

Seniors and Retirement Security

Retirement incomes

Action is urgently needed on pension reform to ensure the future economic security of Canadians as the baby boom generation gets set to retire. The stock market meltdown, combined with the current economic recession, has had a major impact on workplace pension plans. The value of pension fund investments has dropped so that many plans are underfunded — lacking enough money to pay all the promised pensions. Companies that continue in business may have time to make up the shortfall before they have to pay out to retirees. But if a pension plan sponsor with unfunded liabilities goes under, workers may lose their pensions or find they get only a portion of what they had expected. Even employers whose business is ongoing may decide to get out of the pension business or to offer less in the way of benefits to their workers — especially to younger workers who have been hired more recently.

Canadians who have been saving for retirement through RRSPs have found the value of their savings has dropped sharply. And if they are close to retirement age, they may have no time left to

wait for the market to bounce back again. They may now be faced with having to go on working because they can no longer afford to retire. In fact, recent changes to the Canada Pension Plan are designed to encourage them to do just that. It's been estimated that the average amount held in RRSPs by workers nearing retirement is about \$60,000 — enough to provide them with an income of only \$250 a month.

Workplace pensions are only one part of the pension system. Only 38% of paid workers have these pensions. That's down from 45% in 1992. Everyone else must rely on public pension programs — Old Age Security, the Guaranteed Income Supplement, and the Canada Pension Plan (the Quebec Pension Plan in Quebec), supplemented by their own savings. These parts of the retirement income system also need to be reviewed.

Reform of the retirement income system is urgent, and we propose to make a start on needed reforms with this year's Alternative Federal Budget. There is probably no one “magic bullet” that will fix everything. But it's important that we consider what can be done and that we actually start doing it.

Canada's pension system

Canada's pension system has been praised by international bodies like the OECD for the good balance it has maintained between public and private arrangements. In fact, it's a three-tier system. The basic building block is Old Age Security and the Guaranteed Income Supplement. Together, they provide a guaranteed annual income for seniors and do not depend on participation in the work force. The Canada Pension Plan (or Quebec Pension Plan in Quebec) constitutes the second tier. These provide earnings-related pensions for people in the paid work force when they retire or become disabled, and benefits for the dependants of disabled or deceased contributors. The third building block consists of private arrangements — workplace pension plans and RRSPs — that receive tax subsidies. There are issues raised in each of the three tiers that need to be addressed. Changes to any part of the system will likely require adjustments to other parts.

Old Age Security and the Guaranteed Income Supplement

There are actually three programs that fall under the Old Age Security Act: the Old Age Security (OAS) benefit itself, the Guaranteed Income Supplement (GIS), and the Allowance. Programs in this first tier of the retirement income system are generally thought of as the “anti-poverty” part of the program. However, it is also important to note that OAS plays a role in replacing pre-retirement earnings.

Old Age Security is an important source of income for today's seniors — particularly for women. In 2007, for example, women aged 65 or older received almost 21% of their income from OAS; OAS provided 15% of the income of men aged 65 or older in the same year. It should be noted that OAS pays a monthly benefit to individuals who meet the residency requirements. Benefits do not depend on participation in the paid work force or on a spouse's income. In ef-

fect, it provides a retirement pension for women in their own name.

There are several issues of concern with the programs in the first tier of the pensions system:

Benefit levels are low

The maximum annual income a single individual could receive from OAS and GIS combined in the July-September 2009 quarter) is about \$14,000. However, Statistics Canada's 2008 after-tax low-income cut-off for a single individual in a major urban area with a population of 500,000 or over was \$18,373. For a couple with no other sources of income apart from OAS, the maximum annual benefit they could receive from OAS and GIS combined in the July-September 2009 quarter was about \$22,748. While this amount was above the 2008 after-tax LICO for two persons living in smaller urban areas, it was close to the after-tax LICO for a larger city.

Although most provinces pay top-up benefits to low-income seniors who are receiving GIS, the amounts of these benefits tend to be small. There are also tax credits, such as the GST credit and the age credit, given to seniors through the tax system. But the fact that 14% of senior women on their own have incomes below the after-tax LICO, even after taking all these programs into account, indicates an urgent need to address their low incomes. The AFB will therefore increase the GIS for single individuals by 15%, adding about \$100 to the maximum monthly GIS benefit for singles and bringing the maximum annual OAS/GIS benefit up to roughly \$15,200, which approximates the after-tax low-income cut-off for a single person in a small urban area. This measure should help to eliminate poverty among older women on their own, recent immigrants, First Nations people, and seniors with disabilities.

Further increases in GIS may be expected in future budgets. We estimate the total cost of this measure will be about \$847 million. It should be noted that, if CPP retirement benefits are increased to this extent, the cost of a GIS en-

hancement could be less than this. We note that the net cost in lost tax revenues of subsidies to RRSPs is projected to be \$16.8 billion in 2010. We propose to limit tax subsidies to RRSPs to free up funds to improve GIS benefits.

Immigrants are disadvantaged

To qualify for an OAS benefit, a person must be a Canadian citizen or legal resident on the day preceding the application's approval, and must have lived in Canada for at least 10 years after age 18. Full benefits are paid only to those who have lived in Canada for 40 years after age 18. (There are some exceptions to this rule — for example, for people who were 25 or older on July 1, 1977.) Those who don't meet these residency requirements may receive a partial OAS benefit equivalent to 1/40th of a full monthly benefit for each full year lived in Canada after the person's 18th birthday.

As a result of these requirements, many immigrants cannot qualify for full benefits. However, it should be noted that low-income immigrants who cannot qualify for full OAS may be able to receive an enhanced GIS to make up for this. This provision may help low-income immigrants who have not been in Canada long enough to qualify for a full OAS benefit, but it should be noted that high rates of low income among some groups — particularly among older women on their own — are calculated after taking into account taxes and transfers. In other words, even after receiving the benefit of government programs, large numbers of these women are still left with low incomes.

We will review the residency requirements for OAS with a view to modifying it to make it easier for immigrants to qualify for benefits. We do not intend to eliminate the residency requirement completely, but we believe there are grounds for reducing it below the 40 years now required.

Indexing to prices will result in a growing gap between seniors and the rest of the population in future

Benefits in the first pillar of the retirement income system — as well as retirement pensions from the CPP — are indexed for inflation using the Consumer Price Index (CPI). Inflation indexing is particularly important for women elders because, on average, they will spend longer in retirement than their male counterparts, so they need to be protected from erosion of the real value of their benefits over time.

Over the longer-term, however, wages tend to increase faster than prices. As a result, seniors in the future will likely find themselves falling further and further behind the rest of the population in their standard of living. The AFB will therefore phase in a new regime of indexing for public pensions (OAS, GIS and CPP) based on wages instead of prices.

The Canada Pension Plan

No government funding is involved in the second tier of the retirement income system — the Canada Pension Plan (and Quebec Pension Plan in Quebec).¹ Essentially, it is a pay-as-you-go plan, in which contributions from the current work force are used to pay pensions to workers who have retired, although the plan became partially funded when changes were made in the late 1990s. Earnings from the CPP investment fund will be used to supplement contribution revenue, starting around the year 2020.

The Chief Actuary of the CPP has given the plan a clean bill of health. He said that, in spite of the projected substantial increase in benefits paid as a result of an aging population, the plan is expected to be able to meet its obligations throughout the projection period — that is, until 2075. He also confirmed that indicators showed the CPP is sustainable over the long term, “as it is projected that there will be more cash inflows than outflows over the entire projection period.”

However, retirement pensions from the CPP are based on replacing 25% of the average annual earnings of a contributor up to a maximum roughly equivalent to the average annual wage. When the plan was established in 1966, the replacement rate was deliberately set at a very modest level in the expectation that private arrangements, such as workplace pension plans and individual savings, would be used to supplement benefits from the public plans to provide an adequate retirement income for Canadians. Clearly that has not happened. As a result, there are now increasing calls for an expansion of the public pension programs.

We support the proposal by the Canadian Labour Congress to double the CPP's replacement rates from 25% to 50% of a retiree's pensionable earnings. The change will be phased in over a seven-year period. This will require an increase in contribution rates from 4.95% of covered earnings in 2009 (with a matching employer contribution) to 7.8% of the Year's Maximum Pensionable Earnings (YMPE) — with a matching employer contribution — in 2016. The maximum CPP retirement pension then would be \$1,635 a month, compared with \$908 a month in 2009.

We will also introduce measures to offset the impact of a premium increase on lower-income workers by doubling the year's basic exemption for contributions so that no contributions would be made on the first \$7,000 of earnings, instead of the first \$3,500 as it is now. We note that, since it will take longer than seven years to qualify for a doubling of maximum CPP benefits, this particular reform will primarily benefit younger workers.

These changes will require the consent of two-thirds of the provinces having two-thirds of the population, but no government funding would be required.

It should also be noted that most workers retiring today do not receive the maximum CPP retirement pension. In fact, the average monthly CPP retirement pension paid to women who re-

tired in May 2009 was only \$391.29, compared with an average \$564.23 for men. Even if improvements are made to the CPP, increases in OAS/GIS will still be needed to supplement the earnings-related pensions of lower-income workers and to provide benefits for those who have little or no retirement pensions from other sources. However, it may be expected that fewer people will need to access GIS.

Workplace pension plans and private savings

The majority of Canadian workers do not have a workplace pension plan. Although 84% of public sector workers have such a plan, only 25% of paid workers in the private sector have pension coverage. Pension coverage is closely related to union membership. For example, almost 80% of workers in unionized jobs have pension plan coverage, compared with only 27% in non-unionized positions. Coverage is also related to firm size, with smaller employers less likely to provide a workplace pension plan.

Nevertheless, measures need to be taken to protect the benefits of those workers who belong to workplace pension plans. Ontario is the only jurisdiction to have a Pension Benefits Guarantee Fund (PBGF). If an employer goes under without enough funds to pay worker pensions, the PBGF guarantees the benefits up to a maximum of \$1,000 a month. The fund has been built up through levies on pension plan sponsors. The recent report of the Ontario expert commission on pensions (the Arthurs Commission) recommended that the monthly guarantee should be increased to \$2,500.

The AFB will establish a national pension insurance fund, with adequate means to guarantee workers' pensions in the event of corporate bankruptcy. The fund will be self-financing and will be mandatory for all plan sponsors under federal jurisdiction. Provinces could opt into the scheme, which would then become manda-

tory for plan sponsors under the jurisdiction of opted-in provinces. Such a national fund already exists in the United States. The AFB will incorporate a permanent program whose objective is to guarantee a better retirement income to people ending their membership in a pension plan, regardless of whether it is the result of the termination of a plan or termination of employment before retirement.

The financing model will follow the recommendation of the Arthurs Commission which reported on pension plans under Ontario jurisdiction. The cost to a plan sponsor would be \$2.50 per year per plan member, to a maximum of \$12 million per pension plan. We also propose a Financial Transfer Tax on Canadian stock markets to be levied by Ottawa's new securities regulator to cover large claims on the insurance system — thereby forcing speculators to play a role in financing pension insurance.

Rather than purchasing annuities for plan members when a pension plan is terminated, the value of deferred or immediate pension rights of terminated plans would be transferred from the original pension plan to the proposed fund. We believe this will immediately permit an increase in deferred and pension benefits in pay by 15% to 20% for a typical pension plan that is not fully funded on wind-up, compared with the current

situation. No injection of government funds will be required to establish the program, other than the administrative costs.

A pension summit

Provincial premiers, through their Council of the Federation, have called on the federal government to host a national summit on retirement income by 2010. According to the premiers, the summit “should bring together provinces and territories, the federal government, and interested stakeholders and experts, to discuss possible options to improve saving options for Canadians and to encourage greater savings.” We propose to call a national pensions summit at which all stakeholders will be able to discuss reform options for all parts of the retirement income system. Among other things, such an event will make it possible to look at how changes to one part of the system may interact with other parts, and to determine what can be done to address the problems Canada's retirement income system is now facing.

Notes

¹ For the sake of convenience we will refer only to the CPP in the rest of this chapter, although the features of the two plans are generally equivalent.