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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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ACPM Principles for Mandatory Public Pension Plans

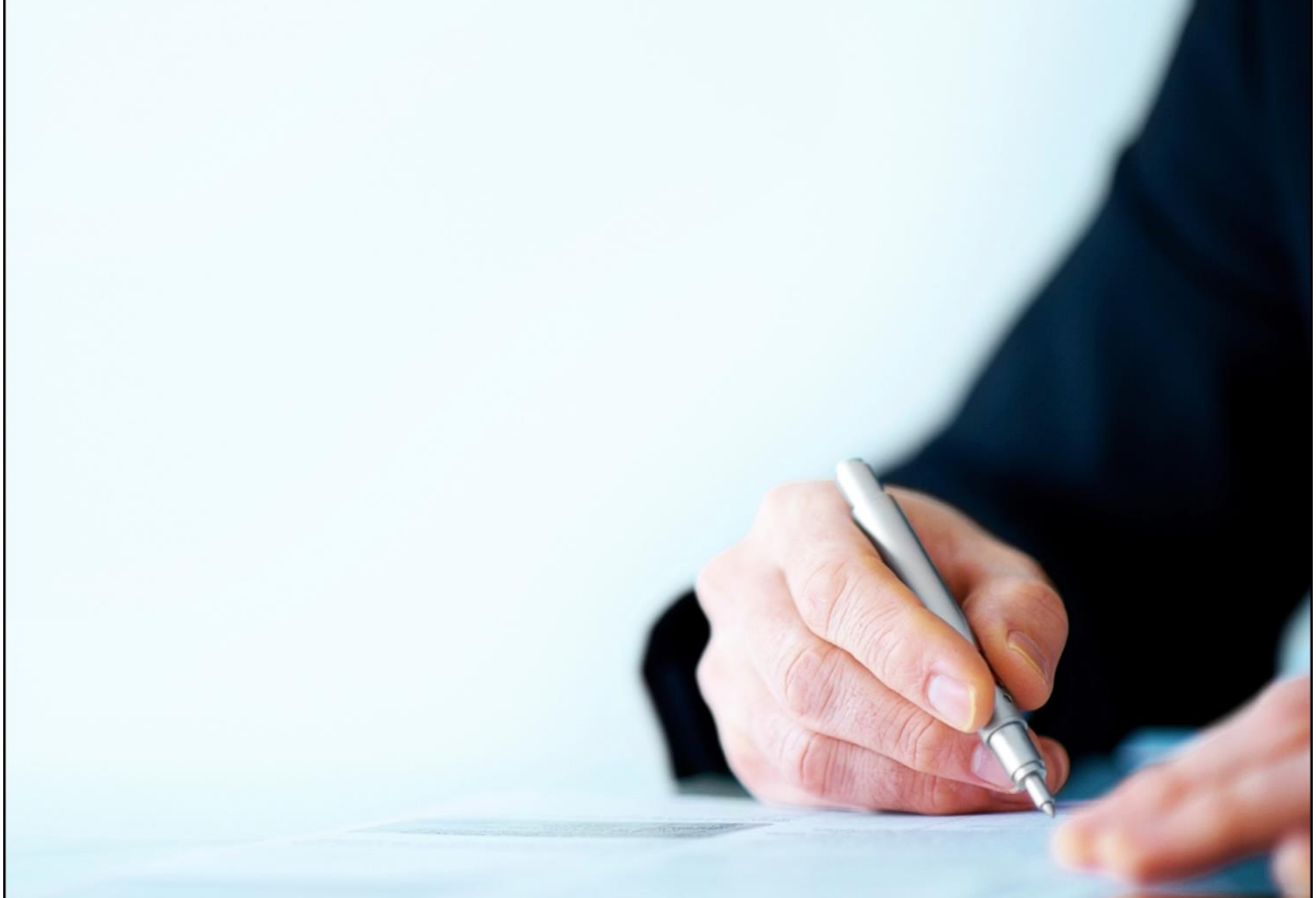

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TABLE OF CONTENTS

FOREWORD

THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT (ACPM)

ACPM is a national non-profit volunteer-based organization acting as the informed voice of plan sponsors, administrators and their service providers, advocating for improvement to the Canadian retirement income system. Our membership represents over 400 retirement income plans consisting of more than 3 million plan members, with assets under management in excess of $330 billion.

ACPM believes in the following principles as the basis for its policy development in support of an effective and sustainable Canadian retirement income system:

Diversification through Voluntary / Mandatory and Public / Private Options

Canada's retirement income system should be comprised of an appropriate mix of voluntary Third Pillar and mandatory First and Second Pillar components.

Third Pillar Coverage

Third Pillar retirement income plan coverage should be encouraged and play a meaningful ongoing role in Canada's retirement income system.

Adequacy and Security

The components of Canada's retirement income system should collectively enable Canadians to receive adequate and secure retirement incomes.

Affordability

The components of Canada's retirement income system should be affordable for both employers and employees.

Innovation in Plan Design

Canada's retirement income system should encourage and permit innovation in Third Pillar plan design.

Adaptability

Canada's retirement income system should be able to adapt to changing circumstances without the need for comprehensive legislative change.

Harmonization

Canada's pension legislation should be harmonized.

INTRODUCTION

Recently there has been much discussion relating to declining workplace pension coverage in the private sector as well as declining personal savings rates. There has been a particular focus on expanding Canada's mandatory public pension programs.

ACPM believes that Canadians are generally well served by Canada's 'Three-Pillared' retirement income system, which includes:

1. Pillar One – tax funded benefits for seniors. This includes Old Age Security benefits (OAS) & the Guaranteed Income Supplement (GIS),
2. Pillar Two – Canada's mandatory public pension system. This includes the Canada Pension Plan and the Québec Pension Plan (C/QPP), and
3. Pillar Three – workplace plans and individual saving. This includes registered pension plans and various other group and individual tax sheltered retirement savings vehicles.

In particular, we note that lower income Canadians without workplace pensions are already achieving satisfactory retirement income replacement levels, while higher income earners without access to a workplace plan appear to be saving adequately on their own. It is middle income Canadians working in the private sector without access to a workplace plan that appear to need help.[1]

While ACPM may not agree that Canada's retirement income system is in 'crisis', we do believe that targeted action is needed to improve pension coverage and retirement income adequacy. We also believe that Canadians will best be served by a retirement income system that includes both mandatory and voluntary components.

In 2010, ACPM released its *Five Point* Plan, calling for changes that would improve coverage and adequacy within Pillar Three. In the *ACPM Five Point Plan* we encourage the following:

1. Remove barriers to group coverage;
2. Ensure Defined Benefit (DB) Plans continue as viable options for coverage;
3. Enable more innovation;
4. Promote simplicity in administration; and
5. Increase incentives to save.

We do not believe that changes to Canada's mandatory public plans alone will produce an optimal result for all Canadians. Instead we would suggest the modest, targeted action described above.

[1] The decline in private sector coverage has particularly impacted middle-income earners in Canada with a resulting decline in their expected retirement income replacement ratio [C.D. Howe Institute study by Moore, Robson, and Laurin (2010) estimated that 16% of Canadians retiring today experience material declines in their standard of living. They project that proportion will increase to 44% in the decades ahead for today's 25-30 year-olds]. It is this group that ACPM believes should receive the attention in any discussions concerning expansion of mandatory public pension plans.

In terms of the various proposals under discussion to enhance or create new mandatory public plans, we have the following general observations:

- Many Canadians are already adequately provided for, or are already adequately providing for themselves, through the existing three Pillars;
- A significant increase in the scope of Pillar Two plans will decrease the flexibility that Canadian employers and individuals currently have to meet their needs in ways that work best for them;[2]
- A substantial increase in Pillar Two contributions and benefits could impact the level of tax deferred retirement savings available through Pillar Three.[3]

With those points in mind, ACPM has developed ten Principles that we suggest should be used as a framework when considering any proposals to expand mandatory public pension plans in Canada.

PROPOSED PRINCIPLES FOR A MANDATORY PUBLIC PENSION PLAN

The following Principles are suggested for the analysis of any potential expansion of Pillar Two.

1. **Limit mandatory coverage of lower income workers so as not to prejudice the availability of government programs at retirement.**

   Many recent studies have demonstrated that lower income Canadians are currently well served by existing government programs such as OAS and the GIS. These means-tested programs already provide lower income workers with income replacement ratios considered to be sufficient to maintain their standard of living in retirement.

   Assuming these programs' claw backs and eligibility do not change, then if lower income workers were required to participate in any expanded mandatory public pension plan, such participation could result in both:

   - financial hardship during working years, due to increased required contributions and the inability to access such funds until retirement; and
   - reduced or eliminated GIS and OAS benefits.

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[2] As stated by David Dodge and Richard Dion in their recent paper, **Macroeconomic Aspects of Retirement Saving,** "To the extent possible, general social welfare is probably better served by leaving the "savings decision" up to individual households."

[3] We are concerned that the limits on tax deferred retirement savings for Canadians are already too low, so would be discouraged by such a result.

Accordingly, we would suggest that lower income Canadians do not need additional retirement savings through expanded public pension plans and, more importantly, mandatory participation could produce a reduction in their expected level of retirement income.

2. Focus on realistic support for the target group.

Recent studies have shown that a cohort of Canadians, sometimes described as "middle-income workers", is not saving enough for retirement. "Enough" depends on individual circumstances, though it should enable retired people to approximate their standard of living before retirement.

As noted in Principle One, the combination of OAS, GIS and C/QPP provides lower income earners adequate income replacement. Higher income earners are considered to have sufficient discretionary income to provide for their own retirements through personal savings and C/QPP.

A broad expansion to mandatory public pension plans might not be desirable or appropriate for all workers. While middle-income workers without pension coverage are generally considered to be the group most susceptible to a retirement savings shortfall, not all middle-income workers need additional retirement savings. Many have other assets that can be converted into income after retirement, such as real estate, personal savings, inheritances, and businesses.

For those with pension coverage, it is possible that any increase in retirement income resulting from the enhancement of Canada's mandatory public plans could be offset by changes to reduce the benefit paid from their workplace plan.

As such, ACPM urges that any action target as best as possible the middle class and ideally those middle class workers most needing to save more.

3. Target simplicity and efficiency of administration for both government and employers.

In order to provide benefits most efficiently, any new scheme should attempt to capture economies of scale by using existing systems and processes. This would minimize the cost and burden to employers, employees and government.

For employers, this means that administrative obligations with respect to the expansion should be integrated as far as possible into their existing obligations. For example, contributions should be payable through the existing source deduction and remittance mechanism, and employers should have no additional administrative obligations. Similarly, the design of the expanded benefit should facilitate integration with existing employer-sponsored pension plans.

For government, it would be preferable to have any expansion as an extension of an existing administration structure rather than a new structure with added cost and complexity.

4. Execute on a fully funded basis to avoid transfer of costs between generations.

Much can be learned from C/QPP history.

Originally, the funding of C/QPP was based on a transfer of cost from contributors to retirees. When the plans started in 1966, the contribution level was set at 3.6%, while full benefits were paid after only ten years. Consequently, the current contribution rate is 9.9% of covered payroll while the cost of the benefits received is closer to 6%. It is important that an expansion of C/QPP or any other mandatory public pension plan is designed not to add to this intergenerational transfer.

It would not be equitable if those who retired in the near future received increased benefits from the mandatory public pension plan before those benefits are fully funded. In addition, if benefits are service related, any increase should apply only to service on and after the date of change. Any benefits paid must be earned.

An additional consideration is the significant change to life expectancy since the launch of the C/QPP. Medical developments are allowing longer and healthier life spans leading to higher costs for retirement benefits. The global trend is towards retirement at a later age. Careful consideration needs to be given to the age at which any expanded benefit is paid.

5. Phase-in or delay implementation to enable adjustment to increased contributions.

It is understood that saving more for retirement will reduce current consumption and thereby impact the economy for a time. In addition there continues to be some weakness in the economy. It is therefore suggested that either a gradual or delayed approach be taken when expanding any public pension plan to mitigate the impacts of reduced consumption, which could include increased unemployment, and slower business growth.

A phased-in expansion through periodic increases in contributions and benefits over a number of years would allow stakeholders time to adapt to the change. Alternatively, a delayed expansion would provide more time for the economy to recover, as well as time for stakeholders to prepare for increased savings.

To remain true to the full funding principle, any contribution phase-in would have to be matched by a phase-in or delay of benefits.

6. **Increased mandatory public pension plan contributions should not crowd out private, tax-sheltered savings, both corporate and individual.**

Savings for retirement should continue to be based on the Three Pillar system. Having part of the responsibility on the individual allows people to adjust their retirement plans to their own circumstances.

Mandatory public plans are less flexible. They can also be subject to political pressures. Individuals can more easily adjust their own retirement planning, the funding of their retirement benefits, and the management of their capital.

If mandatory public plans are to be expanded, the improvement must leave sufficient room for Pillar Three – for individuals (and their employers) to use an already efficient retirement system. A major increase in Pillar Two would likely reduce retirement saving through Pillar Three, to the detriment of the system as a whole.

7. **Ensure no adverse impact to existing tax-sheltered contribution and benefit limits.**

Currently, contributions to mandatory public plans do not impact the room available to individuals to save through workplace plans or individually. For workers saving in RPPs not integrated with C/QPP or, most importantly, who have no workplace plan, it is critical that any changes to mandatory public pension plans do not negatively impact the amount they may contribute to or receive from Pillar Three retirement savings vehicles.

Accordingly, any increase in mandatory public pension plans should not reduce the benefit or contribution limits contained in the *Income Tax Act* (Canada) for other pension or retirement savings plans, including RPPs, Registered Retirement Savings Plans (RRSPs), Deferred Profit Sharing Plans (DPSPs) or Tax Free Savings Accounts (TFSAs). Any reduction of those limits would offset the potential gains to be achieved through expanding mandatory public pension plans, by reducing Canadians' tax-sheltered retirement savings opportunities. The result would be no net gain to retirement incomes and only a reallocation from Pillar Three plans to the expanded mandatory public pension plan.

8. **Ensure tax efficiency.**

The design of any mandatory public pension plan should take into account the tax impact on individuals, and the plan should be structured in a tax-efficient manner including the treatment of contributions, earnings in the plan and pension payments.

9. Mandatory public pension plans should be on a national basis to ensure uniformity across jurisdictions.

Today's workforce is increasingly mobile. Portability of benefits has been a goal of pension legislation for decades although harmonization across jurisdictions is still rare. Enabling plan members to accrue benefits wherever they move in Canada will enhance coverage and adequacy of the benefits. One of the key benefits of the existing mandatory public pension plan system - C/QPP - is its national scope.

A national plan would also minimize the administrative burden and cost on national employers, and would support the scale and efficiencies contemplated by Principle Three.

10. Clearly communicate with all stakeholders.

The communication challenge of any increase to mandatory public pension plans is considerable. There is a significant lack of awareness among the general public as to how the existing mandatory public plans work. There also appears to be a lack of appreciation as to how long it would take for any expansion to produce a meaningful increase in benefits.

Clear communication is necessary to permit a full debate on the structure of any new or enhanced mandatory plan. Using the C/QPP as an example, we would suggest that the following information would need to be clearly communicated:

- The amount of any proposed increase in contributions, and whether employers, employees or both will pay, must be clear.

- The expected increase to the maximum and average monthly benefits should be made very clear to Canadians, so that they will understand what to expect in terms of enhanced benefits. There is a risk otherwise that they will expect the enhanced plan to meet their full need for retirement income.

- Canadians will need clear information on how any enhancements will affect their OAS and GIS eligibility.

- C/QPP benefits are locked-in and not accessible, even in cases of financial hardship, under current rules until age 60. If similar restrictions will apply to expanded benefits, this must be clearly communicated.

- Proposals for a C/QPP increase have generally been consistent on the point that the increased benefits would be fully funded. Canadians must be told that it will take a working lifetime of increased contributions to produce the full amount of the expected benefit enhancement.

- Canadians must understand that additional contributions to a mandatory public plan will have to be made in priority to other expenses that might have had greater utility for them, such as education costs, mortgage and loan repayment, care for elderly or ill dependants, or for other forms of investment.

- Increased employer contributions may impact compensation, pension plan formulas, and other savings programmes currently being offered through the workplace, such as Group RRSPs or TFSAs. In particular the benefits from existing workplace pension plans may be reduced if the expanded public plan benefit is integrated into the pension plan benefit formula.

SOME FINAL THOUGHTS

With the decline of workplace plans in Canada, the enhancement of Canada's mandatory public pension plans has been suggested as the solution. This has resulted in calls for a variety of actions by governments. The suggested actions range from the expansion of the C/QPP, to the creation of provincial plans such as Ontario's proposed provincial pension plan or Québec's longevity pension. However, all of the potential "fixes" will involve consequences for Pillar Three, the voluntary component of the system. Prior to finalizing the design of any new or enhanced public plan, important implementation issues relating to the interrelationship of Pillars Two and Three will have to be addressed.

For example, we raise the question of whether an opt-out should be permitted from Pillar Two enhancements. Would employers providing an existing workplace plan be able to opt out? Would individual Canadians who wished to save on their own be able to opt out? This issue would cut two ways. While opt-out would build flexibility into any mandatory system, it would also limit the effectiveness of any enhancement.

Adding to the complexity of this issue is the uncertain treatment of pooled registered pension plans ("PRPPs") in legislation across Canada. Of the jurisdictions that have introduced PRPP legislation, only Québec has made employer involvement (although not employer contributions) mandatory. In the Québec legislation, as in the Federal and proposed Alberta, British Columbia and Saskatchewan PRPP legislation, there is an opt-out for employees.

If employer and/or employee contributions to PRPPs are mandatory, the burden of an additional mandatory increase in contributions to a public pension plan may be too great. On the other hand, if the contributions to PRPPs are not mandatory, a material increase in required contributions to a public pension plan would surely undermine any possibility of PRPPs becoming an effective retirement vehicle.

Although these types of implementation issues will have to be carefully assessed when considering any specific proposal for the expansion to Pillar Two, they are not within the scope of the general principles outlined above. We leave such issues for more detailed discussion if consensus develops around a specific proposal.