Securing Canada's Retirement Income System

April 1997

Canada

Foreword

Ensuring that Canada's seniors have an adequate retirement income is one of the most important social policy initiatives ever undertaken in this country. And while our system of public and private pensions is widely seen as one of the best in the world, its future sustainability is being threatened by major demographic and economic shifts that have occurred since these programs were set up almost 50 years ago.

The federal government has recognized that these challenges had to be addressed and that confidence in the future of the pension system had to be restored. As a result, it has made securing Canada's retirement income system one of its major priorities.

The government has worked very hard over the past three-and-a-half years to bring about the changes necessary to preserve this system. The February 1997 federal-provincial agreement on the Canada Pension Plan, the new Seniors Benefit that will begin in 2001, and changes to improve, better target and expand tax assistance for retirement savings, will make the pension system secure and sustainable for Canadians now and in the future.

“Everybody recognizes that demographic changes in our society mean that we will have to make changes to ensure that our pension system remains sustainable for future generations of Canadians ... We have an obligation to plan for the future. We do not take that obligation lightly.”

Prime Minister Jean Chrétien
Statement in the
House of Commons
February 28, 1996

How the System Works

In Canada, the responsibility to save for retirement is shared by individuals, their employers and governments. Our retirement income system consists of three pillars.

The Old Age Security Program

The Old Age Security Program – which includes Old Age Security (OAS), the Guaranteed Income Supplement (GIS) and the Spouse’s Allowance – guarantees a basic level of retirement income to all Canadians.

- Old Age Security provides benefits to Canadians age 65 and over based on years of residence in Canada. Benefits are taxable and paid to all seniors.

- The Guaranteed Income Supplement provides additional benefits to low-income seniors based on the combined income of the recipient and his/her spouse. These benefits are, and have always been, reduced by 50 cents for each dollar of income from other sources.

- The Spouse's Allowance provides an income-tested benefit to low-income spouses of Old Age Security pensioners or widows/widowers age 60 to 64.

These benefits are provided out of the general revenues of the federal government and this year will cost about $22 billion.

The Canada and Quebec Pension Plans

The Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP) are compulsory, contributory public pension plans that provide benefits based on earnings to Canadian workers and their families for retirement or in the event of serious disability or death.

The CPP operates in nine provinces and the territories while the QPP, a parallel plan, operates in Quebec. Both plans cover workers age 18 to 70 and are financed by equal employee and employer contributions on earnings between $3,500 and $35,800 in 1997.

About 3.7 million Canadians receive CPP benefits and 1.2 million receive QPP benefits. Of those receiving CPP benefits, some 2.4 million receive retirement benefits, 800,000 receive survivor benefits and 295,000 receive disability benefits.

The CPP also pays benefits to almost 185,000 dependent children of CPP contributors who died or became disabled.

Private Retirement Savings Plans

Private saving in registered pension plans (RPPs), deferred profit-sharing plans (DPSPs), and registered retirement savings plans (RRSPs) forms the third pillar of our retirement income system.

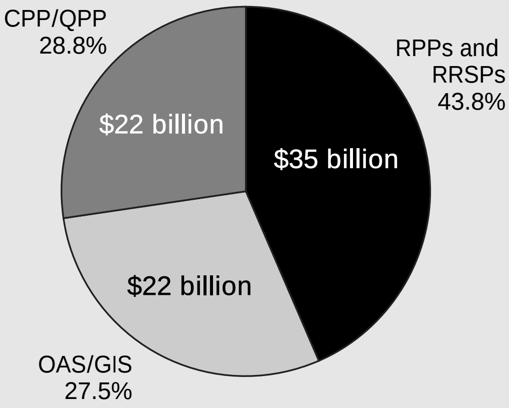
The benefit of private retirement saving is the tax deferral provided by these plans – which is equivalent to an interest-free loan of the deferred tax. Income set aside for retirement is taxed not when it is saved but when it is received. The result is deferred taxation on both the original amounts saved and the investment earnings on them.

The benefits of tax-assisted saving are substantial. Over a person's career, accumulated tax-deferred savings provide a much higher rate of return than non-tax-assisted savings and, therefore, higher retirement income.

Canadians are strongly encouraged to save for their retirement. In 1993 alone, the federal government provided some $16 billion in tax assistance on savings in pension plans and RRSPs.

In 1997, Canada's retirement income system will provide an estimated $80 billion in pension income. About 56 per cent will come from public pensions: $22 billion from OAS/GIS and $23 billion from the CPP and QPP. The remaining $35 billion will come from private retirement savings.

The Retirement Income System:
Sources of pension income
(1997 estimate)



Actions Taken

> *"Confidence in the pension system must be restored. The party that put pensions in place for this country must now act to preserve them. The challenge is clear – it is one of sustainability."*
>
> Finance Minister Paul Martin
> Budget speech
> March 6, 1996

The Seniors Benefit

Beginning in 2001, it is proposed that OAS and the GIS be consolidated into one benefit – the Seniors Benefit.

- The new benefit will be completely tax free and will incorporate the existing age and pension income tax credits.
- All Canadians age 60 and over by December 31, 1995 will have the option of keeping their existing OAS/GIS pension payments. This fulfils the government's pledge to today's seniors that their OAS/GIS payments will not be reduced.

- The vast majority of seniors – about 75 per cent of single seniors and couples – will receive the same or higher benefits.
- Nine out of 10 single elderly women will see their benefits increase.
- Assistance will be targeted to low- and middle-income seniors.
- Benefit levels and income thresholds will now both be fully indexed to inflation.

The Seniors Benefit will create a fairer and more targeted system of assistance. As private income increases, the level of Seniors Benefit payments will be reduced. This is consistent with Canada's tax and social benefits systems. It is also the fairest way of slowing growing program costs in the future and, at the same time, protecting assistance for those who need it most.

The Canada Pension Plan

> *"[CPP reform] is something governments should have dealt with 10 years ago, and we are going to deal with it … From the federal government's point of view, protecting our seniors is a very, very important component of any solution."*
>
> Finance Minister Paul Martin
> *Toronto Star*
> June 19, 1996

In February 1997, the federal and provincial governments announced changes that will restore the plan's financial sustainability and make it fairer and more affordable for future generations.

The proposed measures are the result of the statutory review of the CPP undertaken by the federal and provincial governments over the past year, which included cross-Canada consultations. During these consultations, Canadians were unequivocal in asking their governments to preserve the plan, strengthen its financing, improve its investment practices and limit benefit reductions.

Under the existing legislated schedule, CPP contribution rates – paid equally by employers and employees – were slated to rise to 10.1 per cent by 2016.

The Chief Actuary of the CPP projected that rates would continue to increase to 14.2 per cent by 2030 if no changes were made to the plan.

To avoid having to impose such high rates on Canadians and their employers, the federal and provincial governments have come up with a carefully balanced approach that will secure the CPP for future generations of Canadians.

As a result, CPP contribution rates will increase in steps to 9.9 per cent by 2003, instead of rising to the 10.1 per cent already legislated for 2016. This level – the steady-state rate – is projected to be sufficient to sustain the CPP with no further rate increases. It is also far less than the projected rate of 14.2 per cent that the Chief Actuary said would be necessary without changes to fix the CPP.

Key features of the CPP agreement include:

- accelerating contribution rate increases now so that they will not have to exceed 10 per cent for future generations;
- improving the rate of return on the CPP fund by investing it prudently in a diversified portfolio of securities at arm's length from governments; and

- tightening the administration of benefits and changing the way some benefits are calculated in order to moderate rising costs.

Some important features of the CPP, however, remain unchanged:

- all retired pensioners or anyone age 65 or over on December 31, 1997 will not be affected;
- anyone currently receiving CPP disability benefits, survivor benefits or combined benefits will not have their benefits affected;
- all benefits under the CPP will remain fully indexed to inflation; and
- the ages of retirement – early, normal or late – remain unchanged.

Canadians can rest assured that the CPP will be there for them when they need it. Not only will it be preserved, but the changes will ensure that the CPP is sustainable and affordable now and in the future.

Private Retirement Savings

Private pensions and savings will continue to play a major role in supplementing public pension income for Canadians in retirement.

This government has introduced a number of changes to make assistance to private retirement savings fairer and more effective.

- **To better target tax assistance to modest- and middle-income workers, contribution limits will remain at $13,500 until 2003.** They will increase to $15,500 by 2005 and be indexed to the average wage thereafter. And the age at which people have to begin withdrawing from their pensions and RRSPs has been reduced to age 69. Both measures will help to control revenue costs.
- **The seven-year limit on the carry-forward of unused RRSP room has been removed. Individuals can now fully carry forward their unused RRSP deduction room indefinitely.** This will help those who go through periods where they find it difficult to save for retirement (i.e. people starting careers or raising children).
- **Rules have been developed to accommodate flexible pension plans** that provide employees with the option of making additional contributions to purchase ancillary pension benefits without reducing their annual RRSP contribution limits.

- Persons who leave RPPs or DPSPs before retirement and receive low termination benefits will receive **additional RRSP contribution opportunities through a pension adjustment reversal.**
- Parents who save for their children's education in registered education savings plans (RESPs) and whose children do not pursue post-secondary education, can now **transfer RESP income into RRSPs**, if they have unused RRSP room.

These improvements are helping to provide fair and equal access to tax-assisted retirement savings opportunities for all Canadians regardless of their employment situation.

Guaranteed Retirement Support

"The ultimate test of a nation is its will and capacity to support those who are most vulnerable; to sustain the programs on which every one of its citizens depends."

Finance Minister Paul Martin
Budget speech
February 18, 1997

The three pillars of Canada's reformed retirement income system will work together to ensure that all Canadians have the opportunity to build adequate retirement incomes. They guarantee low-income seniors a minimum income and help other Canadians save enough so that their retirement income can reach about 70 per cent of the income they earned while working. This is the figure that most pension experts believe will provide an equivalent standard of living in retirement.

The Seniors Benefit and the CPP/QPP will provide low-income seniors with at least 70-per-cent earnings replacement. For modest- and middle-income seniors, a combination of public pensions and tax-assisted private savings will make it possible to achieve the 70-per-cent earnings replacement level. For higher-income seniors, tax-assisted private savings can supplement CPP/QPP benefits to attain the target income.

Making the System Secure

As a result of actions the government has taken, **confidence in the retirement income system is being restored.**

- The new Seniors Benefit in 2001 will help to make the public pension system secure and sustainable by targeting assistance to low- and middle-income seniors.
- The CPP is being put on a sound financial footing. Agreement has been reached on changes to make the plan sustainable, affordable and fairer to younger generations.
- Canadians will continue to be encouraged to save for their retirement through tax assistance for savings in RPPs, DPSPs and RRSPs.

The reforms will assure Canadians that the retirement income system will be there for them in the future as it has been in the past.

Fairness, affordability and sustainability – that is what Canadians seek and that is the hallmark of this reformed retirement income system.

Questions and Answers

Q *Won't the tax rates under the Seniors Benefit make seniors worse off?*

- Some media reports have wrongly asserted that the fact that the new benefit is reduced by 20 per cent of income over $25,921 will make modest-income seniors worse off.

- In fact, most seniors will be better off. The Seniors Benefit is completely tax free, unlike Old Age Security benefits now. Also, Guaranteed Income Supplement and Spouse's Allowance recipients will receive an additional $120 per year.

- All those with incomes up to about $40,000 will receive the same or higher benefits under the Seniors Benefit. This includes 75 per cent of single seniors and couples, and nine out of 10 single elderly women.

- Also, the benefit levels and income threshold will now both be fully indexed to inflation – an improvement over the current system.

Q *Some say that the Seniors Benefit will remove the incentive for individuals to save for retirement. Is this true?*

- No, it is not. There will continue to be strong incentives for Canadians to save for their retirement through tax assistance for savings in pension plans or RRSPs.

- The main benefit from tax-assisted saving is the deferral of tax on contributions and investment income which, over the long term, will far outweigh the effect of marginal tax rates in retirement.

- Those with savings in pension plans or RRSPs will continue to be better off in retirement than those who save outside those plans, and much better off than those who do not save at all.

Q *Isn't the Seniors Benefit unfair to those who were just under age 60 at the end of 1995? They can get much lower benefits, for life, than those a few seconds older.*

- We have been careful to introduce these changes in a way that protects the most vulnerable.
- All but those with the highest incomes will continue to receive assistance. Single seniors with income up to $52,000 and couples with income up to $78,000 will receive the Seniors Benefit.

- It is important to remember that about 75 per cent of single seniors and couples – all those with incomes up to about $40,000 – will receive the same or higher benefits. For all these seniors, the age-60 criterion is not an issue.

Q *Why should I believe the CPP will be there for me when I retire?*

- The CPP will be there for retiring Canadians now and in the future. The proposed changes will strengthen the plan's financing, reduce costs and secure its future, while retaining its main features.

- The changes mean that the CPP will continue to be affordable. CPP contribution rates will increase in steps to 9.9 per cent by 2003, instead of eventually rising to 14.2 per cent as projected by the Chief Actuary. This level – the steady-state rate – is projected to be sufficient to sustain the CPP with no further rate increases.

- We are building a much larger CPP fund that will be invested prudently at arm's length from governments to obtain higher returns for contributors. This will help pay for benefits for future generations.

- The growth in costs will be slowed by tightening the administration of benefits and changing the way some benefits are calculated.

- There will be improved stewardship and public accountability to avoid putting the sustainability of the CPP at risk again in the future.

- This is a strong and balanced package of reforms that will ensure the CPP is there for Canadians today and in the future – not just for workers when they retire but equally to help Canadian workers and their families should they become disabled or die.

Q *To be fair to young Canadians, why don't you eliminate the CPP and replace it with a mandatory savings plan?*

- Some media reports have suggested that young Canadians would get much better pensions by putting their money into an RRSP rather than the CPP.

- In contrast, Canadians clearly told their governments during the CPP consultations that they wanted the CPP fixed, not scrapped. There are several reasons for this.

- First, the CPP guarantees all working Canadians a basic retirement income. It is a mandatory savings vehicle that will provide Canadians with fully indexed pensions for the rest of their lives. RRSPs contain a lot more risk; what comes out in the way of pensions depends on how well they are invested during a person's working life and the returns during their retirement.
- Second, the CPP provides not only retirement pensions, but also benefits to families of an income earner who dies or becomes seriously disabled.
- Third, young Canadians would pay more under a mandatory RRSP scheme. If the CPP was scrapped, they would not only have to pay for their own RRSPs, they would also have to pay higher taxes to ensure that the pensions promised to today's seniors and to those who have been paying into the CPP are honoured.
- Fourth, the administrative costs of a private system would be much higher than those of the CPP. The administrative cost of mandatory, individual savings plans in other countries, for instance, is more than 10 per cent compared to less than 2 per cent for the CPP.

- All governments in Canada have rejected the idea of replacing the CPP with mandatory RRSPs. They are committed to maintaining fair and sustainable Canada and Quebec Pension Plans that provide for seniors today and tomorrow.

Q *Some say that the 73-per-cent rise in CPP contribution rates represents the biggest tax hike ever in Canadian history.*
Is this true?

- Payments to the CPP are contributions towards pensions.
- They do not flow into government revenues and get spent, but go into a separate fund that will now be invested in the best interests of contributors so that pensions can be paid to them.
- The changes agreed to by the federal and provincial governments will ensure that contribution rates increase to 9.9 per cent rather than to the 10.1 per cent currently legislated for 2016 or to the 14.2 per cent that the Chief Actuary of the CPP indicated would be necessary if the CPP was not fixed.
- This is much fairer to future generations.

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