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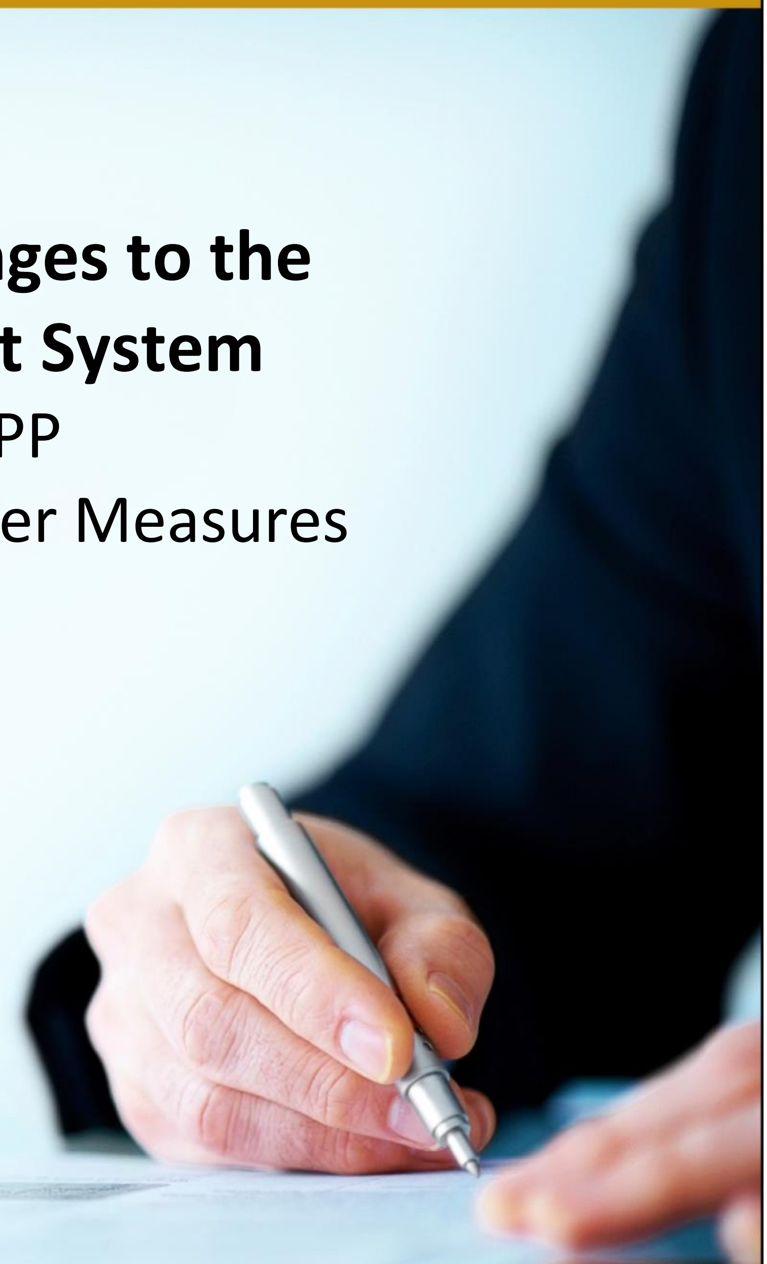
The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

May 30, 2016

Summary of Recommended Changes to the Canadian Retirement System

Recommended CPP/QPP Enhancement and Other Measures



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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

Over the last few years many government representatives, politicians, unions and commentators have expressed much concern that Canada is in the midst of a retirement income crisis. The suggested crisis relates to declining workplace retirement plan coverage in the private sector as well as declining personal savings rates.

The ACPM believes that the 'crisis' label is not warranted – 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 (CPP/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 and non-sheltered savings.

Canada's retirement income system has been rated favourably internationally. Many Canadians have access to a workplace retirement plan that, in conjunction with CPP/QPP, provides adequate levels of income replacement at retirement. For Canadians without workplace retirement plans, those with lower incomes are already achieving satisfactory retirement income replacement levels thanks to Pillars 1 and 2, OAS, GIS and CPP/QPP, while higher income earners without access to a workplace plan appear to be saving adequately on their own. However, there is an established consensus that Canada's middle income earners working in the private sector without access to a workplace plan are not adequately saving for their retirements.

To ACPM, this is not a system in crisis demanding significant universal action by government. Nor should the responding action be shouldered by one Pillar of the retirement system alone. The current Canadian system was designed to share the responsibility of adequate retirement savings in a fair and balanced way among social partners[1] - governments, employers and individuals. This sharing has depended on a diversity of various plans that make up the system. Taking this balance into account, ACPM recommends a set of actions designed to strengthen the current system. Among these actions, ACPM includes adjustments to Pillar 2 - the CPP/QPP - that, together with a Pillar 3 change requiring coverage through a mandatory workplace retirement savings arrangement, would target and improve the retirement readiness of Canadians in the middle income group.

The enhancement of Canada's mandatory public pension plans has been suggested by many as the only appropriate solution. Suggested actions include across-the-board expansions of the CPP/QPP as well as top up structures. Some feel strongly about the need for action. In the case of the government of Ontario, it is proceeding with its own plan to provide additional pension income in the absence of sufficient improvements to CPP/QPP. We have looked at the various proposals and considered the question of CPP/QPP changes and what changes are best for the overall system. Our proposed changes to the system focus on what we believe to be an appropriate improvement.

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[1] *Innovating for a Sustainable Retirement System,* Expert Committee on the Future of the Quebec Retirement System, D'Amours Report.

This improvement should zero in on the problem and look for a solution that is targeted and affordable to all Canadians. The improvement should be efficient in both operation and impact. By its very nature, an appropriate improvement will be a compromise. In recommending a solution, we strove to achieve a balance of the views of the various stakeholders in the retirement readiness debate and focus on a uniform mandatory solution that would apply across all jurisdictions in Canada. To ACPM, uniformity is a crucial element of any reforms to the Canadian retirement system.

Recommended Changes to the Canadian Retirement System

As noted above, the Canadian retirement system balances and diversifies the responsibility and risk of retirement income savings and adequacy among government, employers and individuals through Pillars 1, 2 and 3. The diversity of these plans contributes to better risk sharing. Therefore, in our view, this balance and diversity should be maintained in any proposed enhancements to the system intended to address inadequate savings by middle income earners.

With these principles and goals in mind, ACPM recommends two changes to the Canadian retirement system:

I. Enhancement to CPP/QPP on Earnings between 50% and 100% of YMPE, with the ability of employers to provide a comparable workplace retirement plan in lieu of the enhancement; and

II. Mandatory Workplace Retirement Savings Arrangement for Earnings between YMPE and 150% of the YMPE.

I. Enhancement to CPP/QPP

The first change is to make an enhancement to CPP/QPP. We recommend the same target benefit of 15% income replacement and contribution level as those of the ORPP[2] (estimated combined 3.8% of covered earnings). However, instead of a minimum earnings threshold of $3500 currently applicable to CPP/QPP and the ORPP, we recommend that the threshold be raised to 50% of the YMPE (in 2016, $27,450). As such, based on 2016 YMPE, contributions relating to the enhanced CPP/QPP will be made on earnings between $27,450 and $54,900 keeping more money in the pockets of low income earners who will not be impacted by the change. We also recommend the implementation of a system for excluding employers from the CPP/QPP enhancement if they have comparable workplace retirement plans. It will be important to ensure that the opt-out/exemption system is easy and efficient, likely best achieved through the current T4 pension adjustment reporting system.

Advantages of Higher Minimum Earnings Threshold

The advantages of this higher minimum earnings threshold over the current CPP/QPP and ORPP designs are: (i) it better targets middle income earners, and (ii) it mitigates the negative effects of the Guaranteed Income Supplement (GIS) clawbacks on the enhanced CPP/QPP benefit. The latter advantage is particularly important because any solution involving greater taxable income at retirement needs to recognize that increased premiums (whether CPP/QPP or ORPP) for some

[2] Ontario Retirement Pension Plan ("ORPP").

Canadians during their working lives will actually deliver none, or, at best only some, of the benefits to their income at retirement[3].

Should Enhanced CPP/QPP Benefits be Taxable or Non-Taxable?

The current approach to federal taxation reflects the basic principle that all sources of income received by Canadian taxpayers should be taxable and reasonable expenditures to generate that income should be deductible from income. Our deliberations considered the taxable status of the proposed additional CPP/QPP contributions and the enhanced income generated from any changes to CPP/QPP in an attempt to address: (i) the GIS clawback concern described above, and (ii) the quantum of the increased contribution required to produce a gross indexed pension of 15% after a full career (e.g. a non-tax deductible contribution rate of 1 to 1.25% would suffice as compared to 1.9% on a taxable basis, for each employee and employer). The advantages of non-tax deductible additional CPP/QPP contributions and the resulting benefits are noteworthy in that this approach would neutralize the GIS clawback problem as well as require a lower contribution rate and benefit level. We recognize that the non-taxable treatment of such an enhancement to CPP/QPP would be a significant departure from the federal government's current approach to taxation, although such treatment already exists with TFSAs. As such, our proposal for a CPP/QPP enhancement assumes that the current taxable regime remains applicable.

II. Mandatory Workplace Retirement Savings Arrangement for Earnings between YMPE and 150% of the YMPE

The second change we are recommending is the implementation of a requirement that all employers provide a comparable workplace retirement plan in respect of their employees' earnings between 100% and 150% of the YMPE (currently, $54,900 to $82,350)[4]. For a defined benefit (DB) plan to be comparable we recommend an annual benefit accrual rate of 0.3% to 0.5%, but on this narrow "corridor"[5] of earnings.

For defined contribution (DC) plans, we recommend a contribution rate of between 6% and 9% of the earnings corridor. For example, based on the 2016 YMPE, the maximum combined

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[3] Current rules of the Guaranteed Income Supplement (GIS) state that if a retiree receives income other than Old Age Security and employment income up to $3,500, then the GIS is reduced ("clawed back") by 50% of that other income (including CPP/QPP benefits, pension benefits, withdrawals from RRSPs or RRIFs, but excluding withdrawals from TFSAs). This clawback represents a serious drawback to low income earners to save during their employment in order to receive additional retirement income (other than through TFSAs). This clawback also affects middle income earners who have no significant workplace pension benefits, no spouse earning more and no substantial RRSP or RRIF savings. For example, a retiree who receives the full CPP/QPP benefits (having earned at least the YMPE throughout his or her career) would also be entitled to a small GIS benefit if he or she receives no other income than OAS and CPP/QPP. This other income is already taxable at usual marginal rates that depend on total income, which may be nil or close to it for very low earners, but not for middle income earners, so their combined cut can be even more than 50%. As such, we strongly recommend that solutions to changing CPP/QPP, and for that matter all workplace pensions, need to deal with the interaction with GIS if the solutions are to improve, and not harm, the lower income earners.

[4] For working Canadians without an employer to provide mandatory workplace coverage, we recommend mandatory contributions to retirement savings vehicle available under the *Income Tax Act* (Canada) to the self-employed.

[5] The recommended earnings "corridor" is between 100% and 150% of the YMPE.

employer/employee DC contribution would be $1,647 using 6% or $2,470 using 9%. An employer plan that covers all earnings could be considered a comparable plan with combined employee/employer contributions of only 2% to 3%, since the covered earnings would be at least three times the narrow "corridor" targeted by the new rules.

The advantages of limiting contributions to this corridor of earnings is that it: (i) specifically targets middle income earners who do not currently participate in a workplace plan; (ii) does not affect low income earners, and (iii) is less costly to employers and employees than the ORPP by not requiring contributions on all income above $3500.

Promotes the Balance and Diversity of the Canadian Retirement System

In addition to targeting middle income earners without workplace retirement plans, this implementation of mandatory workplace plan coverage promotes the current balance and diversity of the retirement system by continuing to share the responsibility for addressing the lack of middle income earners' retirement income savings and adequacy with Pillar 3 - employers and individuals. In contrast, if the only change made to the system was a CPP/QPP enhancement up to 150% of YMPE, the public plan would shoulder too much of the responsibility and risk forcing the system out of balance. There are risks associated with putting so many "eggs in one basket". Our proposal ensures that the private sector continues to have an important role in addressing the concern relating to middle income earners by requiring an employer retirement plan in respect of a narrow corridor of earnings above the YMPE.

Uncomplicated Comparable Plan Verification Regime

We recommend that a simple system be implemented to easily verify workplace or other comparable plan coverage. We recommend that all employers with workplace retirement plans be entirely exempted, regardless of whether their plans have waiting periods for entry or voluntary enrolment. The key requirement should be that the employer makes available comparable retirement plan coverage for all its employees.

Other Measures to Improve Pillar Three – Workplace Retirement Plans

In addition to the measures outlined above, we continue to recommend that the following equally important matters that potentially impact millions of Canadians can likewise be addressed in order to further strengthen Pillar Three of the Canadian retirement system:

- Improving and expanding the role of defined benefit formula plans; and
- Upgrading the roles for DC plans.

ACPM believes that private sector DB plans are a necessary component of a strong retirement income system and we have advocated for needed changes in the solvency funding rules in our May 2014 paper, *DB Pension Plan Funding: Sustainability Requires a New Model*.

For employers willing to establish pension plans, but concerned about DB plan risks, target benefit style plans would offer an alternative to the current options of DC plans or group RRSPs. While the potential for benefit reduction is controversial, target benefit (TB) plans offer the same kind of longevity and asset pooling available through DB plans, while providing more benefit certainty than

DCs. ACPM has provided a template for structuring these plans – *ACPM Target Benefit Plans Paper* (March 2012) and *ACPM Target Benefit Plan Supplemental Paper* (September 2014).

DC pension plans also play an important part in Canada's pension system. While employers have continued to offer DC plans and create new DC plans, the growth has been muted by the perception of over-regulation and by the need for a modern regulatory structure. Regulatory changes that can facilitate the adoption of these promising DC design options for more plans include:

- Automatic Enrolment of Pre-existing Employees with Opt- out;
- Automatic Escalation with Opt-out – ACPM paper, *Delivering the Potential of DC Retirement Savings Plans* (May 2008);
- Improve DC by including variable benefit options and "safe harbor" provisions with focus on decumulation of assets.