



Time for a Universal Pension Plan

The current economic crisis has focused public attention on the need for Canadians to prepare for their own retirement and there is a growing recognition of the need for a new broadly based retirement savings vehicle. But that is where the consensus largely ends. There are competing visions of what level of coverage is necessary, whether it must be mandatory, how big it should be, who should manage it and whether it can or must adequately address the needs of those most likely to face poverty in old age, low income Canadians.

The approach in this paper is to set out the primary goals of a universal pension plan – universality, adequacy and robustness - and to identify some of the options that have been suggested. When the pension reform process is formally engaged, these and no doubt many more options will be submitted by the various stakeholders. The ultimate result, however, must improve on the *status quo* in material ways.

Issue:

An estimated one in three Canadians do not have any workplace pension plan nor any other meaningful retirement savings by the time they retire beyond what they may receive through public pension benefits.

The current economic crisis has focused public attention on the need for Canadians to prepare for their own retirement and on the absence of a universally accessible vehicle to do so effectively. In fact, just before the summer recess [June 2009], a Parliamentary Motion was adopted in a historic 294-0 vote to increase public pension benefits and better address the retirement security of Canadians. The debates that preceded the Motion demonstrated the political attention paid to the issue from all four parties¹.

¹ Please see Transcript at:
<http://www2.parl.gc.ca/HousePublications/Publication.aspx?Language=E&Mode=1&Parl=40&Ses=2&DocId=3983511#SOB-2827920>

Various proposals for pension reform have surfaced to address the need for a broadly based retirement savings vehicle to allow Canadians to better save for their own retirement.

However, such proposals do not address the needs of the very low income individuals who must rely entirely on public pension benefits² and who may not be in a position to adequately contribute to any other supplemental pension plans without specific provision such as increased income supports, contribution subsidies, among other strategies.

Recommendations:

The federal and provincial governments must work cooperatively to address the urgent need to provide a retirement savings vehicle that is universally accessible, affordable, adequate and sustainable.

² Please see Appendix B

CARP recommends a Universal Pension Plan modeled on the CPP with mandatory enrolment, utilizing the existing payroll deduction mechanism, professional management, a governance role for the members, a mandate that is focused entirely on optimal performance and independence from government or any single employer and defined benefits as one way to achieve all of these goals.

In offering this model, CARP recognizes that alternatives may be found that may achieve some or all of these goals to a broadly acceptable degree.

There should be a **Pension Summit** convened as soon as possible to review all the various recommendations and consultations that have already taken place and knowledgeable representatives of the people who will be most affected, retirees, must have a seat at the table.

Key facts:

INADEQUATE RETIREMENT SAVINGS

The C. D. Howe Institute estimates that “3.5 million Canadian workers (i.e., one-quarter of the workforce, mainly middle-income, working for smaller employers) constitute the primary group most likely to be on an inadequate retirement saving track”³ and would therefore benefit from access to a supplementary pension plan above and beyond public pension benefits. However, the paper cautions that this is merely an estimate of the number of Canadians who would benefit from a supplementary pension

³ Ambachtsheer, Keith: The Canada Supplementary Pension Plan (CSPP) Towards an Adequate, Affordable Pension for All Canadians. C. D. Howe Institute May 2008 at p. 7

scheme and excludes the 4.9 million workers who earn less than \$30,000 and the high net worth groups.

The first two so-called pillars of Canada’s retirement income system consist of the public pension benefits: Old Age Security [“OAS”], Guaranteed Income Supplements [“GIS”] and Canada/Quebec Pension Plan [“CPP/QPP”]. Together these provide a combined maximum of about \$19,000 at age 65 but since the average CPP/QPP is about half the maximum, the typical individual retiree who relies only on public pension benefits today receives about \$16,000 annually⁴.

The third pillar – private employer sponsored pensions and private savings in the form of Registered Retirement Savings Plans [“RRSPs”] etc. - are unevenly distributed. Thirty-one percent of family units with over \$100,000 in private pension savings held over 90 percent of all such assets. While 85 percent of public sector workers have an employer sponsored pension plan, only 26.4 percent in the private sector have access to such a plan.⁵

Nearly 30 percent of Canadian families have no retirement savings. Also without retirement savings are 45 percent of unattached individuals, 27.5 percent of Canadians over 65 years of age and 23 percent of those 45-plus and 55-plus.⁶

A number of reasons have been advanced to explain the lack of employer sponsored pension coverage in Canada such as its voluntary nature and the financial and legal complexity and costs involved that make it virtually impossible for smaller employers to participate. And despite tax incentives, the

⁴ Ambachtsheer, in op. cit. at p. 4

⁵ 2005 Survey of Financial Assets, Statscan

⁶ 2005 Survey of Financial Assets, Statscan

available RRSP room is not fully utilized whether because the RRSP tax rules are not flexible enough to address different savings priorities throughout a person's career or exclude income or distributions from investments or limited partnerships. Finally, for those without workplace pension arrangements, there may simply be lack of recognition of the need to save adequately for one's own retirement although public awareness must certainly have increased with the constant media coverage during the current economic downturn.

The current tax and regulatory system also operates unfairly. As noted by the C. D. Howe Institute:

“Canada's private retirement saving system serves some workers well and others not so well, depending on whether they have a career in the public sector or in the private sector... The unfairness of Canada's private retirement saving system rests in rules that limit annual contributions to retirement savings vehicles; unnecessarily tie pension saving to employment and employment income; restrict the kinds of income that can be used for retirement saving; and inhibit creation of the kind of large, pooled pension arrangements in the private sector that work well for public sector workers.”⁷

NEED FOR UNIVERSAL PENSION PLAN IDENTIFIED

Three provincial pension review panels [BC-Alberta, Nova Scotia and Ontario] identified the need to provide broader access to larger well-managed pension funds for

⁷ Pierlot, James: A Pension in Every Pot. C.D. Howe Institute Commentary. 275. Toronto. C.D. Howe Institute. November 2008: at intro page

working Canadians who do not have access to workplace sponsored plans. The C.D. Howe Institute has recently suggested the creation of a new savings vehicle: the Canada Supplementary Pension Plan (CSPP). But this is not a novel idea. A broadly accessible pension plan supplemental to the CPP has been advocated over the years, including by the 1980 Ontario Royal Commission on Pensions, the Canadian Labour Congress and many others since.⁸ However, the current economic crisis that has not only decimated private retirement savings but also started to encroach on pension plans may have finally focused public attention on the need for comprehensive pension reform.

As noted in the Ontario Expert Commission on Pension Reform Report "*A fine balance*" [the "Arthurs Report"]:

“...details varied. Some urged an expansion of the existing CPP structure so as to either increase the benefit ..., or to increase the maximum earnings on which the benefits accrue ... or both. Others suggested allowing employers and employees to voluntarily make extra contributions to the CPP (to be invested by the Canada Pension Plan Investment Board) to buy commensurate extra benefits (administered at a low marginal cost within the existing CPP framework). *No matter the details, those making these submissions maintained that a public scheme of some sort would enhance pension coverage, improve benefit portability, and contain costs.* [Emphasis added.]”

⁸ The 1980 Commission and CLC recommended a defined benefit plan whereas the CSPP is a defined contribution plan. However, they and the provincial panels all agreed on the need for broad based access to pension savings vehicles.

Important features of a Universal Pension Plan [“UPP”]

The core goal of any country’s pension system is to provide an adequate system available to the full breadth of the population that is sufficient to prevent poverty in old age. It must be affordable by the employers and employees and other participants and robust enough to withstand major shocks, including economic, demographic and political volatility.⁹ Recent events have demonstrated that Canada’s retirement system is not meeting this goal in part because of inadequate pension coverage.

As noted, there is growing recognition of the need for a new broadly based retirement savings vehicle but that is where the consensus largely ends. There are competing visions of what level of coverage is necessary, whether it must be mandatory, how big it should be, who should manage it and whether it can or must adequately address the needs of those most likely to face poverty in old age, low income Canadians.

The approach in this paper is to set out the primary goals of a universal pension plan – universality, adequacy and robustness - and to identify some of the options that have been suggested. When the pension reform process is formally engaged, these and no doubt many more options will be submitted by the various stakeholders. The ultimate result, however, must improve on the *status quo* in material ways.

Universality – Broad based Coverage, Affordability and Sustainability

- MANDATORY ENROLMENT WITH OR WITHOUT OPT-OUT PROVISIONS

The UPP recommended by CARP is a mandatory enrolment plan as is the CPP¹⁰. To make the idea of additional enforced savings more palatable, some have recommended a single opt-out window either unconditionally or if the employer or employee already has a workplace pension plan. However, if only a relatively small number of people opt out, then the costs of administering the opt out process could outweigh the advantages. If a large number of people opt out, then the objective of a large broadly based, and therefore affordable, plan may be lost.

In the decades after the CPP was established, and despite tax incentives, a significant proportion of employers and individuals have not voluntarily established adequate private retirement savings plans. Recent events that have focused attention on deficiency funding liabilities that threaten the economic viability of even major employers together with the evaporation of self managed savings may fundamentally change that behavioural trend. In such a climate, the mere existence of a broadly based, well-managed and affordable savings vehicle without the fiduciary liabilities and administrative costs of private pension funds could

⁹ Old Age Income Support in the 21st Century [World Bank]

¹⁰ The Canada Pension Plan is a joint federal and provincial plan established by an Act of Parliament in 1965. The Canada Pension Plan is a mandatory contributory defined benefit pension plan operated for the benefit of over 17 million Canadians. All employers and employees, except those in the Province of Québec which has its own QPP, make mandatory contributions to the Canada Pension Plan.

be enough to attract sufficient participation from both employers and employees.

The goal is to provide access to the broadest possible reach of the population. A mandatory plan ensures that goal would be reached but the lack of political will and public acceptance could be insurmountable. A voluntary fund with sufficient incentives and removal of barriers, such as administrative burden and fiduciary obligations, might be enough to create one or more funds of an adequate size to achieve economies of scale to reduce costs, be affordable and be robust enough to withstand demographic and market challenges

The challenge is for the proponents of the various voluntary options to demonstrate how their recommendations would achieve broad based coverage, affordability and sustainability.

CARP members however overwhelmingly support a mandatory system. A recent survey conducted through *CARP ActionOnline* offers a snapshot of the opinion of CARP members who responded.¹¹ Of the 4,045 members surveyed, over 91 percent believed that there should be mandatory contributions from both employers and employees.

The majority of the *CARP ActionOnline* subscribers are CARP members between the ages of 65 and 74, mostly retired and their judgment that a mandatory vehicle is preferable will be informed by their actual retirement experience.

-ACCESS WITHOUT EMPLOYER SPONSOR

Self-employed individuals¹² would be eligible to participate in the UPP as they are under the CPP. If the plan is a voluntary plan, employees whose employers opt out should be able to participate on their own. In addition, those with partnership income, business income and investment income would be eligible.

This increases the opportunity for individuals to who might otherwise have invested in RRSPs or workplace defined contribution plans to choose to contribute to the UPP and take advantage of the economies of scale and professional management.

Adequacy – to provide adequate retirement income

- INCREASED LEVEL OF COVERAGE

The frequently cited goal is that retirement income from all sources, including OAS and CPP/QPP, must provide between 60 percent - 70 percent of pre-retirement income. The existing public service pension plans typically provide a target income replacement of 70 percent of final earnings integrated with CPP/QPP benefits after a 35-year career.

However, this ratio is not necessarily appropriate for all income levels or high net worth individuals. Further, some upper limit must be set for the UPP not only to allow for such differences but also to preserve some level of flexibility for personal choices. For example, the current maximum pensionable earnings limit set in the tax system for de-

¹¹ Please see Appendix A

¹² Canada has 2.6 million self-employed workers (Statistics Canada 2008).

defined benefit registered pension plans in 2009 is \$122,222.

At present the CPP is set to provide a maximum retirement pension at age 65 of 25 percent of the five year average YMPE which for 2009 is set at \$46,300 and results in a maximum CPP retirement pension in 2009 of \$10,905. This is a maximum amount and most Canadians only get a fraction of that \$10,905 a year.

Together with OAS and GIS, a typical retiree relying solely on the current public pension benefits would have to live on \$16,000 to \$19,000 annually¹³. These first two pillars in Canada's retirement system are sufficiently *universal* but insufficient to provide an *adequate* retirement income and arguably insufficient even to prevent poverty in old age [please see: RETIREMENT SECURITY FOR LOW INCOME EARNERS]

The debate that must be engaged is the amount of the increase in coverage to bridge all or part of the gap between the 25 percent that the CPP provides and the top-up to 70 percent that public sector workers currently receive under their pension plans. The UPP that CARP recommends need not be the only retirement savings vehicle but the total income needed from all sources should be established. It would then be possible to determine, for example, what portion of the gap should be bridged through a mandatory pension scheme and what portion may be voluntary.

The corollary is how much are people prepared to pay for this coverage. CPP contributions from both employers and employees total 9.9 percent of the first YMPE [\$46,300 in 2009]. Public sector pensions come with a high cost of contributions (mostly paid by

the employer) that can vary between 18 and 33 percent of total payroll, depending on how it is measured (Office of the Superintendent of Financial Institutions 2005). Few private sector employers offer pensions this costly¹⁴.

The CARP *ActionOnline* poll¹⁵ found that two-thirds of CARP members responding to the poll said they needed 70 percent or more of their pre-retirement income to retire comfortably while just under a third were prepared to live on 50 percent of their pre-retirement income. A quarter were prepared to set aside 18 percent or more of their income [in total employer and employee contributions] to save for their retirement while half were prepared to contribute only 10 percent in total. This shows a lack of general awareness of what it would cost to provide 70 percent of pre-retirement income but the inclinations are clear, namely, what they considered to be necessary for a secure retirement and that they were prepared to contribute to their own retirement security.

- PREDICTABLE BENEFITS

With even the largest defined benefit plans facing unmanageable deficiencies, the current trend of employers avoiding defined benefit plans, if they are sponsoring any pension plans at all, will continue and no new DB plans will come from the private sector. At the same time, individuals watching their RRSPs evaporate in the current market chaos are unlikely to embrace another savings vehicle in which they must still bear the entire investment risk. Consequently, there must be some predictability to the benefits from any new retirement savings vehicle.

¹³ Ambachtsheer, K. in op. cit. p. 4

¹⁴ Pierlot, J. in op. cit at p. 6

¹⁵ Please see Appendix A

Again the CPP recommends itself, not only because its benefits are predictable but also because of its ability to rely on the present value of its future [mandatory] contributions as a buffer against investment risks.

Various options have been proposed, including hybrid plans, target benefit plans and life cycle investing, among others. There will be a trade off between predictability and sharing of investment risks with other plan contributors that must be debated openly.

- RETIREMENT SECURITY FOR LOW INCOME EARNERS

The increased coverage and benefit levels available under a UPP would also benefit low income earners who have modest CPP benefits [i.e. 25 percent of a low income] and generally have no access to workplace pensions. Some 35 percent of Canadians 65-plus currently receive a Guaranteed Income Supplement (GIS) benefit ranging from a few dollars to a maximum of \$7,608.24 in 2008. A person with no CPP would receive a total [OAS + GIS] of \$13,635.96, as of September 2008.

This is lower than the generally accepted poverty level measured by the after tax Low Income Cut-Off in an urban centre of any size¹⁶. After tax LICO for 2008 was \$12,019 for a single person living in a rural community and \$18,373 for a person living in a city with a population of 500,000 or more. A majority of low income seniors live in major urban centres and the argument can be made that there should be a higher LICO for major centres such as Montreal, Vancouver and Toronto.

Under the UPP, lower income earners could receive a retirement pension of up to 70 percent of their career-average pre-retirement

income. While the amount of such a pension would likely still be inadequate for those with less than \$30,000 average income, it is likely to be higher than the current LICO and relieve some pressure on the GIS program¹⁷. Other measures would still be necessary to address the burden of additional contributions by both the employer and employees in the low wage sectors.

The difficulty of crafting a workable solution has led most commentators to simply exclude the low wage sector from their deliberations about more pillar three savings. However, one of the essential goals of a nation having a retirement system at all is to prevent poverty in old age so unless there are significant increases to OAS, GIS and CPP/QPP, some accommodation must be found within pension reform of the private retirement savings system for the low income sector. In this respect, all party support of the Parliamentary Motion to increase public pension benefits is encouraging but legislative action is needed.

Robustness – ability to withstand economic demographic and political volatility

- INDEPENDENT PROFESSIONAL AND COST-EFFECTIVE MANAGEMENT

The stark difference between administrative costs and investment performance as between self-administered investment funds and broadly based professionally managed funds has been described by many commentators.

¹⁶ Appendix B

¹⁷The GIS guarantee of \$13,683 [\$15,672 in 2009] provides a replacement rate of about 50% for a person with \$30,000 pre-retirement income.

The annual cost of managing a typical large public sector plan is about 40 basis points¹⁸ – less than one-fifth of the typical annual management fee charged to a small investor holding a balanced mutual fund in an RRSP¹⁹. Investment fees paid by individuals directly or indirectly can run as high as 2.5 to 3 percent of assets per annum. In contrast, the comparative investment costs reported by the large professionally managed pension funds range between 35 – 60 basis points or 0.35 percent to 0.60 percent.²⁰ The CCPIB reports an expense ratio of 0.14 percent.

The investment performance of the broadly based professionally managed funds is estimated to be from 2 to 4 percent better than smaller self managed funds. While these percentage differences do not seem significant, over a 30 year investment horizon, this extra income could double the size of the pension ultimately received.

Also important is a clear investment mandate independent of political interference or the vicissitudes of a particular employer. The CPP Investment Board was established by statute and a governance model which specifies that its investment decisions cannot be influenced by government direction (other than for the benefit of the CPP), regional, social or economic development considerations, or any other non-investment objectives.

The CPP is more difficult to amend than the Canadian Constitution. Changes to the Plan require the approval of the Parliament of Canada as well as the approval of at least two-thirds of the provinces with two-thirds of the population of Canada. Any UPP should be structured so that political inter-

ference is rendered virtually impossible, perhaps along the same lines as the CPP.

As the current economic climate demonstrates, one of the major advantages of a broadly based pension scheme is that it is not dependent on or subject to the financial circumstances or management priorities of a single employer or a group of employers in the same sector of the economy. Further, the crisis has also revealed the need to shelter pension funds against demands from sponsors such as for contribution holidays or relaxation of deficiency funding requirements.

-CRITICAL SIZE

The Arthurs Report discusses the cumulative effect of the advantages of larger plans with respect to both the cost of investment and the effective expense ratio and concludes that,

“the cumulative effect of all of these advantages is ... so significant ... that plan size may be a greater determinant of a member’s pension than plan design. Or, to make a more modest claim – holding plan design constant – large plans will generally perform better than small ones.”²¹

The Arthurs Report adopts \$10 billion as the threshold at which a fund may claim the necessary economies of scale and leverage in financial markets²². Others point to the high performing Saskatchewan DC pension plan for credit unions which has \$3 billion in assets and manages for less than 0.20 percent in investment costs. The CPP is huge, with \$108 billion covering 17 million Canadian workers in 2009. It is the second largest fund in Canada.

¹⁸ One basis point is equal to 1/100th of 1 percent

¹⁹ Pierlot, J. in op. cit at p. 6

²⁰ Arthurs, H: Ontario Expert Commission on Pension Reform Report "A fine balance" October 2008, at p. 183

²¹ Arthurs, H: in op. cit. at p. 184

²² Arthurs, H: in op. cit. at p. 184

Critics of a single, national fund point to the sheer size of such a fund – possibly twice as large as the CPP – as too unwieldy and they raise the understandable fear of having all our retirement nest eggs in the same basket. And the preference of the provinces to maintain jurisdiction over the pension savings within their territory is already starting to show – with British Columbia having already put in place its provincial defined contribution multi-employer pension plan and the three western provinces discussing a regional plan.

CARP does not prescribe a particular size of fund nor whether it must be a single national fund or several provincial or regional funds. Rather, the focus of debate should be on whether the various options would provide the level of robustness and sustainability that is critical to providing an adequate level of retirement security for all Canadians.

Action Required:

The federal and provincial governments must work cooperatively to address the urgent need to provide the one in three Canadians who retire without any retirement savings with *a retirement savings vehicle that is universally accessible, affordable, adequate and sustainable.*

CARP recommends a Universal Pension Plan modeled on the CPP with mandatory enrolment, utilizing the existing payroll deduction mechanism, professional manage-

ment, a governance role for the members, a mandate that is focused entirely on optimal performance and independence from government or any single employer and defined benefits as one way to achieve all of these goals.

In offering this model, CARP is not putting forward an absolute prescription and recognizes that alternatives may be found that may achieve some or all of these goals to a broadly acceptable degree. The key is to ensure that any deliberations address these goals.

The current economic crisis has focused public attention on the need for Canadians to prepare for their own retirement and on the absence of a universally accessible vehicle to do so effectively. The June 2009 Parliamentary Motion reflects some political will to better provide for the retirement security of all Canadians.

As a test of that political will, there should be a *Pension Summit* convened as soon as possible to review all the various recommendations and consultations that have already taken place in earnest and knowledgeable representatives of the people who will be most affected, *retirees, must have a seat at the table.*



Appendix A

Universal Pension Plan Survey issued April 14, 2009

1. Do you believe there should be a Universal Pension Plan for the 1 in 3 Canadians who do not have a workplace pension plan?

a) yes	3560 Votes	88.0 %
b) no	273 Votes	6.7 %
c) don't know	212 Votes	5.2 %
Total	4045 Votes	

2. Should there be mandatory contributions from:

a) employers only	112 Votes	2.8 %
b) employees only	241 Votes	6.0 %
c) both employers and employees	3692 Votes	91.3 %
Total	4045 Votes	

3. Should the self-employed be able to participate in a Universal Pension Plan?

a) yes	3770 Votes	93.2 %
b) no	127 Votes	3.1 %
c) don't know	148 Votes	3.7 %
Total	4045 Votes	

4. What %age of your pre-retirement income do you need to live comfortably after you retire?

a) 25%	130 Votes	3.2 %
b) 50%	1211 Votes	29.9 %
c) 70%	2150 Votes	53.2 %
d) more than 70%	554 Votes	13.7 %
Total	4045 Votes	

5. What %age of your salary (including the employer's portion) are you willing to contribute to a pension plan for your retirement?

a) 0%	58 Votes	1.4 %
b) 5%	944 Votes	23.3 %
c) 10%	2015 Votes	49.8 %
d) 18%	706 Votes	17.5 %
e) more than 18%	322 Votes	8.0 %
Total	4045 Votes	

Appendix B

Old Age Security Benefit Payment Rates January - March 2009				
Type of Benefit	Recipient	Average monthly benefit (October 2008)	Maximum Monthly Benefit	Maximum Annual Income
Old Age Security Pension	All recipients	\$489.83	\$516.96	
Guaranteed Income Supplement	Single person	\$452.04	\$652.51	\$15,672

From: Pierlot, James: *A Pension in Every Pot*. C.D. Howe Institute Commentary. 275. Toronto. C.D Howe Institute. November 2008: at page 3:

Paid from general tax revenue, OAS and GIS deliver an indexed maximum benefit of about \$14,000 annually at age 65. The second pillar programs, the Canada and Quebec pension plans, are partially funded by the invested contributions of employers and employees, and currently pay an indexed maximum benefit at age 65 of about \$11,000. This doesn't mean Canadians can each count on getting a \$25,000 indexed pension from government sources. The income-tested GIS benefit is quickly reduced by other income (including C/QPP) and the OAS benefit gradually reduces when retirement income exceeds a threshold of about \$65,000. The average benefit paid by C/QPP is about half the maximum. As a result, a typical retiree born in Canada with no other sources of income won't receive more than \$1,200 – \$1,300 per month from government sources. For recent immigrants, this amount will be significantly lower for two reasons: residency requirements to qualify for full OAS benefits; and short C/QPP contribution periods.

Low income cut-offs (1992 base) after tax

2008	Rural Area	Community size			
		Less than 30,000	30,000 to 99,999	100,000 to 499,999	500, 000 and over
Size of Family Unit					
1 person	12,019	13,754	15,344	15,538	18,373
2 persons	14,628	16,741	18,676	18,911	22,361
3 persons	18,215	20,845	23,255	23,548	27,844
4 persons	22,724	26,007	29,013	29,378	34,738
5 persons	25,876	29,614	33,037	33,453	39,556
6 persons	28,698	32,843	36,640	37,100	43,869
7 persons	31,519	36,072	40,241	40,747	48,181

Source: Statistics Canada: Low income cut-offs for 2008 and low income measures for 2007. Catalogue no. 75F0002M, at page 19