Régie des rentes du Québec

Working paper

Adapting the Pension Plan to Québec's new realities

Québec

Adapting the Pension Plan to Québec's new realities

Régie des rentes Québec

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Message from the Minister

A major reform of the Québec Pension Plan was carried out in 1998. The reform had become necessary because of the anticipated impact of an aging population on the Plan's costs. First and foremost, the reform made it possible to improve the Plan's funding by means of a rapid increase in the contribution rate and the accumulation of a reserve to ensure the Plan's sustainability when baby boomers retire in great numbers.

The reform was also an opportunity for the government to put into place governance mechanisms so as to better monitor the Plan's financial performance and to act in a timely manner to make any adjustments required by changes in Québec's social environment. A public consultation must now be held every six years to analyze the Plan's situation and, if need be, modify certain aspects of the Plan.

In meeting this new requirement, I am happy to present this document, which proposes certain orientations intended to adapt the Québec Pension Plan to Québec's new realities.

The Québec population is aging more rapidly than the populations of most other industrialized societies, and it is important to be prepared for the results of that phenomenon. Moreover, the labour force is very different than it was when the Québec Pension Plan began, and the current mechanisms for the transition from economically active life to retirement do not correspond to these changes. Family realities have also changed. Some adjustments have become necessary. Finally, this working paper informs the public on the Québec Pension Plan's financial situation.

I urge all citizens and the groups that represent them to examine the options that are proposed in this working paper and to prepare their comments for the parliamentary committee that will consider the matter early in 2004.

CLAUDE BÉCHARD
Minister of Employment, Social Solidarity and Family Welfare

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1.1 The performance of the retirement system

A balanced system

In Quebec, the retirement income security system has three levels:

- the Old Age Security pension, the Guaranteed Income Supplement, and the Spouse's Allowance, which are **assistance** measures administered by the federal government;
- the Québec Pension Plan;
- private retirement plans, such as supplemental pension plans and registered retirement savings plans (RRSPs).

The last two levels are **insurance** measures.

The main purpose of assistance measures is to combat poverty by coming to the aid of older citizens whose incomes are insufficient. There is no fund specifically earmarked for financing these measures; they are financed by income taxes.

Insurance measures are intended to provide a level of income after retirement that maintains to some extent the pre-retirement level of employment income and prevents an unacceptable decrease in the standard of living after retirement. Unlike assistance measures, these benefits depend on the contributions made.

The Québec Pension Plan, like the Canada Pension Plan, its equivalent in other Canadian provinces and territories, is a public and universal social insurance plan. These plans began in 1966. They provide financial protection in the event of retirement, death, or disability. The retirement pension replaces 25% of a worker's covered average career earnings.

Supplemental pension plans are generally set up by employers on a voluntary basis. The Québec government essentially has a supervisory role in regard to them. Its function is to ensure that these plans respect certain minimal requirements:

- minimum rights (e.g.: immediate pension vesting, information to plan members);
- funding rules;
- administration requirements.

RRSPs must conform to the rules set in the *Income Tax Act*. The purpose of RRSPs is to encourage workers to put aside money for retirement by allowing them to defer the payment of income tax on the amounts put aside.[1]

[1] Supplemental pension plans are also subject to fiscal rules and also allow workers to defer the payment of income tax on contributions.

The usual income replacement rate at retirement is considered to be 70%. This objective allows workers to maintain, during retirement, a standard of living comparable to the standard that they had while in the labour force.

Public retirement plans guarantee this minimum level when career income is low (approximately 20 000 $). The Old Age Security pension and the Québec Pension Plan replace approximately 40% of the income of an average employee (37 000 $) and 20% of the income of a worker with career earnings of approximately 75 000 $. Thus workers with an average or high income must count on private retirement savings vehicles to make up the difference and avoid a lower standard of living after retirement.

An effective system

Research conducted at the Régie des rentes du Québec reveals that workers who retire at age 65 are assured, on average, of an income replacement equivalent to 65% of their average career earnings, an amount close to the objective. This is, however, an average, which indicates that a certain proportion of workers arrive at the end of their careers without sufficient savings.

Our retirement system is effective in combating poverty among senior citizens. A comparative study on the relative poverty of seniors in several countries at comparable levels of development and on the adequacy of their retirement income was made for the Organisation for Economic Co-operation and Development (OECD) [2] and the International Labour Organization (ILO). The financial situation of seniors is evaluated on the basis of several criteria, allowing the comparison of the household income of retirees and non-retirees, the proportion of retirees living in poverty, and the differences in the retirement incomes of men and women.

According to this study, Canada, and indirectly Québec, are among the leaders when it comes to protection for the elderly. Retired households enjoy a high relative prosperity and inequalities are maintained at a low level. In addition, Canada was able to achieve these results while keeping public spending at an acceptable level.[3]

More recently, the OECD published a report on the resources of retirees in nine member countries.[4] Our retirement system is described as a diversified, well defined scheme that combines different forms of retirement income. The Organization estimates that, of the nine systems studied, ours is the most successful at looking after the economic well-being of retirees and at protecting the most vulnerable groups. According to the OECD, our primary challenge will be to raise the age of retirement in order to better balance the duration of economically active life and the duration of retirement.

2 Hauser, Richard *Adequacy and Poverty among the Retired*, working paper presented at a joint ILO-OECD workshop on the development and reform of pension schemes, 1997.
3 OECD, *Aging in OECD Countries: A Critical Policy Challenge,* Social Policy Studies, no. 20.
4 OECD, *Aging and Income: Financial Resources and Retirement in 9 OECD Countries*, Social Issues, 2001.

A system to maintain

The good performance of our retirement system argues for its maintenance. For this reason, a significant reform of the Québec Pension Plan took place in 1998 with the goal of improving the Plan's funding and assuring its long-term sustainability. This reform achieved its goals. However, the environment in which the Plan evolves is dynamic and changes over time. It is necessary to remain vigilant, to monitor changes affecting the Plan, and to take the right steps at the right time to continue to provide workers with protection that meets to their needs.

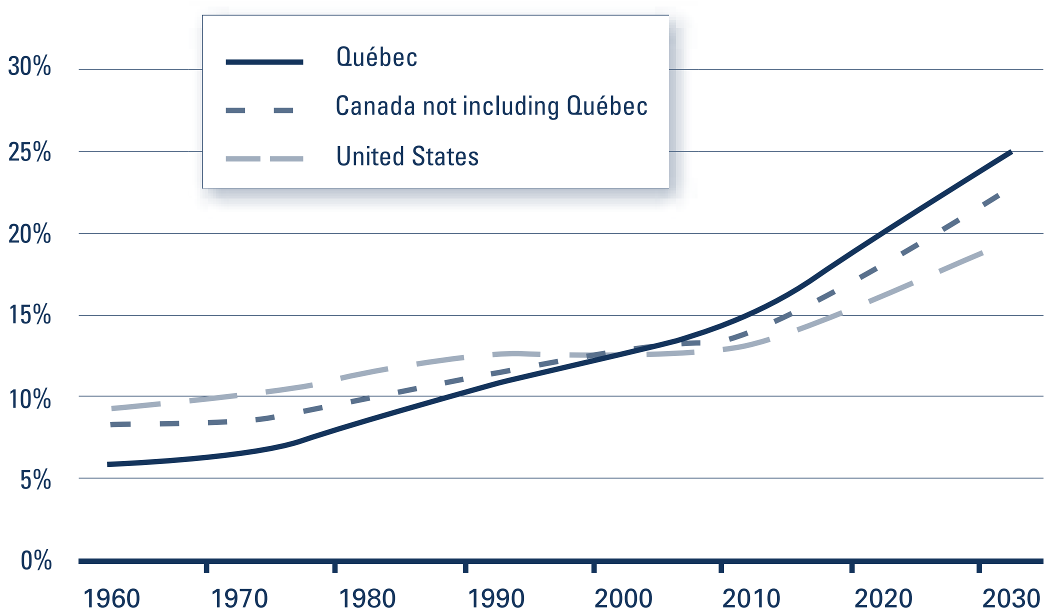
1.2 The aging population

All developed societies will experience an aging of their population in the course of the coming decades. However, the extent of this demographic transformation and the rate at which it occurs will vary from one country to another. In Québec, the extent of this change will be significant and the rate rapid, making aging a major concern for society.

The proportion of seniors is increasing more rapidly in Québec

In the 1960s, the population of Québec aged 65 and over represented approximately 6% of the total population. At that time, elsewhere in Canada as well as in the United States, seniors made up a higher percentage of the population. In the mid-1990s, the proportion of seniors was more or less the same in Québec, in the other Canadian provinces and territories, and in the United States, that is, approximately 12% of the total population. In the coming years, the proportion of seniors will grow much more rapidly in Québec, so that the Québec population will be older than the populations of Canada or the United States. This will be a significant trend reversal for Québec in relation to the rest of Canada and the United States.

Population aged 65 and over in proportion to the total population



Sources: United Nations Secretariat, *World Population Prospects*, The 2002 Revision.
Statistics Canada, *Population Projections*, 2001.
Actuarial report of the Québec Pension Plan as at 31 December 2000.

Fewer workers in relation to retirees

Public retirement plans are often financed by a pay-as-you-go funding scheme,[5] that is, worker contributions are used to pay the benefits of the current year. A reduction in the number of workers relative to the number of retirees imposes significant financial constraints on these plans:

- In the 1960s, there were eight people aged 20 to 64 for each person aged 65 or over.
- Today, there are almost five people of working age per retiree.
- In 2030, there will be only two people aged 20 to 64 per retiree.

Population aged 20 to 64 relative to those aged 65 or over

Country	2000	2030
Canada (without Québec)	4,9	2,5
United States	4,8	2,8
Québec	**4,7**	**2,1**
Germany	3,8	2,0
France	3,6	2,3
Japan	3,6	1,8

Sources: United Nations Secretariat, World Population Prospects, The 2000 Revision.
Statistics Canada, Population Projections, 2001.
Actuarial report of the Québec Pension Plan as at 31 December 2000.

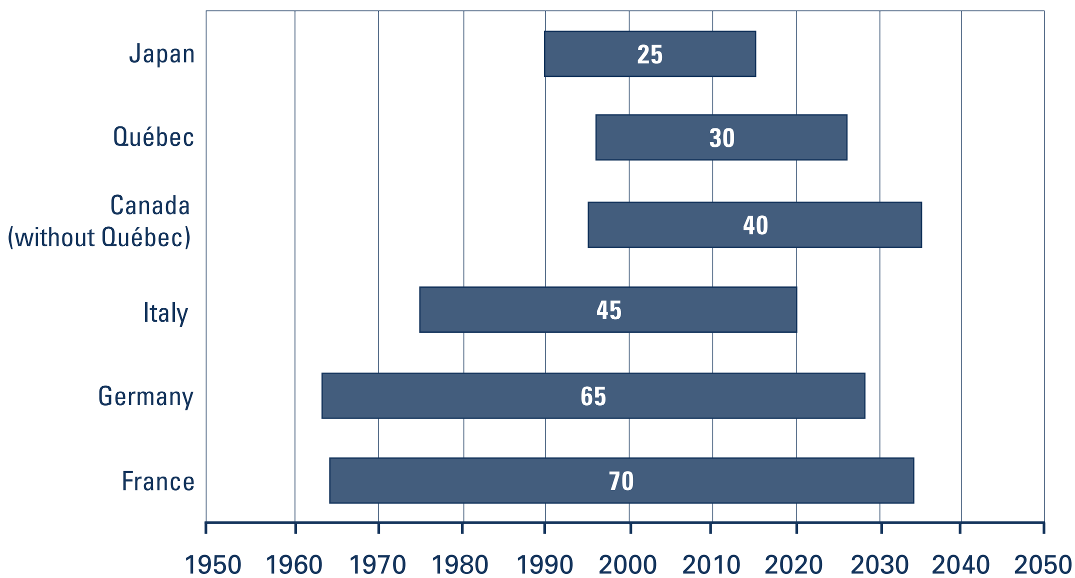
A population aging more rapidly than elsewhere

The rate at which the aging of the population occurs is another factor to consider since a society's ability to adapt to a change is dependant on the speed at which the change takes place.

Elsewhere in Canada, it will take approximately forty years for the proportion of people aged 65 or over to go from 12% to 24% of the total population. In Québec, it will only take about thirty years for the same change to occur. In most European countries, the aging of the population began earlier but the transition occurred over a much longer period. The United States and the United Kingdom will not reach the ratio of 24% of the population aged 65 or over before the end of the projection period.

[5] Certain plans are partially funded. Others, like the Old Age Security pension, are financed through income taxes.

Number of years required for persons aged 65 or over to go from 12% to 24% of the total population



Sources: United Nations Secretariat, *World Population Prospects*, The 2002 Revision.
Statistics Canada, *Population Projections*, 2001.
Actuarial report of the Québec Pension Plan as at 31 December 2000.

1.3 – The 1998 reform

Why the reform?

The reform of the Québec Pension Plan, which came into effect in 1998, had become necessary because of the anticipated impact of the aging of the population on the costs of the Plan.[6]

In 1996, the working paper on the reform of the Québec Pension Plan showed that the rate of increase of the contribution rate initiated in 1986 was not sufficient. If the Plan had not been modified, the contribution rate would have reached 13% in the long term. On the one hand, the principle of intergenerational fairness was called into question by the necessity of this large increase in contribution rate. On the other hand, the confidence of contributors and beneficiaries in the future of the Plan was shaken by the prospect of insufficient funds.

What was the result?

Most importantly, the reform allowed the Plan to improve its funding by rapidly increasing the contribution rate and accumulating a reserve to assure its viability in the future when large numbers of baby boomers are expected to retire.

A rapid increase in contribution rate, set at 9,9% starting in 2003, also helped improve fairness between the generations of contributors because it allowed the rate to be fixed at a lower level than the 13% previously projected. In addition, because of this increase the contributions required from baby boomers who retire as of 2010 will come close to the value of the benefits which will be paid to them.

The reform also provided an opportunity for the government to set up governance mechanisms in order to better monitor the financial results of the Québec Pension Plan and to act at the appropriate time to adjust the Plan according to changes in Québec society. The *Act respecting the Québec Pension Plan* now makes a provision for the Plan to be the object of an actuarial analysis every three years rather than every five years, as was previously the case. In addition, a public discussion must be held at least every six years to analyze the situation and, if necessary, review certain elements of the Plan.

6 As with the demographic context, an economic context which was less favourable than that which prevailed at the inception of the Plan called its funding into question and made a reform necessary. Economic growth and changes in the total contributory payroll also have an influence on expected changes in the Plan. In the 1960s and 1970s, the massive entry of women into the labour force, combined with a sustained growth in wages, made it possible to increase cash inflows. From 1966 to 1979, the total payroll increased 4,9% per year. However, over the following decades, the increase in wages slowed down markedly. The average annual growth rate of the total payroll was barely 0,9% from 1980 to 1989. This slowdown continued into the 1990s.

And now?

To respond to this new obligation, the government submits the present document and invites the public and interested organizations to express their comments regarding new orientations for the Plan. This exercise is important. Indeed, this consultation is the best way to inform workers of the status of their plan.

In addition to an aging population, Québec society, like other modern societies, has experienced numerous changes over the last several decades. The labour market and family realities are significantly different from what prevailed at the time of the Plan's inception. This consultation is an opportunity to adjust the Plan to the new realities in order to adapt the Plan to its participants' needs.

Summary

The retirement income protection system is a balanced, multi-level system. It is effective and must be maintained.

The population is aging more rapidly in Québec than elsewhere. Today, the proportion of seniors is more or less the same in Québec, the other Canadian provinces and territories, and the United States, that is, approximately 12% of the total population. In the coming years, the proportion of seniors will grow significantly in Québec, with the result that the Québec population will be older than populations elsewhere in Canada and the United States.

In Québec, it will take approximately thirty years for the proportion of people aged 65 or over to go from 12% to 24% of the total population. Elsewhere in Canada, the population is aging more slowly and it will take approximately forty years to attain the ratio of 24% of the population aged 65 or over.

In 1998, the government carried out a significant reform of the Québec Pension Plan to counter the anticipated impact of an aging population on costs and to ensure the long-term sustainability of the Plan on a basis of fairness and social solidarity.

At the time of this reform, the government also created new governance mechanisms, including periodic public consultations to review various elements of the Plan on the basis of changes in Québec society and to act at the appropriate time to adapt the Plan to its participants' needs.

CHAPTER 2: TRANSITION FROM WORK TO RETIREMENT

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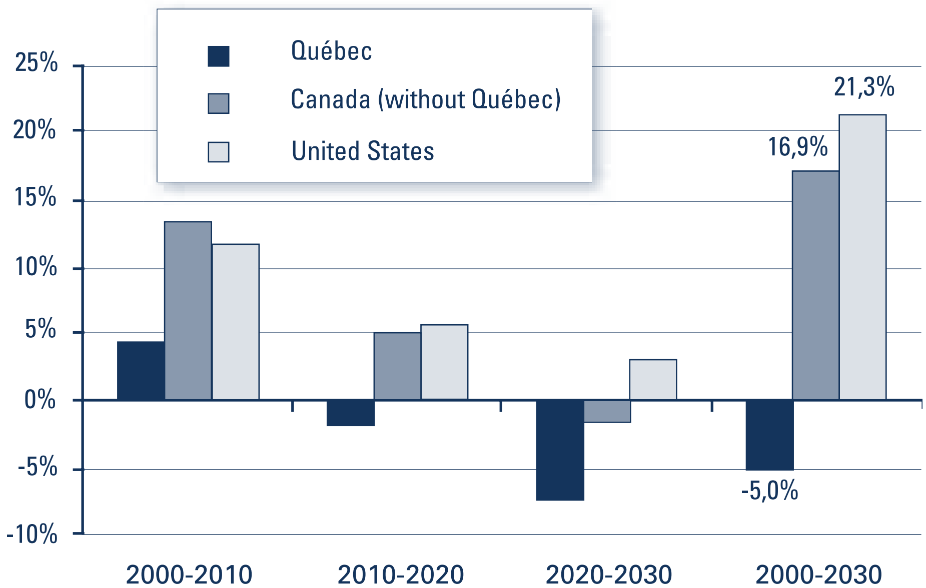
2.1 A changing labour force

Trend reversal: the working-age population of Québec is going to decrease

The aging of the population has repercussions on changes in the working-age population. In approximately ten years, the number of workers retiring from the labour force will be greater than the number of those entering. Thus, unless the labour force participation rate improves, aging leads us to expect a reduction in the economically active population as early as the next decade.

Elsewhere in Canada, in spite of an anticipated slowing in its growth rate, the working-age population will continue to increase until approximately 2025. In the next 30 years, the working-age population will grow in the rest of Canada and the United States while in Québec, it will decrease by 5%.

Change in the working-age population (aged 20-64)



Sources: Actuarial report of the Québec Pension Plan as at 31 December 2000.
Statistics Canada, *Population Projections*, 2001.

United Nations Secretariat, *World Population Prospects*, The 2002 Revision.

Québec workers are retiring earlier than workers elsewhere

The trend toward earlier and earlier retirement, observed in recent decades, seems to have ended in the second half of the 1990s, although that could simply reflect a favourable economic situation.[7] However, Quebeckers continue to retire from the labour force earlier than other Canadians or Americans, as well as earlier than what is generally observed in other G-7 countries.

[7] OECD, *Aging and Income: Financial Resources and Retirement in 9 OECD Countries*, Social Issues, 2001.

Average age of retirement from the labour market, men

	1970	1990	2000
Québec	**64,6**	**61,2**	**60,0**
Canada (without Québec)	65,1	62,5	61,5
United States	65,4	64,2	63,5
G-7 countries*	65,1	62,5	61,8

* Canada, United States, Japan, Germany, France, Great Britain and Italy.
Source: Research conducted by the Régie des rentes du Québec.

In addition to earlier retirement, life expectancy of retirees continues to rise, thus leading to an increase in the estimated length of retirement and a reduction in the number of economically active years for each year of retirement. In Québec, for example, in 1970 a man worked on average for close to four years for each year of retirement. In 1990, he spends only two years in the labour force for each year retired.

In future, if older workers do not remain in the labour market for a longer period of time, the ratio of the number of economically active years to the number of years in retirement should decrease since life expectancy should continue to rise.

An increasing number of women in the labour force

The participation rate of women aged 15 or over in the labour market was 33% in 1966 and 41% in 1976. It reached 56% in 2000. The integration of women into the labour market continues at a slower rate for women aged 25 to 54 and a faster rate for women aged 55 to 64 as younger cohorts reach that age. In the coming years, we will witness a "feminization" of the transition from economically active life to retirement.

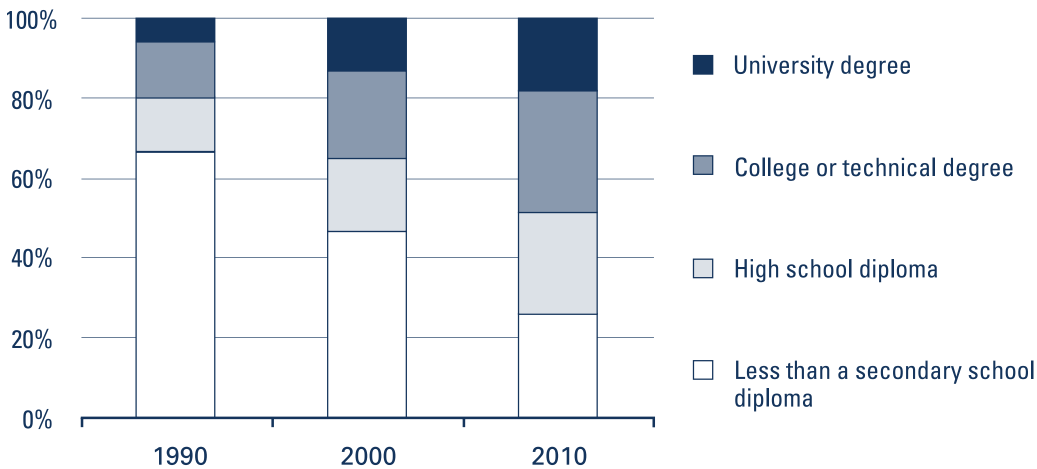
Education levels are improving

The school attendance rate for young Quebeckers aged 15 to 24 began to increase significantly in the mid-1970s. Higher education levels are an important factor in workers' ability to adapt to changes in the labour force.[8]

As the following graph shows, the general increase in education levels has repercussions on older workers as younger generations age. In 1990, almost two-thirds of the population aged 55 to 64 had not completed high school. Around 2010, when most baby boomers reach retirement, more than three-quarters of people age 55 to 64 will have a high school diploma or more. Older workers, because they will then have a higher level of education, will find it easier to stay employed.

8 The creation of continuing education programs in companies is another essential factor in allowing workers to maintain and improve their skills.

Distribution of the population aged 55 to 64 according to education level



Source: Statistics Canada, *Labour Force Survey* and compilation made by the Régie des rentes du Québec.

Furthermore, people in the younger generations are more and more likely to combine studies and work. In 2001, 50% of full-time students aged 20 to 24 had a job. This is twice as many as in 1976. Young people are now entering professional life more gradually than before.

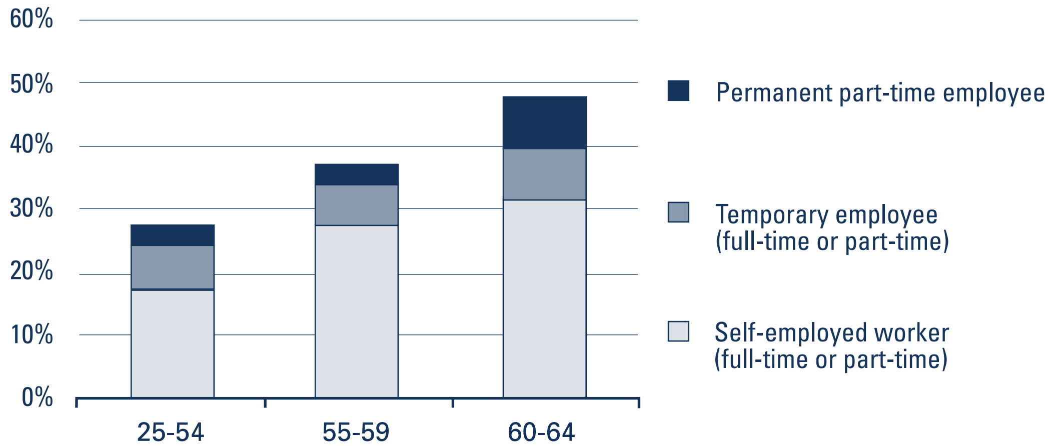
Non-standard employment[9] at career end is increasing

Although non-standard employment has increased in recent years, the majority of male workers aged 25 to 64 have full-time paid employment. The importance of non-standard employment is however more pronounced in older workers:

- one worker out of four aged 25 to 54 has non-standard employment;
- one worker out of three aged 55 to 59 and one out of two aged 60 to 64 have such employment.

[9] "Non-standard employment" is defined as employment that does not correspond to the ideal of full-time regular employment. In general, non-standard employment includes part-time employment, short-term or contract work, employment obtained through temporary placement agencies and self-employment.
Source: McCartin, Michel et Schellenberg, Grant, *The Future of Work: Non-Standard Employment in the Public Service of Canada,* Research Directorate, Policy, Research and Communications Branch, Public Service Commission, March 1999.

Proportion of workers with non-standard employment in 2001



Source: Institut de la statistique du Québec, *Données sociodémographiques en bref*, June 2002

Attitudes toward phased retirement are changing

- A survey, carried out by the Conseil du patronat du Québec and the Régie des rentes du Québec reveals changes in the attitude of employers toward measures promoting early retirement:
  - two-thirds of employers have a rather negative opinion of early retirement programs;
  - 60% say they are concerned by requests for early retirement;
  - 60% are thinking about having gradual retirement programs in future;
  - approximately three out of four companies are ready to modify the way work is organized to hold on to their aging workforce;
  - nevertheless, close to 60% of companies say they have no medium- or long-term planning policy for their workforce.
- Workers attitudes are also changing. A survey[10] by the Québec Federation of Labour (QFL) reveals that close to one worker out of two would consider staying employed longer if he or she had access to more flexible work hours.

[10] Survey conducted by Écho Sondage on behalf of the QFL and its Fonds de solidarité FTQ.

- The Conseil consultatif du travail et de la main-d'œuvre[11] suggests promoting and facilitating access to phased retirement in order to offer individuals the possibility of having a real choice between remaining employed or retiring.
- Researchers talk of a fourth pillar of retirement income security.[12] Part-time work at the end of one's career is considered more and more as a solution for the future to supplement the income ensured by the other pillars of the system. It is also an important mechanism for social integration and participation.

Conditions are becoming more favourable for the employment of older workers

While conditions are becoming more favourable for the employment of older workers, retirement plans must also be designed to encourage workers to pursue paid work at the end of their careers. Where does the Québec Pension Plan stand in regard to this issue? Do the current retirement transitions mechanisms encourage plan contributors to work past the age of 60? Should adjustments that would make working after becoming eligible for retirement more attractive be considered? The next section will deal with these questions.

[11] Conseil consultatif du travail et de la main-d'œuvre, *Adapter les milieux de travail au vieillissement de la main-d'œuvre,* April 2002.

[12] The Geneva Association, International Association for the Study of Insurance Economics, *The Four Pillars*, Newsletter 32, February 2003

2.2 Fairer and more flexible measures

Varied transition mechanisms

The slowdown of economic growth in the 1970s and increased unemployment encouraged several countries[13] to design mechanisms to facilitate retirement for older workers and thus promote employment for younger people. Some countries set up very generous measures to make it easier for older workers to leave the labour force and to compensate them for their loss of employment income.

Other countries, notably the United Kingdom, the United States and Canada, opted for more moderate government intervention. They preferred to leave a greater responsibility to companies, through private retirement plans and collective agreements, for the management of workers ending their careers and for adjustments in the workforce according to conditions in the labour force.

Québec adopted the second strategy. The Québec Pension Plan was modified to assure flexibility in the retirement age without creating strong financial incentives:

In 1984 two measures were introduced to facilitate the retirement of older workers from the labour force:

- The first allows workers who want to retire to do so as of age 60. The pension paid is reduced 0,5% for each month that retirement is taken before the age of 65 to take into account the longer payment period. An individual can also choose to retire after age 65. In this case, the pension is increased by 0,5% for each month that retirement is taken after age 65.
- The second measure allows contributors aged 60 to 64 to receive a disability pension if they are unable to perform their usual work whereas normally they must be unable to perform any type of work to be entitled to the pension.

In 1998 two new measures were adopted to encourage phased retirement.

- An employee aged 55 or over may, after reaching an agreement with his or her employer, reduce his or her work hours and continue to contribute to the Plan as if there had been no reduction in pay. This measure was introduced so that workers who opt for phased retirement from the labour force are not penalized.
- A retirement pension can also be paid to a contributor aged 60 to 65, if his or her pay is reduced by at least 20% because of phased retirement following an agreement with the employer. This measure compensates for the loss in wages by beginning payment of the retirement pension.

[13] Member countries of the OECD set up these types of measures.

Also since 1998, beneficiaries of a retirement pension who continue to work must contribute to the Plan, in the same way as other workers. In compensation, each new year of earnings can replace a lower one in the calculation of average pensionable earnings and thus increase the pension being paid.

Mechanisms poorly adapted to the diversity of career profiles

In the past, different stages of life were clearly divided: youth corresponded to a period of education, adult life was the work period, and old age was marked by the beginning of retirement. Today, reality is different. Forms of entry into the labour market and departure for retirement are likely to vary from one individual to another. A mid-career interruption of work for varied reasons (further education, family responsibilities, career change) is likely to become more frequent. There is no longer a single model for our path through life.

Although they do guarantee flexibility in retirement age, the transition mechanisms provided for in the Plan may or may not fit an individual's choices in life. Moreover, these mechanisms can create problems if an individual wants to continue working after the age of eligibility for a pension. Note, for example, the following facts:

- The number of years considered for the calculation of a retirement pension varies between 36 and 44, depending on the age at which the pension begins. The later the retirement, the more years of contribution are required to be entitled to the maximum pension.
- An individual must have stopped working or have reached an agreement with his employer regarding phased retirement in order to be entitled to a pension at age 60. A career-end worker who chooses, for example, a less demanding job or reduced hours without an agreement is not eligible for an early pension.
- The retirement pension is calculated on the basis of the contributor's average career earnings. An individual who continues to work after age 60 at a wage lower than his average career wage makes contributions which reduce his average earnings, leading to a reduction in the pension.
- According to their career profiles, individuals who have made the same contributions could receive different benefits at retirement.
- The retiree who returns to work makes contributions to the Plan. Despite these additional contributions, there is no guarantee that the pension will increase even if it has not yet reached the maximum payable.

Strengthen the flexibility in the different forms of retirement

Considering the rapid aging of the population and the new realities of the labour market, the Québec Pension Plan must evolve so as to:

- **preserve the flexibility of the age of eligibility** for retirement and **strengthen the flexibility of different forms** of retirement;
- treat all workers fairly in spite of different career profiles;
- make it advantageous to remain employed by strengthening the relationship between contributions and benefits;
- simplify the rules so that individuals better understand the different forms of retirement and the calculation of the pension.

In fact, instead of maintaining a set of measures (early or late retirement, right to an early pension if the individual has reached a phased retirement agreement, increase in the pension of a retiree who returns to work), the new provisions would allow a worker to choose his own form of retirement. He could in this way:

- take phased retirement or work full-time then retire definitively;
- claim his pension at the beginning of phased retirement or at the definitive end of his career;
- work or not work after pension payments have started.

No way would be more advantageous than another. In each case, the pension would be calculated according to the same rules. All pensionable earnings, that is, earnings on which the worker made a contribution, would contribute to increasing the pension. For this reason, we propose the following:

Proposals

1. Allow workers to take their retirement pension starting at age 60 even if they continue to work.
2. Calculate the retirement pension according to all career earnings. A worker who participates in the Plan for more than 40 years could receive a higher pension.
   The pension would be equal to: $\frac{25\% \text{ X total pensionable earnings}}{40}$
3. Maintain the obligation to contribute if the beneficiary returns to work after starting to receive a pension. The additional contributions could increase the pension up to the maximum payable.[14]

[14] Readers who would like more details concerning the proposals for change can consult the appendix to this document, which compares these proposals with the current provisions of the Québec Pension Plan.

Review the actuarial adjustment factors

Flexible retirement, introduced in the Plan in 1984, allows an individual to begin receiving a pension at any time between age 60 and 70. An actuarial adjustment factor is applied when retirement begins before or after age 65 to take into account the period during which the pension will be paid. Thus, an early retirement pension is reduced because the beneficiary will receive a pension over a longer period. Conversely, a postponed pension is increased to compensate the beneficiary who has delayed starting the pension payment. To be neutral, the actuarial adjustment factor must be established in such a way that the total value of the pension remains the same regardless of the beneficiary's age when the pension begins.

The adjustment factors must be periodically re-evaluated according to changes in life expectancy, in the economic environment and in the Plan itself. A recent study by the Régie des rentes du Québec showed that the reduction of 0,5% per month, in the case of an early pension, is still appropriate. On the other hand, the increase in the case of a postponed pension is not sufficiently high and penalizes individuals who begin their pension after age 65. In order to correct this situation, and at the same time have a factor that is easy to use, the increase should go from 0,5% to 0,7% per month. At this level, an individual who begins his pension at age 70 would receive an increase of 42%, rather than 30%, of the pension calculated for a person aged 65.

Maintain support measures for persons with dependant children

Women who have had children can, if it is to their advantage, exclude from the calculation of their average earnings all years during which they withdrew from the labour force or had only low earnings because they were taking care of their children under the age of 7. For the purposes of the pension calculation, this provision allows us to consider that a woman accumulated, for each of the years when her children were young, income equivalent to her average earnings for the rest of her career.

The exclusion of years when earnings are low or nil is advantageous for women who are currently reaching the age of retirement because the majority of them left the labour force when they had their children. This provision has the greatest effect on individuals who stop working to take care of young children.

It is likely that this measure will not be as advantageous for younger women who have not reached retirement age, because they behave differently with regard to the labour force. On the whole, they have a greater participation in the labour force. When they have children, they are more likely to reduce their paid work hours without leaving the workforce completely. Those who leave the workforce do so for a shorter period and go back to work before their child reaches age 7.

Nevertheless, the exclusion of years when earnings are low (which correspond to the months during which an individual took care of a young child) remains an effective measure and must be maintained. However, adjustments would be necessary to adapt the measure to the new methods of calculating the retirement pension. For this reason, instead of excluding years, earnings would be credited for each of the years in which an individual took care of a child under the age of 7 in order to increase the earnings of the year in question to the level of the average earnings for the rest of the career. At retirement, the earnings credited would be added to the total earnings thus increasing the pension.

Improve coherence

1. In the definition of disability

When early retirement was introduced in the Québec Pension Plan, another legislative amendment was adopted to facilitate the retirement of older workers from the labour force. That amendment made it possible to ease the eligibility criteria for a disability pension for workers aged 60 to 64. Thereafter, workers could receive a pension if, because of their state of health, they had become unable to perform their usual work. A younger worker must be unable to perform any type of work to be eligible to a disability pension.

When this measure came into effect, older workers in general had less schooling than younger individuals seeking employment, and this made older workers vulnerable. Those whose state of health had deteriorated and who had to leave their job had a great deal of difficulty finding another less demanding job. In fact, the older worker who had become unable to perform his **usual work** was considered unable to perform **any other type of work**.

Compensation for partial disability was appropriate in the 1980s. Several countries had adopted provisions comparable to those provided for under the Québec Pension Plan but they tightened their criteria in the mid-1990s. For the Québec Pension Plan, the measure allowing workers aged 60 to 64 to receive a disability pension if they are unable to perform their usual work raises particular problems:

- The worker who left his job for health reasons and who then takes another job better suited to his condition is not eligible for a disability pension at age 60, yet he would be if he did not have the other job.
- The measure results in coherence problems with other social legislation dealing with the rehabilitation of workers and their reintegration into the workforce, notably the *Act respecting industrial accidents and occupational diseases*, administered by the Commission de la santé et de la sécurité au travail (CSST). The worker who suffers a work-related injury and who accepts the new job suggested by the CSST is disqualified from benefits under the Québec Pension Plan.

- The distinction between retirement and disability can be subtle. How is a worker who is unable to perform his usual work different from one who retires because he feels "too tired" to continue working?
- The disparity between benefits is significant and difficult to justify. In 2003, the maximum disability pension is 971 $ while the maximum retirement pension at age 60 is 561 $.

The labour market has changed over the last several decades. The worker whose job has become too demanding is more likely than in previous years to find another job more suitable for his situation. Access to two types of benefits for workers aged 60 to 64 is difficult to justify. In order to offer older workers income protection measures that are coherent and fair to all, it is proposed to:

Proposals

1. Maintain financial protection for the loss of income resulting from total and permanent disability. As defined by the Plan, an individual is disabled if he under age 65 and has become unable to regularly hold any type of substantially gainful employment.
2. Remove the relaxed definition of disability for persons aged 60 to 64. These individuals will be entitled to an early retirement pension in the same way as other workers.[15]

2. In calculating the disability pension

The modifications proposed to calculate the retirement pension of a contributor could affect the pension paid in case of disability. In several cases, there is a risk that the pension could be reduced. Changes in the calculation of the disability pension should be considered in order to avoid this undesirable result and to assure a more stable income for workers who become disabled.

Currently, the disability pension has two components:

- a fixed portion equal to 370 $ per month in 2003;
- a variable portion, which depends on the earnings of the contributor, equal to 75% of his or her basic retirement pension, that is, the retirement pension to which he or she would be entitled if he or she were age 65.

Disability pension = 370 $ + 75% of the basic retirement pension

[15] Readers who would like more details concerning these proposals for change can consult the table presented as an appendix to this document.

Payment of the disability pension ends when the beneficiary turns 65. The disability pension is automatically replaced by the retirement pension. The amount of the pension is reduced by 0,5% for each month that the disability pension was received between age 60 and 65.

The proposed adjustments are intended to:

- increase the fixed portion to 453 $ per month, which would be equal to the Old Age Security pension paid to individuals aged 65 or over;
- pay a variable portion equal to the retirement pension paid when the contributor becomes disabled or to the retirement pension payable at age 60, if the contributor has not yet reached this age when the disability occurs.

Disability pension = 453 $ + Retirement pension payable

The fixed portion would end when the beneficiary turned 65 and be replaced with the Old Age Security pension. The variable portion would continue to be paid as the retirement pension and would be indexed to inflation so that the individual's standard of living would be maintained.

A disability pension composed of a fixed portion equal to the Old Age Security pension and a variable portion equal to the retirement pension would help strengthen the coherence of the system. Indeed, an individual who becomes disabled would be entitled to the same protection as if he retired.

Impact of the proposals for change on future beneficiaries

Effective date for the measures

- The proposals for change to the retirement pension would progressively go into effect starting from 2010, when the majority of workers will have participated fully in the Plan. Adopting a measure early that will take effect several years later allows the population to adapt to the changes and to plan retirement accordingly.
- The new measures would not affect beneficiaries whose pensions have already started.
- Changes affecting disability pensions could be implemented immediately.

Retirement pension changes

- Workers would no longer be required to have stopped working or to have reached a phased retirement agreement in order to be entitled to a retirement pension at age 60. This measure would be advantageous for all individuals who wish to work reduced hours or in a less demanding job and receive their pension to compensate for some of the loss in income.

- The pension would be calculated on the basis of all contributory earnings. The overall impact of the measure would be rather small. In general, the effect of these new rules would be to reduce the retirement pension of people who request it at age 60 and have not had a stable career. On average, pensions would be reduced by 6%.
- Moreover, individuals who retire after age 62 would, on average, have an advantage according to the new calculation rules. This would also be the case for those who have accumulated more than 40 years of earnings. The average pension of individuals who retire at age 65 would be increased by 7%.
- Finally, other factors, notably the maturity of the Plan, general economic growth, and labour force changes, will also have an impact on the pensions of future retirees. By and large, pensions paid to retirees in 2030 will be greater than those paid to new retirees in 2003. In constant dollars, the average pension for men should increase 18% and those for women close to 45%. The greater increase in women's pensions is explained principally by their increased participation in the labour force.

Disability pension changes

- Removing the relaxed definition of disability for applicants age 60 to 64 would reduce the number of beneficiaries receiving a disability pension by approximately 18%. The individuals affected could request their retirement pension in the same way as other workers. They would also have the possibility of increasing their pension if they worked in a job other than their usual work.
- In 2003, the average pension starting at age 60 was 763 $ for the beneficiary of a disability pension and 341 $ for the beneficiary of a retirement pension. Individuals affected by the removal of the relaxed definition of disability would see a reduction in their pension for a maximum period of five years, that is, for the period going from age 60 to 65.
- In 2003, a worker whose average career earnings are around 30 000 $ is entitled to a monthly pension of approximately 820 $ if he or she becomes disabled. The pension would be increased to 873 $ a month if the adjustments intended to increase the fixed portion of the disability pension to the amount of the Old Age Security pension were in effect. This would increase the pension by 6,5%. In return for this increase, the pension paid as of age 65 would be lower than that currently paid because the variable portion of the disability pension would simply continue to be paid and indexed to inflation. Currently, the pension is recalculated to take into account changes in wages after the date when the worker became disabled until he or she turns 65.

Summary

The aging of the population will have important repercussions on the size and the composition of the working-age population. Québec, where aging will be more significant than elsewhere in North America, will face a reduction in its population aged 20 to 64.

Parallel to the aging of the population and the rise in life expectancy of retirees, workers have had, in the last several decades, a tendency to retire from the workforce earlier and earlier.

In addition, the labour force is changing in a variety of ways:

- improvement in the education level of older workers;
- significance of non-standard employment at the end of the career;
- change in thinking concerning the forms of retirement;
- greater diversity in career profiles.

In short, more favourable conditions for the employment of older workers are currently emerging. The transition mechanisms from economically active life to retirement provided for in the Québec Pension Plan are not well suited to these realities because they do not provide enough flexibility in the various forms of retirement. Changes are necessary to strengthen this flexibility, to treat all workers fairly despite the diversity of career profiles, and to make working after becoming eligible for retirement more attractive. For this reason, the following proposals are formulated:

1. Allow workers to request their retirement pension before age 65 even if they remain employed.
2. Calculate the retirement pension on the basis of all the contributor's earnings. The pension will be increased, up to the maximum payable, if the worker has more than 40 years participation in the Plan.
3. Maintain the obligation to contribute if the beneficiary works after beginning to receive a pension. The additional contributions will increase the pension until the maximum is reached.
4. Improve the actuarial adjustment factors applying to the pensions of individuals who defer their retirement until after age 65.
5. For each of the years when an individual took care of a child under age 7, credit earnings in order to increase those years' earnings to the level of the average earnings for the rest of the career.
6. Clearly establish that the Plan provides financial protection against the loss of income resulting from a disability making the individual unable to perform any type of work. Remove the relaxed definition of disability for individuals aged 60 to 64. These individuals would be entitled to an early retirement pension in the same way as other workers.
7. Adjust the calculation method for the disability pension to strengthen coherence and assure a more stable income for disabled persons.

Chapter 3: Protection following death

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3.1 The new family realities

Life as a couple

At the time the Québec Pension Plan was created, individuals who decided to live as a couple and to start a family got married in the majority of cases. Since the 1970s the number of marriages in Québec has decreased significantly (51 000 registered marriages in 1976, 22 000 in 2001). The dramatic changes in this area are due, in a large part, to the growing popularity of de facto (common law) unions.

In addition, the "divorce index" indicates that the proportion of marriages likely to end in divorce is high. According to this index, since 1987 one out of two marriages will probably end in divorce. This data is comparable to what is observed in numerous countries, including Sweden, Great Britain, and the United States.

Since the mid-1970s, the incidence of divorce has grown significantly. The nuclear family with children under 18 is more likely to be broken by divorce than by the death of one of the parents. Provisions were added to the Québec Pension Plan to deal with the partition of accumulated pension credits for retirement when a separation occurs. It would be appropriate to establish a certain link between these measures and the protection provided to survivors in the event of death.

The family environment of children[16]

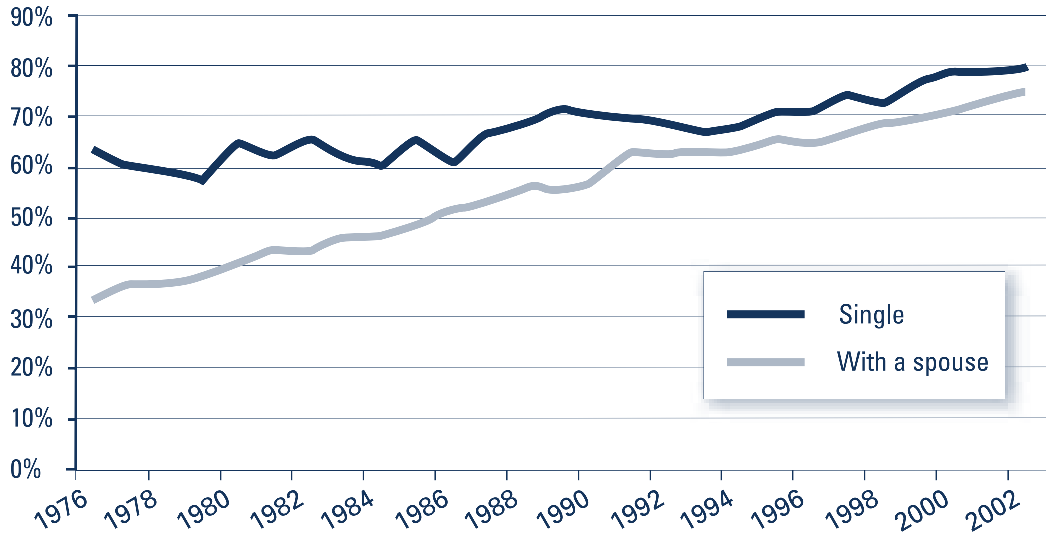
The great majority of minor children live in a two-parent family (82%), of which 9% are blended families. The children of blended families live in fact with just one of their parents. Furthermore, close to 18% of children aged 0 to 17 live in a single-parent family; 15% of them live just with their mother and 3% just their father. As a result, one child out of four lives with just one of his or her parents, either in a single-parent or a blended family.

Parents and the labour force

In 1976, women living with a spouse were less likely to be in the labour force than single women. The reality is different in the first decade of the 21st century where the proportion of women who work is approximately the same for the two groups.

[16] Bureau de la statistique du Québec, *Un portait statistique des familles et des enfants au Québec*, 1999.

Labour force participation rates for women aged 45 to 54, single or living with a spouse



Sources: Statistics Canada, *Labour Force Survey* and Régie des rentes du Québec

The labour force participation rate of women with children under age 16 has also increased over the last several decades as shown in the following table. Currently, three-quarters of mothers with school-age children and two-thirds with at least one child under age 6 work.

Labour force participation rates for women with children, according to the age of the youngest child, Québec

	Under age 6	Age 6 to 15
1976	30,2%	40,3%
1997	64,2%	76,0%

Source: Statistics Canada, *Labour Force Survey* and compilation made by the ISQ.

In short, life as a couple and family realities have changed greatly since the Québec Pension Plan came into effect. Married life is based more and more on the economic interdependence of the spouses rather than the dependence of the person who stays at home on the one with paid employment. Both parents contribute to the Plan and save for their retirement. The death of one worker no longer has the same impact; the survivor is less affected financially or, rather, is not affected in a permanent way. In addition, the surviving partner is not necessarily the other parent of the children of the deceased.

3.2 Benefits better suited to needs

The amounts payable in 2003

The contributor to the Québec Pension Plan who dies makes his spouse eligible for a surviving spouse's pension payable for life. The Plan also provides for an orphan's pension.

The pension payable to the spouse under age 65 is made up of two components:

- A fixed portion intended to assure a minimum income for subsistence;
- A variable portion corresponding to 37,5% of the basic retirement pension of the deceased contributor.

The spouse aged 65 or over is entitled to a pension equal to 60% of the retirement pension of the deceased contributor. In this case, there is no fixed portion since the Old Age Security pension becomes payable.

Monthly pensions in 2003

Before age 65	
Variable portion: 37,5% of the basic retirement pension	Maximum 300 $
Fixed portion	
Under age 45, without children and not disabled	95 $
Under age 45, with children and not disabled	344 $
Under age 45, disabled	370 $
Aged 45 to 54	370 $
Aged 55 to 64	400 $
After age 65	
Variable portion: 60% of the basic retirement pension	Maximum 481 $
Orphan's pension	59 $

A beneficiary can receive two pensions from the Plan: his or her own retirement pension and a surviving spouse's pension, for example. However, because of established rules, the payment is never equal to the sum of the two pensions. The surviving spouse's pension is always reduced even in cases where the pension is low. In addition, the combined pension can never exceed the maximum retirement pension.

Measures poorly suited to family realities

The Plan's survivors' benefits, designed according to family characteristics in the 1960s, now raise certain questions:

- Is it appropriate to pay a life pension in every case? What support should the Plan provide following a death if the spouse is young and has no dependant children?
- Because of the instability of couples, the Plan does not always reach the children when paying a pension to the spouse. Who should be given priority?

- The fixed portion increases as the spouse becomes older, without regard for his or her actual situation. Is this appropriate?
- Is the treatment of the beneficiary who is entitled to two pensions from the Plan appropriate?

Models observed elsewhere

In G-7 countries, public retirement plans do not provide for survivors' benefits comparable to those of the Québec Pension Plan:

- In general, the surviving spouse's pension is payable with no age requirements, if the survivor has dependant children or is disabled. If not, the survivor must be at least age 45 in order to be eligible for a pension and at least age 55 to be eligible for a pension without reduction.
- Payment of the surviving spouse's pension is often conditional on an evaluation of the surviving spouse's income or resources.

Certain foreign plans, particularly in Sweden, are intended to assure the surviving spouse of financial support in the event of death without, however, providing a pension payable for life. Survivors' benefits consist of an adaptation benefit which helps the surviving spouse face his or her new situation. Rather than taking the surviving spouse into charge, the plan encourages the survivor to develop financial independence. This approach is also used by the Commission de la santé et de la sécurité au travail and the Société de l'assurance automobile du Québec to compensate victims of work-related or automobile accidents.

A new approach to adopt

Survivors' benefits provided for in the Plan are intended to provide the contributor's dependants with a subsistence income as a replacement for the financial loss caused by the death of the contributor. This principle, which guided the lawmakers in 1966, now seems out of date. The Plan's provisions should be based on new principles, such as:

- the spouses' financial interdependence at the time of death and the survivor's ability to achieve financial independence after a period of adjustment ;
- the opportunity to direct assistance toward the true dependants, that is, the children;
- the recognition of the right of the spouse to a part of the retirement savings of the deceased contributor, as in divorce.

The following adjustments are proposed in order to better adapt survivors' benefits to the needs of families:

Proposals

1. Substantially increase the amount of the orphan's pension in order to direct assistance towards the dependants. The orphan's pension would go from 59 $ to 187 $ a month, that is, the amount of the pension provided for under the Canada Pension Plan.
2. (a) Pay the surviving spouse who is not retired at the time of the contributor's death a temporary pension lasting three years. The pension would be higher than the current pension payable for life. It would be equivalent to the pension paid in the event of disability.

   (b) Transfer to the account of the spouse 60% of the earnings entered in the deceased contributor's record for each year of life together, in a way similar to the partition of earnings that occurs following the breakdown of a union. For a given year, the sum of the earnings transferred and the earnings already entered into the spouse's record could not, however, exceed the maximum pensionable earnings for the year.
3. Pay the spouse who is retired at the time of the contributor's death a surviving spouse's pension equal to 60% of the deceased contributor's retirement pension.
4. Allow beneficiaries to receive both a retirement pension and a surviving spouse's pension up to the maximum retirement pension.[17]

Should the pension for a disabled person's child be modified?

In addition to the orphan's pension, the Plan pays a pension for the child of a disabled contributor. This pension is the same amount as the orphan's pension, that is, 59 $ a month. Some might suggest that the pension for the disabled person's child should be increased to 187 $ in order to provide the same protection to the child whether the contributor dies or becomes disabled. This has been the preferred approach since the Plan came into effect.

Others might argue that the Québec Pension Plan should provide **protection for the contributor himself** if he becomes disabled and **protection for his family** if he dies. Up until this time, protection following the death of a contributor was directed towards the spouse. A new proposal now suggests protecting the children first.

The new principles on which the proposals to change survivors' pensions are founded do not apply in the event of disability. The disabled contributor will continue to receive a pension for the duration of the disability. The amount of the pension paid will even be increased if the proposed adjustments are accepted. Would it be necessary, in addition, to increase the pension of the disabled person's child?

[17] Readers who would like more details concerning these proposals for change can consult the table presented as an appendix to this document.

Some people will agree so that, in the case where the disabled person has several dependent children, the possibility that protection during the period of disability would be less than the protection provided in the event of death could be avoided.

Others will assert that, on the contrary, it would be more appropriate to compensate the loss of employment income caused by the disability without providing additional protection for dependents. This would be more like the measures of the Commission de la santé et de la sécurité au travail and the Société de l'assurance automobile du Québec under which the victim of a work-related accident or an automobile accident receives an income replacement indemnity.

It is interesting to note that the majority of European Union countries, including France, Germany and Sweden (since 1990 in the last case), do not provide for an increase in benefits paid in the event of disability when the beneficiary has dependent children, while almost all of these countries pay orphans' pensions in the event of the worker's death.

Impact of the proposed changes on future beneficiaries

Effective date for the measures

The increase in the orphan's pension and the proposals intended to pay a temporary pension to a young surviving spouse could be adopted in the short-term. Furthermore, periods of transition would be provided to minimize the impact of the proposals for change on older women who have spent less time in the labour force than younger generations.

Orphans

The new provisions would improve the protection given to children. The significant increase in the orphan's pension, compensating for the temporary pension paid to the spouse, would allow financial support to be directed towards the children, who remain the primary dependents. At present, the protection provided to orphans is limited, particularly in cases where the contributor dies without a spouse or when the spouse is not the other parent of the children.

Surviving spouses

Widowhood or widowerhood is a circumstance that takes place relatively late in life and especially affects women. In 2002, 82% of the new beneficiaries of a surviving spouse's pension were women. Thus the proposed changes primarily affect women.

Spouses who are not retired at the time of the contributor's death

- The temporary pension would be greater than the pension currently granted to the spouse under age 65. In this way the measure would assure better financial support in the years immediately following the death, the period when the presumed needs of the surviving spouse are the greatest. The pension would on average be 45% greater than that currently received by a surviving spouse aged 55 to 64. However, the pension would be of a limited duration and would not necessarily be paid until retirement.
- The transfer of earnings which goes with the temporary pension would entitle certain surviving spouses to additional benefits, for example, making them eligible for a disability pension. In addition, this transfer would allow spouses to increase their own retirement pension.

Spouses who are retired at the time of the contributor's death

- The pensions payable to the majority of spouses who are already retired at the time of the death would be reduced. In fact, they would be equal to 60% of the retirement pension paid. At this time, surviving spouses are entitled to 60% of the basic retirement pension of the deceased contributor, that is, the pension the contributor would have received if he had retired at age 65.
- On the other hand, because of their increased presence in the labour force, more women will have both a retirement pension and a surviving spouse's pension. The new provisions would allow the elimination of "combined pensions" which are often the source of complaints because the application rules are complex and difficult to understand. The surviving spouse would simply receive both pensions up to the maximum retirement pension payable.
- In 2003, the combined retirement/surviving spouse's pension paid to a widow represented 62% of the maximum retirement pension. In 2030, in accordance with the current provisions, the combined pension should correspond to 67% of the maximum retirement pension. According to the suggested proposals, the total pension paid to a widow would represent 63% of the maximum payable. In constant dollars, the pension would go from 499 $ currently paid to 655 $ in 2030.

Summary

Conjugal and family realities have changed in a variety of ways since the Québec Pension Plan came into effect.

- Unions are less numerous and less stable than previously.
- The traditional sharing of roles in the family has changed. More and more often, both spouses contribute to the financial support of the household.
- The traditional family, composed of a father, mother and children, remains the dominant model but a multiplicity of other family models are appearing.
- A growing proportion of children live with just one parent.
- Marital status is no longer a determining factor in the labour force participation rate of women. However, women who have children under age 6 are somewhat less present in the labour force.

Survivors' benefits provided for under the Québec Pension Plan are still designed on the basis of the traditional family and have not been adapted to these new realities. The following adjustments should be introduced:

1. Increase the orphan's pension for the child of a deceased contributor.
2. Pay a temporary pension to the surviving spouse who is not retired and transfer to his or her account 60% of the earnings recorded under the contributor's name for each year of life together.
3. Pay the spouse who is retired at the time of the death a pension equal to 60% of the retirement pension of the deceased contributor.
4. Allow the spouse to concurrently receive both the retirement pension and the surviving spouse's pension up to the amount of the maximum retirement pension.

Chapter 4: Funding the Québec Pension Plan

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4.1 Financial changes in the plan

A plan under pressure

The Québec Pension Plan is a partially funded plan, that is, the contributions of one year are used to pay the benefits of the current year, while at the same time maintaining a reserve. The reserve makes it possible to attain two objectives. First, it generates investment income which, added to the contributions made by workers, makes it possible to pay the Plan's current obligation. Secondly, it acts to stabilize the contribution rate in the context of economic cycles and demographic changes.

During the first years of the Plan's existence, the amount of contributions received was greater than the cash outflows, so that a substantial reserve was accumulated. Certain increases in benefits were then introduced. As the Plan matured, the number of beneficiaries grew. Starting from the mid-1980s, it was necessary to use a portion of the investment income generated by the reserve to pay benefits. By the beginning of the 1990s, the cash outflows of the plan had become greater than the total of the contributions and the investment income, with the result that a portion of the reserve had to be used to make up the difference. The reserve progressively diminished and, without significant changes, would have been completely depleted as soon as 2005.

The 1998 reform was intended to improve the Plan's funding and to ensure its long-term sustainability. Thus the contribution rate was increased rapidly to 9,9% and some limited adjustments were made to benefits. Since 2001, the contributions made during each year have been sufficient to pay benefits and cover administration costs. Consequently, investment income generated by the reserve is able to accumulate.

According to the actuarial report as at 31 December 2000, the reserve was expected to grow over the next several years to reach 4,5 times the cash outflows of the following year in 2020, a time when massive numbers of baby boomers will be retiring. Subsequently, the reserve was expected to increase more slowly, since a growing part of the investment income was expected to be used to make up the difference between contributions and cash outflows. At the end of the projection period, the reserve would be 3,1 times the cash outflows of the following year.

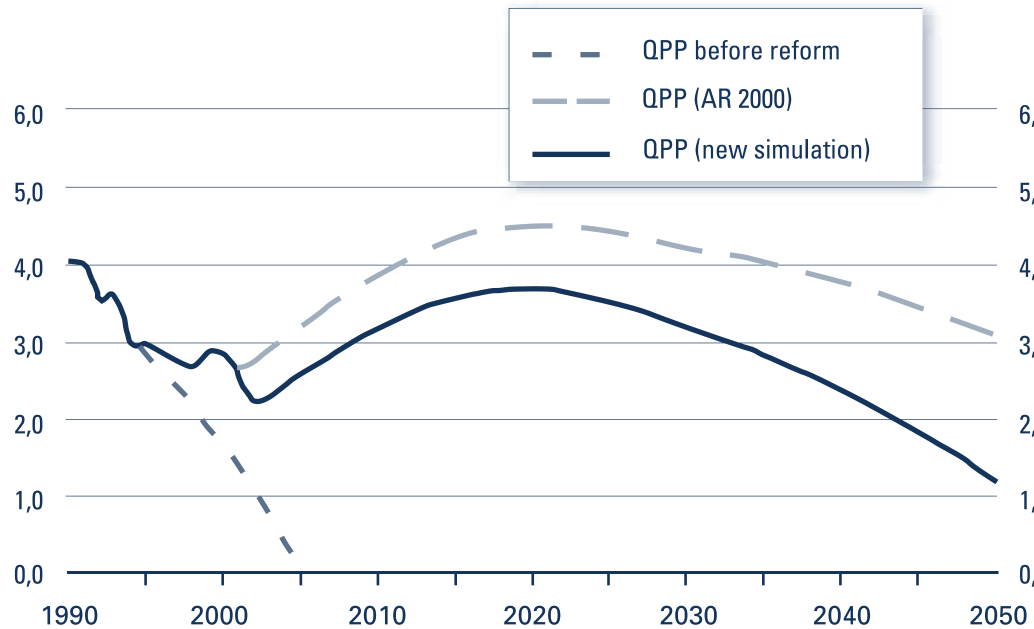
Poor performances of 2001 and 2002

In 2001 and 2002, the rate of return realized on the assets of the Québec Pension Plan was lower than that forecast in the 2000 actuarial report.[18] Consequently, investment income was lower than the estimate by more than 3,6 billion $. On 31 December 2002, the reserve was established at 16,0 billion $ while the report anticipated a reserve of 19,6 billion $.

[18] The nominal return was – 4,8% in 2001 and – 10,0% in 2002, compared to the rates of – 1,2% and 6,7% used in the actuarial report.

Considering the poor performance of the financial markets in 2001 and 2002, an update of the 2000 actuarial report was carried out taking into account recent experience and maintaining the long-term actuarial assumptions.[19] Yields lower than estimates significantly affect the evolution of the reserve. At the end of the projection period, in 2050, the reserve will be 1,2 times the cash outflows rather than 3,1 times, as initially anticipated.

Changes in the ratio of the reserve to the cash outflows of the following year, with and without the experience of 2001-2002



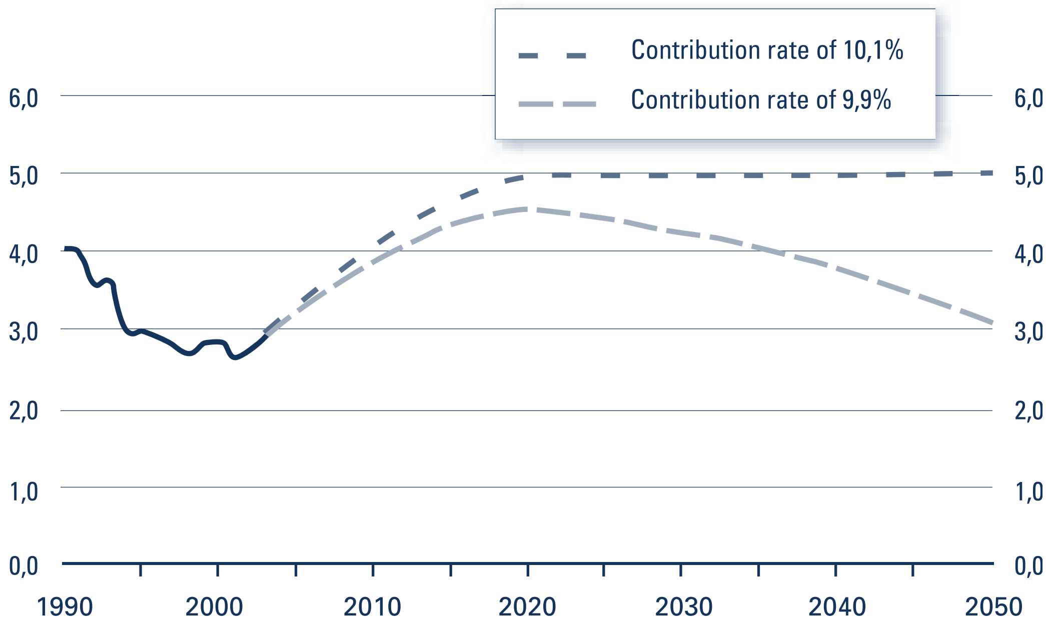
A situation to watch closely

The ratio of the reserve to the annual cash outflows is an important indicator of whether the Plan will have sufficient funds. The financial situation becomes worrisome if, over the projection period, the reserve drops below the minimum level desired before the 1998 reform, that is, twice the annual cash outflows. The experience of 2001 and 2002 made the ratio between the reserve and the cash outflows go below this critical threshold.

Another way to evaluate the stability of the Plan's long-term funding is to refer to the concept of "balanced contribution rate". This is the contribution rate that would be necessary to maintain a constant ratio between the reserve and the annual cash outflows.

[19] A new actuarial report, with a complete revision of the actuarial assumptions, must be carried out as at 31 December 2003. The study will be completed in 2004.

Changes in the ratio of the reserve to the cash outflows of the following year, according to the contribution rate



According to the assumptions of the 2000 actuarial report, this balanced rate would be 10,1%, that is, a difference of 0,2 compared with the contribution rate of 9,9% set by law.[20] If this rate were applied, the reserve would be stable at approximately 5 times the annual cash outflows starting from 2020. At that level, the reserve would generate sufficient investment income to make up the difference between contributions and cash outflows. It would increase at the same rate as the cash outflows, and the ratio of the reserve to the annual cash outflows would be stable.

The adverse financial experience of the last two years brings the balanced contribution rate to 10,25% rather than 10,1%, that is, a difference of 0,35 compared to the actual contribution rate of 9,9%.

Set up monitoring systems

Since the financial situation of the Plan remains under stress, there must be a provision for monitoring in order to avoid a deterioration of the situation. The balanced contribution rate is an indicator of the "ideal" state of the Plan's funding. In reality, it is not necessary for the Plan to be perfectly balanced. A certain difference between the actual contribution rate set by law and the balanced rate can be tolerated without making an adjustment to the Plan necessary.

[20] Section 44.1 of the *Act respecting the Québec Pension Plan* provides that the contribution rate is 9,9% for 2003 and subsequent years.

A difference of 0,3 points can be considered an acceptable tolerance zone. On the other hand, a difference greater than 0,3 translates into a reserve lower than twice the annual cash outflows at the end of the projection period. Adjustments to the Plan could then be necessary. Ideally, such a difference should be noted in two successive actuarial reports to go beyond being purely an exceptional economic circumstance and to be considered factual for changes to the Plan.

Indicators like this would make it possible to inform the public and members of the National Assembly about the Plan's financial situation and the permanent nature of the contribution rate. The contribution rate must remain as stable as possible in the long term to be consistent with the principle of fairness between generations according to which, for the same contribution rate, workers would be entitled to the same benefits. If a situation such as the one described earlier should occur, the public consultation required by law every six years could be an opportunity to discuss the proposals required to assure the rebalancing of the Plan and its funding.

The recent experience is due to an exceptionally unfavourable economic situation whose consequences could be mitigated (or aggravated) in the future. Strictly with regard to the Plan's funding, it would be necessary to act only if the actuarial report as at 31 December 2003 as well as the following report were to confirm that the difference between the rate of 9,9% and the balanced rate would be greater than 0,3 points and that the ratio between the reserve and the cash outflows of the following year would consequently be lower than 2.

On the other hand, the proposals for changes to the Québec Pension Plan presented in this document are necessary to adapt the Plan to the new social and economic realities. In addition, the nature of these changes would make it possible to ensure harmonization with the Canada Pension Plan as indicated in the following section.

4.2 Similarity of the Québec Pension Plan and the Canada Pension Plan

Similar plans

The Canada Pension Plan is the public retirement plan to which workers in other provinces and territories contribute. The Canada Pension Plan and the Québec Pension Plan are similar plans. When the plans came into effect, the two governments wished to have similar plans since all workers in Canada would be covered and a significant number of them would participate in both plans in the course of their career. Similarity was important to assure the competitiveness of companies and to facilitate the mobility of workers.

Today, the greater mobility of workers increases the proportion contributing to both the Québec Pension Plan and the Canada Pension Plan. As the number of contributors to both plans increases, similarity becomes even more important in order to maintain confidence in the plans and to simplify the process for a growing number of participants who can claim their pensions as if they had always contributed to a single plan.

Non-identical plans

Because the plans are similar does not necessarily mean that they are identical. While the plans' principle characteristics are the same, particularly their contribution rates, pensionable earnings, and the retirement income replacement rate, certain secondary provisions can include differences without calling the similarity of the plans into question.

Over the years, various changes have been introduced to make the plans better suited to the needs of workers and to provide them with better protection. Often the plans changed in the same way, so that a modification made by one was adopted by the other shortly thereafter. On occasion, however, certain changes were made to one plan without subsequently being adopted by the other. This is the case, for example, for certain provisions concerning survivors' and disability benefits.

The Québec Pension Plan provides for more generous pensions to surviving spouses under age 65 than the Canada Pension Plan. In addition, eligibility requirements for a disability pension under the Québec Pension Plan are more relaxed for contributors aged 60 to 64. These provisions put the Québec Pension Plan in an unfavourable financial position relative to the Canada Pension Plan.

Similarity to be maintained

The 18th actuarial report on the Canada Pension Plan as at 31 December 2000 established the balanced contribution rate at 9,8%, that is, a difference of 0,3 points relative to that of the Québec Pension Plan, which is 10,1% according to the 2000 report. This difference is explained, on the one hand, by a less favourable demographic situation in Québec, and, on the other hand, by more generous survivors' and disability benefits under the Québec Pension Plan than under the Canada Pension Plan.

Other factors, notably the legislative amendments related to the management of the investments of the Canada Pension Plan, the poor performance of the stock markets in 2001 and 2002, as well as certain differences in actuarial assumptions, increase the difference between the plans' financial situations an additional 0,3 points. Overall, the actual difference between the plans' balanced rates is estimated at 0,6 points.

The balanced contribution rates of the Québec Pension Plan and the Canada Pension Plan do not necessarily have to be identical. A reasonable difference can be allowed without calling the similarity of the plans into question. However, a difference of 0,6 points seems too great. In fact, a difference of this order means that the Québec Pension Plan would not be in a position to maintain parity of rates if the Canada Pension Plan reduced its contribution rate below the threshold of 9,9%. A contribution rate lower than 9,9% could not be sustained by the Québec Pension Plan.

Corrective measures are necessary to reduce the difference between the balanced contribution rates of the two plans. The adjustments proposed to the benefits under the Québec Pension Plan to adapt them to the new social and demographic realities are a step in this direction. These changes would lead to a decline in the cost of benefits to the Québec Pension Plan, which would bring the difference to 0,3 points, that is, within the tolerance zone defined in the proceeding section. However, a difference at the limit of this zone leaves little room to manoeuvre if future economic experience turns out to be unfavourable.

A plan under pressure

The 1998 reform set out to improve the Plan's funding and to ensure its long-term sustainability. The actuarial report as at 31 December 2000 forecast that at the end of the projection period, in 2050, the reserve would be 3,1 times greater than the cash outflows of the following year.

In view of the poor performance of the financial markets, the 2000 actuarial report was updated. At the end of the projection period, the reserve will be only 1,2 times greater than the cash outflows.

The balanced contribution rate is the rate necessary to maintain a constant ratio between the reserve of the Québec Pension Plan and the annual cash outflows. According to the results of the actuarial report, this rate is 10,1%, that is, a difference of 0,2 points relative to the contribution rate of 9,9% set by law. The unfavourable financial experience of 2001 and 2002 brought the Plan's balanced rate to 10,25%.

A tense situation to watch closely

Two indicators are useful for evaluating the financial situation of the Plan:

1. the difference between the balanced rate and the contribution rate set by law;
2. the ratio of the reserve to the annual cash outflows at the end of a projection period.

The financial health of the Plan can be considered sound if the difference between the balanced rate and the rate set by law is less than 0,3 points and consequently if the reserve is at least twice the annual cash outflows at the end of the projection period.

In view of recent experience, the financial situation of the Québec Pension Plan must be watched closely. Action would be necessary if both the 2003 actuarial report and the subsequent report showed that these criteria are not met.

On the other hand, the changes proposed to adapt the Plan to the new social and economic realities would reduce the gap between the balanced rate and the rate of 9,9%.

Similarity to be maintained with the Canada Pension Plan

In addition, the disparity between the financial situation of the Québec Pension Plan and that of the Canada Pension Plan is increasing. Various factors, including the less favourable demographic situation in Québec and more generous survivors' and disability benefits, help explain this difference.

Adopting the proposals for change intended to adapt the Plan to the new realities would lead to a reduction in costs. The new measures would, in this way, help reduce the financial difference between the plans and would bring the difference between the balanced rate and legal rate within the tolerance zone of 0,3 points.

CONCLUSION

In 1998, the Québec government carried out an important reform of the Québec Pension Plan to counter the expected impact of the aging population on the costs of the Plan and to ensure the Plan's long-term sustainability on a basis of fairness and solidarity. At the time of the reform, the government also adopted new governance mechanisms, including periodic public consultations, to review different components of the Plan in relation to changes in the economic and demographic situation.

Considering the rapid aging of the Québec population and the new realities of the labour force, it is important to review the mechanisms for transition from economically active life to retirement provided for in the Plan, in order to encourage workers to remain employed longer.

The Plan's survivors' benefits must also be reviewed since they are still based on a traditional family model that no longer corresponds to the current realities.

The 1998 reform made it possible to improve the Plan's funding and to ensure its viability without transferring too great a cost to future generations. The Québec Pension Plan nevertheless remains under pressure. The changes proposed to adapt the Plan to the new social and economic realities would also make it possible to bring the Plan's contribution rate, which is now set by law at 9,9%, into line with the balanced contribution rate, that is, the rate necessary to maintain a constant ratio of the reserve to the annual cash outflows.

The changes would also reduce the disparity between the financial situation of the Québec Pension Plan and that of the Canada Pension Plan, a necessary step in preserving similarity between the plans.

Appendix

Comparison of the provisions of the Québec Pension Plan and the proposed changes

Retirement pension

Current provisions	Proposed provisions
Eligibility	**Eligibility**
From age 60 to 64: • if the contributor stops working, or • if he or she expects, in the 12 months following his or her application, to earn less than 25% of the MPE* (less than 9 975 $ in 2003); or • if his or her pay is reduced by at least 20% following an agreement with the employer, in view of phased retirement. Starting from age 65, the contributor can request his or her pension even if he or she continues to work. *MPE: maximum pensionable earnings	As of age 60 without other conditions connected to earnings.
Method of calculating the pension	**Method of calculating the pension**
The pension is equal to 25% of the average earnings included in the contributory period, after excluding from the calculation of the average 15% of the years in which earnings were the lowest. The contributory period begins when the contributor turns 18 and ends when he begins to receive his retirement pension. When the Plan is more mature, the contributory period of an individual will be 42 to 52 years depending on age at retirement. After the exclusion of 15%, the pension will be calculated on the basis of 36 to 44 years of contribution.	The pension is calculated on the basis of all career earnings. It is equal to $\frac{25\% \text{ X Total earnings}}{40}$, up to the maximum pension.

Retirement pension (continued)

Current provisions	Proposed provisions
Years of caring for children	**Years of caring for children**
Years in which earnings were low that correspond to years when a person took care of children under age 7 can be excluded from the calculation of average earnings, which has the effect of increasing the pension.	Earnings can be credited for each of the years when an individual took care of children under age 7. The credited earnings have the effect of increasing the year's earnings to the level of the average earnings for the rest of the career and thus increasing the pension. This proposal is almost the same as the current provision.
Actuarial adjustment factor	**Actuarial adjustment factor**
An actuarial adjustment factor is applied to take into account the payment period of the pension. This factor corresponds to a reduction in the beneficiary's pension of 0,5% for each month that precedes his 65th birthday or, conversely, to an increase in the pension of 0,5% for each month retirement is postponed up to the 70th birthday.	The retirement pension is reduced 0,5% for each month of early retirement. It is increased 0,7% for each month of postponed retirement.
Beneficiary who works	**Beneficiary who works**
The beneficiary who works must make contributions, in the same way as other workers. In return, the pension may increase. The increase is made by substituting the new earnings for the lower earnings of a year already included in the contributory period and recalculating the pension.	The beneficiary who works must make contributions, in the same way as other workers. The additional earnings are added to the earnings already entered into the contributor's record and contribute to raising the amount of the pension up to the maximum level.

Disability pension

Current provisions	Proposed provisions
Definition of disability	**Definition of disability**
A contributor may be eligible for a disability pension: • if he is under age 65; and • if he has a severe and prolonged disability which makes him unable to perform any type of substantially gainfulemployment. An individual aged 60 to 64 can also be eligible for a disability pension if, for health reasons, he is unable to perform his usual work.	A contributor may be eligible for a disability pension: • if he is under age 65; and • if he has a severe and prolonged disability which makes him unable to perform any type of substantially gainful employment.
Calculation of the pension	**Calculation of the pension**
370 $ + 75% BRP* *BRP: The "basic retirement pension" of the disabled contributor is the pension that would have been payable if he had been age 65 when he became disabled.	453 $ + RPP* The fixed portion of the pension is increased to the amount of the Old Age Security pension. *RPP: The "retirement pension payable" is the pension payable at the time the contributor becomes disabled; or the retirement pension payable at age 60, if the contributor is under age 60 when the disability occurs.
Calculation of the retirement pension of the disabled beneficiary who turns 65	**Calculation of the retirement pension of the disabled beneficiary who turns 65**
Payment of a disability pension ends when the beneficiary turns 65; the pension is replaced by a retirement pension. The retirement pension is calculated as if the beneficiary had retired when he became disabled, and is then indexed to wage increases. An actuarial adjustment factor is applied to the amount of pension paid to take into account the months for which the beneficiary received a disability pension between ages 60 and 65.	The fixed portion of the disability pension ends when the beneficiary reaches the age of eligibility for the federal Old Age Security pension. The variable portion (equivalent to the RPP) continues to be paid and is indexed to inflation.

Surviving spouse's pension

Current provisions	Proposed provisions
Calculation of the pension	**Calculation of the pension**
Before age 65	Non-retired spouse
Fixed benefit + 37,5% BRP* Fixed benefit Under age 45, without children: 95 $ Under age 45, with children: 344 $ Under age 45, disabled: 370 $ Age 45 to 54: 370 $ Age 55 to 64: 400 $ *BRP: the basic retirement pension of the deceased contributor is the pension that would have been payable if the deceased contributor had retired at age 65.	Temporary pension paid for three years and equal to the pension payable for disability and transfer to the spouse's account of 60% of the earnings entered into the deceased contributor's record during the period of life together.
After age 65	Retired spouse or non-contributing and aged 65 or over
60% of the BRP.	60% of the deceased contributor's RPP.

Orphan's pension

Current provision	Proposed provision
Pension payable to the minor child of the deceased contributor. Monthly pension of 59 $ (in 2003), indexed to inflation.	Pension payable to the minor child of the deceased contributor. Monthly pension of 187 $ (in 2003), indexed to inflation.

Pension for a disabled person's child

Current provision	Proposed provision
Pension payable to the minor child of the disabled contributor. Monthly pension of 59 $ (in 2003), indexed to inflation.	Two possibilities: • increase the pension to the level of the orphan's pension; or • abolish the pension following an increase in the fixed portion of the disability pension which would rise from 370 $ to 453 $ a month.

Combined pensions

Current provisions	Proposed provisions
Combined retirement/survivors' pension for beneficiaries aged 60 to 64	**Receive concurrently both a temporary pension and a retirement pension**
The beneficiary can receive both pensions. However, the sum of the variable portion of the survivors' pension and the retirement pension cannot exceed the maximum retirement pension taking into account the age of the beneficiary at the time of retirement.	The surviving spouse who receives a temporary pension may request a retirement pension if eligible. However, the sum of the variable portion of the survivors' pension and the retirement pension cannot exceed the maximum retirement pension taking into account the age of the beneficiary at the time of retirement.
Combined retirement/survivors' pension after age 65	**Receive concurrently both a retirement pension and a surviving spouse's pension**
A beneficiary can receive a retirement pension and a surviving spouse's pension. However, he or she cannot simply receive the sum of the two pensions; he or she does not receive his or her own retirement pension and 60% of the deceased contributor's pension. Rather, she receives the higher of the following combinations: • 100% RP + 37,5% RP of the deceased contributor; • 60% RP + 60% RP of the deceased contributor. The combined pension is subject to a ceiling; it cannot exceed the maximum retirement pension calculated on the basis of the beneficiary's age when he or she retires.	A beneficiary may receive both a retirement pension and a surviving spouse's pension. However, the total paid cannot exceed the maximum retirement pension calculated on the basis of the beneficiary's age when he or she retires.
Combined disability/survivors' pension	**Receive concurrently both a temporary pension and a disability pension**
The disability pension and the survivors' pension both include a fixed portion. The beneficiary receives the higher of the two. He or she also receives the sum of the variable portion of the two pensions. The total of the variable portions cannot exceed the maximum retirement pension.	The disabled surviving spouse receives both the temporary pension and the disability pension that she was receiving at the time of the contributor's death. The sum of the variable portions of the pensions cannot exceed the maximum retirement pension.

Notes

Adapting the Pension Plan to
Québec's new realities

Working paper

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