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CPP enhancements: Understand what's not changing

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Last year, Canada's ministers of finance announced they had reached an agreement in principle to make changes to the Canada Pension Plan. Under the proposed alterations, the amounts that Canadians pay into the plan (before retirement) and receive from the plan (in retirement) will both gradually rise.

The Government of Canada says the changes are needed because many middle-class Canadians "are worried that they won't have put away enough money for their retirement, and fewer and fewer Canadians have workplace pensions to fall back on."

The coming changes address one element of CPP – the amount that you pay in before retirement, and thus the amount of CPP income you get in retirement. They don't affect any of the other elements of CPP, which include disability and survivor pensions and a death benefit for those who've paid into the program.

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Because only one element of the CPP program is being changed, some observers believe CPP is becoming increasingly disconnected from its original design and purpose without being realigned to the needs of today's workers and retirees. We spoke to two experts to get their take.

CPP survivor pensions: From single to dual-income families

"In many ways, CPP was designed for a world that no longer exists," comments Joe Nunes, president of Actuarial Solutions Inc., a consulting firm based in Windsor, Ont. "That is, one in which a family had a single-income earner, almost invariably male, who worked for 40 years without interruption, and had a lower-income or no-income spouse who received his survivor pension when he died. Many of those conditions are no longer reflected in today's families, but the CPP program hasn't caught up to the changes."

One example of how CPP program design reflects an earlier era is the survivor benefits component of the plan. Here's how it works: If you have a legal or common-law spouse who dies after having made minimum contributions to the CPP program, you may be entitled to part of their CPP payment after their death, as a "survivor's pension."

In practice, however, there's a limit on how much CPP will pay you each month, because the survivor is entitled to only the maximum of one full benefit – and if you add your CPP pension and a survivor pension together, you may hit that cap.

As a result, if you have significant CPP retirement benefits because of your own employment, you may only get minimal survivor benefits if you have a spouse who predeceases you. When CPP was introduced in 1965, only about two in 10 families had two earners. For the vast majority of families in that era, the survivor pension would allow household income to continue in the event of the death of the main income-earner – and the cap on survivor benefits would have little impact.

This is different from today, when about seven in 10 families have two income earners and survivor pensions may be a much smaller benefit of CPP than when the plan was designed.

Death benefits: Shrinking payout

Another example of how the coming changes bring the program further away from its original design is the death benefit component of CPP. The main benefit of CPP is guaranteed income in retirement, but when eligible CPP contributors die, a one-time, lump-sum, taxable death benefit payment is made to their estate. (This is in addition to the survivor benefit that may be paid to a spouse or common-law partner.)

"In previous decades, the death benefit amount was calculated quite differently," says Lea Koiv, a chartered professional accountant and Toronto-based specialist in retirement matters, "and it was more generous than it is now."

Until CPP reforms in 1999, the maximum CPP death benefit was set at 10 per cent of the yearly maximum pensionable earnings (YMPE). The YMPE is a figure set each year by the Canadian government as the maximum amount on which to calculate CPP contributions. It's based on salary and wage growth in Canada and has increased each year since 1967.

When the death benefit was set at 10 per cent of YMPE, contribution levels to CPP were much lower than they are now – keeping in mind that the contribution rate for employees and employers will rise with the coming CPP changes.

In 1998, as part of a package of reforms to the CPP program, the maximum death benefit was "frozen" at $2,500 instead of continuing to be pegged at 10 per cent of the YPME. Had that change not occurred, the maximum death benefit for 2017 would be about $5,500. For 2017, the YMPE is $55,300 – and CPP contributions on behalf of an employee earning the YMPE total $2,564.10. (The actual death benefit paid out is equal to six months of the contributor's expected CPP monthly payment in retirement, or $2,500, whichever is greater; whether the contributor had reached retirement age or not.)

"With the coming changes in CPP but no changes in the death benefit, what this means is that people will be paying more into CPP but receiving even less over time as a death benefit, as inflation continues to erode its real value," says Ms. Koiv. "The fact that the death benefit is taxable just adds insult to injury."

The bottom line: Are CPP changes new wine in old bottles?

The coming changes to CPP will affect the retirement income component only, and result from the view that Canadians need more guaranteed, lifetime income in retirement – the ancillary benefits of CPP are not the focus of changes to the program. But is omitting reform of the additional components of CPP a problem?

"The reality is that CPP is designed to take in contributions from and provide benefits to Canadian workers, and there's no attempt to make sure workers get out what they put in," says Mr. Nunes. "For better or worse, this is how the program is designed. If we want a larger death benefit, for example, we would need to contribute more or cut benefits elsewhere."

"CPP works well for people who live a long time in retirement, as the benefit lasts as long as you are alive, providing a form of longevity insurance," adds Ms. Koiv. "But there are winners and losers with CPP. There are 14 million contributors to CPP – but it is an extremely poorly understood program.

"A wholesale review of the program to reflect today's realities would likely lead to different outcomes, but who knows if there's a political appetite for that. The best thing that future retirees can do now is become informed about how CPP works in practice, so they can intelligently arrange their financial affairs around it."
