 10 years with earnings between 10% and 50% of the YMPE
2. Less than 20 years absence from the labour force

Increasing lower earnings threshold would reduce replacement rates

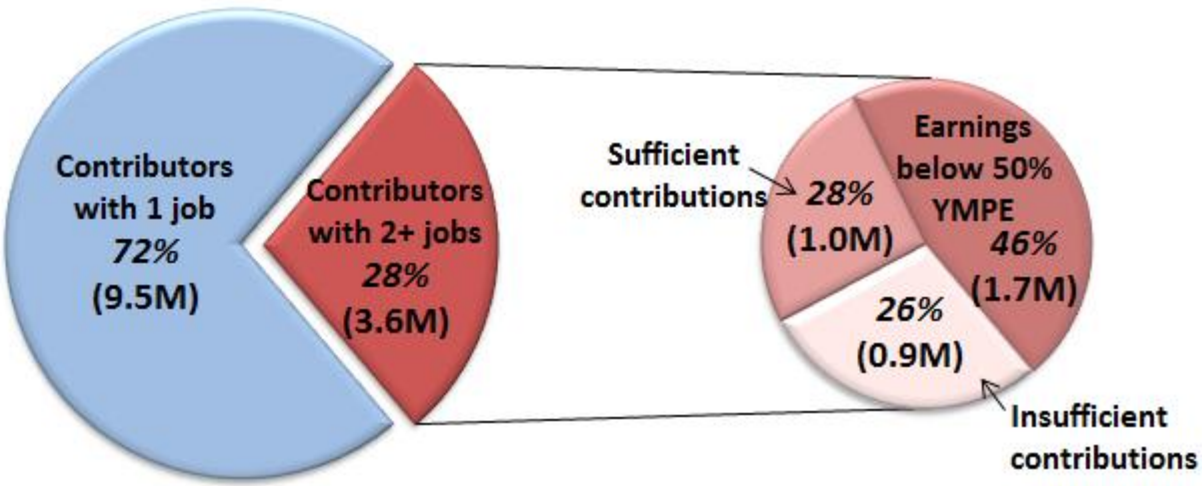
Replacement rate for Annual Retirement Benefit at Age 65 (after full implementation)



Increasing the lower limit of covered earnings excludes some middle income workers from the enhancement

- Each year almost **30%** of CPP contributors have more than one job
  - Each employer deducts and remits CPP employer and employee contributions on the first dollar earned based on a prorated YBE.
  - If the exemption is set at 50% of the YMPE, **one quarter** (almost 1 million in 2014) of these individuals as well as their employers would not make sufficient contributions to the enhancement.

Based on an exemption of 50% of the YMPE, 2014



Note: Contributors represent workers with earnings above the YBE ($3,500), excluding self-employed workers.

Canada Pension Plan Enhancement

Thank you

November 8, 2016

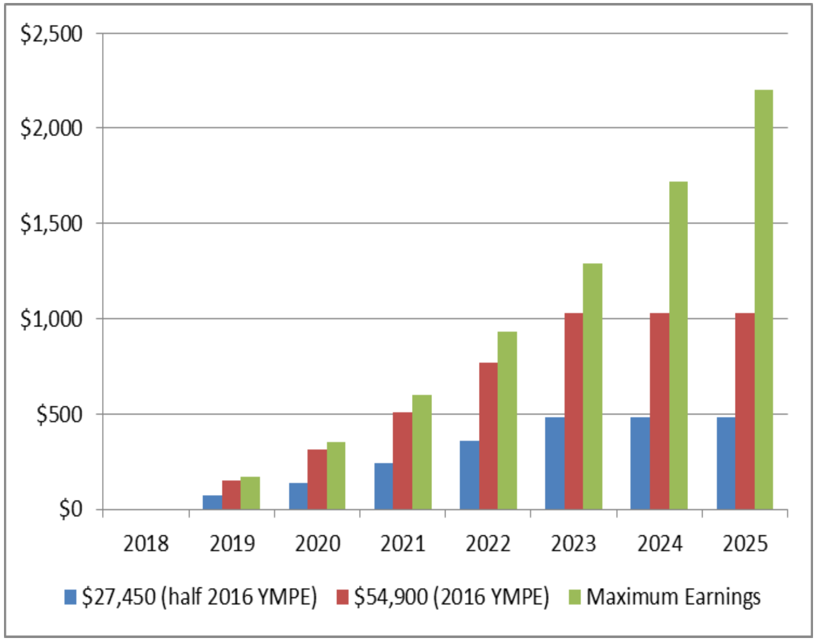
Appendix

Bill C-26: an Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act

- Increase the amount of the retirement pension, as well as the auxiliary benefits subject to the amount of additional contributions made and the number of years over which those contributions are made;
- increase the maximum level of pensionable earnings by 14% as of 2025;
- provide for the making of additional contributions, beginning in 2019;
- provide for the creation of the Additional Canada Pension Plan Account and the accounting of funds in relation to it; and
- include the additional contributions and increased benefits in the financial review provisions of the Act and authorize the Governor in Council to make regulations in relation to those provisions.

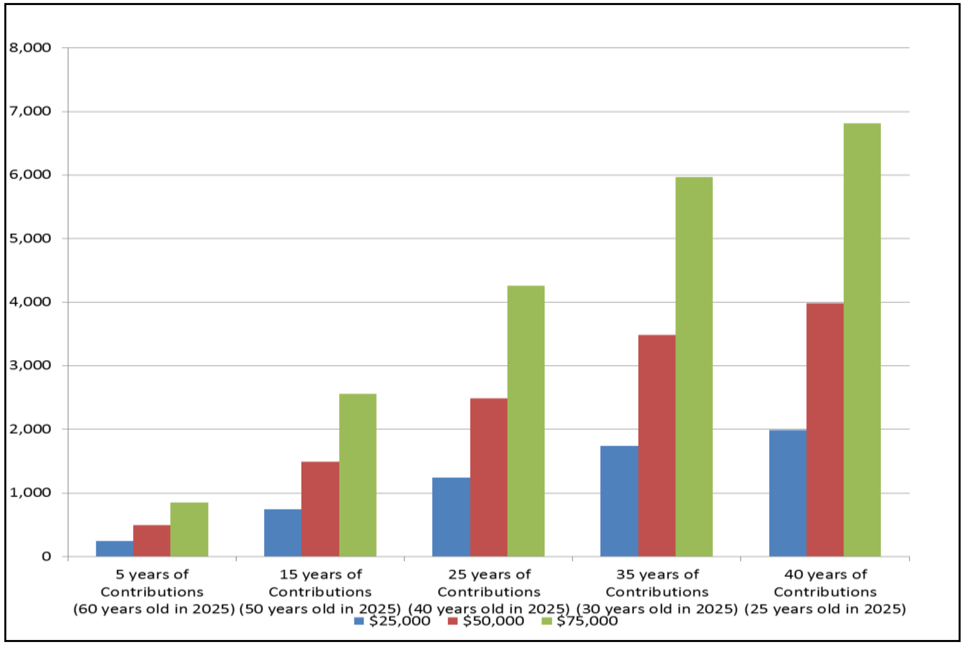
Additional Contributions and Benefits

Estimated additional annual combined employee/employer contributions (nominal; rounded to nearest $10; pre-tax)



Note: Assumes constant nominal earnings.
Source: Finance Canada

Illustration of Additional Annual CPP Benefits for Different Age Cohorts and Income Levels ($2016)



Note: This illustration assumes that individuals have constant earnings and that individuals would take-up CPP benefits at age 65. The increase in benefits is based on contributions starting in 2025 (when enhancement is fully implemented); rounded to nearest $10.
Source: Finance Canada