PBI ACTUARIAL CONSULTANTS LTD.
PENSIONS BENEFITS INVESTMENTS

Client Memo

Legislative Updates

January 2014: Still Waiting for CPP Enhancements

January 6, 2014

Canada's finance ministers met in Meech Lake, Quebec on December 16 and discussed the issue of the pension crisis, but were unable to come to an agreement on both the scope and timing for implementing any reform to the Canada Pension Plan (CPP). The Provinces of Ontario, Manitoba, Nova Scotia, Newfoundland and Labrador, P.E.I. and Quebec were all in favour of enhancing the CPP and QPP. Ontario Finance Minister Charles Sousa even considers the issue so pressing that it will be using the Council of the Federation to plan on the next steps and is considering a made-in-Ontario solution. However, B.C., Alberta, Saskatchewan and New Brunswick expressed reservations. At the Federal level, Canada's state Finance Minister Kevin Sorenson also expressed his concerns over increasing CPP contributions during difficult economic times and Federal Finance Minister Jim Flaherty, though he did not rule out possible future CPP enhancements, was also inclined to wait for better economic times before taking any action.

The Scope

PBI believes the CPP, as it is currently designed, has a limited scope and offers a very low percentage of pre-retirement earnings to middle-income citizens as confirmed by the paper by the Steering Committee of Provincial/Territorial Ministers on Pension Coverage and Retirement Income Adequacy released nearly four years ago. Moreover, the number of Canadians covered by private pension plans, in particular DB (defined benefit) pension plans, is continuously shrinking. If nothing is done, the majority of Canadians retiring in 2030 who were working in the private sector and earning between $30,000 and $100,000 will have insufficient income to cover their necessary living expenses.[1] We believe an enhancement targeting this group, as once suggested by Finance Minister Jim Flaherty, is needed as soon as possible.

The Timing

One of the justifications used by Ottawa for delaying enhancements to the CPP is that Canadians cannot afford to save more for retirement in this fragile economy. This contradicts the principle behind the recent creation of the Pooled Registered Pension Plans: the PRPPs were introduced as a pension option to *boost retirement savings* for private-sector employees and self-employed workers. If these are not good economic times for Canadian workers to save more, then why is Ottawa urging the provinces to enact the PRPPs? Pushing for a prompt agreement over targeted increases in contribution rates from the very same people currently targeted by the PRPPs would seem to make more sense.

[1] Numbers based on a 2007 study by the University of Waterloo. Necessary living expenses are identified as food, shelter, clothing, transportation, health care, energy and taxes.

Enhancing the CPP/QPP vs. Promoting PRPPs

The PRPP might be presented by Finance Minister Kevin Sorenson as a "viable, low-cost option"[2] for retirement saving, but the truth is, as all risks are assumed by the individuals, PRPPs bring high levels of income uncertainty for future retirees. As for the low-cost aspect, since PRPPs are optional, it is unlikely the providers of these investment options will be able to offer significantly lower management fees than with Registered Retirement Savings Plans (RRSPs).

On the other hand, because they are mandatory for all Canadians, the CPP and QPP spread both the risk and management fees providing a guaranteed income in the most cost-efficient way possible. If the government agrees that Canadians should save more, these additional savings would provide more benefits to Canadian workers as a whole if directed to the CPP and QPP rather than PRPPs.

PTBPs: A Better Alternative than PRPPs

We understand and support that the solution to the looming pension crisis is not in CPP/QPP enhancements alone, but that Canadians should also be encouraged and supported in planning for their individual retirement using the current available tools, which are RRSPs and/or TFSAs. PRPPs, as currently designed, do not provide sufficient additional advantages to these other individual retirement saving tools.

However, far better than PRPPs alongside an increase to the CPP/QPP would be an arrangement known as Target Benefit Plan (TBP) and, when combining the employees of many employers, a Pooled Target Benefit Plan (PTBP). Combining the best of both the DB and DC worlds for both employees and employers, we believe that the government should instead focus on encouraging these types of arrangements, similar to multi-employer pension plan (MEPP) designs, through improvements in the legislative and regulatory framework for these arrangements that would make their creation and management easier. Indeed, PTBPs or MEPPs have a number of advantages over PRPPs:

- Greater predictability of pension benefits so members can better plan for their retirement;
- Income for life (sharing of mortality risk);
- Professionally managed fund on a long-term versus short-term basis, which means superior investment returns, which means higher pensions (pooling of investment risk);
- Low unit costs due to spreading over a large membership base, again meaning higher overall pensions being provided (spreading of plan expenses);
- They would require employer contributions, but spread risk across the members of multiple employers;
- They would allow smaller and mid-size employers to attract workers with higher levels of pension benefits security without the administrative burden and prohibitive costs that can come with sponsoring a defined benefit pension plan;
- Possibility of ancillary benefits, such as early retirement benefits or post-retirement indexing.

Canadian workers are open to CPP expansion…

According to a Forum Poll survey released to CARP in November 2013, it seems that the majority of Canadians are willing to contribute more to the CPP: 53% of Canadian voters surveyed said they want to see Canada Pension Plan contributions increased so benefits can be expanded.[3] But it seems that the government is not so much concerned about increasing individual contributions, but rather is wary of pushing for higher employer contributions. Indeed, while PRPPs do not require employer contributions, the government would have to increase both employer and employee contributions in order to enrich the CPP.

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[2] Commentary by Kevin Sorenson, Minister of State (Finance), published http://www.fin.gc.ca/n13/13-161-eng.asp.

[3] More about the survey available on CARP's website http://www.carp.ca/2013/11/25/86069/.

…but many business owners are not willing to contribute more

In a December 5, 2013 press release, the government presented a survey by the Canadian Federation of Independent Business that revealed that if the CPP was increased, 65% of surveyed businesses said they would freeze or cut salaries, 48% said they would reduce investments in their businesses, and 42% said they would decrease the number of employees. It is not certain that all of these businesses would actually take these actions whatever the level of CPP contributions increase is, but it does show that business owners currently dread a CPP boost.

To Summarize

We believe that an improved legislative and regulatory framework across Canada for the creation of PTBPs (Pooled Target Benefit Plans), ideally with an expanded CPP/QPP and critical without it, is the answer to Canada's looming pension crisis.

If you have questions regarding this article, or would like to submit your comments, please do not hesitate to contact ***Clare Pitcher*** *at 416-214-7736 or by email at* clare.pitcher(at)pbiactuarial.ca.

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