

The Canadian Pension System

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Outline of presentation

- Overview of the pension system
- Is the system meeting its objectives?
- Will the system continue to meet its objectives with an ageing society?
 - Financial sustainability
 - Evolving incomes of seniors
- Conclusions

Overview of the Canadian pension system

Core objectives

- **Poverty avoidance:**
Ensuring a minimum income to the elderly
- **Income replacement:**
Assisting seniors to maintain pre-retirement living standards after retirement

Multi-pillared system

<i>World Bank model</i>	<i>Canada</i>
"Zero" pillar: <i>Non-contributory, ensures minimal protection</i>	Old Age Security
1 st pillar: <i>Contributory, earnings-related</i>	Canada/Quebec Pension Plans
2 nd pillar: <i>Mandatory, individual accounts</i>	---
3 rd pillar: <i>Voluntary arrangements</i>	Registered pension plans, retirement savings plans
Other	Universal health care insurance, etc.

Old Age Security

- Objective: Mainly poverty avoidance, but also income replacement for low- and modest-income workers
- Non-contributory
- Financed entirely from general tax revenues
- Entitlement based on age, length of residence in Canada and income

Old Age Security

■ Benefit amounts

(July-September 2005, monthly, maximum)

- Basic pension CAD^(a) 476.97
- Supplement (single) 566.87
- Supplement (married) 369.24

■ Beneficiaries (March 2005) 4.1 M^(b)

■ Cost (2005/06, estimated) CAD 29.7 B^(c)

(a) CAD 1.00 = JYP 92 (b) M=Million (c) B=Billion

Canada/Quebec Pension Plans

- Objective: Income replacement
- Cover all employed & self-employed persons in Canada
 - Quebec Pension Plan (QPP): Employees working in Quebec, self-employed persons residing in Quebec
 - Canada Pension Plan (CPP): All others
 - Coordinated through agreements between federal/Quebec governments

Canada/Quebec Pension Plans

- Contributory, social insurance
 - Contribution rate 9.9%
 - Basic exemption CAD 3,500
 - Maximum contributory earnings (2005) CAD 41,100
- Partially funded
- Financed entirely by contributions and investment earnings

Canada/Quebec Pension Plans

■ Benefit amounts (2005, monthly, maximum)

• Retirement	CAD 828.75
• Disability	1,010.23
• Survivor <65	(a) 462.42
• Survivor 65+	497.25
• Children	(b) 195.96
• Death (one-time lump-sum)	2,500.00

(a) For QPP, CAD 410.31-710.37 (b) For QPP, CAD 62.22

Canada/Quebec Pension Plans

■ Contributors (2002)	14.9 M
<i>of which:</i>	
• <i>Canada Pension Plan</i>	<i>11.3 M</i>
• <i>Quebec Pension Plan</i>	<i>3.6 M</i>
■ Beneficiaries (March 2005)	5.3 M
■ Cost (2005/06, estimated)	CAD 32.8 B
<i>of which:</i>	
• <i>Canada Pension Plan</i>	<i>CAD 24.9 B</i>
• <i>Quebec Pension Plan</i>	<i>7.9 B</i>

Tax-assisted retirement savings

- Objective: Income replacement
- Registered pension plans, registered retirement savings plans
- Contributions deductible from taxable income to a limit: 18% of earnings, up to CAD 16,500 (RRSPs, 2005)
- Investment earnings not subject to tax as long as they remain in plan
- Benefits/withdrawals subject to tax

Tax-assisted retirement savings

- Registered pension plans:
 - Contractual arrangements, usually between a company and its employees
 - Voluntary – no private company is required by law to have a pension plan; however, usually mandatory for employees of a company with a plan
 - Regulated by federal and provincial laws
 - Also subject to requirements of the *Income Tax Act*

Tax-assisted retirement savings

- Registered pension plans (2003)
 - Plans (number) 14,376
 - Members (number) 5.5 M
 - Contributions (total) CAD 23.5 B
 - Pensions paid (number) ^(a) 2.8 M
 - Pensions paid (amount) ^(a) CAD 41.0 B
 - Assets (total) CAD 794.1 B

^(a) Data for 2002

Tax-assisted retirement savings

- Registered retirement savings plans:
 - Individual retirement savings accounts
 - Entirely voluntary
 - Subject to requirements of the *Income Tax Act*
 - Wide range of investment possibilities: mutual funds, guaranteed income certificates, stocks and bonds, etc.

Tax-assisted retirement savings

■ Registered retirement savings plans (2002)

• Plans (number)	N/A
• Contributors (number)	6.0 M
• Contributions (total)	CAD 27.1 B
• Benefits paid (number)	N/A
• Benefits paid (amount)	CAD 6.3 B
• Assets (total)	CAD 292.5 B

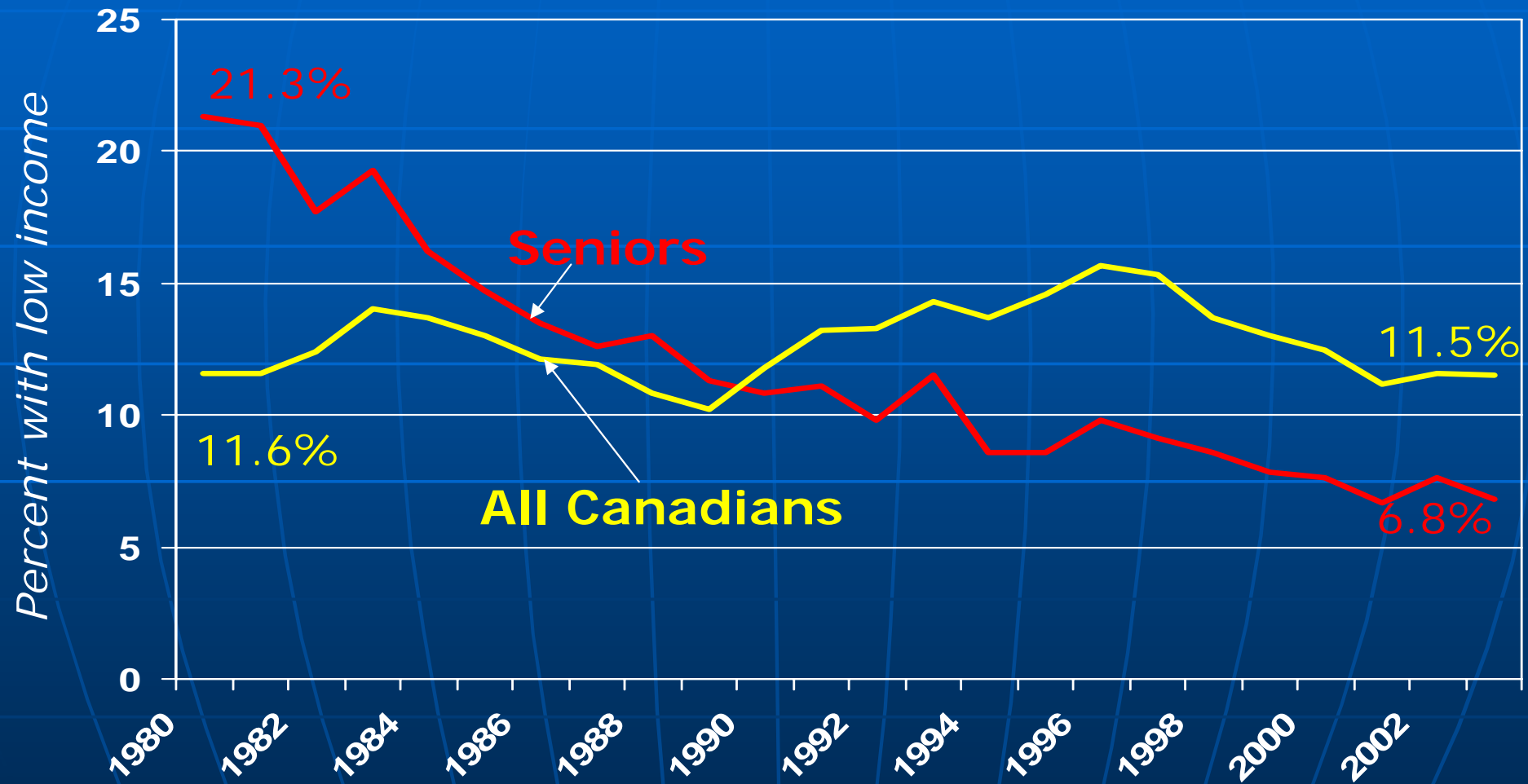
Tax-assisted retirement savings

- Cost of related “tax expenditures”
(tax foregone because of deductibility of contributions and non-taxability of investment earnings, less tax collected on payments and withdrawals)
 - Registered pension plans (2005, estimated) CAD 10.7 B
 - Registered retirement savings plans (idem) CAD 12.6 B

Is the Canadian pension system
meeting its objectives?

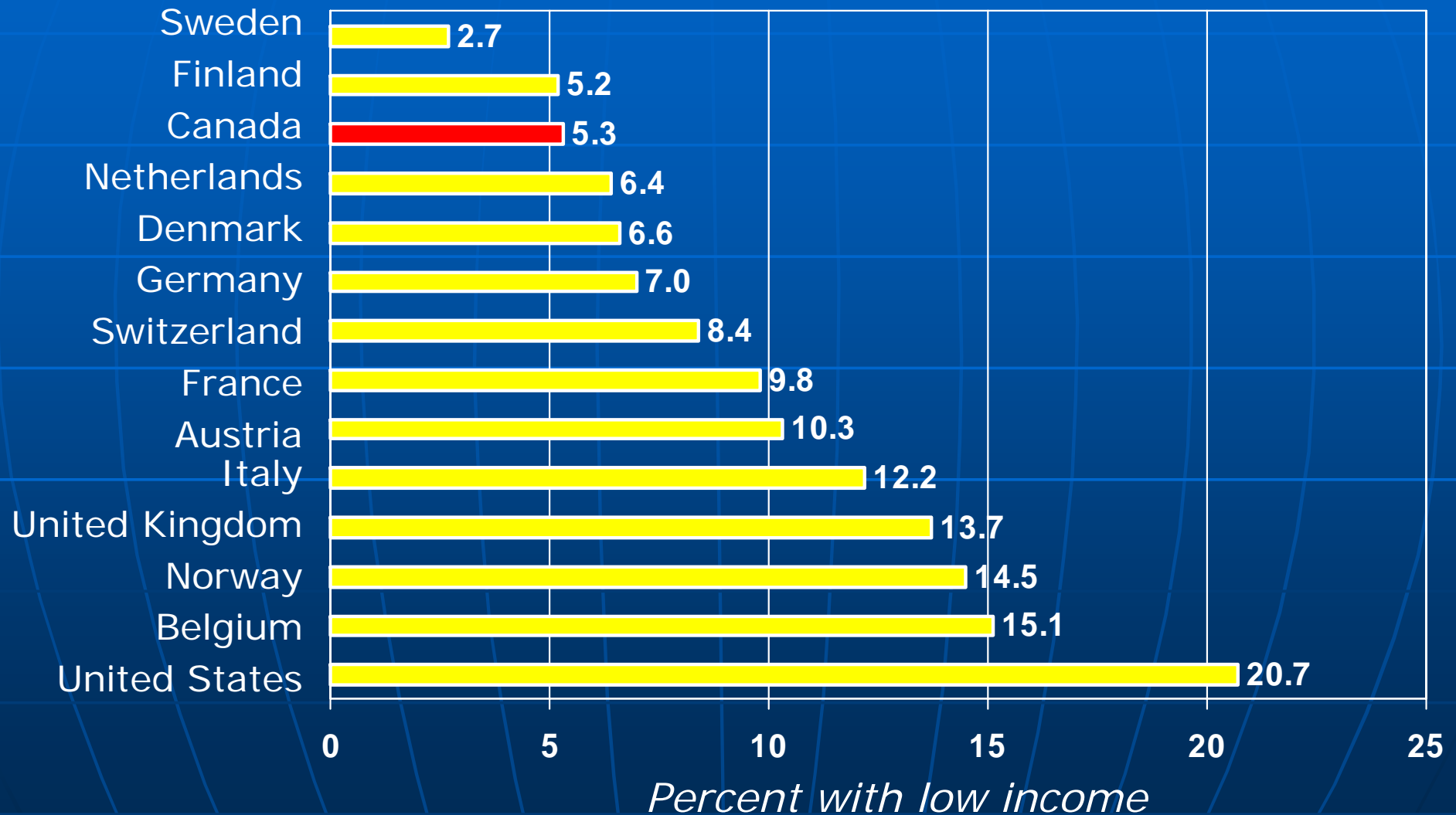
Objective: Poverty avoidance

Low-income: Seniors / All Canadians



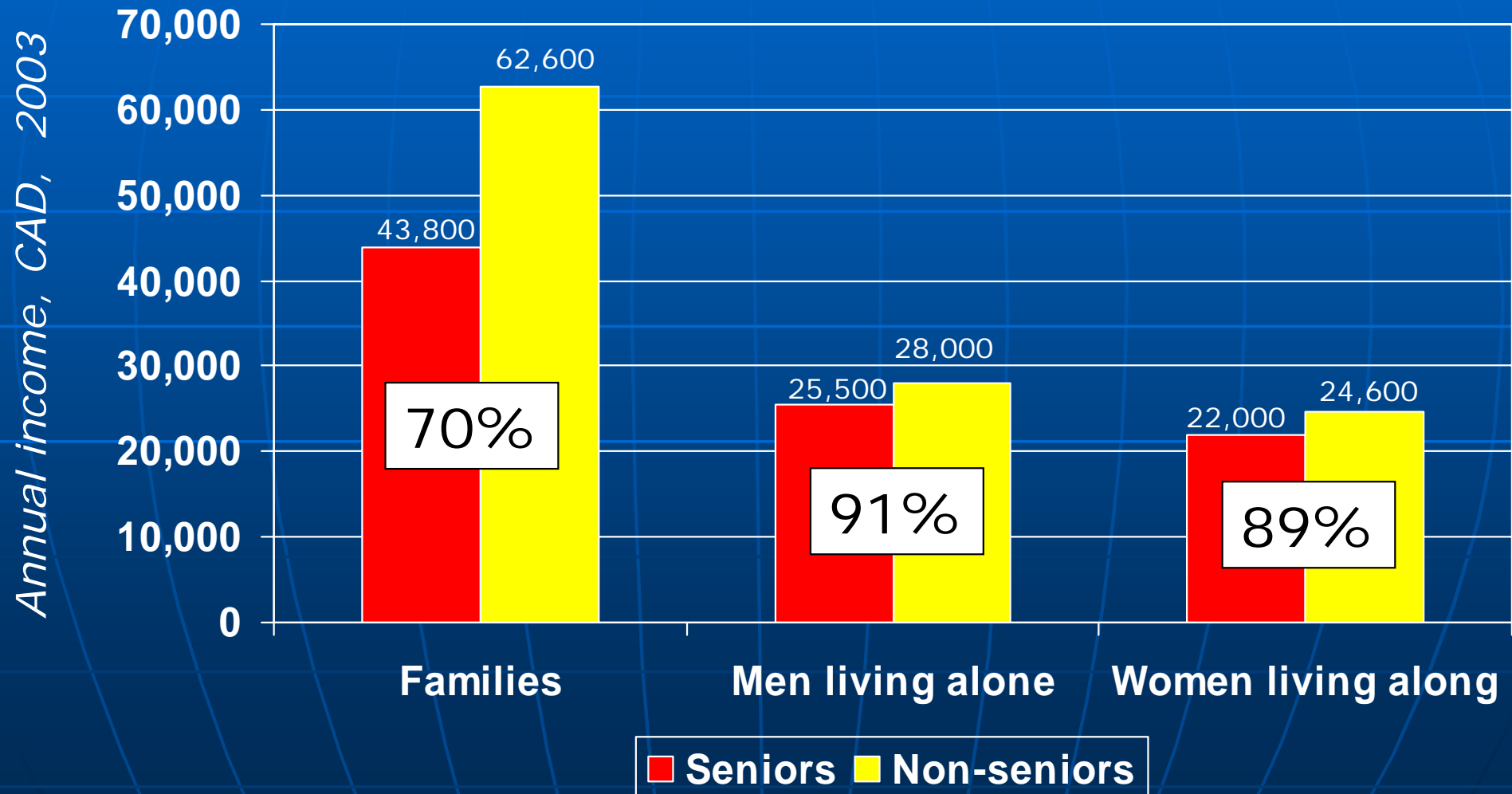
Objective: Poverty avoidance

Low income: International comparisons



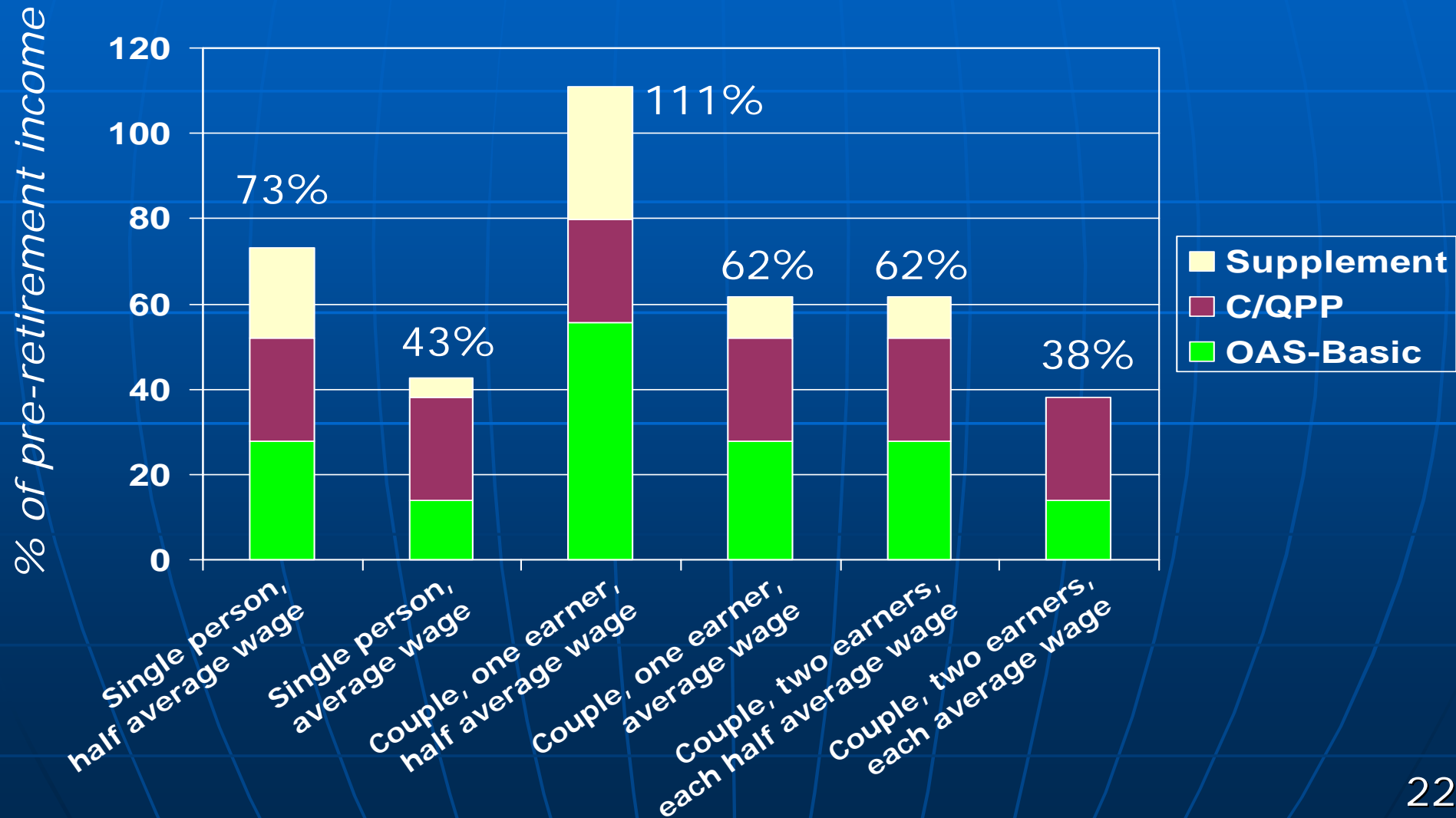
Objective: Income replacement

*Average income:
Seniors / Non-seniors*



Objective: Income replacement

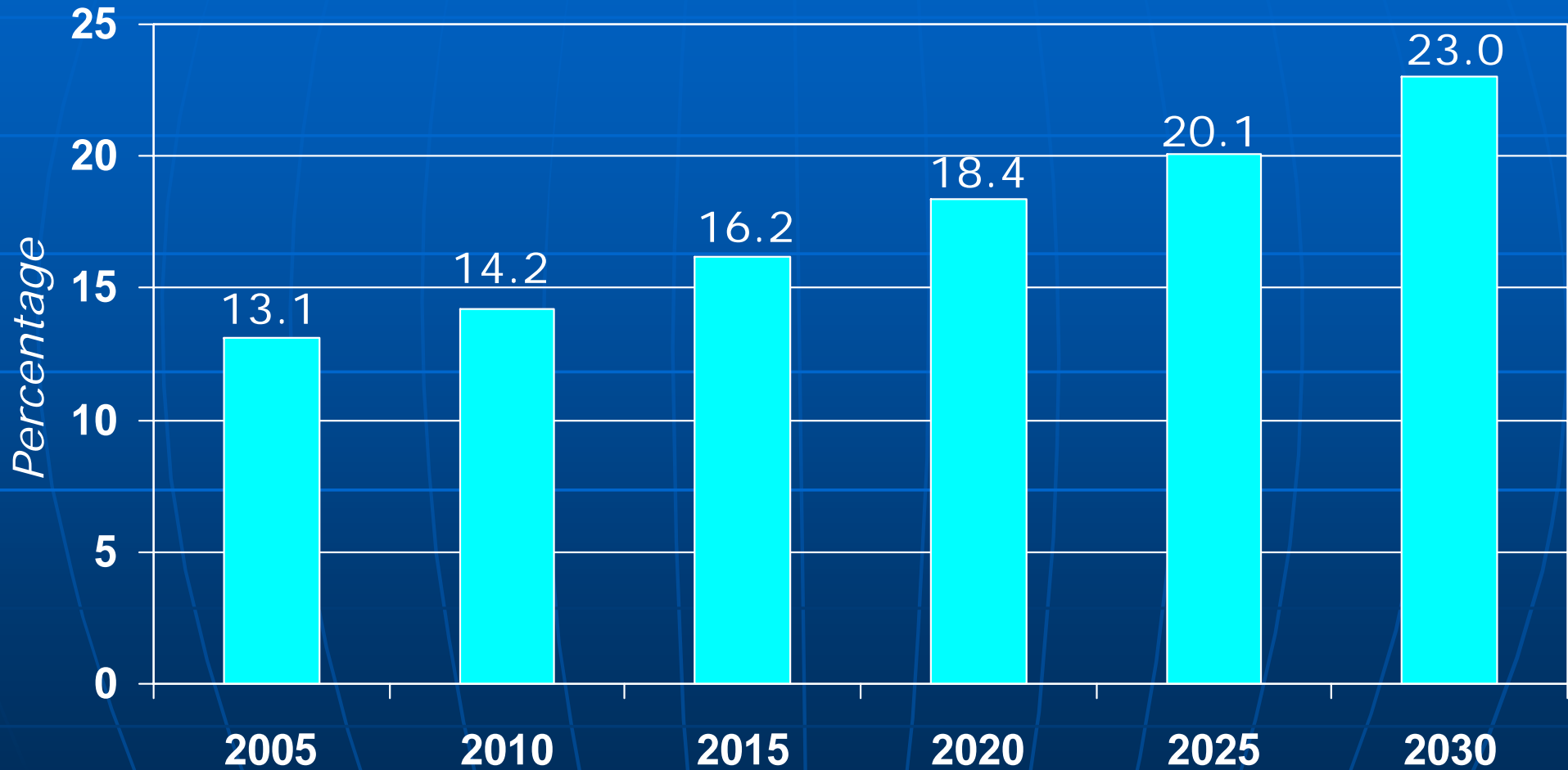
Replacement rates of public programs (OAS, C/QPP)



Will the Canadian pension system
continue to meet its objectives with
an ageing society?

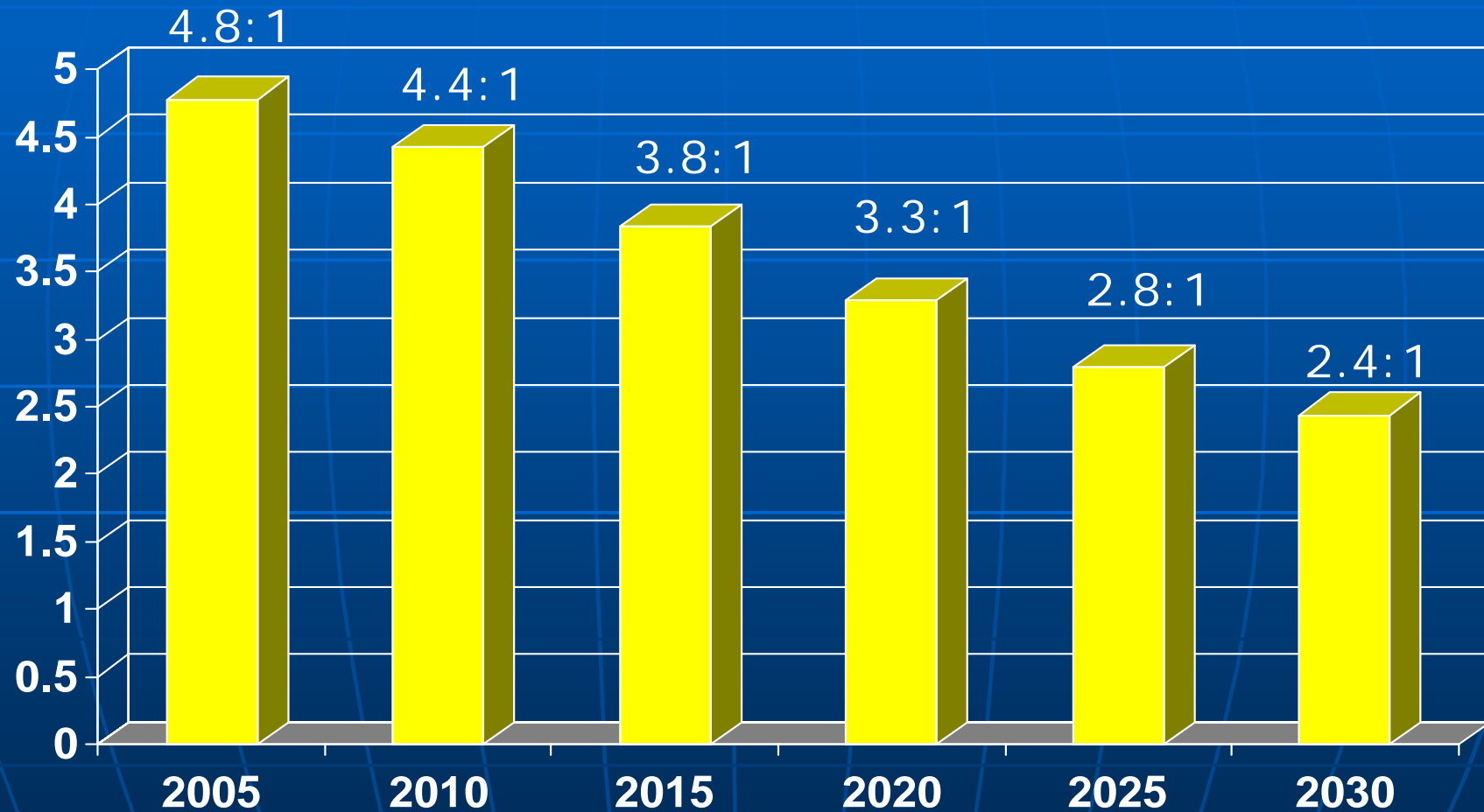
Ageing of Canada's population

Percentage of population aged 65+



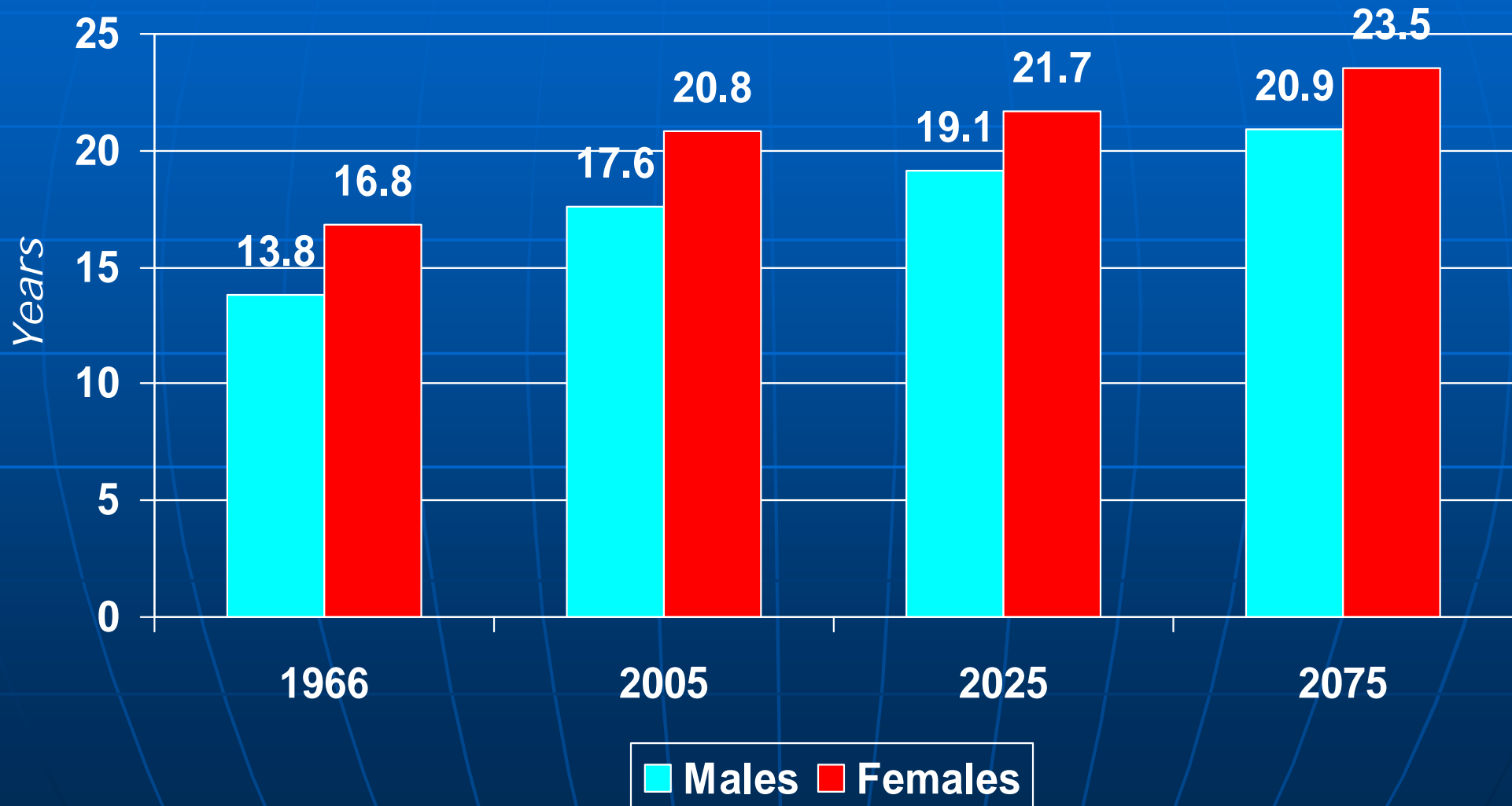
Ageing of Canada's population

Ratio of persons 20-64 to persons 65+



Ageing of Canada's population

Life expectancy at age 65



Financial sustainability

Financial sustainability

- Prior to 1997 reform of the financing of the Canada Pension Plan (CPP):
 - Plan was pay-as-you go, with small reserve fund equal to two years' costs (benefits and administration)
 - Contribution rate was forecast to reach 14.2 percent by 2030

Financial sustainability

- With 1997 reform of CPP financing:
 - Plan is partially funded (to reach about 25 percent of total liabilities), with reserve fund to exceed five years' costs
 - Contribution rate will remain at 9.9 percent ("steady-state rate") for the indefinite future

Financial sustainability

- Principal elements of 1997 reform:
 - Rapid increase to 9.9 percent contribution rate
 - New investment strategy – creation of the Canada Pension Plan Investment Board
 - Freezing of the basic exemption at the 1997 level of CAD 3,500

Financial sustainability

Increase in the contribution rate

<i>Year</i>	<i>Pre-reform</i>	<i>Post-reform</i>	<i>Difference</i>
1997	5.85	6.0	+0.15
1998	6.10	6.4	+0.30
1999	6.35	7.0	+0.65
2000	6.60	7.8	+1.20
2001	6.85	8.6	+1.75
2002	7.10	9.4	+2.30
2003	7.35	9.9	+2.55

Financial sustainability

Increase in the contribution rate

<i>Year</i>	<i>Pre-reform</i>	<i>Post-reform</i>	<i>Difference</i>
2004	7.60	9.9	+2.30
2005	7.85	9.9	+2.05
2006	8.10	9.9	+1.80
...
2016	10.1	9.9	-0.20
...
2030	14.2	9.9	-4.30

Financial sustainability

- New investment strategy:
 - Objective: Increase the average annual real rate of return on the reserve fund to 4.1 percent
 - Approach: Diversify the assets in the reserve fund to resemble those of occupational (“private” or employer-sponsored) pension plans

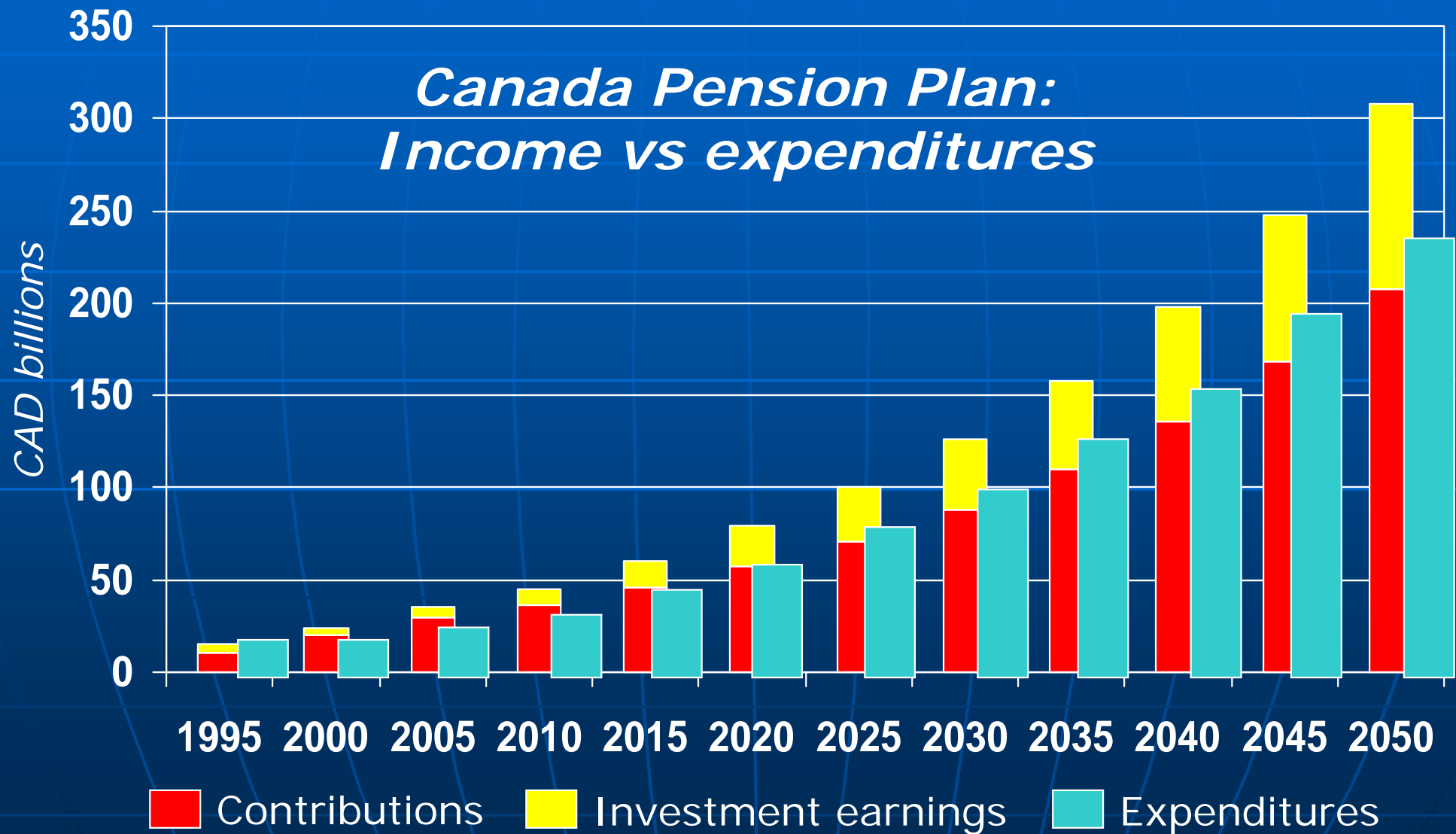
Financial sustainability

- New investment strategy:
 - Mechanism: Create an independent (“arms’ length”) agency – the Canada Pension Plan Investment Board – with a mandate to invest the reserve fund

Financial sustainability

- Design and operation of the Canada Pension Plan Investment Board based on three principles:
 - Independence from political interference in investment decisions
 - Accountability to stakeholders (contributors, pensioners, governments)
 - Transparency

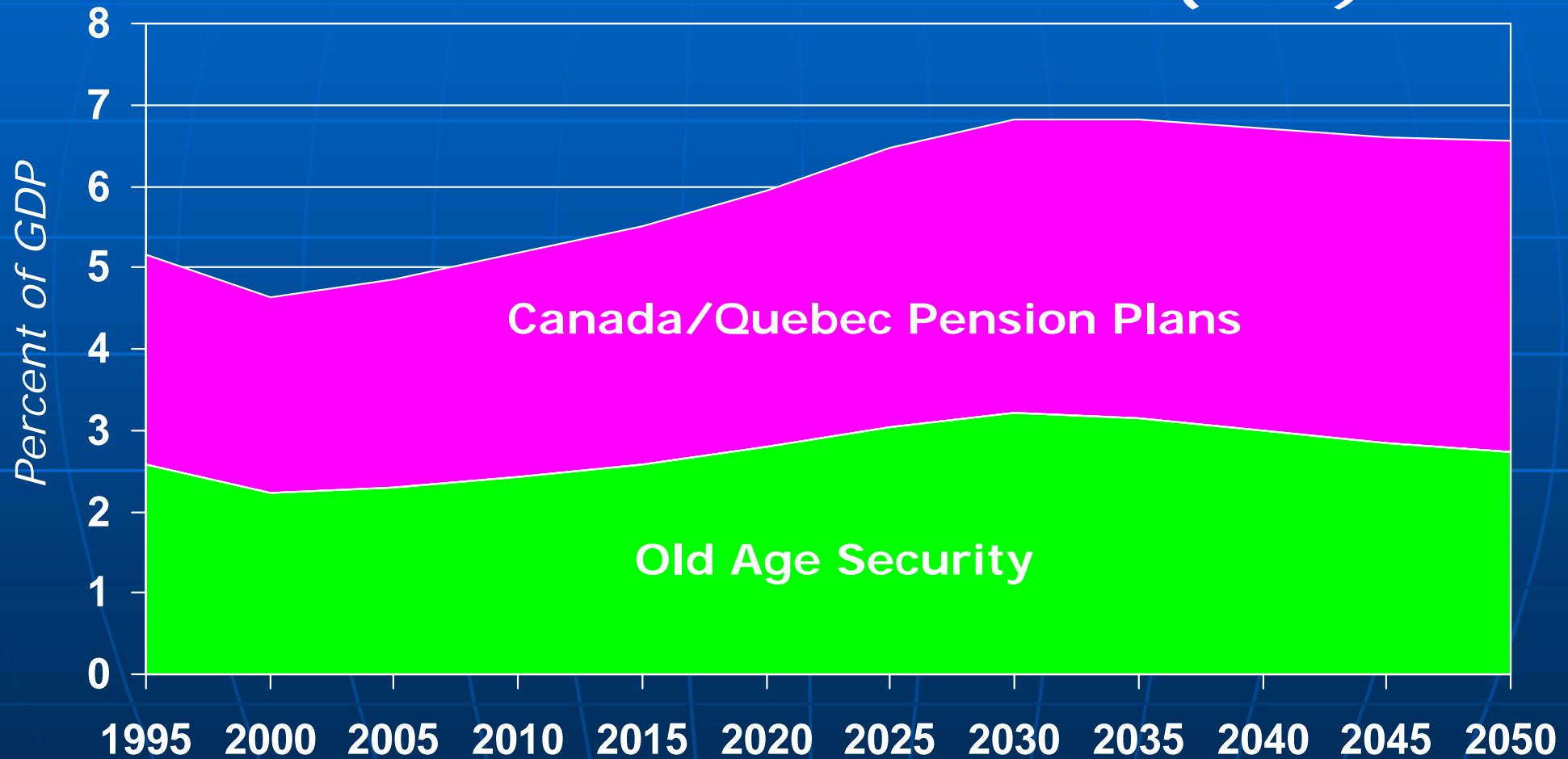
Financial sustainability



Source: Office of the Chief Actuary

Financial sustainability

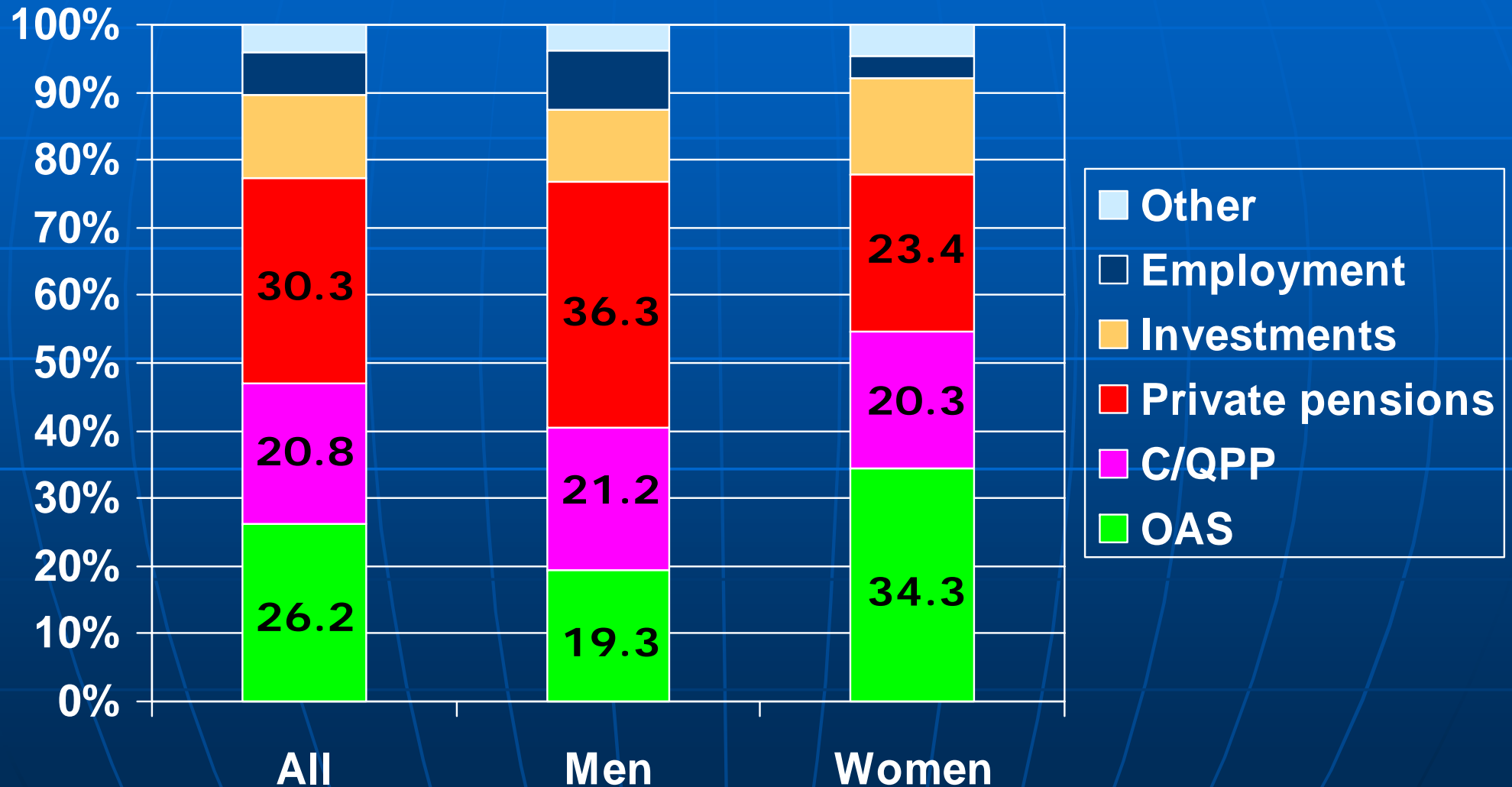
Public pensions as a percentage of Gross Domestic Product (GDP)



Evolving incomes of seniors

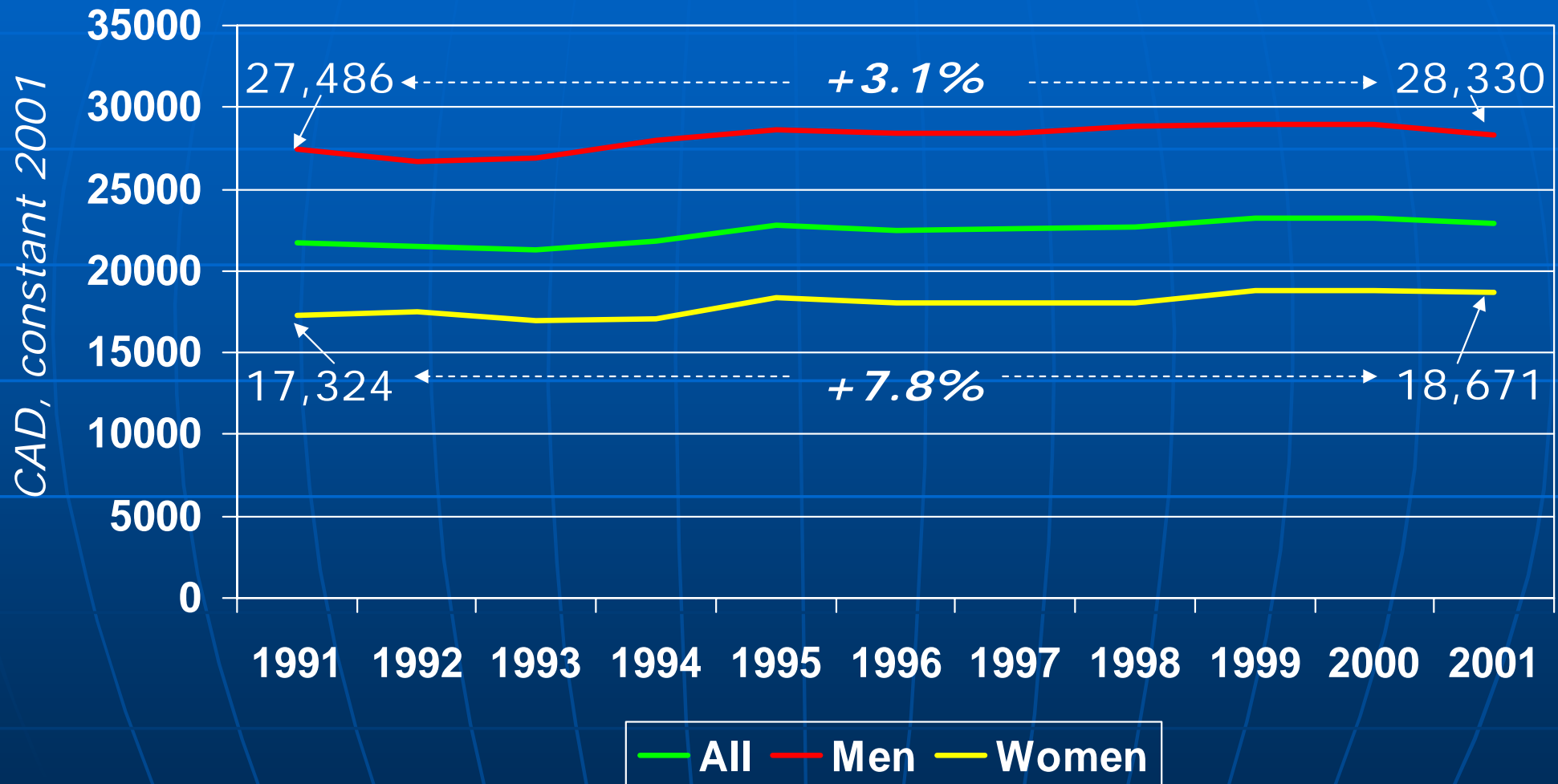
Evolving incomes of seniors

Sources of income (percentage), 2001



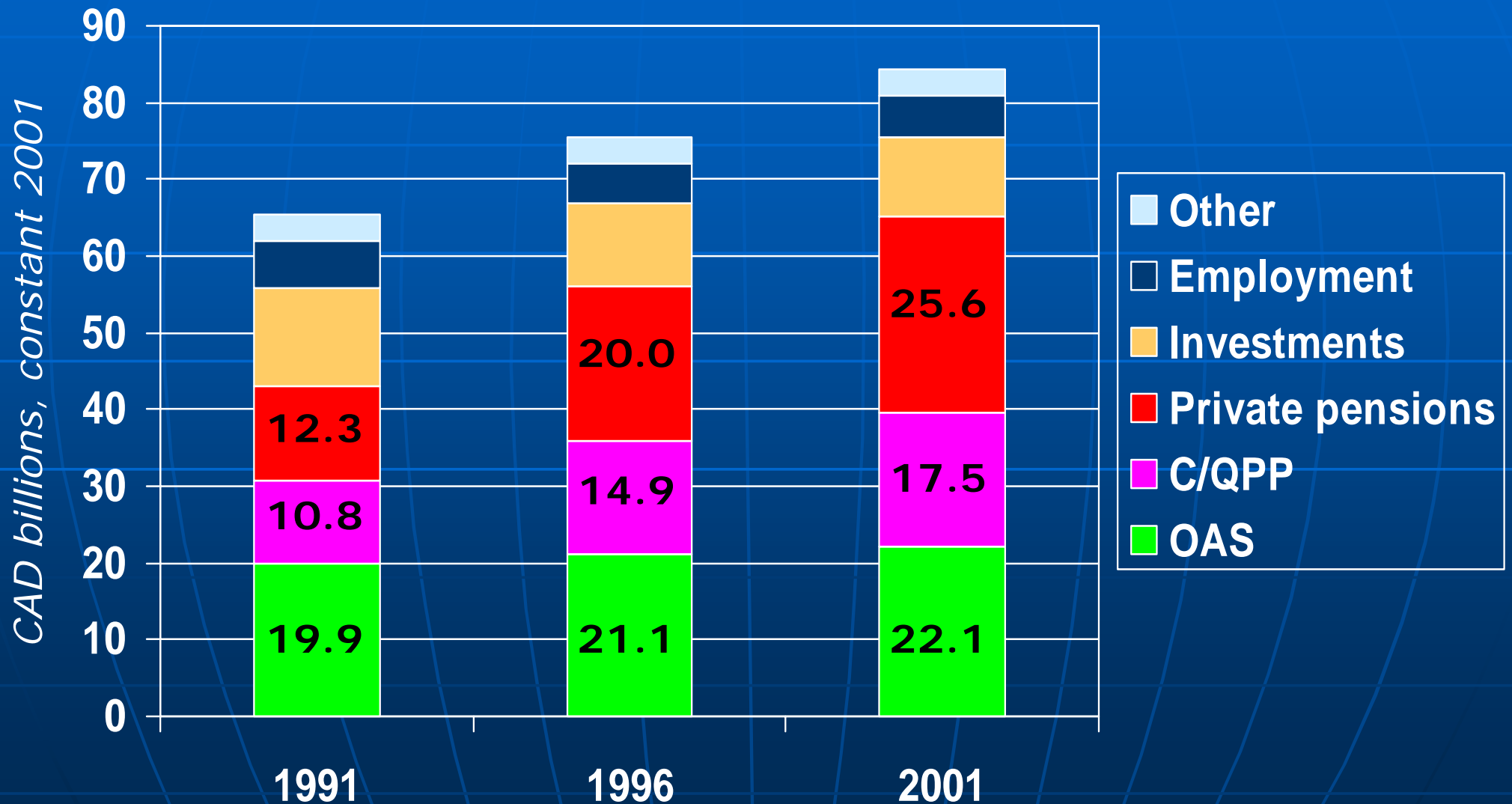
Evolving incomes of seniors

Average income



Evolving incomes of seniors

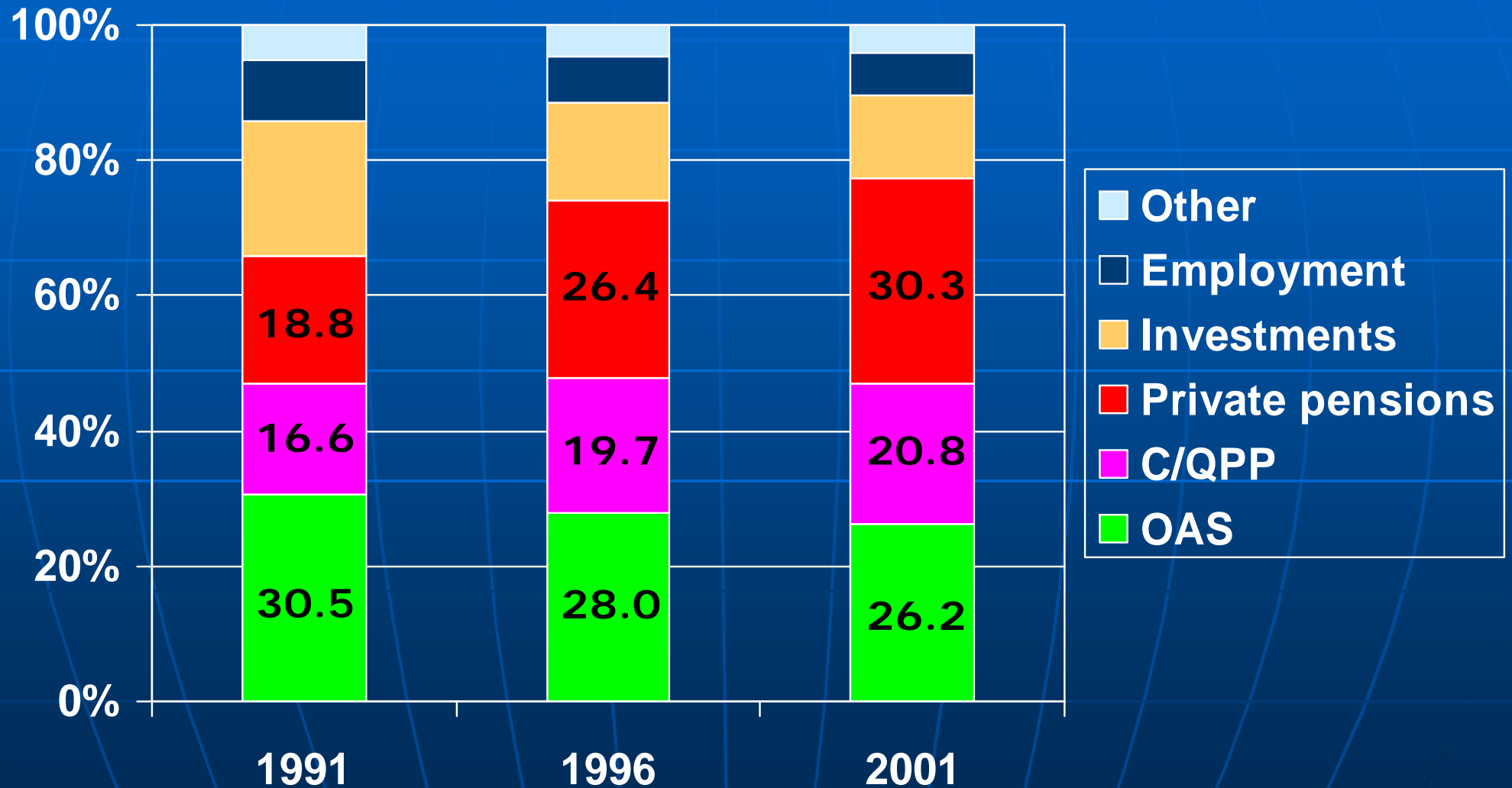
Sources of income (total amount)



Source: Statistics Canada

Evolving incomes of seniors

Sources of income (percentage)



Conclusions

Conclusions

- Overall,
 - The Canadian pension system is meeting its core objectives of poverty avoidance and income replacement
 - The system will continue to meet its objectives, and the incomes of seniors will continue to increase in real (after inflation) terms

Conclusions

- The Canadian pension system is financially sustainable over the long term
- However, problems remain (e.g. low income among some seniors, some disincentives to continued work) and require on-going policy attention