Consultation on Retirement Income Adequacy

Hon. Greg Byrne, Q.C.,

Minister of Finance

April 2010

The Government of New Brunswick is working in partnership with the federal government, provinces and territories, on ensuring the ongoing strength of Canada's retirement income system. Over the past year, governments have been examining how best to address challenges with Canada's retirement income system and are now in the process of reviewing possible options that could help ensure that Canadians save enough for their retirement.

Significant research and analysis has been, and continues to be, undertaken by Federal-Provincial-Territorial governments, taking into consideration proposals and comments submitted by numerous interest groups and individuals. Finance Ministers will consider this information at their spring meeting and present recommendations to premiers at the August 2010 Council of the Federation meeting.

The Government of New Brunswick wants to ensure that the perspectives of New Brunswickers on this important issue are taken into consideration. This consultation paper provides background and questions that will help stimulate feedback from New Brunswickers.

BACKGROUND

Canada's retirement income system has been described as being composed of three supporting pillars:

- **Pillar One** consists of Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). They are publicly funded pension programs that are financed through federal tax revenues. These programs are typically available to Canadian citizens and legal residents based on criteria such as age, years of residence and income level.

- **Pillar Two** consists of the Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP). They are made up of compulsory programs for the employed and self-employed. These programs are funded by employer and employee contributions, and investment earnings, and are available only to those who contribute.

- **Pillar Three** includes workplace Registered Pension Plans (RPPs), group or individual Registered Retirement Savings Plans (RRSPs), and the new Tax-Free Savings Accounts (TFSAs). They consist of voluntary personal savings including employer-sponsored retirement savings plans and individual retirement savings.

The three pillars combined are intended to provide retirees with adequate income to maintain their pre-retirement living standards.

In general, current retirees are receiving adequate income replacement levels from Canada's retirement income system. Research commissioned for this review shows that Canada's retirement income system generally does a good job of providing minimum income protection to seniors. Canada has one of the lowest senior poverty rates among developed countries. However, the situation for future retirees is less certain. RPP coverage is declining and evidence indicates that the average Canadian is not saving enough through RRSPs and other retirement savings vehicles to fill the gap.

OPTIONS CURRENTLY UNDER REVIEW

A range of possible approaches to enhance Canada's retirement income system have been proposed by various stakeholders. These ideas have been organized into four broad categories and are summarized below:

1. **Expansion of the existing Canada Pension Plan (CPP);**
2. **Creation of a voluntary defined contribution supplement to the CPP;**
3. **Modernization of pension standards to improve flexibility in pension plan design; and**
4. **Tax reform – changes to the *Income Tax Act* (Canada).**

1. Expansion of the existing Canada Pension Plan (CPP)

The CPP is a national, mandatory defined benefit (DB) pension plan. A DB pension plan is a plan that promises to deliver a specified monthly retirement benefit that is predetermined by formulas based on earnings history, years of service and age rather than being based on contributions and related investment returns.

All employers, employees and the self-employed are required to pay combined contributions (currently 9.9 per cent) on employment and self-employment income up to the Year's Maximum Pensionable Earnings (YMPE), a limit set annually by the CPP based on that year's average wage in Canada ($47,200 in 2010). Funds are invested by an independent expert board of trustees. Canada's federal, provincial and territorial Finance Ministers are the stewards of the plan. Like all DB plans, longevity risk (the risk that an individual will outlive the value of his or her assets) is pooled among members. A maximum pension is payable if an individual earns the maximum pensionable earnings under the CPP over a 40-year period. The maximum pension payable in 2010 is $934.17 per month, which together with OAS, would provide about 40 per cent of the average monthly wage in Canada.

According to the 2007 World Bank study "Pensions Panorama", Canada's public pensions (Pillars One and Two), although financially strong, provide considerably less income for individuals in middle-to-higher income classes than public pensions in most other comparable (OECD) countries.

The degree to which coverage and retirement income adequacy would be improved under an expanded CPP would depend on the details of the model adopted. Some proponents have suggested doubling the CPP replacement rate to 50 per cent while maintaining the existing maximum earnings threshold. The CPP currently replaces a maximum of 25 per cent of average earnings up to the YMPE.

This proposal would follow the current structure and design of the CPP, thus participation would be mandatory and the benefit would be a defined amount. The CPP benefit provided would increase. However, there would be an increase in mandatory employer and employee contributions in order to fund the increased benefit. As well, there is a requirement in the CPP to fully fund any benefit enhancements to ensure that the CPP remains financially sustainable and that costs are not transferred to future generations. The effect of this requirement is that it would take 40 years to achieve the full increase (e.g., the doubling) of the CPP benefit.

A variant of this proposal is to expand the CPP by increasing the YMPE. For example, the CPP would continue to cover 25 per cent of average earnings but up to a higher threshold of earnings (e.g., doubling the YMPE to $94,400). This variant would also require increased, mandatory employer and employee contributions but only for workers earnings above the current YMPE.

A combination of the above two options is also being explored, that is, increasing the replacement rate while increasing the maximum contributory earnings.

This category of proposals raises a number of important issues including: the extent to which additional retirement savings would be generated instead of participants substituting current savings (for example, in RRSPs) to the expanded CPP; the impact of changing the balance between mandatory and voluntary savings in the system on certain individuals, such as those with low income; and the increase in costs for businesses due to the increase in mandatory employer contributions.

2. Creation of a voluntary defined contribution supplement to the CPP

Under this approach, a new, voluntary defined contribution (DC) plan would be designed and established for all Canadian workers who currently do not have a registered pension plan, including the self-employed. A DC plan is a plan under which each member's contributions, set in advance, are used to provide that person's retirement benefits. The amount of the benefits depends on the level of contributions and amount of investment income earned in the fund rather than being predetermined by a formula. The new plan could be developed as a 'top-up' to the CPP.

Enrolment in the plan would be automatic with the opportunity for workers to opt out – for example, if they have alternative retirement savings vehicles that they prefer. Economies of scale and portability could be achieved by creating one large plan that would bring together unrelated employees, self-employed individuals and employers.

The proposal envisions a default contribution rate, although participants could ultimately choose the amount they wish to contribute. In some variants of the proposal, employers would be required to make contributions if their employees participate. Contributions and returns would be tracked in an individual account. Individual savings would be pooled and invested by a fund manager.

There have been different suggestions for the fund manager. If a new, voluntary defined contribution tier was to be added to the CPP, the current CPP Investment Board could potentially be the fund manager, though a new and different function for funds management and tracking individual accounts would have to be established. If the new, voluntary defined contribution plan was not part of the CPP, a new investment board would have to be established. Like the CPP Investment Board, it would operate at arm's length from government.

Contributions and investment returns would generally be locked-in until retirement. That is, participants would not have access to these funds prior to retirement for another purpose. The benefits ultimately provided to participants would depend on the amount contributed and the rate of return of the investment fund. The benefits could be paid out upon retirement using standard defined contribution payout vehicles: purchase of an annuity from an annuities provider, transfer of the funds to a Registered Retirement Income Fund (RRIF) or withdrawals from the individual's account. In some variants, annuity-type payments would be paid from the plan.

It is understood that contributions to any such plan would be subject to current RPP/RRSP contribution limits.

This category of proposals raises a number of important issues including: the extent to which additional retirement savings would be generated instead of participants substituting current savings (for example, in RRSPs) to the new plan; the role of employers in sponsoring RPPs; the impacts on the financial services sector; and the role of and costs to governments.

3. Modernization of pension standards to improve flexibility in pension plan design

All Canadian provinces (except Prince Edward Island) and the federal government have pension benefits standards laws that set minimum standards for RPP investments, eligibility for benefits, funding requirements and disclosure to members. These standards are comprised of rules that are detailed and prescriptive for the traditional DB plans and are less well developed for other types of plans such as DC plans.

Pension plans have two fundamental characteristics that distinguish them from other retirement savings vehicles:

- The plan sponsor has a fiduciary duty to plan members to act only in the best interests of the plan members in all actions undertaken in relation to the plan and its fund; and
- Pension plan funds are 'locked-in' – i.e., subject to restrictions that ensure the money is used for a retirement pension.

Both characteristics preserve the intended purpose of pension plans, which is to provide income security for individuals when they are no longer expected to work.

Several Canadian jurisdictions have recently reviewed their pension standards and identified possible changes to promote new pension plan designs. A number of private sector organizations – including insurance companies who operate plans and plan sponsors – have proposed that such changes are a good way to increase pension coverage and retirement savings for individual Canadians. These proposals include:

- Under a principles-based approach:
  - Create principles in the statute that would apply to all plan types and create different detailed rules for different types of plans in regulation or administrative policy (DB, DC, targeted benefit, etc.);
  - Permit the regulator to approve, and issue guidelines for, new plan designs;

- Broaden the definition of plan administrator to permit an entity that is not an employer or a board of trustees to sponsor a plan (e.g., multi-employer groups, professional associations, not-for-profit corporations) subject to the requirement that the administrator, as the fiduciary for the plan members, must be in a position to make decisions in the best interests of members; and
- Broaden the definition of member to permit a worker who is not an employee to become a member (e.g., self-employed).

- For voluntary plans, enable the plan sponsor to:
  - Enroll members through automatic enrolment and assign a default investment portfolio, subject to the right to opt out; and
  - Annually increase a member's contribution rate to the maximum permitted under the plan, subject to the right to opt out.

4. Tax reform – Changes to the *Income Tax Act* (Canada)

This category of proposals involves possible amendments to the *Income Tax Act* (Canada) that have been suggested by stakeholders to promote greater retirement savings in registered retirement savings vehicles (RPPs, RRSPs and TFSAs). The proposals suggested by stakeholders include:

- Introduce lifetime retirement savings limits as well as, or instead of, annual limits;
- Increase the age limit on RRSPs (currently contributions must cease and RRSPs must be converted to cash or an annuity at age 71);
- Permit the creation of pension security funds by employers to meet their solvency obligations without creating surplus ownership issues;
- Provide a better balance of tax compliance rules between the retirement savings possible under various registered retirement savings vehicles;
- Allow tax-deductible employee contributions to broad-based plans where the employer opts not to participate.

QUESTIONS FOR CONSIDERATION

Below are some questions that will help to focus your submission. Should you have other comments not addressed by these questions, please include them.

1. Are changes needed to further strengthen Canada's retirement income system?

2. This paper describes a number of possible options for increasing retirement savings in Canada. What do you feel are the merits of the various options? Do you have particular concerns with any of these options?

3. Do you think that additional *mandatory* measures are required to ensure adequate retirement savings in Canada? Do you think this would be better accomplished through expanded CPP coverage, through mandatory enrolment in a new supplementary plan, or a combination?

4. If a *voluntary* supplementary plan were to be introduced, do you think that participation in the plan should be completely voluntary (i.e., individuals would have to sign up for the plan) or be voluntary with automatic enrolment and the ability to opt out of the plan?

5. Employers play a critical role in Canada's retirement income system. However, the proportion of Canadian workers with employer-sponsored registered pension plans has been steadily declining for many years. How do you think these options would affect employers' participation in, and support for, the retirement income system?

6. How might the options presented in this paper positively or negatively affect lower income workers?

7. Do you have any other ideas for measures that would help to improve Canada's retirement income system?

DEADLINE FOR COMMENTS: Friday, May 14, 2010

Email: ria-consultation-narr@gnb.ca

Please submit written comments to:

Retirement Income Adequacy Consultation
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Please note that the Government of New Brunswick will take into consideration input received during the consultation process as part of the ongoing discussions among federal, provincial and territorial Finance Ministers.