

Public Consultation Package

A large graphic consisting of the silhouettes of a group of approximately ten people of various ages and heights. The silhouettes are filled with a landscape image showing a range of mountains under a blue sky with white clouds, and a forest of evergreen trees in the foreground. The text is centered within the upper portion of this graphic.

**Request for Comments
Retirement Income Adequacy in Canada**

Yukon Finance

March 2010

Whitehorse, Yukon

March 2010



Message from the Premier and Minister of Finance

The Yukon Government is seeking public comments and suggestions on ways to strengthen the pension system and expand pension coverage for workers currently without occupational pension plans.

Three-in-four private-sector workers in Canada are not covered by an employer-sponsored pension plan. Research indicates that many private sector workers who do not have access to employer-sponsored pension plans, or who do not have sufficient personal savings, will not have adequate retirement income in the future. We are asking for your views and comments on this issue.

We offer several ways to provide your comments:

- Print the “Public Consultation Package on Retirement Income Adequacy in Canada” on the [Yukon Finance website \(http://www.finance.gov.yk.ca/\)](http://www.finance.gov.yk.ca/). You can fill out the form, print it, and send a copy via mail to Finance, Yukon Government, Box 2703, Whitehorse, YT, Y1A 2C6 or submit your answers to the consultation questions and/or comments directly to the email fininfo@gov.yk.ca.
- Obtain a package by visiting the information desk at the Yukon Government Main Administration Building in Whitehorse, calling 867-667-3571 or writing Finance, Yukon Government, Box 2703, Whitehorse, YT, Y1A 2C6.

You are encouraged to review the consultation package and provide your views on the questions provided or simply send your comments, views, or submissions on the issue directly to Finance, Yukon Government, Box 2703, Whitehorse, YT, Y1A 2C6 or fininfo@gov.yk.ca. This is not a survey, we are gathering ideas and views of Yukoners in advance of federal, provincial, and territorial discussions and the inclusion of names or personal identification in a submission is completely at your discretion.

There are two main sections to the consultation package, Part #1, a backgrounder and Part #2, a set of questions.

Part #1: The backgrounder in this paper focuses on various options that include:

- Expansion of the Canada Pension Plan (CPP) system to provide increased, universal CPP pension benefits.
- A voluntary supplement to the CPP system that would provide additional pension coverage utilizing the existing infrastructure of the CPP system.
- Changes to pension standards legislation to allow for new types of pension plans that would better serve the requirements of today’s employers and workers.
- Tax reform directed at increasing pension plan coverage and retirement savings.
- Potential combinations of any of the above options or approaches.

Part #2: A series of questions is provided for consideration.

- You are invited to provide responses to a series of questions or simply provide your views on any of the approaches raised in the backgrounder or by suggesting alternative approaches.

The deadline is April 30, 2010 for comments and submissions.

Thank you,



Premier and Minister of Finance
Honourable Dennis Fentie





Why are we asking for comments about retirement income adequacy?

In 2009 Federal, Provincial, and Territorial Finance Ministers initiated research to improve governments' understanding of the Canadian retirement income system. While Canada is recognized internationally for the long-term financial sustainability of its public pension system and its success in significantly reducing poverty among seniors, a number of suggestions have been made that could improve the effectiveness and adequacy of the retirement income system for future retirees.

This consultation package requests your views on how best to address potential problems with the future of Canada's retirement income system.

What is the current retirement income system in Canada?

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

Pillar One is comprised of publicly funded pension programs financed from tax revenues and focused on the elimination of poverty. Pillar One consists of Old Age Security (*OAS*), the Guaranteed Income Supplement (*GIS*) and two smaller programs targeted at spouses and surviving spouses (*aged 60-64*) of *OAS/GIS* recipients.

Pillar Two is made up of compulsory programs for the employed and self-employed that provide minimum income protection in retirement by replacing a portion of pre-retirement earnings. These programs are funded by employer and employee contributions, and investment earnings, and are available only to those who contribute. Pillar Two consists of the Canada and Quebec Pension Plans (*CPP/QPP*).

Pillar Three consists of voluntary personal savings, including employer-sponsored occupational pension plans and tax-assisted individual retirement savings. Pillar Three includes registered pension plans (*RPPs*) provided voluntarily by employers and/or unions, group or individual registered retirement savings plans (*RRSPs*), and the new Tax Free Savings Accounts (*TFSA*s).

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



What is the problem facing the Canadian retirement income system?

The current problem

Although research suggests that in Canada most current retirees have sufficient income to maintain their pre-retirement lifestyles, concerns have been raised about the fate of future retirees.

Current pensioners receive a significant proportion of their income from workplace pension plans. However, workplace pension coverage has been steadily declining. Employers are not required to offer a pension plan. Changing workplace dynamics (*international competition, reduced unionization of the workforce and declining size of employers*), rising costs and increasing regulatory burden are making employer sponsorship of pension plans less attractive.

Today, sixty-seven percent of the Canadian labour force and three in four private sector employees are not covered by an occupational pension plan.

This may not create a problem if other types of savings are available; however, evidence indicates that the average Canadian is not saving enough for retirement. Registered Retirement Savings Plans (*RRSPs*) are tax-effective savings vehicles, yet they are not being fully utilized – contribution rates are low, and are skewed towards higher income individuals. In addition, the capacity of individuals to accumulate personal savings for retirement is seriously impacted by high fees for retail investment – some studies say the highest in the world.

Canada's public pension system (*CPP/QPP and OAS programs*) is designed to provide up to approximately 40% of the average wage to retirees (*\$46,300 in 2009*). The CPP is considered exemplary for its funding model, but ranks poorly among comparable high-income countries within the Organization for Economic Co-operation and Development (*OECD*) for its limited scope. Public pensions in comparable OECD countries cover almost double the average wage, twice the scope of the OAS and CPP.

In summary, shortfalls appear to exist in both the mandatory and voluntary parts of Canada's retirement income system. Those individuals who are not adequately covered by mandatory programs, who have no access to a voluntary employer-sponsored pension plan, and who are not accumulating enough personal savings will not have adequate income in retirement.

Uncertainty about the future is challenging for decision-makers.

(From the recent paper of the provincial-territorial Steering Committee of Ministers on Pension Coverage and Retirement Income Adequacy.)

In the longer term

Many of Canada's current retirees receive a significant proportion of their income from workplace pension plans, one of the key components of Pillar Three. Yet workplace pension coverage has been steadily declining. Further, evidence indicates that the average Canadian is not saving enough through other retirement savings vehicles to fill the gap from declining register pension plan coverage. There is also growing awareness that the capacity of individuals to accumulate personal savings for retirement may be less than expected due to costs associated with retail investment services and the complexities of investing and financial planning.

A number of stakeholders have recommended that the CPP be expanded or supplemented to help fill the gap in retirement savings for Canadians. Others have called for legislative changes that would strengthen the voluntary savings vehicles in Pillar Three. Many suggest that Canada's retirement income system can be strengthened through an improved balance amongst the three pillars.



On January 21, 2010, British Columbia's Finance Minister, Colin Hansen, Chair of the Provincial-Territorial Steering Committee of Ministers on Pension Coverage and Retirement Income Adequacy publicly released "[Options for Increasing Pension Coverage among Private Sector Workers in Canada](http://www.gov.bc.ca/fin/)". (<http://www.gov.bc.ca/fin/>) This paper provides information on two potential national pension plan solutions to deal with the issue of retirement income adequacy.

Federal, provincial, and territorial governments have now embarked on a process to analyze a range of possible solutions to deal with the challenges Canadians face as they attempt to save for their retirement years. Stakeholders have already made a number of recommendations and suggestions for ways to improve Canada's retirement income system and these will be considered in the upcoming work of the federal, provincial and territorial governments.

What approaches have been suggested so far in the discussions?

The range of possible approaches to pension reform falls into four broad categories:

- Expansion of the existing CPP;
- Creation of a voluntary defined contribution supplement to the CPP;
- Modernization of pension standards to improve flexibility in pension plan design;
- Tax reform - changes to Income Tax Act (*Canada*); and
- A blend of options.

A. Expansion of the existing CPP

The CPP is a national, mandatory defined benefit pension plan (*defined benefit pension plans commit to specified retirement benefits predetermined by formulas based on earnings history, years of service and age rather than 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, a limit set annually by the CPP based on that year's average wage in Canada (*\$47,200 in 2010*). An independent, expert board of trustees invests these funds. Canada's federal, provincial, and territorial Finance Ministers are the stewards of the plan. Like all defined benefit 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 after forty years (*in 2010 - \$934.17 per month*), and together with OAS, would provide about 40 per cent of the average monthly wage in Canada in 2010.

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 targeted earnings replacement rate is the percentage of pre-retirement earnings to be replaced by the pension plan (*e.g., if an individual earned \$50,000 before retirement, and the targeted replacement rate was 60 per cent, one would expect that earnings in retirement would equal approximately \$30,000 (60 per cent of \$50,000)*). The target replacement rate needed to maintain an individual's pre-retirement standard of living varies depending on the level of pre-retirement income and other factors, such as whether there will continue to be mortgage payments required or if there will be significant costs in retirement. It is generally agreed that higher replacement rates are required for individuals earning very low incomes before retirement.

The CPP could be expanded by increasing the targeted replacement rate or by increasing the Year's Maximum Pensionable Earnings. An increase in the replacement rate on career pensionable earnings would increase retirement benefits and contributions for all participants in the plan. An increase in the Year's Maximum Pensionable Earnings would improve retirement benefits for only those individuals who earn more than the average wage during their careers.



Employers and individuals would pay contributions on earnings that had not previously been covered under the CPP.

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

Under this approach, a new, voluntary defined contribution defined contribution plan would be designed and established for all Canadian workers who currently do not have a registered pension plan, including the self-employed (*defined contribution plans are those in 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 formula.*) The new plan could be developed as a 'top-up' to the CPP. This design could significantly reduce start-up costs and make it possible for ongoing administration and investment costs to be very low, which would maximize the rate of return for plan members.

The plan would be established in legislation by a new statute and regulated under the existing regulatory framework for pensions and income tax (*as is the case with all multi-employer pension plans*). The new legislation would clarify who assumes the role of fiduciary (*the entity charged with acting in the best interests of plan members*), governance requirements, administration, investment management, and investment performance expectations.

Enrolment in the plan would be automatic, with the opportunity for workers to opt out. Economies of scale and portability could be achieved by creating one large plan that would bring together unrelated employees, self-employed individuals and employers.

One proposal envisions an annual contribution rate of 10 per cent of earnings: five per cent each from the employer and employee (*in addition to current CPP contributions*), although employers may also have the opportunity to opt out of contributions. A tiered approach could also be considered, offering an option of three per cent, six per cent or nine per cent each. Contribution levels could change over time to accommodate changes in priorities and financial resources of the member or the employer.

Government would not sponsor the plan, nor would government be responsible for pension obligations to members. An independent board of trustees with related expertise would govern the plan. The funds could be invested either through the existing CPP Investment Board, or some other entity. A nominating committee could make board appointments, similar to the current arrangement for the CPP Investment Board. However, the difference would be that the board in this case would be the fiduciary of the plan rather than the investment manager, as is the case with the CPP Investment Board (*the "fiduciary" role for the CPP is assumed by the Ministers of Finance as stewards of the plan*).

C. 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 registered pension plan investments, eligibility for benefits, funding requirements and disclosure to members. The federal Pension Benefits Standards Act covers employees who work and reside in the Yukon, Northwest Territories or Nunavut. These standards are comprised of rules that are detailed and prescriptive for the traditional defined benefit plan and are less well developed for other types of plans, such as defined contribution 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 proposals exist for modernization and include:

- Under a principles-based approach:
 - Create principles in statute that would apply to all plan types and create different detailed rules for different types of plans in regulation or administrative policy (*defined benefit, defined contribution, target 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.

D. Tax reform - changes to 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 TFSA*s). The Income Tax Act (*Canada*) comes within federal jurisdiction and any changes to it would have to be agreed to and implemented at the federal level. The Income Tax Act (*Canada*) and regulations set out the tax rules that must be followed to maintain registered status.

Proposals suggested by stakeholders include:

- Introduce lifetime retirement savings limits as well as or instead of annual limits;
- Allow individuals to repay RRSP withdrawals used in times of financial hardship;
- Increase the age limit on RRSPs (*currently contributions must cease and RRSPs must be converted to cash or 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;
- Update rules on the maximum transfer values from defined benefit to defined contribution plans to allow the tax-free transfer of the value of defined benefit benefits;
- Allow tax-deductible employee contributions to broad-based plans where the employer opts not to participate; and
- Allow self-employed individuals to make deductible contributions to a registered pension plan.

E. A blend of options

While the various proposals for pension reform have been presented separately, many could be combined to improve the overall effectiveness of Canada’s retirement income system.



How can I provide comments and where do I send them?

Submit Submission in any of the following ways

Mail: Finance
Yukon Government,
Box 2703, Whitehorse,
YT, Y1A 2C6.

eMail: fininfo@gov.yk.ca

Please note the responses will be subject to the *Access to Information and Protection of Privacy Act*. Information, including names of individuals and organizations that provide comments, may be used or disclosed in accordance with the *Act*.

Deadline

April 30, 2010

Other Resources to consider

Federal - Provincial - Territorial Ministers of the Research Working Group Steering Committee, chaired by Mr. Ted Menzies

[Summary Report on Retirement Income Adequacy Research](#), (<http://www.fin.gc.ca/activty/pubs/pension/riar-narr-eng.asp#ref>), by Jack M. Mintz, Research Director.

Government of Ontario.

Baldwin, Robert 2009, [Research Study on the Canadian Retirement Income System](#), (<http://www.fin.gov.on.ca/en/consultations/pension/dec09report.html>), prepared for the Government of Ontario.

Provincial-territorial Steering Committee of Ministers on Pension Coverage and Retirement Income Adequacy.

[Options For Increasing Pension Coverage Among Private Sector Workers In Canada](#). (<http://www.gov.bc.ca/fin/>).



B. Creation of a voluntary defined contribution supplement to CPP

3. Under this approach it is envisioned that investment choice be limited, to keep costs down and utilize expert investment management. How much investment choice is necessary to provide sufficient flexibility for individuals?
4. Should a supplementary plan have features that lessen risk to the individual, (*shifting individual's investments to less-risky investments over time, and/or purchasing annuities as the individual nears retirement age*)? Should these features be automatic or choices offered individuals?
5. Should participation in a supplementary plan be voluntary, voluntary with an option to opt out after being auto-enrolled, or mandatory?



D. Tax reform – changes to Income Tax Act (Canada)

9. Do you have any comments on the types of tax reforms that could help increase pension coverage?

E. A blend of options

10. Can you think of combinations of approaches that would achieve increased pension coverage for future retirees?



Other Comments

11. If you own or manage a business do you have any comments about the impacts on your business regarding any of the proposals in this paper?

12. In general what measures do you think would be most successful in increasing pension plan coverage and retirement income adequacy for Canadians?



Open Comments

In place of, or in addition to the above questions, what are your views on the future of retirement income adequacy in Canada?

