Remarks by Michel Montambeault, Director, CPP, OAS Actuarial Valuations
Office of the Chief Actuary,
Office of the Superintendent of Financial Institutions Canada,
to the House of Commons Standing Committee on Finance (FINA)
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Introduction

Good morning, Mr. Chairperson, Honourable members of the Committee. Thank you for the opportunity to appear before you today. I am Michel Montambeault, Director of the Canada Pension Plan (CPP) and Old Age Security (OAS) actuarial valuations at the Office of the Chief Actuary. I have here with me my colleague Michel Millette, Managing Director; Michel is involved in the CPP actuarial valuations and liaised with the Canada Pension Plan Investment Board (CPPIB). Michel is also responsible for the actuarial evaluations of the Employment Insurance (EI) Premium rate-setting and the Canada Student Loans (CSL) program.

Mandate and Activities of the Office of the Chief Actuary

The Office of the Chief Actuary (OCA) is an independent unit within the Office of the Superintendent of Financial Institutions (OSFI) that provides a range of actuarial valuation and advisory services to the Government of Canada. While the Chief Actuary reports to the Superintendent of Financial Institutions, he is solely responsible for the content and actuarial opinions reflected in the reports prepared by the office. The OCA plays an important role in helping decision-makers', Parliamentarians' and the public's understanding of some of the risks associated with the public pension arrangements by providing checks and balances on the future costs of the different pension plans under its responsibilities.

As part of its mandate, the OCA conducts statutory, periodic actuarial valuations of the Canada Pension Plan (CPP), Old Age Security program, federal public sector employee pension and insurance plans and the Canada Student Loans Program. Since

2012, the OCA is also responsible for preparing the statutory actuarial report on the Employment Insurance premium rate. In addition, for the CPP, whenever any Bill is introduced in the House of Commons to amend the Plan in a manner that would materially affect the estimates contained in the most recent actuarial report, a supplementary actuarial report must be prepared reflecting the change in those estimates. A similar requirement also applies for other plans and programs.

The purpose of all the actuarial valuations is to determine the financial status of the plans and to assist the stakeholders in making informed decisions regarding the financing of the plans.

CPP Enhancement – Bill C-26 (tabled Oct 6, 2016): *An Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act*

Bill C-26 provides for the enhancement of the CPP as agreed to principle by the provincial and federal Finance Ministers on June 20th. The enhancement both increases the replacement level from one quarter to one third of pensionable earnings and increases the upper eligible earnings limit, the Year's Maximum Pensionable Earnings (YMPE), by 14% by 2025. The additional contribution rates required are set at 2% below the YMPE and 8% above it, with the rates split evenly between employers and employees. There is a scheduled seven-year phase-in of the enhancement between 2019 and 2025. Under the enhancement, the new benefits will accrue gradually over time with full accrual occurring by about 2065. Individuals with less than forty years of contributions will receive partial (prorated) benefits.

As required by the CPP statute, a supplemental actuarial report (the 28th) on the CPP was prepared to show the effect of Bill C-26 on the long-term financial state of the Plan. The 28th CPP Report was prepared on the basis of the last regular, triennial report – the 27th CPP Actuarial Report as at December 31, 2015, which pertains to the current or base Plan. The 27th and 28th CPP Reports were tabled on September 27th and October 28th, respectively.

The findings of the 27th Report confirm that legislated combined employer-employee contribution rate of 9.9% is sufficient to financially sustain the base Plan over the long term. The legislated rate is higher than the minimum rate to sustain the base Plan, 9.79%, as stated in the 27th Report.

For the enhanced or additional CPP, the 28th Report confirms that projected contributions under the proposed legislated first and second additional contribution rates of 2% and 8% together with projected investment income are sufficient to fully pay projected expenditures over the long term. The legislated rates are higher than the minimum required first and second additional rates of 1.93% and 7.72%, respectively, as stated in the 28th Report.

It is important to note that the financing approaches of the base and additional CPP differ. The base Plan is partially financed, such that contributions are and will continue to be the main source of revenue. In contrast, for the additional Plan, it is required that projected contributions and investment income be sufficient to fully pay projected expenditures over the long term in order to minimize intergenerational transfers. As such, investment income is the main source of revenue for the additional Plan. This means that the minimum required contributions rates for the additional Plan are far more sensitive to the rates of return earned on its assets compared to the base CPP.

As shown in the 28th Report, for the additional CPP, if the projected real (net of inflation) rate of return is reduced by 100 basis points, so that the average real return falls from 3.55% to 2.55%, the minimum additional rates would increase by 32%, exceeding the legislated rates of 2% and 8% (from 1.93% to 2.55% and from 7.72% to 10.20%).

In comparison, for the base CPP, the same 100 basis point drop in the projected return for the base CPP (from 3.98% to 2.98%) would result in a projected increase of 8% in the minimum rate, from 9.79% to 10.53%. Although the base minimum rate would also exceed the legislated rate (9.9%), the relative impact of lower investment returns is much higher for the additional Plan – about four times higher than the impact for the base Plan.

Thank you for the opportunity to appear before this Committee. We are pleased to answer any questions that you might have.