Senate – Standing Committee on Banking, Trade and Commerce
Statement by the Chief Actuary, Jean-Claude Ménard
20 October 2005

Good morning Mr. Chairman, honourable members of the Committee. Thank you for the opportunity to appear before you today to talk about issues dealing with the demographic change that will occur in Canada within the next two decades, its implications and possible actions that could be taken to address these implications for public pension plans.

Mandate and Activities of the OCA

Let me start by talking about the mandate and activities of the Office of the Chief Actuary (OCA). Although the OCA is housed within the Office of the Superintendent of Financial Institutions (OSFI), it operates independently with a unique role and mandate different from OSFI's. The primary role of the OCA is to provide actuarial services to the federal and provincial governments who are Canada Pension Plan (CPP) stakeholders. While I report to the Superintendent of Financial Institutions, I am solely responsible for the content and actuarial opinions reflected in the reports and prepared by my office. The reporting and accountability framework for the Office of the Chief Actuary establishes this responsibility.

Our mandate is to conduct statutory actuarial valuations of the CPP, Old Age Security (OAS) Program, and pension and benefit plans covering the federal public service, the Canadian Forces, the RCMP, federally appointed judges and Members of Parliament. Since 2001, we have also performed an annual actuarial review of the Canada Student Loans Program. In addition, whenever a Bill is introduced before Parliament that has a significant impact on the financial status of a public pension plan falling under the statutory responsibilities of the Chief Actuary, the OCA must submit, to the appropriate minister, an actuarial report valuing this impact. I submit these reports as well as the triennial statutory actuarial reports to the ministers of Finance, Social Development,

Human Resources and Skills Development and to the President of the Treasury Board. The OCA also provides sound actuarial advice to these departments to assist them in the design, funding and administration of these programs.

Size and Aging of the Canadian Population

As reported in the most recent 21st Actuarial Report on the CPP and the 7th Actuarial Report on the OAS, the population of Canada in 2003 stood at 31.6 million people. At that time, the median age was 38 years; that is, half the population was older than this age. The proportion of the population aged 20 to 64 (those of working age) was 62%, the proportion for those aged 65 and older (retirees) was 13%, and those aged 80 and older comprised about 3% of the population. According to the demographic projections of these Reports, the Canadian population is expected to age considerably by 2030, the year by which most baby boomers will have retired.

From the year 2003 to 2030, the population is projected to grow to 38.6 million. By 2030, the median age is expected to increase by over 6 years to 44. During this period, the working-age population will decrease in proportion from 62% to 56% of the population or 21.7 million people, while the proportion of retirees will increase significantly from 13% to 23% or 8.9 million people. Those 80 and older will also significantly increase from 3% to 6% of the population or 2.3 million. This group represents one of the fastest growing segments of the population.

These projections are based on assumptions developed for fertility, migration, and mortality. It is expected that the population will continue to increase, but at a declining rate due to projected low levels of fertility. The population will also age over time as a result of low fertility, increasing life expectancies, and the aging of the baby boomers. The fertility rate has been generally declining since the late 1950s and is projected to remain low at below replacement level. Future gains in life expectancy are anticipated, albeit at a slower pace than has been observed in the past. Net migration (the excess of migration over emigration) is

expected to not change materially. As fertility will likely remain low, by 2030 all projected growth in the population will come from net migration.

Implications of an Aging Society and Government Actions Taken to Date

As the population grows at a slower rate and ages, greater dependency will be placed on those of working age, as a greater number of youths and retirees will depend on those in the workforce. In 2003, there were 21 retirees for every 100 persons of working age. By 2030, it is expected that this ratio will almost double to 41 per 100. During the same period, the number of youths per working age persons is expected to fall somewhat from 40 to 37 per 100 due to low fertility. The total dependency ratio is thus expected to increase significantly. The size of the working-age population will continue to grow, except for a temporary period between 2020 and 2030 when the bulk of the boomers will retire. However, the working-age population as a percentage of the total population will likely fall.

In 2003, there were 243,000 Canadians who reached age 65. By 2030, this number is projected to more than double to over 509,000. A labour shortage may occur in the future as older workers retire with a resulting extended period of high labour demand. The impact of this would be particularly felt from those professions and sectors of the workforce whose members are older on average than those from other sectors.

As the population ages, the cost of the public pension plans (OAS, CPP and QPP) will likely increase from 5% of the GDP in 2003 to 7% by 2030. In comparison to other OECD (Organization for Economic Co-operation and Development) countries, the cost of public pensions for Canada is relatively low. Australia, the United States, and the United Kingdom have lower public pension costs than Canada and their costs are projected to remain lower, ranging between 4% and 6% of GDP in 2030. OECD countries with much higher public pension costs are France, Italy, and Germany. Projected costs in the year 2030 for these countries are approximately 16% of GDP. Despite relatively low

public pension costs in Canada, we rank very well compared to other countries in terms of the adequacy and equity of our retirement income system.

Old Age Security Program and Guaranteed Income Supplement

The ratio of OAS expenditures to GDP is expected to increase from 2.4% to 3.2% between 2010 and 2030, driven largely by the retirement of the baby boomers. However, Canada has shown the largest budgetary improvements of any of the other G7 countries over the past decade. Balancing the budgets and taking steps to put the debt as a proportion of the GDP on a downward track are effective ways to ensure sustainable financing of the OAS funded from the Consolidated Revenue Fund.

Included in the projected cost for the OAS are planned increases in GIS benefits as proposed in the 2005 federal Budget and stated in Bill C-43, which received Royal Assent on 29 June 2005. Increases are set for the maximum monthly GIS benefits in the amounts of $36 for single seniors and $58 couples. Half of these increases are to take effect 1 January 2006, and the other half are to take effect 1 January 2007. A total of 1.6 million GIS recipients will benefit from these increases. These increases will result in an additional cost of $2.7 billion in GIS payments over the next 5 years.

Canada Pension Plan

Following extensive consultations in 1997, the provincial and federal governments agreed to change the funding approach of the CPP to one of "steady-state" funding – a hybrid between pay-as-you-go and full funding. The contributions were increased, the future growth of benefits was reduced, and the CPP Investment Board (CPPIB) was created to invest the funds not required by the CPP to pay current benefits. These measures have acted to ensure the long-term financial sustainability of the CPP. Contributions are projected to exceed benefits until 2021. Funds not required to pay benefits will be invested by the CPPIB. As a result, the assets will cover an increasing number of years of

expenditures over this period, reaching more than 5 years after 2015. The retirement of the boomers will create upward pressure on the Plan outflows, and a part of the investment income of the Plan will be required to pay for benefits after 2021. However, assets will still continue to grow through the long term.

At the time of the amendments, the steady-state rate was determined in an actuarial report to be 9.9% for years 2003 and onward. As a result, the legislated rate is 9.9%. Under the 21st actuarial report, the steady-state rate is now 9.8%. As the legislated rate is higher than the steady-state rate, the funding status of the Plan will improve over time, and the greater this difference, the greater the improvement. On the other hand, if in the future the steady-state rate exceeds the legislated rate, then default provisions in the *Canada Pension Plan* Act may result in adjustments being made to both the contribution rate and benefits in pay if the federal and provincial governments are unable to reach agreement on action to take. In such a case, one half of the difference would be applied to increasing the contribution rate, and the other half would be applied to non-indexation of benefits in pay until the next triennial review. In other words, the contributors and beneficiaries would equally support the additional cost shown in the actuarial report.

Future Government Actions

The Canadian retirement income system includes diversification of both sources of income (private and public pensions) and funding approaches. A mix of full funding (RPP/RRSP), partial funding (CPP/QPP) and pay-as-you-go funding (OAS/GIS) is well recognized for its capacity to adapt rapidly to changing conditions, including the aging of the population. Canada has also succeeded in maintaining a reasonable cost of pensions, in significantly reducing poverty among seniors and in ensuring seniors can maintain their standard of living in retirement. This system is expected to be sustainable and affordable well into the future in the face of changing demographic conditions. Ongoing review of the system will help to ensure this remains the case.

The federal and provincial governments are co-stewards of the CPP, and as such, jointly govern the plan. In 1997, as part of the reforms to ensure the long term financial health of the CPP, the governments agreed to increase the frequency of actuarial reporting from every five years to every three years. The CPP legislation was also changed to require federal and provincial finance ministers to review the Plan's finances every three years. The ministers are required to make best efforts to complete the next review by the end of 2005.

You were given the most recent CPP actuarial report that was tabled before Parliament in December 2004. This report is one item considered by the federal and provincial finance ministers when reviewing and making recommendations on the CPP. In a past Federal-Provincial Review of the Canada Pension Plan, the ministers endorsed regular peer reviews of such reports and consultations by the Chief Actuary with experts on the assumptions to be used in actuarial reports.

In the most recent independent peer review of the statutory actuarial report on the CPP, the reviewers state that they found each of the major actuarial assumptions to be in the reasonable range. Five of the assumptions were found to be near the centre of the range, while two assumptions were found to be more conservative and two assumptions less conservative than what the reviewers would have chosen. Overall, the best-estimate assumptions in aggregate were found to be within the reasonable range, but a little more conservative than what the peer reviewers would have chosen. To ensure the quality of future actuarial reports, I continue to consult with experts in the fields of long-term demographic and economic projections in the preparation of actuarial reports.

Factors that may reduce the future financial pressure on the public pension system include increases in net migration, further increases in labour force participation rates particularly for women and older workers, and higher salaries due to the expected labour shortage. Public policy may be able to influence the

evolution of some of these factors. It should be noted that it is difficult to directly influence the fertility rate.

Of these factors, increases in net migration could have a material impact – provided that those who immigrate to Canada are younger than the general population. An increase in net migrants along these lines would result in a younger population and thus a larger working-age population and mitigate some of the aging challenges on government finances, public pensions and the economy more generally.

Higher than projected labour force participation could also materially impact the Plan. Under the most recent CPP and OAS actuarial reports, increases are projected for labour force participation rates, more so for women than for men, and upward pressure on the real wage rate is expected as a result of a potential labour shortage. These developments should act to moderate Plan costs.

Greater work force attachment among older workers, which is expected in the report –will also help to mitigate plan costs and is widely viewed as providing important benefits to employers and the broader economy in terms of skills retention and knowledge transfer to younger generations. This said, labour force participation rates among older workers are expected to remain well below those of core age workers.

Minimizing institutional and financial disincentives to work has the potential to raise the labour force attachment of older Canadians. This said, changes to the CPP likely have only a minimal impact on the decision of most people to retire from the labour force, and therefore would not be expected to in and of themselves address the broader economic and fiscal challenges posed by an aging population.

An actuarial study was prepared in March 2003 by the OCA on the CPP actuarial adjustment factors which are used for those who commence their CPP

retirement pensions either before or after age 65. The CPP retirement pension is permanently adjusted downward or upward by 0.5% for each month between age 65 and the age the pension commences, which can be as early as age 60 or as late as age 70 at the discretion of the contributor. The study found that these current adjustments are too generous for those who elect to take their benefit before age 65, and that conversely, benefit uptake after age 65 is penalized. It is worth noting, however, that the Plan is financially sustainable even though the adjustments are no longer cost neutral to the Plan.

Policy makers may also want to consider whether the CPP is sufficiently accommodating of the more varied transitions to retirement and career paths that are becoming increasingly common. Allowing people to take their CPP pension and continue to accrue additional CPP pension benefits may merit consideration. It would, of course, require that working pensioners contribute to the Plan, which is currently not the case in the CPP. In contrast, the QPP has required working pensioners to contribute and potentially accrue additional QPP retirement benefits since 1998.

In the context of an aging population, where life expectancy at age 65 is expected to continue to increase and projected labour force shortages could induce older workers to stay at work longer, policy makers will have to determine whether the current actuarial adjustments should be changed or certain plan provisions modified to restore neutrality to the Plan's flexible retirement provisions. This said, the CPP is expected to remain financially sustainable at the 9.9 per cent contribution rate without any changes to the Plan.

I hope that I have succeeded in providing you with a greater understanding of the aging of the Canadian population and its implications for public pension plans. I wish to thank you for the opportunity to appear before this Committee, and I will be pleased to answer any questions that you might have.