

Canada's Pension Pillars In Need Of Repair:

Report Of Provincial Finance Ministers

By: Mark Newton

The steering committee of provincial finance ministers has posted its report on retirement income adequacy in Canada and its proposals for improving pension plan coverage. The committee is chaired by Colin Hanson, the minister of finance for British Columbia.

The committee's report is sobering and presents credible evidence that Canada's retirement income system is woefully inadequate when compared with other industrialized nations. The committee proposes a couple of solutions, through broadening the Canada Pension Plan (and Quebec Pension Plan), using either an additional layer of Defined Benefits or by introducing a Defined Contribution component.

It used to be that Canada's pension system was described as a three-legged stool, with the three legs being:

- government pensions (Old Age Security plus CPP/QPP)
- employer-provided pension and retirement savings plans
- personal retirement savings.

The stool analogy has given way to 'pillars' in recent years, in order to permit better comparisons with the regimes of other countries. The pillars are a little different and much shakier than the stool legs of old.

There are now three pillars, and possibly four, as follows:

- the OAS and Guaranteed Income Supplement (GIS), funded from tax revenues
- the CPP/QPP, being a compulsory program covering all employees and self-employed persons
- employer pension and retirement plans and personal tax-assisted retirement savings
- a possible fourth pillar consists of other personal savings and investments, including home equity.

The committee's report focuses on the first three pillars.

In a nutshell, the committee found that while the income needs of current retirees are fairly adequate, this will not be the case in future. The difference is largely attributable to declining pension plan coverage and inadequate personal retirement savings. Added to that is the inadequacy of the CPP/QPP.

The picture is bleak and does not portend well for the future generation of retirees without significant change to the retirement system.

Pillars 1 and 2 are designed to provide about 40 per cent income replacement for persons earning up to the national average wage (\$46,300 in 2009). The report cited a study conducted by the Organisation for Economic Co-operation and Development (OECD). The OECD study found that while the OAS and CPP/QPP are financially stronger than in most other OECD countries, the level of income replacement on retirement ranked 20th out of 26 countries for persons earning one and a half times the average wage (about \$70,000).

With regard to Pillar 3, according to the report, two thirds of the Canadian labour force (public and private sectors) are not covered by a pension plan. In the private sector alone, a full three quarters of employees are not covered by a pension plan. In addition, only six per cent of available RRSP contribution room is being used.

Quoting a 2007 study by the University of Waterloo, two thirds of private sector employees planning to retire in the next 20 years and who earn between \$30,000 and \$100,000 "will not have sufficient retirement income to cover necessary living expenses."

The committee proposed two models to buttress the retirement savings system, having regard to where the current problems exist and what solutions are most likely to be effective in providing solutions. The two proposed models are:

- a 'Canada Supplementary Pension Plan' (CSPP), which would be a Defined Contribution top-up plan adjoined to the CPP/QPP
- an expansion of the CPP/QPP defined benefits.

The two models are not presented as mutually exclusive.

The committee focused on solutions that build upon the CPP/QPP because of the existing expertise within the CPP/QPP and the CPP Investment Board in administration and investment management. Using this expertise, according to the report, would serve to keep costs down. The report noted the inefficiencies in the private sector system, particularly with regard to investment management fees and individual selection of investments.

The CSPP would be a voluntary DC plan for those not currently covered by an employer retirement plan and operated at arm's length from the government. Employers and employees would be automatically enrolled unless they decided to opt out. Automatic enrolment was found to work well with 401(k) plans in the U.S. Contributions would be set at 10 per cent of earnings, shared equally by employers and employees. Employees would not have investment choice. Individual investment choice was found to be very inefficient in terms of fees and returns.

Several models to expand the level of defined benefits under the CPP/QPP were presented. This type of solution would be operated under the CPP/QPP, would be mandatory and would cover all employees and self-employed persons. The report examined three variations on the current CPP/QPP, that would increase the earnings limits and/or increase the income replacement rate. All three variations would include additional employer and employee contributions.

There appears to be a growing impetus behind some form of 'super-plan' model to shore up the retirement savings system. The expert commission reports in Ontario, Nova Scotia, and Alberta/British Columbia have all recommended supplementing the current system through the use of large province-wide or national plans. The Ontario government enacted legislation last year to permit the Ontario Teachers' Pension Plan and the Ontario Municipal Employees Retirement System to administer smaller pension plans. ■

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