Enhancement of the Canada Pension Plan (CPP) is expected to be a major issue in the upcoming federal election. This article provides an overview of likely features of a CPP enhancement proposal along with the pros and cons.

CPP Enhancement: The Debate Takes Centre Stage

by | **Jeremy Bell**

Canadian retirement income and, in particular, enhancements to the Canada Pension Plan (CPP) may be one of the defining issues in the next federal election in October 2015. Depending on the outcome of the election, the impact could be felt for generations.

In recent years, many CPP enhancements have been proposed by interest groups, observers and governments. These proposals have varied considerably from modest escalation to very large increases. Supporters argue Canadians are facing a retirement income crisis that must be addressed, while those in opposition say the retirement crisis is not as severe as some believe and that expanding the CPP could hurt the economy.

Federal Positions—Government and Opposition

Efforts to enhance CPP stalled in December 2013, largely because of the federal government's position that a precondition for its support is unanimity, or near unanimity, from the provinces.

The two main federal opposition parties—the NDP and the Liberals—have expressed support for the concept of CPP enhancement. In fact, both have official policies stating that they will work with the provinces to enhance CPP. In other words, both parties should be expected to actively support efforts toward CPP enhancement.

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The Real Retirement
Fred Vettese and Bill Morneau. Wiley. 2013.
Visit *www.ifebp.org/books.asp?8989* for more details.

Retirement in Canada
Thomas R. Klassen. Oxford University Press. 2013.
Visit *www.ifebp.org/books.asp?9004* for more details.

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The federal opposition parties may be emboldened by the 2014 Ontario election results. The Ontario Liberal Party announced the Ontario Retirement Pension Plan—a made-in-Ontario alternative to CPP enhancement—within its platform and secured a majority government in the 2014 election.

One can expect that CPP enhancement will be part of the official platforms of the NDP and the Liberals. CPP enhancement may become one of the handful of defining policies over which the election is contested.

Provincial Positions

In addition to the support of the federal government, enhancing CPP requires the support of two-thirds of the provinces representing two-thirds of the population.

As of this writing, observers generally believe that six of the ten provinces have expressed support publicly for CPP enhancement: Ontario,[1] Quebec, Manitoba, Nova Scotia, Newfoundland and Labrador and Prince Edward Island. These six provinces represent more than two-thirds of the population of Canada but only 60% of the provinces.

Alberta and Saskatchewan have expressed the strongest objections to CPP enhancement. British Columbia and New Brunswick are believed to have reservations. In September 2014, however, power in the New Brunswick government shifted from the Progressive Conservative party to the Liberal party. Although CPP enhancement was not included in the New Brunswick Liberal platform, the party may reach a different conclusion on the issue than its predecessors.

In any event, provincial support for CPP enhancement is either at or very close to the required standard to move forward. As such, the federal government after the 2015 election, whether for or against, has a good chance of defining whether CPP enhancement will proceed.

Enhanced CPP

As evidenced by the proposal made by Prince Edward Island in 2013 and the details of the Ontario Retirement Pension Plan, it appears that CPP enhancement supporters are settling on the more modest proposals in the spectrum.

General themes most likely to gain approval in CPP enhancement proposals are:

- **No cost to governments.** Governments, federal and provincial, would not be responsible for funding enhanced benefits. This is consistent with the current state of CPP, where the cost is borne by employers and employees.
- **Cost sharing**. Employees and employers would fund the additional cost on a 50/50 basis.
- **No opt-out**. Participation in the enhanced CPP would be mandatory for employers and employees, as is the case for CPP currently.
- **Universality**. All working Canadians would be covered by the enhanced CPP. No employer or employee would be exempt from participation because of their participation in an employment pension plan or personal savings.
- **Earned**. Enhanced CPP would be earned while an active contributor to CPP. In other words, Canadians at or near retirement would see no or very little CPP increases. Instead, Canadians at the beginning of their careers would see a nearly full impact of increased CPP.
- **Phased in**. Contributions required to fund the CPP enhancements would be introduced gradually rather than all at once, likely over a number of years. Benefits may be introduced gradually as well.
- **No increases for low-income recipients.** Those with incomes below a certain threshold would not receive increases in CPP entitlements and contributions. The rationale for the wedge is that government programs—CPP, Old Age Security (OAS) and Guaranteed Income Supplement (GIS)—provide adequate support for lower income Canadians and, at lower income levels, additional CPP benefits may decrease other entitlements, particularly GIS.
- **Doubling of benefit levels.** Many of the proposals will provide benefits at roughly double the current level for certain incomes—say, at or above $100,000 per year. Increases will be less than double at lower incomes.
- **Less-than-doubled contributions**. Contributions would increase by less than double at the incomes where benefits double. Today, contributions fund current service and past service; maximum contributions are about $5,000 per year (employee plus employer). With enhanced CPP, the current service would increase but past service would not be affected; maximum contributions to get double the benefits would be about $8,000 per year (employee plus employer).

There are a number of ways to define and calibrate a model to achieve the themes above.

Arguments for CPP Enhancement

Those supporting CPP enhancement primarily cite an impending decline in senior standard of living without government intervention, particularly for today's younger working Canadians. Gerry McCaughey, former CEO of CIBC, stated, "Our economists estimate that almost 60% of adults in their late 20s or early 30s can expect to experience a significant decline in their standard of living when they retire."

In theory, Canadians rely on a combination of government programs (CPP, OAS and GIS), employment pensions and personal savings, but:

- **Personal retirement savings are limited:**
  —23.7% of tax filers contributed to a registered retirement savings plan (RRSP) in 2012. Of those who contributed, the median contribution was $2,930.[2]
  —As of 2011, 23.1 million people had unused RRSP contribution room totalling $828 billion.[3]
  —59% of RRSP contributions in 2012 were made by contributors with total income greater than $80,000.[4]
- **Employment pension coverage is uncommon:**
  —About 38% of working Canadians had coverage in a registered workplace pension plan in 2012.[5]
- **Government programs only provide limited support for middle-income earners:**

—Those earning between $50,000 and $100,000 per year can expect to receive income replacement from government programs of 40% to 15%, respectively.

- Maintaining a standard of living in retirement is generally thought to require income replacement at around 70% of preretirement income.

Access to retirement savings vehicles is not a problem: RRSPs offer enough room so that, when combined with government programs, Canadians can achieve a retirement income of around 70% of preretirement income. Rather than access, the issue is usage of retirement vehicles: Canadians are not using RRSPs and employers are not providing workplace pensions. Because usage is the issue rather than access, supporters of CPP enhancement tend to focus on mandatory CPP enhancement rather than voluntary CPP enhancement.

In addition to limiting the likelihood of significant declines in standards of living in retirement, proponents say CPP enhancement brings the added benefit of cost-efficiency:

- CPP enhancement would result in limited additional administrative costs because existing processes will largely suffice for collecting higher contributions and issuing larger cheques.
- CPP Investment Board costs, including external investment manager costs, have been about 0.85% of assets in recent years. This investment fee is much lower than retail fees that would otherwise be paid on personal savings, generally 2-3% per year. That's in spite of the fact that about 40% of CPP assets are allocated to private assets—assets with attractive risk-return characteristics and correspondingly higher fees.

Arguments Against CPP Enhancement

Those arguing against CPP enhancement advance the following arguments:

- **The timing is not right**. CPP enhancement involves an additional payroll tax. Increasing payroll taxes may harm the fragile economic recovery.
- **CPP enhancement is a broad solution to a problem only affecting a subset of Canadians**. Canadians in workplace pension plans and Canadians diligently saving for retirement in personal vehicles, like RRSPs, do not need CPP enhancement. These Canadians should not be forced to take part in a mandatory CPP.
- **CPP is risky and not guaranteed**.CPP is technically a target benefit plan. In other words, if investments perform poorly and contributions can't be increased, benefits may be cut.
- **CPP enhancement would crowd out RRSP contributions**. With additional contributions being made to CPP by employees and employers, less money would be available to contribute to RRSPs.
- **There is no pension crisis at all.** The analysis supporting the existence of a pension crisis misses significant nonregistered savings. When these are considered, there may not be a pension crisis after all.
- **Decreased access to GIS and OAS.** An increase in CPP, depending on how implemented, could limit lower income Canadians' ability to access GIS in retirement and middle-income Canadians' ability to access

Takeaways

- Enhancements to the Canada Pension Plan (CPP) have been proposed in recent years, but the issue is expected to be one of the defining issues of the 2015 federal election.
- CPP enhancement supporters appear to be settling on the more modest proposals in the spectrum.
- Supporters cite an impending decline in the senior standard of living without government intervention.
- Those opposed to CPP enhancement say enhancing the CPP now could harm the economy and that the CPP is a broad solution to a problem affecting only a subset of Canadians.
- Pension plan sponsors and trustees should be prepared to research the options in CPP enhancement and take part in the debate.

OAS in retirement. In other words, certain Canadians may not enjoy the full benefit of CPP enhancement.

Some of the objections to CPP enhancement may be dealt with through implementation decisions: For example, a “wedge” feature can limit the offset of GIS. Other objections may be acceptable: For example, it is likely desirable that those making maximum contributions to RRSPs would decrease their RRSP contributions after CPP is enhanced.

The first two objections, impact on the economy and that CPP enhancement is a broad solution to a problem only affecting a subset of Canadians, are likely the more valid objections.

Conclusion

Everyone involved in the pension and benefits industry should be excited about the prospects of debate in 2015 that could shape Canadian retirement income. Plan sponsors and trustees should be prepared to research the options and take part in the debate.

If CPP enhancement proceeds, there will be an impact on workplace pensions. It is premature for trustees or sponsors to consider any actions now. However, as CPP enhancement proposals coalesce around a preferred proposal with details, they should be ready to consider actions, likely including prospective benefit decreases.

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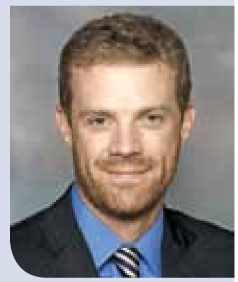

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Endnotes

1. While the Ontario government is actively implementing the Ontario Retirement Pension Plan, it is generally believed that the Ontario government would prefer CPP enhancement and would forgo implementing the Ontario Retirement Pension Plan if CPP enhancement were available.
2. Statistics Canada, “Table 111-0039—Registered Retirement Savings Plan (RRSP) contributions, by contributor characteristics.” 2014.
3. Statistics Canada, “Table 111-0040—Registered Retirement Savings Plan (RRSP) Room for 2012.” 2014.
4. Statistics Canada, “Table 111-0039—Registered Retirement Savings Plan (RRSP) contributions, by contributor characteristics.” 2014.
5. Statistics Canada, *Pension Plans in Canada and Labour Force Survey*. 2011. http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/labor26a-eng.htm.