

# The Canada Pension Plan: Part 1 – Past and Present

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# Introduction

The June 20th announcement by Finance Minister Bill Morneau of an expansion in the Canada Pension Plan heralds the most significant change in Canada's 3-pillar retirement income system in half a century. The question is whether it is a change for the better. And will it put an end to the long-running debate on pension reform?

In recent years, politicians, unions and special interest groups have clamoured for an expansion of the Canada Pension Plan (CPP). Without it, they say, younger Canadians face a retirement crisis, and it is up to government to make things right. The Ontario government injected a sense of urgency to the reform process when they declared they would proceed to launch their own state pension plan (the ORPP) by January 2018 if a consensus on CPP expansion was not reached by year-end.

To complicate matters, not everyone agrees there is a crisis or with the proposed remedy. The former Conservative government, for instance, opposed CPP expansion on the grounds that the economy was too fragile. Business groups agree, and add that the extra payroll taxes will result in lost jobs. Then there is the age-old controversy of how much government intervention is appropriate. Would CPP expansion create a moral hazard by diluting the natural inclination to save and does it encroach too much on private-sector solutions?

This Morneau Shepell special report provides our perspective on the proposed changes to the CPP. In the process, we revisit the circumstances surrounding the birth of the CPP a little over half a century ago and how the situation has evolved since then. The history is not only interesting; it provides a better context from which to assess the events that are now unfolding.

In this paper, we conclude that a reasonably good case can be made for CPP expansion, though not for the reasons that most people think:

- Senior poverty is really not a problem in Canada.
- People nowadays are saving more for retirement, not less.
- While coverage in workplace pension plans is sub-optimal, it is not as low as it looks.
- Pillar 3 has not failed – it has simply evolved.

The real problems are prospective. The long-term economic and demographic trends are not favourable, and many, if not most, Canadians do not have the financial acumen to cope with the challenges those trends will pose. Expanding the CPP is the simplest remedy.

The proposed formula for CPP expansion entails increasing the benefit rate from 25 percent to 33.3 percent while also increasing the earnings ceiling by 14 percent. This change will not suit everyone, but that was never possible anyway. A larger enhancement would have been strongly opposed by businesses while a smaller enhancement might have led to the balkanization of Canada's retirement income system as Ontario would almost surely have gone its own way.

This report is the first of two parts. Part 2, which will be released in September, will analyze the CPP enhancement in more detail and will consider the longer-term implications. In particular, it will consider the actions that the sponsors of workplace pension plans should take.

## In this paper, we will make frequent reference to Canada's 3-Pillar Retirement Income System:

- **Pillar 1** – Old Age Security (OAS) and its companion program, the Guaranteed Income Supplement (GIS);
- **Pillar 2** – The Canada Pension Plan and its Quebec counterpart, the Quebec Pension Plan (QPP); and
- **Pillar 3** – The tax-assisted retirement savings programs including (registered) workplace pension plans, Registered Retirement Savings Plans (RRSPs), Pooled Registered Pension Plans (PRPPs) and Tax-Free Savings Accounts (TFSA).

Public pensions include Pillars 1 and 2 while Pillar 3 represents private pensions.

There is also an informal "Pillar 4" that consists of assets that are not in the first three pillars. This includes equity in a home or vacation property, equity in a business or investment property, cash in bank accounts, accounts with brokerage houses, and mutual funds. Even if we ignore home equity, Canadians have more assets in Pillar 4 than in the first three pillars combined!

# Section 1

## Before there was CPP

Consider the following pronouncements by politicians, pension leaders and the press on the question of expanding Canada's public pension plans:

- “. . . there has been an acceptance of the fact by almost all political parties and other people, and perhaps even by management, that private pension plans have not succeeded very well in supplementing . . . Old Age Security.”
- “Businesses want to be shown that the country can afford the dollar cost of the program and that pensions are more important than education or Medicare.”<sup>1</sup>
- “Insurance companies, trust companies and pension consultants have waged a stiff fight.”<sup>2</sup>
- (Ontario's) “Premier . . . is considering establishing an Ontario pension plan . . . and as a result is being charged in some quarters with fragmenting Canada”.<sup>3</sup>

One could be forgiven for thinking that these comments were made recently in reaction to a new proposal to expand the CPP. In fact, they all appeared in the *Globe and Mail* in 1964, a few months before the federal government passed Bill C-136 giving birth

to the CPP. It seems the issues, and the positions taken by the various stakeholders, have not changed much over time.

### Poverty in the 1960s

One thing that has changed dramatically since the 1960s is the economic status of seniors. The situation was exceptionally harsh half a century ago as is evident from the following facts culled from the early 1960s:

- In 1961, the poverty rate among households headed by a senior was 43.9 percent;<sup>4</sup>
- In the case of unattached individuals age 70 or over, the poverty rate was an astonishing 72.5 percent;
- The monthly benefit of \$55 that was provided by OAS (until 1962) was meager, even by the standards of the day;
- The GIS, which is the salvation today of many a low-income household, did not exist yet;
- The average retirement age was 67.5, even though male life expectancy based on the Canada Life Tables at the time was 68.75 (as measured from birth);

1 Dr. Robert Clark recommended strengthening OAS rather than introducing an earnings-related scheme.

2 Reported in the *Globe and Mail*, Dec. 22, 1964.

3 Reported in the *Globe and Mail*, April 10, 1964.

4 Lars Osberg, “Poverty among Senior Citizens: A Canadian Success Story.” The poverty line is the Low Income Cut-off (LICO), which is the income level at which 70 percent of pre-tax income is being spent on basic necessities.

Perhaps Bryden<sup>5</sup> captured the *Zeitgeist* best when he noted in 1974 that “*the destitute were considered to be more in need of moral exhortation and uplift than material assistance.*”

Certainly in hindsight, if not at the time, it is obvious that moral exhortation was not sufficient to improve the lot of seniors. OAS, the universal flat pension, was important but not enough by itself. The time had come for a second-tier public plan, one in which pension benefits were based on earnings and contributions rather than years of residency. This idea had been circulating at least since 1950 when an earnings-based plan was endorsed by the Canadian Congress of Labour as well as the Canadian Manufacturers Association.

One of the more intriguing arguments for a contributory plan was that it would ensure the long-term health of the retirement income system. A public system that consists of flat, universal benefits paid out of general revenues would eventually encounter resistance as the people who are paying for it would balk at funding improvements that benefit the lower-income group disproportionately.

By the late 1950s, an earnings-based public plan had found some favour with all three major political parties:<sup>6</sup>

- It was an active issue in the 1957 election campaign as Tory Prime Minister John Diefenbaker bandied about the idea of

a contributory, earnings-based national pension program along the lines of US Social Security, which he claimed provided “far greater benefits” than the Canadian program. Diefenbaker commissioned a study of the suitability of the US system for Canada;

- The CCF (the Co-operative Commonwealth Federation), which would become the NDP in 1961, was also keen on a contributory earnings-related pension scheme as they had growing doubts that a universal program like OAS was adequate by itself; and
- The Liberal party under the leadership of Lester B. Pearson resolved in its January 1958 convention to consider a national contributory pension scheme (known at the time as the Pearson Plan).

In addition, an international movement to create contributory, earnings-related public schemes was underway. Great Britain launched its own in 1959 and most of the Western European countries followed suit by the 1960s.

**“The destitute were considered to be more in need of moral exhortation and uplift than material assistance.”**

5 Kenneth Bryden, “Old Age Pensions and Policy-Making in Canada.” McGill-Queens University Press, 1974.

6 Bryden, *ibid.*

## Obstacles to the CPP

In spite of this consensus, the CPP did not have a quick or easy birth. The 1959 study commissioned by the Diefenbaker government<sup>7</sup> was ultimately cool to the idea of a public, earnings-related pension plan so the Conservatives quietly moved it to the back burner, which is where it stayed until 1963.

By then, the Liberals were back in power with a near-majority and used that opportunity to make good on their earlier promise to create a national plan. Their first formulation of a CPP involved a 30 percent benefit rate at age 70 and pay-as-you-go funding.

The insurance industry and various chambers of commerce were not happy with the idea of a national plan, however; once they realized that the Liberals were serious about creating the CPP, they attacked it as economically and actuarially unsound. They also claimed it was inequitable since it would not benefit workers with very low income or seniors who were already retired.<sup>8</sup> The fact that the CPP would cut into insurance companies' business and raise employer costs did not help either.

Many ordinary Canadians also objected to the plan on the basis of its compulsory nature, which was described by one MP in

Public pensions were never meant to provide more than a “subsistence level” of support.

the House of Commons as “repugnant to all those who support the concept of individual initiative and responsibility”.<sup>9</sup> It was regarded by other MPs as heavy-handed government intervention into the private sector. One of the more interesting views expressed in the House in this regard was that “it (Bill C-75) is hypocritical legislation because under the pretence of providing protection for Canadian citizens, the government is levying a new tax that 90 percent of the people cannot afford to pay.”<sup>10</sup>

The Liberals themselves were a little conflicted since they wanted a national plan but did not want to alienate private business interests who opposed it for the reasons mentioned above. That is why Judy LaMarsh, the Minister of National Health and Welfare who was responsible for the CPP, said, “our consultations with the provinces revealed a widespread fear that the original proposal (which would have provided 30 percent of covered earnings at age 70) was on a scale which would substantially lessen the incentive for people to save through private pension plans.”<sup>11</sup>

7 Dr. Robert Clark, “Economic Security for the Aged in the United States and Canada,” 1959.

8 Bryden, *ibid.*

9 Hansard, March 23, 1965, page 12697.

10 Hansard, March 23, page 12703.

11 Statement made in the House of Commons on March 17, 1964, in introducing a resolution respecting an act to establish the Canada Pension Plan.

Even before that, Liberal MP James Sinclair had declared that public pensions were never meant to provide more than a “subsistence level” of support.<sup>12</sup> Mr. Sinclair’s comment was significant for two reasons. First, it may have been one of the last times a politician has clearly articulated the purpose of public pension plans. Second, he was the grandfather of the current Prime Minister.

So while the government endorsed the idea of an earnings-related, contributory public plan, they too were leery of creating too big a pension promise.

Finally, it was difficult to gain agreement among the provinces. In an uncanny parallel to the present state of affairs, Quebec and Ontario were both inclined in the early stages to go their own way in lieu of a national pension program.

Quebec was considering its own version of a state-sponsored, mandatory, earnings-related pension program, which materialized eventually in the form of the QPP. In the meantime, Ontario’s preference was to mandate workplace pension plans for every employer with at least 15 employees.

The situation in Ontario and Quebec today is remarkably similar except that the two provinces have reversed roles: Ontario is prepared to introduce a state-sponsored DB pension plan of its own (the ORPP) while Quebec has essentially mandated workplace pension plans (what they call VRSPs) for all employers with five employees or more.

## Making a deal

The Liberals eventually came back with a slimmed-down version of a CPP in early 1964, this time featuring a 20 percent benefit rate.<sup>13</sup> Before they could muster support for their new proposal, Premier Jean Lesage of Quebec stole the show by unveiling a proposal for a stand-alone Quebec Pension Plan at a federal-provincial meeting in April 1964.

The proposed QPP, which was the brainchild of actuary Claude Castonguay, was more robust than the new federal proposal as it featured a 25 percent benefit rate (versus the federal 20 percent), a \$6,000 earnings ceiling (versus \$4,500) plus both disability and survivor benefits (versus neither in the federal plan). Quebec’s plan received the backing of most of the other provinces and Ottawa’s modest offering was essentially dead on arrival.

The Liberals scrambled to regain the initiative by negotiating secretly with Quebec to reach a compromise. This led to the third and final version of the CPP in late 1964 (which is presented in Section 2) and once this compromise was reached, any change in the basic design parameters of the CPP was off the table.

While the negotiation between Ottawa and Quebec was ultimately successful, it put a number of noses out of joint. Judy LaMarsh was furious about having been left out of the negotiations, while John Robarts, the Conservative premier of Ontario, was miffed

<sup>12</sup> SEDAP *ibid.*

<sup>13</sup> SEDAP, Research Paper No. 223.

that Ontario had not been involved. And the private sector would eventually learn that the extensive public consultations involving presentations from both business and labour were for naught since the main parameters of the plan were not subject to change once Quebec was onside.

Nevertheless, Ontario eventually bought into this brokered plan because the Conservative government judged it to be politically preferable to support a national plan that was gaining momentum rather than pursue the party's pet idea of mandatory workplace plans.

A significant inducement to the provinces to gain their blessing for the CPP was access to the assets in the CPP fund. A sizeable fund would accumulate in the early years of the CPP as contributions would initially outstrip payouts. The federal government offered to lend half the monies back to the provinces for long periods at very favourable rates. Ostensibly the money lent to the provinces was to be used to fund infrastructure projects, but in reality there was minimal oversight over how it was spent.

The final days of debate in March 1965 before the passage of Bill C-136 saw the opposition parties putting up stiff

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resistance, especially in three areas. The first, which was raised by the NDP, was whether the OAS benefit should be increased to \$100 a month instead of \$75. Second, the Conservatives continued to harp on the compulsory nature of the proposed CPP, which they found anathema. The third issue was the apparent unfairness of bringing in a plan that would help future retirees but do nothing for workers who had already retired. None of these objections resulted in any changes to the bill, however.

The opposition MPs also raised other concerns that are noteworthy today, if only because they proved to be rather prescient:

- They claimed that the employee contribution rate of 1.8 percent would prove to be too low to be sustainable and would eventually have to rise. (The rate did indeed rise, to the current 4.95 percent. It is even higher under the QPP.)
- They argued that it was unfair that higher-income workers would effectively pay less for CPP by virtue of their contributions being tax-deductible. (Twenty-two years later, the tax deduction was turned into a tax credit.)
- It was feared that integration of the CPP with workplace pensions would become a problem for employers with collective bargaining since the integration would be necessary but could not be forced. (This was indeed a problem in 1965 and may rear its head again as the recently announced enhancement is implemented.)

## Section 2

# The original version of the CPP

Here is a basic description of the CPP as it was passed into law on March 29, 1965:

- CPP contributions started on January 1, 1966, and benefits started to become payable in 1967.
- Contributions by both employees and employers were set at 1.8 percent of annual employment earnings between \$600 and \$5,000. There was no timetable for increasing the contribution rate though it was known that a pay-as-you-go funding scheme would eventually require higher contributions.
- The earnings limit of \$5,000 was approximately the average national wage at the time. It was increased by 2 percent a year for a few years and later on by 12.5 percent a year until it caught up to the average national wage.
- The benefit was 25 percent of earnings up to the ceiling in the year of retirement and the two previous years (but subject to adjustment for prior years when less than the maximum was contributed).
- Younger Canadians would need to work for about 40 years before becoming eligible for a full CPP pension. Older Canadians in 1966 were fast-tracked and could be eligible for a full pension after only 10 years. This was done largely in recognition of the hardship that older Canadians had faced during the Great Depression when unemployment wiped out the savings of many. While the fast-tracking of full pensions for this group is understandable from a humanitarian perspective, it created an unfunded liability that present and future generations will continue to pay for.
- Full pensions were payable starting at age 70, not 65. In the words of the Honourable Judy LaMarsh, *"The principle of paying pensions at 65 was part of the Canada pension plan from the beginning,"* but Ms. LaMarsh went on to say, *"but payments were to be scaled down from the full amount at age 70."*<sup>14</sup>
- CPP pension could not begin before age 65, and if one wished to start their pension as early as age 65, it was subject to a highly punitive earnings test. The pension was reduced by \$1 for every \$2 of employment earnings in excess of 18 percent of the earnings ceiling (which was initially \$5,000) plus another \$1 for every \$2 in excess of 30 percent of that ceiling.
- Once the CPP pension was started, benefits were increased annually to reflect inflation, but the increases were capped at 2 percent per annum.
- The plan also contained survivor's benefits and a disability benefit.

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<sup>14</sup> Hansard, March 15, 1965

## Section 3

# Did the CPP fulfill its promise?

The changes to the retirement income system that were made in the 1960s were a spectacular success in terms of alleviating poverty among seniors. Certainly the CPP contributed to this, but we cannot ignore the role of the GIS and a growing Pillar 3.

By 1976, the poverty rate of seniors (as measured by the Low Income Cut-off or LICO) had dropped to 30 percent.<sup>15</sup> That rate continued to drop steadily over the next couple of decades as ever more seniors retired with CPP pensions, bigger private pensions and growing account balances in RRSPs.

By 2011, only 5.2 percent of seniors still had income below the LICO<sup>16</sup>, a fact that is all the more striking relative to the 10.5 percent poverty rate amongst the working-age population<sup>17</sup> or when one considers who falls within the 5.2 percent group:

- Some are immigrants who have not spent their entire adult life in Canada and hence do not qualify for full OAS and GIS.<sup>18</sup> If they are receiving inadequate public pensions, it is by design and not by neglect;
- Over 150,000 (representing about half the seniors below the LICO) are seniors

who have not filed to receive GIS even though they are eligible for it;

- Some are grandparents who are taking care of underage children.<sup>19</sup>

Therefore, it could be argued that in the case of long-term Canadians who no longer have dependent children, Pillars 1 and 2 have virtually eliminated poverty after age 65.

This essentially was the conclusion reached by the task force headed by Jack Mintz when reporting to the federal and provincial finance ministers in 2009<sup>20</sup> on the state of retirement security in the country. In his report, he asserted that *“Canadians are, by and large, doing relatively well in ensuring that they have adequate savings for their retirement.”*

The CPP was a success in other ways, too. The management of the plan turned out better than many people expected. In the early years, the CPP put a great deal of money at the disposal of the provinces at very favourable borrowing rates and with minimal oversight. This raised two concerns: that the

### Pillars 1 and 2 have virtually eliminated poverty after age 65.

<sup>15</sup> CANSIM Table 202-0802.

<sup>16</sup> Actually, it is after-tax income below the after-tax LICO. This is more relevant than before-tax figures.

<sup>17</sup> About 10.5 percent of working Canadians had income below the LICO in 2011.

<sup>18</sup> Michael Veall, Special Senate Committee on Aging, “Canada’s Aging Population: Seizing the Opportunity,” April 2009.

<sup>19</sup> Veall, *ibid.*

<sup>20</sup> Jack Mintz, “Summary Report on Retirement Income Adequacy Research,” prepared for the research working group on retirement income adequacy for the Federal and Provincial Finance Ministers’ meeting, December 2009.

money might not be repaid on time and that it could be more profitably invested elsewhere.

This problem was rectified by the creation of the CPP Investment Board (the CPPIB) in the 1990s. The CPPIB operates at arm's length and looks for the best investment opportunities around the world. The CPPIB has achieved net long-term returns that are significantly better than the median pension fund manager.

Another concern before the CPP's launch was the impact it would have on the economy. It was reported at the time that the plan would take \$400 million to \$500 million of spending power out of the pockets of consumers<sup>21</sup> (a concern that resonates today). While economic growth may have slowed a little in the late 1960s due to the CPP, the country weathered it well as the economy still saw better-than-average economic growth. In the 1970s, OECD figures show that Canada's average annual growth in GDP exceeded that of both the US and Europe, though certainly a part of this over-performance can be attributed to a resources boom that occurred.

This is not to say that the CPP is perfect. It has its flaws, some of them rather serious ones:

- The current total contribution to the CPP is 9.9 percent of pay, but the benefit has a value that is closer to 6 percent. We are overpaying — and will continue to do so — because the original participants did not pay enough.

*“As soon as it was legislation, the (Canada) pension plan fitted into the fabric of Canadian society as if it had always been there.”*

- The CPP benefit is not particularly welcomed by low-income recipients since it results in a claw-back of up to 75 percent of their GIS entitlement.
- Higher-income participants are not treated fairly since the CPP benefit they will eventually receive is fully taxable but their contributions are not fully tax-deductible.
- While the investment returns achieved by the CPP Investment Board have been better than the median pension fund manager, the CPPIB is taking more risk to achieve it and this may eventually come back to haunt them.

It seems the public is prepared to forgive these peccadillos, to the extent they are aware of them. The bottom line is that public pensions have practically eliminated senior poverty in the country and CPP is part of the reason for it. The program is widely considered to be well managed and appears to be sustainable for decades to come. Even the most vocal opponents of CPP expansion do not say the country would have been better off without the original CPP. In the words of Tom Kent, one of the architects of the original deal between Ottawa and Quebec, *“as soon as it was legislation, the (Canada) pension plan fitted into the fabric of Canadian society as if it had always been there.”*

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<sup>21</sup> *Globe and Mail*, September 8, 1965.

## Section 4

# So why improve CPP again?

In spite of, or perhaps because of, the success of the CPP, some governments, labour groups and various other stakeholders have been pressing for an expansion of the plan for years.

Before explaining why, it is important to note that expansion has already taken place as both Pillars 1 and 2 have been improved a number of times since the 1960s. The CPP and GIS in particular provide better income protection today than any political party of the early 1960s envisioned was necessary or even appropriate. Consider the following milestones:

- The earnings test for receiving CPP benefits at age 65 was eliminated in 1975;
- Full automatic indexing of pensions to annual changes in the CPI was adopted in 1974;
- The ability to receive CPP at age 60, albeit at a reduced level, was granted in 1987;
- The original CPP benefit starting at age 70 initially provided 25 percent of covered earnings (remember 30 percent was deemed excessive); over time, it has quietly been elevated to 35.5 percent;
- The GIS, which was meant to be a temporary program and slated to be unnecessary when the CPP was fully

phased in, became a permanent fixture; for married couples, the maximum GIS benefit has increased from \$30 a month in 1967 to \$513 in 2016. Even after adjusting for inflation, the increase is nearly 150 percent.

Consequently, the income gap that needs to be filled by personal savings and private pension plans has shrunk more than was contemplated by the founders of the CPP. In the case of the bottom 20 percent of workers by income level, there is no longer any pension income gap at all. This appears to be at odds with the original intent of CPP. Here is what Judy LaMarsh said in 1964:

*“It [the CPP] is not intended to provide all the retirement income which many Canadians wish to have. This is a matter of individual choice and, in the Government’s view, should properly be left to personal savings and private pension plans.”<sup>22</sup>*

Therefore, the CPP, combined with the OAS and GIS, appears to have over-achieved as it replaces more than 100 percent of pre-retirement income for the bottom 20 percent of Canadians and close to 100 percent for the next 20 percent tranche. Why then the continued pressure to improve CPP?

Below, we explore various possible explanations for the apparent change of heart.

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22 Ibid.

## Reason 1: Pressure from seniors

In spite of what has already been achieved, seniors will continue to want better pensions. The Canadian Association of Retired Persons (CARP), for example, was clamouring for an expansion of the CPP, even though none of the serious expansion proposals would benefit existing CARP members and indeed none would have a measurable effect on anyone's retirement income for many years to come.

Their interest in a bigger CPP may simply be a sign that CARP is looking out for its future members but perhaps they aspire for a little more than that. They might be hoping that a CPP expansion would indirectly benefit current seniors in some other fashion. In his 1974 book, Kenneth Bryden noted,

*"It proved to be politically impossible to project a substantial upward revision of the benefits of future pensioners without doing considerably more than originally planned for those already at or near pensionable age. Hence, pensioner associations were active in making their needs known to Parliament".<sup>23</sup>*

Since 1966, the ratio of seniors to the working population<sup>24</sup> has doubled from 13.3 percent to 26.5 percent and will rise to 40 percent within 20 years. Seniors tend to be more vocal and more likely to vote than younger Canadians so it is not surprising that their political clout is great and will continue to grow in the years ahead.

## Reason 2: Pressure from labour groups

Labour groups have been strong advocates of a bigger CPP for some time. In the 1970s, they wanted the CPP benefit to be tripled. Since 2009, the Canadian Labour Congress has been recommending a doubling of the current benefit. CUPE hosts a website that says *"Stop Stalling: expand the CPP NOW."* Unifor, Canada's largest private-sector union, states on its website that *". . . the need for an enhanced CPP has never been greater."*

The rationale for their endorsement of Big CPP is a little murky, though. If a higher CPP were to result in a dollar-for-dollar reduction in workplace pensions (through full integration), then such a change would be neutral at best for the affected employees and possibly negative for the unions themselves. When CPP was first launched in the 1960s, many unions fought hard against integration on the grounds that it would result in reduced workplace pension benefits.

Therefore, the strong suggest an expectation that it will increase pension benefits, even in situations where workplace plans already exist, and whether they are integrated with the CPP or not.

<sup>23</sup> Bryden, *ibid.*

<sup>24</sup> "Seniors" are defined here as 65 and over and the working population is defined as 20–64. The 1966 figures are taken from SeriesA78-93 published by Statistics Canada. The 2016 figures come from Statscan publication 91-520-X.

### Reason 3: Key data has been misinterpreted

An often-cited reason for expanding the CPP is the long-term decline in the national savings rate. The Household Saving Rate (HSR), which is calculated by Statistics Canada as a by-product of Canada's National Accounts, has plunged from over 20 percent of income to just 5.5 percent over the past 30 years. While the HSR numbers suggest that Canadians are saving much less than they used to, such a conclusion would be erroneous.

As is explained in a C.D. Howe commentary,<sup>25</sup> there are two major reasons why the HSR is not an appropriate measure of Canadians' savings habits:

- The HSR does not include CPP contributions as retirement savings, even though few people would object to CPP contributions being classified as retirement savings. If CPP contributions and benefits were doubled, the HSR would not budge. If anything, it would *drop* since an increase in CPP contributions would likely trigger a reduction in RRSP contributions, something that *is* captured in the HSR.
- Amounts that are withdrawn by retirees in the form of retirement income are subtracted from aggregate savings when calculating the HSR. If the amount that was being saved by the working population was balanced out by withdrawals by retirees, the HSR would be calculated as nil, even if workers were saving at adequate levels.

When adjustments are made for these factors,<sup>26</sup> it is estimated that the percentage of employment earnings Canadians contribute toward retirement has soared from 7.7 percent in 1990 to 14.1 percent in 2012. If this fact were better understood, much of the pressure to improve public pensions would likely dissipate.

Another statistic that may suggest an impending, if not existing, retirement crisis is the recent rise in the poverty rate amongst seniors using the Low Income Measure (LIM) as a benchmark. The LIM is a relative measure of poverty that is arbitrarily defined as half the median income of the general population. The LIM bottomed out at 3.9 percent in 1995 but has since climbed to 12.0 percent in 2011.<sup>27</sup> The primary reason for the higher percentage of seniors below the LIM since the mid-1990s is a dramatic rise in the median income of the working population, not a fall in the incomes of seniors.

In fact, retirement income has continued to grow substantially since the 1990s; the median income of the elderly in 2010 was more than 20 percent higher in real terms than it was in 1995.<sup>28</sup> The percentage of seniors with after-tax income below the after-tax LICO (a more common proxy

**The percentage of employment earnings Canadians contribute toward retirement has soared from 7.7 percent in 1990 to 14.1 percent in 2012.**

25 Malcolm Hamilton, "Do Canadians Save Too Little," C.D. Commentary No. 428, June 2015.

26 Ibid.

27 Statistics Canada CANSIM Table 202-0802.

28 Milligan and Schirle, *ibid.*

for the poverty line) continues to be within one percentage point of its all-time low.

### Reason 4: Eliminating poverty is no longer enough

Rather than merely helping to nudge Canadians just over the poverty line, governments are now intent on bringing the standard of living of retiring workers closer to what they enjoyed while they were working. It appears there has been a subtle but important shift in public sentiment in this regard since the 1960s.

It is not surprising that employees are in favour of more public pension if they think they do not have to pay for it. What is more remarkable is that modern-day employers also seem to be more accepting of a bigger CPP benefit as well (see the sidebar “What employers expect from Pillars 1 and 2”).

The reason that most stakeholders are focusing on the CPP as the best vehicle to improve retirement security is that Pillar 3 appears not to be up to the task.

### Reason 5: Pillar 3 has failed (or has it?)

If CPP needs to be expanded because Pillar 3 has purportedly failed, that is a serious claim and deserves closer scrutiny.

In 1960, 34 percent of the total labour force participated in workplace pension plans. The coverage rate rose to 35 percent by 1965 and continued to climb, post-CPP, to 39 percent in 1970 and 40 percent in 1974.<sup>29</sup> The coverage rate peaked at 46 percent<sup>30</sup> of the paid labour force in 1977 and has since fallen to just under 38 percent (see Figure 4.1).

On the surface, the low coverage rate makes for a compelling case that Pillar 3 is floundering. This statistic, however, is misleading since the 38 percent coverage rate is not as low as it sounds. The *effective* coverage rate is considerably higher since certain groups defined by age or income level do not need to participate in workplace pension plans.

### What employers expect from Pillars 1 and 2

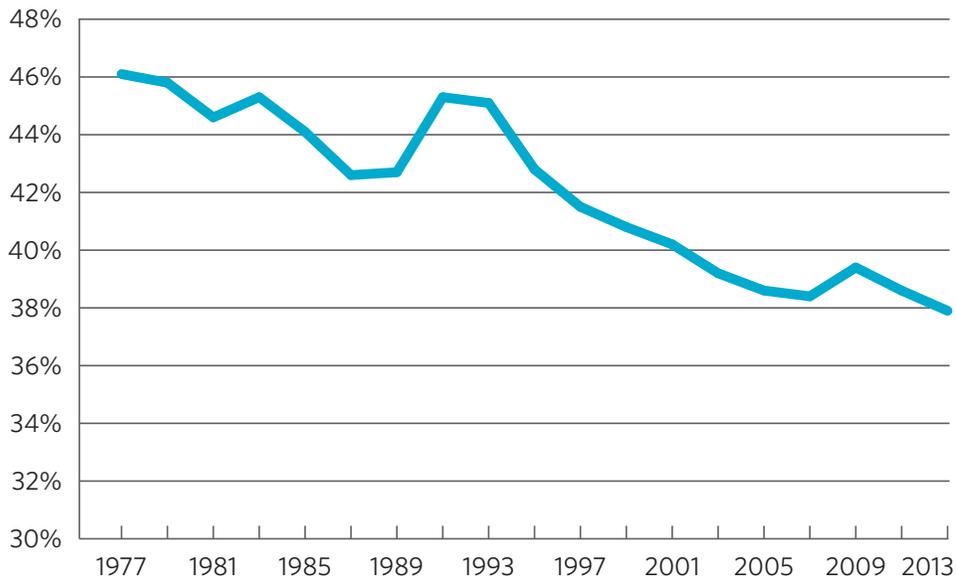
Morneau Shepell conducted a survey of employer attitudes<sup>31</sup> regarding the role that C/QPP, Old Age Supplement (OAS) and Guaranteed Income Supplement (GIS) combined should play. Of 200 respondents, 65 percent said middle-income individuals should derive enough income from these sources to retire comfortably while 27 percent said government pensions should only be enough to avoid poverty. Only 8 percent felt that government pensions alone should only enable middle-income Canadians to continue the same standard of living into retirement, even if they do not participate in workplace pension plans or RRSPs.

29 Geoffrey N. Calvert, “Pensions and Survival, The Coming Crisis of Money and Retirement,” 1977.

30 Data provided by Statistics Canada. It includes the Canadian Forces and Reserve Forces and the self-employed. Both DB and DC pension plans are included but not group RRSPs. Pre-1977 figures are from historical sources and may have been measured slightly differently.

31 Morneau Shepell’s 60 Second Survey, released in December, 2013.

Figure 4.1 – Declining coverage in workplace pension plans



Source: Statistics Canada

For workers under age 30, saving for retirement is not their highest priority as they are paying off student loans, getting settled into their first full-time job or saving for a down payment on their first home.

Workers over age 65 have for the most part already saved sufficiently and in any event, the fact they are continuing to work is reducing the amount of savings they need for retirement.

As for those with low income, the bottom 20 percent of income earners in particular, we have already seen that they do not need to save at all since they will have more disposable income from public pensions after 65 than they had while they were working.

Finally, there are workers who are completing a waiting period before joining their workplace pension plan.

If we eliminate these groups, then just half the paid labour force truly needs coverage in workplace pension plans, not 100 percent. From this perspective, the 38 percent coverage rate, while still low, is not as miserable as it sounds.

Of course, that 38 percent figure needs to be adjusted because some of the workers in that group are under 30, over 65 or have low income. When they are subtracted out, we estimate that about 34 percent are covered by a workplace pension plan or 16 percent short of “full” coverage. That gap is still a significant problem, or at least it would be if Pillar 3 consisted of nothing but workplace pension plans.

We should not forget that RRSPs are also a part of Pillar 3. RRSPs were still in their infancy in the 1960s — they were first introduced in 1957 — and they took a

## Just half the paid labour force truly needs coverage in workplace pension plans, not 100 percent.

while to catch on. In 1965, for example, only 29,190 RRSPs were registered,<sup>32</sup> a number that represents just 0.3 of the labour force at the time. By contrast, 5,974,000 Canadians contributed to their RRSPs in 2014 with the average amount contributed exceeding 10 percent of the average national wage.

Between 1999 and 2012, RRSP assets grew from \$536 billion to \$958 billion (in constant 2012 dollars),<sup>33</sup> a near doubling in spite of the contraction in wealth caused by the financial crisis of 2008. Today, RRSP assets are about half as great as the assets held for workplace pension plans.

Finally, TFSAs are an important addition. While the TFSA is not being used exclusively as a retirement saving vehicle, there is no doubt that many Canadians are using it for that purpose. To that extent, TFSAs can be considered to be a part of Pillar 3 and, unlike RRSPs, which took a long time to gain traction, TFSAs were an instant hit with Canadians. In a country with just 28 million people age 20 and over, there are already nearly 11 million<sup>34</sup> TFSA holders.

Hence, the plateauing and subsequent decline in workplace pension plan coverage did not signify a failure of Pillar 3 so much as a shift from workplace pension plans to RRSPs and TFSAs. Even if we exclude TFSAs, the total assets in Pillar 3 more than doubled in real terms between 1999 and 2012, jumping from \$1.3 trillion to \$2.8 trillion,<sup>35</sup> hardly the behaviour of a pension pillar in jeopardy.

While Pillar 3 has held its own, it has not been as effective or as efficient as one would like. Here are the problems:

- a) Coverage in Pillar 3 vehicles has gaps. As many as 18 percent of middle-income workers are not in workplace pension plans and are not saving very much on their own.<sup>36</sup>
- b) Many individuals who do contribute regularly to their own RRSPs are incurring much higher investment management fees than necessary,<sup>37</sup> this will materially reduce the income they could otherwise generate from their savings.
- c) Over 50 percent of recent retirees<sup>38</sup> have “excessive” pensions, meaning they have more disposable income in retirement than they had while they were working. (See sidebar, “Excessive pensions.”)

32 Bryden, *ibid*, page 116.

33 Cansim Table 205-0002.

34 CRA statistics show 10,713,000 TFSA holders after the 2013 taxation year.

35 Cansim Table 205-0002.

36 From a pending C.D. Howe paper “Assessing The Role of Fourth Pillar Wealth For Retirement Preparedness”.

37 Keith Ambachtsheer, “The Canada Supplementary Pension Plan (CSPP), Towards an Adequate, Affordable Pension for All Canadians,” C.D. Howe Commentary no. 265.

38 Author’s calculation based on LifePaths data with some manual adjustments. “Excessive” is defined as having a net replacement ratio of 115 percent or higher.

Expanding the CPP will remedy problems a) and b), but in the process will almost certainly increase the number of people with excessive pensions. Some pension observers regard this as a minor issue, and maybe even desirable, but over-saving is a problem as it represents a misallocation of scarce financial resources.

In conclusion, Pillar 3 has not failed Canadians in general but it is not without its shortcomings. Expanding the CPP will alleviate those shortcomings, but could have some undesirable side effects such as the continued erosion of Pillar 3.

## Reason 6: We are falling behind international benchmarks

The period from the 1960s to about 2000 saw the expansion of social security programs in most developed countries. Since then,

however, the trend has reversed itself in those same countries. Consider the following passage taken from the OECD's Pensions at a Glance:

*The last decade has been a period of intense reform activity in the area of pensions, with governments changing key parameters of their retirement income systems . . . often scaling down the ambition of public pensions and giving a larger role to funded defined contribution retirement provision.*

*The most visible progress has been made in raising official pension ages . . . 67 has indeed become the new 65 and several countries are going even further towards ages closer to 70 . . .*

*The pension reforms undertaken over the past decade are biting. The combination of cuts in future pensions through higher pension ages,*

### Excessive pensions

In true Canadian fashion, we are more apt to harp on our shortcomings than to celebrate our successes. A significant but rarely mentioned statistic is that about 55 percent of retirees from 2006 to 2010 had more disposable income after they retired than while they were working, and most of the rest had nearly as much. This was revealed in a C.D. Howe Commentary,<sup>39</sup> which is credible not only for the sophisticated micro-simulation tool that was used in the calculations (LifePaths) but because the main purpose of the paper was to highlight a looming retirement crisis. Moreover, the methodology used in that paper was conservative in that (a) some pre-retirement disposable income was over-estimated (e.g., interest on mortgage payments was not deducted), (b) financial assets not found in tax-sheltered vehicles were ignored and (c) it was assumed that all retirement income is fully indexed to inflation, which is unrealistic and unnecessary according to various researchers. If the calculations were adjusted to reflect these factors, the true percentage with excessive net replacement ratios would be higher again.

39 Moore, Robson and Laurin, "Canada's Looming Retirement Challenge," C.D. Howe Commentary No. 310, December 2010.

*fewer options for early retirement, changes in the way benefits are calculated, and lower adjustments of pensions in payment... has greatly improved the financial sustainability of pay-as-you-go pension systems.*

An expansion of the CPP puts Canada out of step with the rest of the developed world. Our determination to swim against the international current might seem a little foolhardy but it could be justified if Canada was:

- immune to the economic challenges — slow growth, high deficits and the ever-looming threat of deflation — that are afflicting other countries in the G20;
- unaffected by the demographic shift that is hobbling other G20 countries; in particular, an aging population, rising healthcare costs and a decreasing worker-to-retiree ratio; or
- behind other G20 countries with respect to what is provided by public pensions.

Of these three possibilities, the first two are clearly not true. The question then is whether we have lagged other G20 countries in the evolution of our public pension system.

Comparing Canada to the OECD and G20 countries<sup>40</sup> reveals that net replacement rates in Canada are in fact relatively low for middle-income earners and lower still for higher-income earners. Among 42 OECD

and G20 countries, Canada's public pension system ranks in the bottom third in the net replacement ratios it provides to middle-income earners. It performs much better in the case of low-income earners for whom the net replacement ratio is higher than in almost every major developed country apart from Austria, the Netherlands and Denmark.

Hence, if we accept the G20 and the OECD as the proper comparators, a higher earnings-related pension could be justified for Canadian workers with average or above-average incomes but less so for low-income earners.

### **Reason 7: The future is less rosy**

Actuaries and economists generally expect that the next 30 years will be a much more challenging time to save for retirement than the last 30 years:

- There is a strong case to be made that an aging population will keep interest rates low for a very long time.<sup>41</sup> Basically, older people have assets looking for a place to invest while younger people are net borrowers. Having more people who are older means lower interest rates because it increases supply and reduces demand. It seems the tipping point occurs when the population of people age 50 to 75 exceeds 40 percent of the population under 50. One by one, the world's developed countries are reaching and

<sup>40</sup> Pensions at a Glance 2011, OECD, page 125. The 2011 version was used instead of the 2013 or 2015 version since the government recently reversed its decision to raise the eligibility age for OAS and GIS.

<sup>41</sup> Michael Walker, *Why are interest rates so low? A framework for modeling current global financial developments*, The Fraser Institute, January 20, 2015.

then exceeding this ratio — the first being Japan in the 1990s, followed by Europe, Canada and the US. China will follow within five years. It is not coincidental that interest rates have dropped and then stayed low in each country where this tipping point has been breached. This demographic effect will almost certainly remain in place for several decades.

- Investment returns are also expected to be appreciably lower, once again because of aging populations. In their valuation of private-sector pension plans, actuaries overwhelmingly are forecasting that the real annual return of 6 percent that equities have achieved historically will not be realized. As for government bonds, long-term nominal returns may even turn negative. Public-sector plans, including the CPP, continue to expect high returns but this requires their investment managers to take on increasing risk.
- Life expectancies have increased dramatically, a trend that is expected to continue, so higher savings or later retirement will be needed to produce the same income stream.
- The housing boom that has characterized much of the last 30 years cannot continue indefinitely. Younger homeowners are unlikely to realize the same wealth

## Among 42 OECD and G20 countries, Canada's public pension system ranks in the bottom third in the net replacement ratios it provides to middle-income earners.

accumulation from home equity that their baby-boomer parents enjoyed. Younger homeowners in major centres will be required to devote a significantly higher percentage of their income toward mortgage payments than the previous generation, making it more difficult to save for retirement.

- The OAS benefit rises with price inflation while the average national wage rises at a faster pace that also reflects changes in productivity. As a result, the OAS pension is slowly diminishing as a percentage of the average national wage.

Therefore, by acting now to improve CPP, we are not so much correcting existing shortcomings (other than our international pension ranking), but rather are taking pre-emptive measures against future problems that will almost certainly emerge.

## Section 5

# Is the new CPP enhancement good for Canadians?

Clearly, not all the reasons being given for improving the CPP are sound and in fact what may seem to be the more compelling reasons do not stand up to closer scrutiny:

- Senior poverty is very low and is not trending upward. Workers in the lowest income bracket are doing the best of any income group, relative to their pre-retirement situation; they also compare very well against international benchmarks.
- Savings rates have been rising for decades, not falling.
- Pillar 3 is doing a better job than the low-coverage ratio within workplace pension plans.

Nevertheless, one cannot ignore the following facts:

- Societal expectations appear to be evolving; a modern public pension system is expected to do more than merely help citizens avoid outright poverty.
- A significant portion of the middle class have no workplace pension plan, and the pensions they will receive from the existing CPP, OAS and GIS do not come close to replicating their pre-retirement standard of living.

- Many people who should be saving in RRSPs are not doing so or are not saving enough for a low return/high life expectancy future.
- Even if they are saving enough, they may be paying unnecessarily high investment management fees, a problem that a competitive marketplace has not been able to solve.
- When it comes to pensions from public plans, Canada's middle-income earners do not compare favourably to their counterparts in other G20 countries.

If workers were more financially literate, and recognized the individual responsibility they must assume, it would justify doing nothing. That is not the case, however, and so the situation for retirees will almost certainly worsen in the coming years. Among the possible remedies, the simplest is a bigger CPP.

In summary, enhancing the CPP is both reasonable and appropriate. But is the enhancement that was just announced the right one?

To answer this question, consider the following six criteria for the ideal CPP enhancement:

1. It should not hurt low-income earners, meaning they should not be forced to contribute more;
2. It should be targeted at middle-income earners, which is where the main gap in pension coverage exists.
3. It should leave room for Pillar 3 in the case of middle-income earners (even though Pillar 3 has already become redundant for the lowest-income group).
4. It should be affordable in the present economic environment growth and should be financially sustainable in the longer run.
5. It should respect intergenerational equity.
6. It should be as simple as possible.

For the most part, the recently announced enhancement satisfies the above criteria. The requirement for low-income workers to contribute another 1 percent of pay is suboptimal but the government has

neutralized this drawback using the Working Income Tax Benefit. The increase in the benefit rate as well as the higher earnings ceiling will help to close the pension gap for middle-income earners. There is still a significant role for Pillar 3 savings, and in spite of the protests from the business sector, the enhancements should prove to be affordable.

The one criterion that was not met was simplicity, but in fairness, this is difficult to achieve given the job of reconciling the very different positions of the provinces. In an ideal world, it would have been better to have just one contribution rate rather than 5.95 percent up to the old earnings ceiling and 4 percent beyond that ceiling. It would also have been preferable to make all contributions tax-deductible rather than just the additional contribution due to the enhancement.

On the other hand, there were many CPP enhancement proposals that were decidedly worse than the one that was adopted (see Appendix A) so we should be relieved with what we got. In summary, we give the Finance Ministers a passing grade.

## Section 6

# Conclusions

A little over half a century ago, stakeholders from various backgrounds argued strongly against the implementation of the CPP. They said the CPP would be unaffordable, actuarially unsound, an unnecessary violation of individual freedom and/or a flagrant intrusion into the private sector, which was already providing services to savers.

Looking back, it seems clear they were wrong to object to the original CPP. Not only does it figure into the retirement planning of millions of Canadians, it has become an integral part of Canadian culture.

The recently announced expansion is encountering the same type of resistance as did the original CPP implementation, and mostly for the same reasons. Had the proposed enhancement been larger, the naysayers might have been right this time around. After all, seniors are no longer poor; the economy's ability to absorb a cost increase has diminished; other costly public expenditures may take precedence — health care and long-term care in particular. Finally there is the health of Pillar 3 to consider.

Fortunately, the CPP expansion that was announced is close to the optimal size. A larger increase would not have been appropriate and a smaller increase would not have led to an agreement; or it would not have quelled demands for further expansion. Once Canadians grow accustomed to it, we expect that the enhanced CPP will eventually gain the same degree of public acceptance as did the original plan.

There is still much work to be done as CPP expansion will have numerous knock-on effects, not all of them favourable. Pension plan sponsors in particular will need to consider what actions they should take to accommodate the expanded CPP. These issues will be explored in Part 2, which will be released in September.

## Appendix A

# Failed CPP expansion proposals

In the past few years, a number of proposals for CPP expansion have been offered up. These have been analyzed in an excellent paper by Milligan and Schirle.<sup>42</sup>

A brief summary of these proposals is presented below.

The diagrams on the opposite page give a good idea why these proposals all failed. The preceding sections show that only a modest expansion could be justified

and all the failed proposals are much more than just modest expansions.

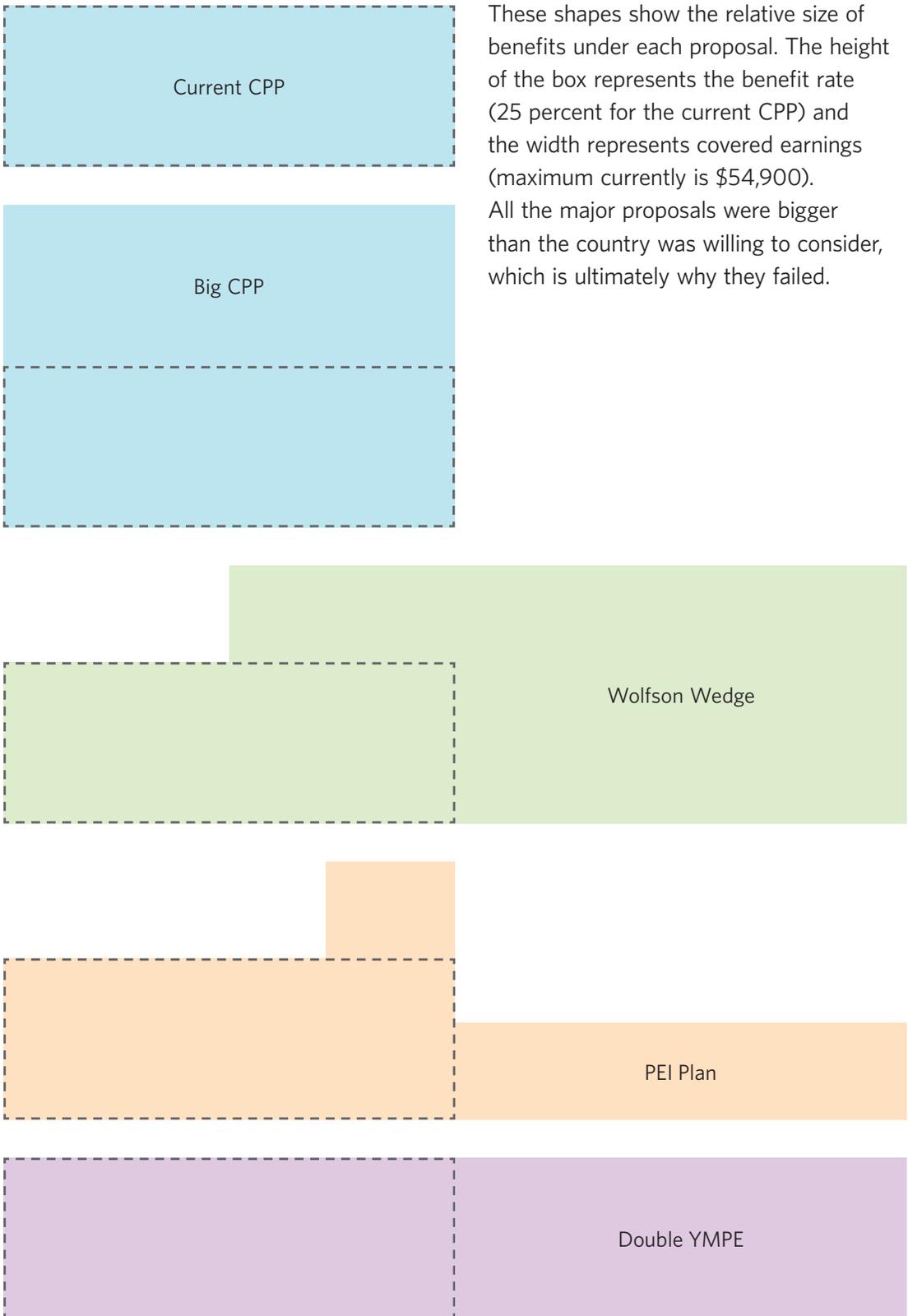
In particular, Canadians are not ready to embrace a six-figure earnings ceiling on a public plan and yet all the proposals (except Big CPP) called for the ceiling to double to about \$110,000 in 2016 dollars. The proposal that the Finance Ministers actually adopted would see the ceiling rise eventually to \$82,700, but even that will not occur until 2025.

Table A.1 – Failed CPP expansion proposals

	Basic Idea	Main Proponent	Contribution rate
Big CPP	Double the benefit rate but keep the earnings ceiling the same	The Canadian Labour Congress	About 16%
Wolfson Wedge	Significantly increase benefits for middle-income earners	Michael Wolfson	9.9% up to half the YMPE 14% between half and 1 times to YMPE 10% between 1 and 2 times the YMPE
PEI Plan	Modestly increase benefits for middle-income earners	Wes Sheridan	Same as Wolfson Wedge except just 4% between 1 and 2 times YMPE
Double YMPE	Double the earnings ceiling but leave the benefit rate the same	Kevin Milligan	9.9% below YMPE plus 6% between 1 and 2 times YMPE

<sup>42</sup> Milligan and Schirle, *ibid.*

Figure A.1 – Relative size of the expansion proposals



# Appendix B

## Summary of the existing and proposed CPP

### Who participates

Virtually everyone in the labour force who is age 18 to 70, including the self-employed. Certain religious groups are excluded as is anyone with employment earnings in a calendar year of less than \$3,500. If you are age 65 or over and have employment earnings, you can choose not to contribute.

### Earnings ceiling

Contributions are made and pensions are credited only on employment earnings up to a given ceiling. That earnings ceiling, which is known as the Year's Maximum Pensionable Earnings or YMPE, rises annually by the same percentage as the average wage in Canada. The YMPE for 2016 is \$54,900. By 2025, it is expected to be about \$82,700, which is 14 percent higher than without the expansion.

### Contribution rate

Since 2003, the employee contribution rate has been 4.95 percent of employment earnings between \$3,500 and the earnings

ceiling. Employers contribute a matching amount while the self-employed contribute both the employee and employer parts. The maximum employee contribution in 2016 is \$2,544.30. If you contribute more than the maximum in a given year by virtue of having worked for two employers, you will receive a refund of the excess when you file your income tax return. The employer, however, does not receive a refund of the matching portion. The contribution rate below the YMPE will be increased in steps over 5 years starting January 1, 2019, to a final rate of 5.95 percent.

### Pension benefit

The maximum pension benefit if you retire at age 65 is 25 percent of the average earnings ceiling in the year of retirement and the 4 preceding calendar years. In 2016, for instance, this would be 25 percent of \$52,440, which equals \$1,092.50 a month (see Table B.1).

Less than the maximum is payable if you did not contribute the maximum amount for enough years. The normal contributory period is 47 years (from age 18 to 65), but you can drop out eight years of lowest earnings (17 percent of 47) for calculation purposes. For instance, if you had earnings over the ceiling in 41 out of 47 years and no earnings in the other six years, you would still receive the maximum pension. (More years of low earnings can be excluded including years after 65, periods of disability and periods of child-rearing for a child under seven.)

Table B.1 - Benefit calculation

Year	Earnings ceiling
2016	\$54,900
2015	\$53,600
2014	\$52,500
2013	\$51,100
2012	\$50,100
5-year average	\$52,440 X 25% /12 = \$1,092.50/month

Except for the dropout provision, the pension is essentially proportional to how much you contributed relative to the maximum each year. If you earned exactly half the earnings ceiling in all years between 18 and 65, you would receive half the maximum pension. The benefit rate will rise to 33.3 percent. This will be phased in between 2019 and 2023.

### **Adjustment for early or postponed retirement**

You could decide to retire as early as age 60 and receive a CPP pension immediately. In this case, the pension is reduced by 0.6 percent for each month the start date precedes age 65. The reduction if you start the pension at age 60 is 36 percent. If you turned 60 and started your pension in 2016, the maximum pension you can receive is \$699.20 a month.

If you defer starting your pension beyond age 65, the amount payable is increased by 0.7 percent for each month you wait. If you start it at age 70, it would be increased by 42 percent. In 2016 dollars, the maximum at age 60 would be \$1,551.35 a month, which is more than double the maximum payable at age 60. While almost no one waits until

70 to start their CPP pension, it is a good way to ensure you do not outlive your money since the higher amount is payable for life.

In addition, if you have employment earnings after age 65, you can choose to continue contributing (it is optional) until age 70 and you will earn additional pension at the rate of 1/40th of the maximum pension.

### **Disability pension**

A disability pension is payable if you are severely disabled. While the rules are complicated, the amount payable consists of both a flat-rate portion, and an earnings-related portion and the maximum can exceed the normal retirement benefit. The maximum that is payable in 2016 is \$1,290.81 a month.

### **Survivor pension**

If you were actively contributing to the CPP and die, your surviving spouse and dependent children, if any, would be entitled to survivor's benefits. Once again, the rules are complicated and depend on whether the surviving spouse is under age 45, age 45 to 65 or over 65. Both a flat-rate amount and an earnings-related amount are payable. In the case of a surviving spouse age 45 to 65,

the maximum monthly pension payable is \$593.62 in 2016. In the case of a surviving spouse 65 or older, the survivor's pension would be 60 percent of (a) the retirement pension that was being paid to the deceased or (b) the retirement pension that would have been payable had the deceased been contributing up until the time of death. The maximum survivor pension in 2016 in this case is \$655.50.

A surviving spouse who has reached age 60 can start his or her own CPP pension immediately, but would be well advised to wait until 70 in most cases because the sum of the regular pension plus the surviving spouse pension cannot exceed the maximum regular pension.

### **Death benefit**

A modest lump sum benefit not to exceed \$2,500 is payable to the estate of the deceased contributor, assuming the eligibility rules for survivor benefits are met.

### **Inflation protection**

Once pension payments begin, they are fully indexed to inflation on an annual basis as measured by the change in the

CPI for Canada from October to October. The exception is in the event of deflation where the pension is not decreased even though the change in CPI would be negative.

### **Tax treatment of contributions and pensions**

The employee's contribution creates a federal tax credit of 15 percent. There is also a provincial tax credit, which in Ontario for instance is 5.05 percent. For people in higher income tax brackets, this tax treatment is much less favourable than if the contributions were tax-deductible.

The employer contribution is fully tax-deductible by the employer. CPP pension is considered taxable income but the tax impact can be mitigated by the age credit and the pension credit. Moreover, CPP pension is considered income for purposes of determining the Guaranteed Income Supplement (GIS), meaning that for every \$2 of additional CPP income, the GIS benefit (if any) is reduced by \$1.

The higher contributions due to the enhancement will be fully tax-deductible.

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