CARP's Vision for Pension Reform

Retirement Savings Crisis

Canadians are not saving enough for their own retirement. If nothing is done to provide Canadians with robust and safe ways to plan and save for retirement, many Canadians will be financially unprepared and may experience significant drops in standard of living in retirement.[i]

CARP's call for pension reform targets middle-income earners who are especially unlikely to have workplace pension plans and to have saved sufficiently for retirement on their own.[ii] Low-income earners can generally expect to replace a sufficient amount of their pre-retirement income through CPP, Old Age Security (OAS), and the Guaranteed Income Supplement (GIS) and higher income earners tend to save sufficiently on their own:

- Two-thirds of the workforce – 12 million working Canadians – do not have workplace pension plans.[iii]
- Private savings options, such as Registered Retirement Savings Plans (RRSPs) have not been the answer to retirement security.
- In 2011, Canadians contributed $34.4 billion to RRSPs, which was only 4.5% of the total room available to eligible tax-filers. In effect, Canadians have left $738 billion of RRSP contribution room untouched.[iv]

Inadequacy of Private Savings

The 2008 recession took a heavy toll on retirement savings, but even before the recession, Canadians were underprepared for retirement and in real risk of outliving their savings.
At the time of retirement, a typical Canadian family will require roughly $500,000 to $1,000,000 to retire securely, depending on pre-retirement income, retirement needs, and age of retirement.[v] The Canadian median RRSP value in 2005 was only $30,000, far short of even the lower range of expected savings' needs.[vi]

Many Canadians will not have saved sufficiently for retirement and there is little reason to believe that another private savings option will address the savings gap. Canada's pension system, including the Canada Pension Plan (CPP) and Old Age Security, has gradually reduced rates of poverty in old age over several decades. However, 300,000 Canadians over 65 still live in poverty and many more straddle the low-income threshold and struggle with financial insecurity in retirement.

If nothing is done to help Canadians save for retirement, by 2031 when the number of seniors is expected to double, there could be well over 600,000 seniors in Canada officially living in poverty and millions more facing financial insecurity. [vii]

Another private savings option will not close savings gap

There is a growing consensus that private savings options such as PRPPs are not the answer to the pension crisis.[viii] PRPPs, similar to voluntary group RRSPs, fall short of the core goal to provide a universally accessible and affordable retirement savings vehicle that would help provide an adequate retirement income.

Australia experimented with a nearly identical private plan over a decade ago, with The Australian Super Fund, which is mandatory – with opt out – and requires employers to enrol their workers in one of many defined contribution plans offered by the private sector. However, the results are discouraging. A recent review commissioned by the Australian government shows that while people were saving in droves through the Fund's mandatory contributions, investment returns were no better than inflation.[ix] The review blamed the high fees and costs despite the presumed role of competition.

PRPPs have similar disadvantages, and Canada's track record with RRSPs suggests that voluntary, private savings vehicles will not go far enough toward helping Canadians save for retirement.

Principle Features of a Public Retirement Savings Vehicle

In addition to existing private savings options, Canadians need public retirement savings vehicle with the following features:

1. **Independence and accountability**: It should be independent of government or single employers and should provide a governance role and accountability to plan members;
2. **Use existing enrolment and administration mechanisms:** It should include employer contributions, with mandatory enrolment using the existing payroll deduction mechanism;
3. **Professional management**: It should be managed professionally with a focus entirely on optimal performance, along with low management and administration fees;
4. **Large, pooled funds:** It should be large enough to increase investment returns and ensure greater fund stability;
5. **Portability and predictable benefits:** It should be available to all working Canadians, with full portability across jobs and provinces and provide target benefits to help people prepare and plan for retirement.

CARP's Plan: A Universal Pension Plan and Modest CPP Enhancement

In 2009, CARP proposed the creation of a supplementary Universal Pension Plan (UPP). CARP's UPP would provide Canadians a large pool of funds that is big enough to provide more protection against market volatility and shocks and produce higher investment returns than small, individual savings accounts, PRPPs, and other retail investment options. A UPP would provide target benefits allowing Canadians to better plan for retirement. Such a plan would provide Canadians true portability across jobs and provinces, similar to the CPP.

CARP's UPP model is based on the five principle features noted above, and it would help Canadians save and prepare for retirement by providing supplementary retirement savings through a large national plan.[x]

The core goal of any country's pension system should be to provide adequate retirement savings to prevent poverty in old age. It must be affordable to contributors and robust enough to withstand major shocks, including economic, demographic and political volatility.[xi] Universal access and widespread enrolment in any new retirement savings vehicles should be a primary goal of pension reform. CARP's model for a UPP would accomplish these goals.

Large pension plans benefit members and broader economy

A study of large pension funds in Canada, similar to the CARP model, shows that up to 80% of current benefits are paid from investment returns, rather than member contributions or existing fund capital.[xii]

The benefits of large pension funds extend beyond those provided for members. The same study showed that the top ten pension funds have invested roughly $400 billion in Canada, including $100 billion in real estate, private equity, and infrastructure. They directly employ 5,000 professionals in Canada's financial sector and another 5,000 employees in real estate.

Enact modest CPP enhancement

The CPP, which already shares many of the features of CARP's UPP, should be modestly enhanced to further help all working Canadians retire securely, in addition to a UPP.

The CPP is professionally managed by the CPP Investment Board (CPPIB) and is independent of government. It provides target benefits to help people prepare and plan for retirement and is available to all working Canadians, with full portability across jobs and provinces.

The CPP fund is robust and well-funded, with all benefits for the next decade to be paid with investment returns alone, leaving accumulating contributions untouched. It is currently one of the most efficient pension systems.

A Model for CPP Enhancement

On average, an individual should have approximately 70% of their pre-retirement income for retirement.[xiii] The CPP is currently designed to replace 25% of earnings up to a ceiling of $51,100. To achieve this amount, premiums are set at 9.9% of earnings, shared equally between employees and employer.

The maximum annual individual benefit amounts to approximately $12,000. In reality, most Canadians receive closer to $7,000 annually from CPP and have not sufficiently saved on their own to bridge the retirement income replacement gap.

As one of the largest pension funds in the world, the CPP can provide sustainable and predictable benefits for the next 75 years.[xiv]

There are many ways to enhance CPP to target the various needs of working Canadians, but Prince Edward Island Finance Minister Wes Sheridan recently proposed a concrete plan for CPP enhancement targeting middle-income earners.[xv]

The proposal is notable in that it exempts low-income earners from paying additional premiums. Low-income earners can generally already expect to replace a sufficient amount of their pre-retirement income through CPP, Old Age Security (OAS), and the Guaranteed Income Supplement (GIS). For this reason, Sheridan's plan and CARP's focus is on middle-income earners, who may have saved enough to exempt them from GIS eligibility but not enough to sustain a secure retirement over many years.

Sheridan's proposal also aims to increase both the amount of pensionable earnings that can count towards CPP and the income replacement rate.

Canadians currently contribute on the first $51,100 of their income. Someone who currently earns $60,000, for example, does not pay CPP contributions on the additional $8,900 of their income. Sheridan's plan proposes to double the maximum of pensionable earnings from $51,100 to $100,000, thereby providing wider CPP earnings coverage for middle incomes above the current threshold.

The replacement rate (benefit) would be increased by 15% for all workers earning between $25,000 and $51,100 for a new total of 40%. People earning above $51,100, up to $100,000, would receive a new 15% replacement rate on earnings within that range.

This would be funded by gradually phasing in a 3% premium increase to be shared equally between employees and employer.

Two thirds of CARP members disagree that the economy is too weak to permit modest CPP enhancement.

Critics of CPP enhancement argue that any increase to CPP premiums and benefits will dampen job growth.[xvi] But there is no evidence to support this claim. In fact, CPP premium rates were gradually increased from 1997 to 2003, from 5.8% to the current level of 9.9%. The national employment rate rose steadily during that period, with only a small slip in recessionary 2001.[xvii]

And CPP enhancement would likely be modest, and phased in gradually, thereby further guarding against any negative impact on the economy. And because the plan increases the maximum earning amount and shields lower income earners from additional premiums, the plan would go far towards targeting middle income Canadians who will need the most help achieving retirement security.

Political Action to date

The federal, territorial and provincial [FTP] finance ministers acknowledged after their meeting in June 2010 that Canadians were not saving enough and that government had a role to play by proposing a two-part plan: another private savings option and a commitment to modest CPP enhancement.

The federal government acted on the first part of that plan when they introduced a PRPPs; provincial enabling legislation is in various stages of completion. PRPP's may help some Canadians save for retirement, but the track record of private savings options show that they did not historically provide Canadians with the required retirement savings, and it's unlikely that another private option will help substantially.

Almost 70% of members polled will make their vote conditional on political action on CPP enhancement.

There has been little advancement on the 2010 commitment to enhance the CPP, despite adequate consensus among the provinces to allow the federal government to move forward.

It's increasingly clear that Canadians need a robust savings option in addition to personal savings.

Now is the time to act

Modest CPP enhancement will prove helpful to many Canadians but the success of pension reform will depend on the magnitude and timeliness of the expansion and the adequacy of supplementary pension savings vehicles.

Given the expected modest level of CPP expansion proposed, supplementary pension plans like CARP's UPP will still be needed to bridge the savings gap between inadequate personal savings and a modestly enhanced CPP.

The federal and provincial governments must act now to address the urgent need to provide Canadians with a retirement savings vehicle that is universally accessible, affordable, adequate and sustainable, along with a modest enhancement of the CPP.

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