Report suggests raising DC, RRSP contribution limit to 30%

Martha Porado | November 7, 2017

The current environment is simply too difficult for Canadians to save adequately for retirement, given increased longevity and the low yields on appropriate investments, according to a new report by the C.D. Howe Institute that suggests raising contribution limits to retirements savings plans to 30 per cent per year.

"People are living longer and — even more importantly — yields on investments suitable for retirement saving are very low," said William Robson, the report's author and president and chief executive officer of the C.D. Howe Institute, in a release. "These changes have raised the cost of obtaining a given level of retirement income."

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Robson argues that the factor-of-nine equivalency test, which limits contributions to registered retirement savings and defined contribution pension plans to 18 per cent of earnings per year, is out of date. The test assumes a theoretical defined benefit pension, in which members save nine per cent of annual earnings, would allow them to purchase an annuity equal to one per cent of pre-retirement income. Members of a defined benefit plan accrue benefits at a maximum of two per cent of earnings per year, as the Income Tax Act allows. An annuity over 35 years of service would then provide them with a pension replacing 70 per cent of pre-retirement earnings. The idea of the 18 per cent limit, therefore, is to allow capital accumulation plan members to mimic the defined benefit plan scenario, according to the report.

Robson, however, argues that in today's investment environment, the attempt to achieve equivalency is actually preventing RRSP and defined contribution plan savers from reaching adequate retirement security. He notes the factor-of-nine equivalency test fails to account for the higher investment risk that RRSP and defined contribution plan savers take on compared to defined benefit plan members, as well as the combined leverage defined benefit plans can use to their advantage when investing.

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For example, a market downturn would affect defined contribution plan members far more severely, since they wouldn't have the option of boosting their contributions to cover a loss.

"Defined contribution plan participants and RRSP savers should enjoy the same opportunity for pension wealth as their defined benefit plan and public sector plan counterparts," said Robson. "All Canadians should have the ability to accumulate sufficient savings for retirement, and unfair tax treatment should not stand in their way."

As such, the report recommends an update to the factor-of-nine equivalency test's underlying assumptions to take current conditions into account. Doing so would mean raising the contribution limit to 30 per cent or more. The updated rules, the report noted, should also help those who aren't able to save earlier in life catch up. In addition, it suggests either indexing unused contribution room for inflation or establishing an inflation-indexed, lifetime tax-deferred savings limit.

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The fact that the current rules aren't adding up to adequate retirement savings isn't surprising, says Joe Nunes, president of Actuarial Solutions Inc. However, simply upping the available contribution amounts may not be a complete solution, he adds.

"I am not sure C.D. Howe is reaching the right conclusion," says Nunes. "I don't think giving private sector workers the chance to save 30 per cent of pay will be a useful improvement for the majority of workers. To me, the work again exposes the inequity between private and public sector pensions and the need to scale back the public sector promises to a more affordable level."