The Great CPP Debate

Expanding the CPP is a golden opportunity *By Greg Hurst*

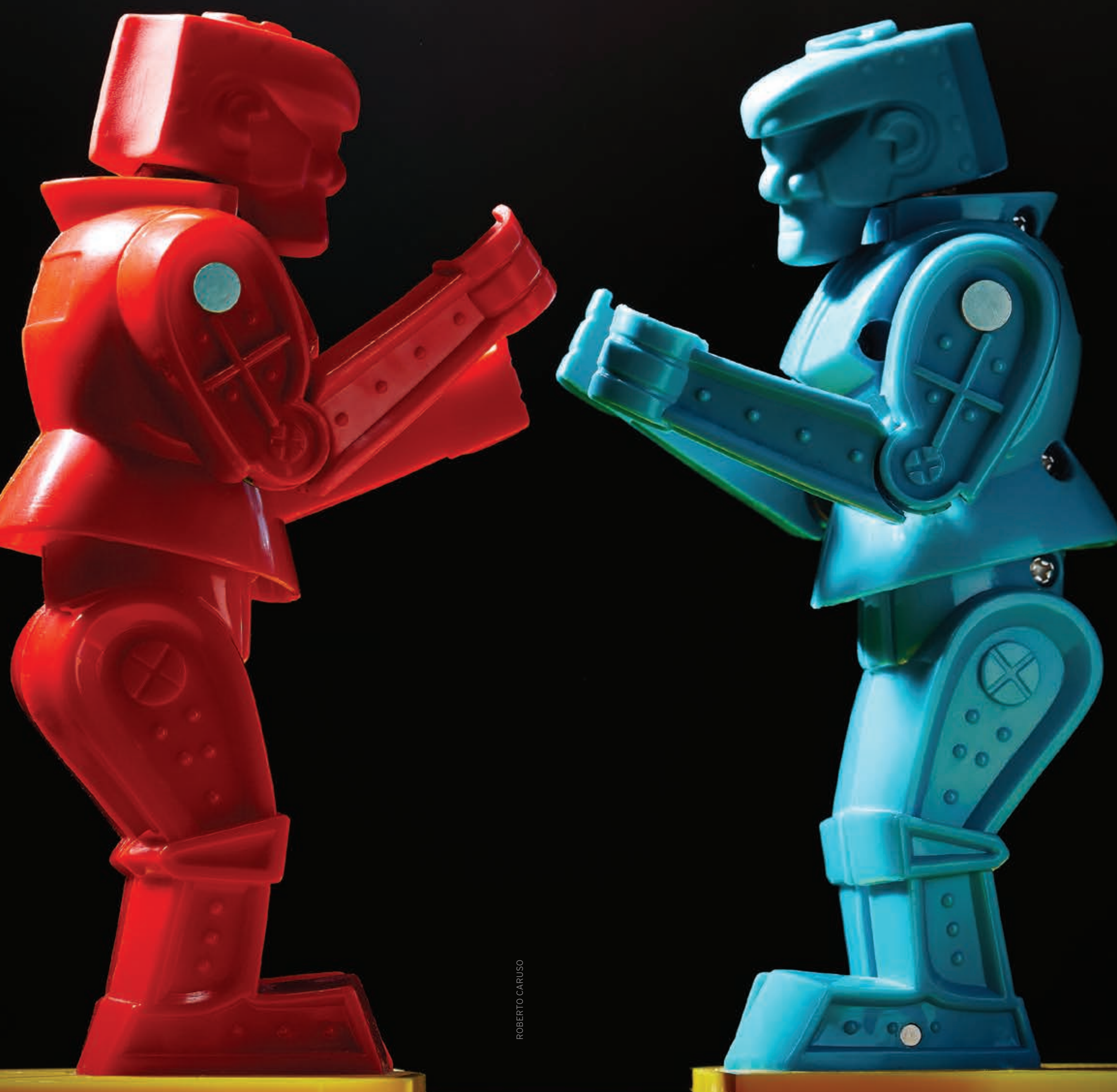
Canada's pension system has a large problem that needs addressing—and the sooner, the better. Our pension system is often characterized as a stool supported by three legs: public pensions, in the form of the Canada Pension Plan (CPP) and old age security (OAS); workplace pensions [registered pension plans (RPPs)] featuring employer and some employee contributions; and personal retirement savings via RRSPs for individual contributions.

Two of the legs have problems. The RPP leg keeps getting shorter as pension coverage continues to fall. According to figures just released by Statistics Canada in December, pension coverage across all sectors was 38.4% in 2011 compared with 38.8% in 2010. RRSPs have long been the weakest leg, honeycombed (rotten) by accessibility for withdrawals prior to retirement and generally inadequate personal savings rates. The result is, individual Canadians are sitting on retirement stools that vary in stability from a precarious perch on a one-legged "shooting stick" of CPP and OAS to a potentially wobbly two- or three-legged model. Under the current regime, many future retirees will have to be financial acrobats to avoid hitting the cold hard ground of poverty.

From a long-term policy standpoint, provincial and federal governments are becoming increasingly concerned about the declining adequacy of retirement incomes. This has been the impetus for most examinations of the pension system and regulations carried out over the past six or seven years on mandates of various provinces and the federal government. It has been a central theme, at least annually, of provincial and federal finance ministers' meetings since 2010. They are aware that governments and taxpayers will be facing increasingly tough challenges to fund minimum income supports and healthcare costs, as retirement incomes decline under the pension system status quo.

Provincial and federal governments working together have focused on two paths for pension reform. Implementation along the pooled registered pension plan (PRPP) path has already occurred federally and in Quebec. Unfortunately, the PRPP is doomed to fail, as the federal government has laid an inadequate foundation for this path in at least three ways.

First, it failed to exercise leadership and make workplace pensions mandatory for federally regulated employers. Although Quebec has taken this step in its version (called the voluntary retirement savings plan), we can expect that many other provinces will not, creating both regulatory and economic disharmony.



ROBERTO CARUSO

Expanding the CPP is a bad idea *By Joe Nunes*

CPP expansion doesn't solve the problem that we have today, and it may not solve a problem that we may *not* have in 40 years.

First, the problem. The middle class (argued by some to be those earning $30,000 to $100,000) has not been saving enough to afford the comfortable retirement they wish to have. I have witnessed first-hand this problem of undersaving by many workers in their 40s and 50s. While we could debate the income bracket for the middle class, I am willing to concede that there are a significant number of undersavers in the boomer generation and gen X.

How did we get here? In the 1980s, Ontario decided that too many workers were not realizing the benefits they were reasonably promised as pensions—vesting at age 45 with 10 years of service and fixed-dollar pensions were not doing a good enough job for the average private sector worker to retire comfortably. The solution was to strengthen the rules for vesting, interest on contributions, eligibility for early retirement, etc.

Arguably, these changes were good ideas. Ontario even legislated post-retirement indexing, but, thankfully, it was never implemented. Ontario pushed further and added rules for the Pension Benefits Guarantee Fund, solvency testing and "grow-in" benefits. Ontario also changed the sometimes-unwritten deal with employers about surplus ownership, starting with a fight with Conrad Black at Dominion Stores. The wisdom behind these latter changes is a little more suspect.

All of Ontario's efforts have increased the retirement security for those workers who continue to enjoy participation in DB plans, many of whom are public service workers. Unfortunately, Ontario's efforts—along with the uncoordinated efforts of the other provinces—have pushed the vast majority of private sector, non-union employers to get out of the DB plan business: a promise that was always voluntary, under legislation.

The response of private sector employers has been to provide DC plans. In the 1990s—a period of double-digit equity returns—workers were more than happy to say goodbye to a DB pension that they didn't understand in exchange for "money in the bank" that would improve their retirement fortunes even if they earned only 8% per annum on their investments. Unfortunately, for the new legion of DC participants—as well as the many workers who never enjoyed a DB plan—the 1990s assumptions about investment returns and annuity prices at retirement have not, in almost all cases, been achievable in the most recent decade.

Second, the flaw of PRPPs lies in the pipe dream of federal politicians that these vehicles will be "low cost," as they are unlikely to achieve the necessary economies of scale (although they might if workplace pensions were made *mandatory*). Furthermore, the gratuitous handing over of PRPPs to the financial services industry provides little incentive to make them low cost.

Finally—and perhaps the most fatal flaw—financial institutions mandated to deliver PRPPs have a trust deficit in the eyes of many Canadians.

The other path is CPP expansion. Common arguments in favour include the fact that Canadians have developed a very high level of trust in the administration and investment of the CPP, and the CPP has much lower administrative costs than what the financial services industry charges for most of its retirement savings products—certainly much lower than PRPPs are expected to cost. Increasing the base level of CPP benefits will help *all* workers and provide more financial stability for those who lack adequate workplace pensions or individual retirement savings.

In addition, CPP expansion offers a golden opportunity to address what may be the thorniest issue in systemic pension reform: raising the current retirement age of 65, which could significantly reduce the costs of increasing CPP benefit levels. CPP expansion will also significantly boost the economy over the medium to long term, as higher retirement benefits increase the purchasing power of recipients.

These last two arguments—together with a gradual, phased-in approach to CPP expansion—are sufficient to overcome the notion that the Canadian economy is too fragile to withstand the shock of increasing employer and employee contributions to fund increased CPP benefits.

In the absence of a national consensus on reforming the Canadian pension system, provinces will develop their own solutions. Some will be more effective than others, and, undoubtedly, this would result in even more economic balkanization of the Canadian federation. It was apparent from media reports of the last federal/provincial finance ministers' meeting in December last year that a sufficient political consensus (two-thirds of the provinces representing two-thirds of the population) is close, if not already a reality. It's time for the Government of Canada to move forward to this will of its people.

Greg Hurst is managing director of Greg Hurst & Associates Ltd.
ghurst@greghurst.ca

KEY CONSIDERATIONS FOR PLAN SPONSORS

By Susan Eng

There are good reasons for those who are already providing workplace pension plans to support an increase to the CPP. The most obvious is that higher CPP benefits reduce pension obligations under most plans. According to a recent survey by Morneau Shepell, more than half of those polled were willing to increase employer contributions to the CPP or some kind of DC arrangement.

This counters the impression that all employers resist contributing to the security of their employees' futures because the economy is too "soft." The concerns of small and medium-size businesses that they could not afford increased CPP contributions can be addressed with a phase-in period or an exclusion of lower-income earners. (Low-income employees in every workplace do not have to contribute to the plan or have contributions matched by the employer.)

Pension contributions are not taxes; they are immediately reinvested, creating jobs and bolstering business growth. Pension benefits are taxed and spent in the economy. Government coffers also benefit. Pensions are not handouts—they're bought and paid for by pensioners, and they actually offset OAS and the Guaranteed Income Supplement (GIS) that the government would otherwise pay. And, most important, to secure the same amount of income stream, individual savings would have to be much greater than the CPP contributions. Plan sponsors no doubt adopted this type of deferred compensation as less costly than current salary increases.

And it bears repeating that only the younger generation will benefit from any improvements to the CPP, which has enough to pay out benefits for the next 75 years (based on the 75-year period of the Chief Actuary's report). All Canadians pay their own way.

There is fairly broad agreement among think tanks, pension experts such as Jim Leech (newly retired CEO of the Ontario Teachers' Pension Plan), retirees and even most of Canada's finance ministers that Canadians are not saving enough; that the middle-income groups are most at risk of a substantial drop in their standard of living once the paycheques stop; and that increasing the CPP is one good way to improve their retirement future. The federal and provincial finance ministers disagree as to timing, so no consensus was reached at the December 2013 meeting.

With the federal government unlikely to agree in the foreseeable future, Ontario has decided to lead the charge for the provinces to join a made-in-Ontario plan or set up parallel plans. Consultations have already begun, and a proposal will be introduced in the spring. CARP has long proposed a universal pension plan (UPP) modelled on the CPP, with payroll deductions and professional management independent of employers and government. CARP's UPP can be, but is not necessarily, part of the CPP.

A supplementary provincial or regional plan allows for some flexibility in design. Enrollment can be mandatory but with an opt-out. Employer contributions can be matching or also subject to an opt-out. Contributions can increase with longer service or age to address the problem that people early in their career may not be able to save or even pay higher premiums, and specific income groups can be targeted. Any regional plan must be portable and accessible by all Canadians to avoid the patchwork and inequities that would otherwise occur.

The purpose of a country's pension system is to prevent poverty in old age. Over the past decades, OAS and GIS—along with increasing CPP benefits—have brought seniors' poverty levels down from double digits throughout the '70s, '80s and most of the '90s to about 5.2% in 2007. But the CPP is at its maximum now, and senior poverty rates have begun to increase again, rising to 7.2% in the latest Organisation for Economic Co-operation and Development figures. This will continue unless action is taken now to either increase the CPP or create a supplementary, universally accessible and affordable pension plan to help Canadians secure their retirement future.

Susan Eng is vice-president for advocacy at CARP. s.eng@carp.ca

The pension consulting community has been warning the province about this problem for a quarter-century. But now, Ontario has suddenly decided that we need to take swift action and push for major and untested changes to solve the problem immediately. The difficulty with retirement savings is that you can't solve the problem in a year, or even a decade—saving for retirement takes 30 or 40 or 50 years. And whether it is done on an individual basis or through a collective program, the timeline can only be shortened if we put in more money each year.

There are a number of different proposals to expand the CPP, all intended to address the problem of undersaving that will make it difficult for many hoping to retire in the next 10 to 20 years. However, if an individual earning $75,000 annually agrees to save an additional $750 each year and this amount is matched by the individual's employer, then, after a decade, he or she will have an additional nest egg of $15,000 plus investment income. With a 4% return, the nest egg grows to $18,500; at 8%, it grows to $22,500.

You can expect this decade of increased contributions to provide a 65-year-old with an additional fully indexed income of between $75 and $125 each month, depending on the assumptions that an insurer or the CPP uses. But let's not forget that the guarantee provided by the CPP is paid for by future contributors. I'm not convinced that we should ask the next generation of working Canadians to extend increasing guarantees to the boomers. At some point, the boomers need to be responsible for themselves.

So ramping up a tiny bit of forced savings will not, in the near term, solve anything. If all we are going to do is help a 55-year-old earning $75,000 per year save enough to receive an extra $100 per month in retirement, then telling him or her that we have "fixed CPP and everything will be fine" is worse than doing nothing at all.

Expanding the CPP is a 40-year project, so we first have to ask ourselves if we are sure that the most important thing we can do for those in their 20s is to help them save more for retirement. Frankly, I think the answer is no. What we need to do for twentysomethings is to help them find meaningful and reasonably paid work. If, in 40 years, 90% of Canadians are earning less than the current year's maximum pensionable earnings (YMPE) (projected with inflation), then covering higher earnings isn't going to help them at all. And, if the next few generations spend their working career earning less than the YMPE, reducing their disposable income to increase their comfort in retirement is unlikely to be optimal for their circumstances.

What is working and what is not working within the current DC marketplace is beyond the scope of this commentary. But before we run to make adequate retirement income a problem for the federal government to solve, we need to look at DC programs to leverage what is working and address what is not. At a minimum, if our governments are prepared to legislate an increase in mandatory retirement savings, they should do so in the current DC environment to find out just how much of the problem is solved with this one easy step.

Joe Nunes is president of Actuarial Solutions Inc.
joe@actuarialsolutionsinc.com