Office of the Superintendent of Financial Institutions Canada | Bureau du surintendant des institutions financières Canada

Enhancement of the Canada Pension Plan

Presentation to the Northwind's 14th Annual Pension Fund Invitational Forum
Pensions 2017: Redefining the Risk Reward Spectrum

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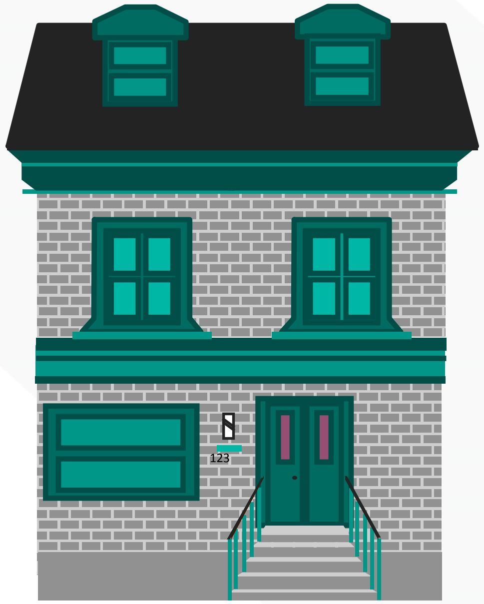
Canada

Canadian Retirement Income System is based on a diversified approach to savings

- Canadian retirement system is a three-tiered system with mixed funding approaches
  - Old Age Security Program – a universal basic pension/supplement aimed at poverty reduction (PAYG)
  - **Canada / Québec Pension Plan – mandatory earnings -related DB plans aimed at providing basic retirement income (partially funded)**
  - Occupational Pension Plans and tax-favoured individual savings – voluntary schemes aimed at providing adequate retirement income (fully funded)
- Today, first two pillars replace about 40% of pre-retirement earnings for an individual with average level of earnings



Canadian retirement income system is well recognized in the world for its capacity to adapt rapidly to changing conditions.

Canada Pension Plan is managed jointly by 11 governments

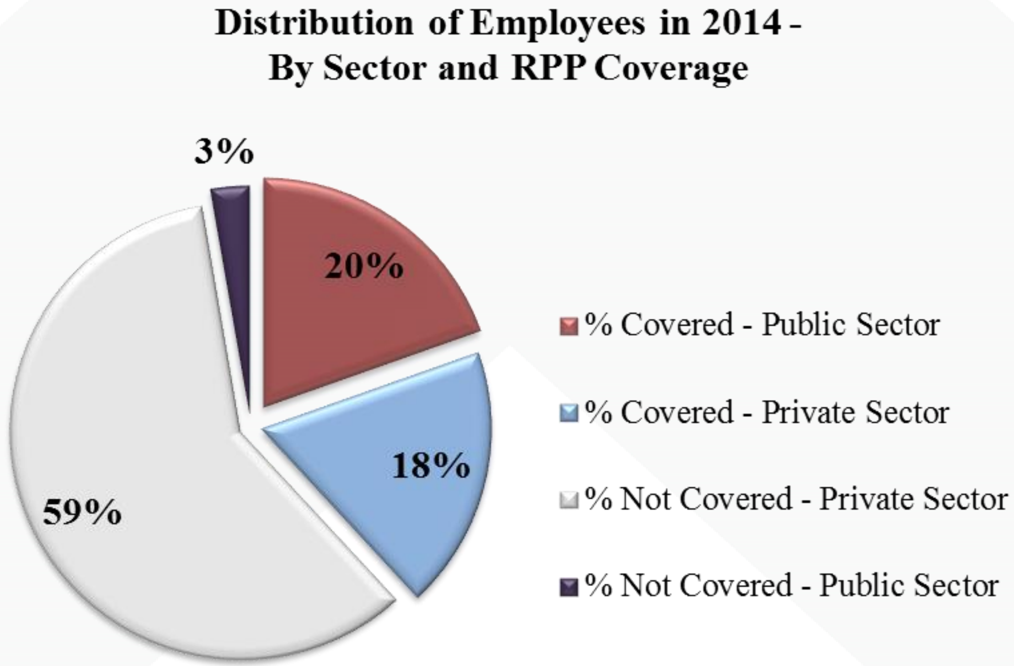
- Canada Pension Plan is jointly governed by federal, provincial and territorial ministers of finance
  - All changes to the Plan require agreement of two-thirds of provinces covering at least two-thirds of the population
  - Québec participates in decision-making regarding changes to the CPP
- Québec Pension Plan is governed by the Government of Québec

1997 CPP changes strengthened governance framework

- FTP finance ministers review CPP every three years.
  - Actuarial reports prepared by the OCA are one of the main sources of information for these reviews
  - The actuarial reports are tabled in Parliament
  - The actuarial reports are reviewed by an independent external review panel and results of this review are publicly available
- At the end of the triennial review, ministers must make recommendations whether benefits and/or contribution rate should be changed, taking into account results of most recent actuarial report.
  - According to the most recent CPP Actuarial Report tabled before Parliament, the Plan is expected to be able to meet its obligations over long term.

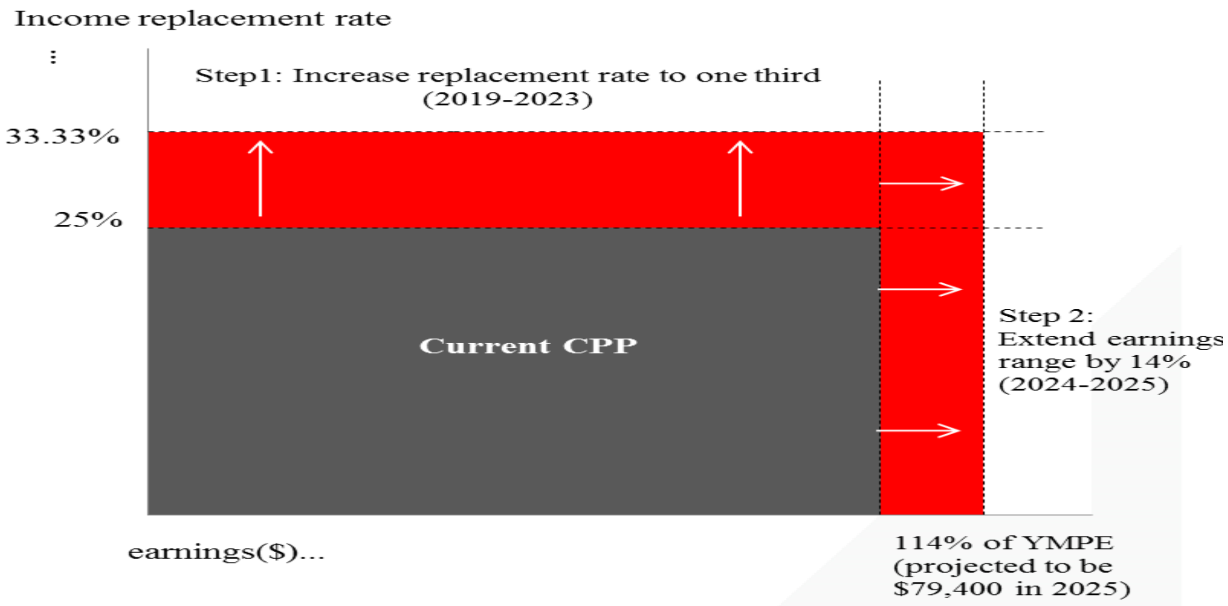
Triggers of the CPP enhancement

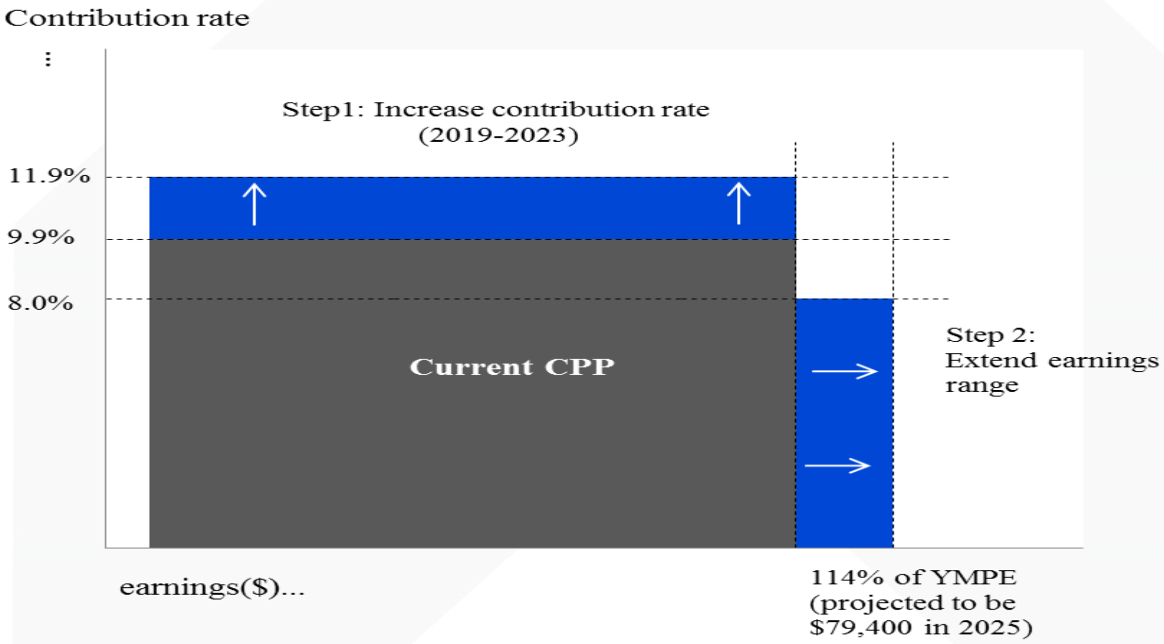
- Decline in coverage by employer-sponsored pension plans (especially in private sector)
- Changing labour market – increased employment mobility
- 2008-2009 financial crisis
- **One in four families approaching retirement—1.1 million families—are at risk of not saving enough**



Stewards of the CPP agreed on expansion principles:
<u>modest</u>, <u>gradual</u> and "<u>fully-funded</u>"

Federal and provincial Ministers of Finance reached an agreement on the CPP expansion in June 2016





Year's Maximum Pensionable Earnings (YMPE) approximate the Canadian average wage and are equal to CAD$55,300 in 2017

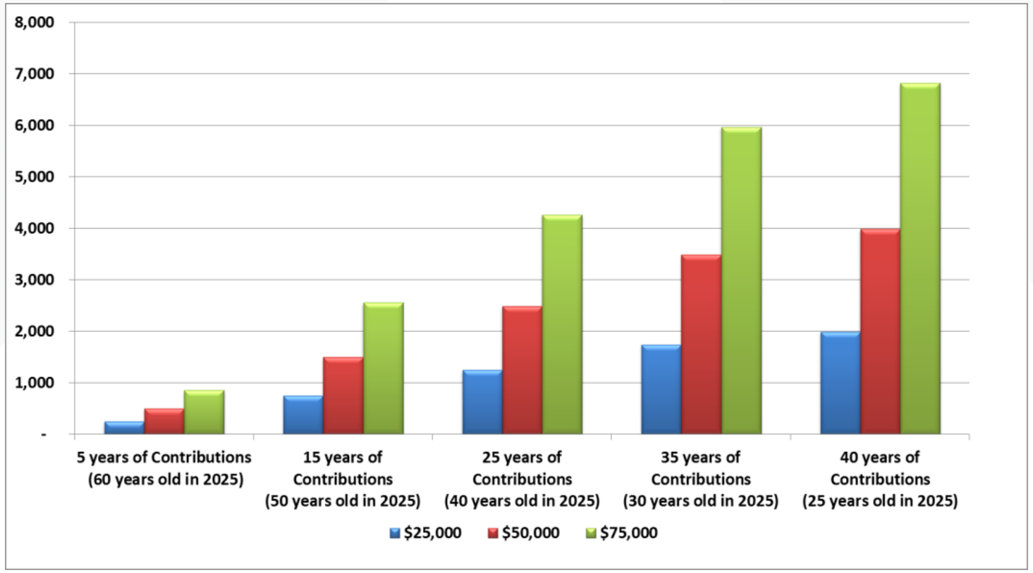
- The Working Income Tax Benefit is increased to help offset CPP contributions for eligible low-income workers.

Source: Bill C-26: An Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act received Royal Assent on December 15, 2016

Additional CPP strengthens link between contributions and benefits

- Each year of contributing to the enhanced CPP will allow workers to accrue partial additional benefits
  - Full enhanced CPP benefits will be available after 40 years of making contributions.
  - Partial benefits will be available sooner and will be based on years of contributions

Illustration of Additional Annual CPP Benefits for Different Age Cohorts and Income Levels ($2016)



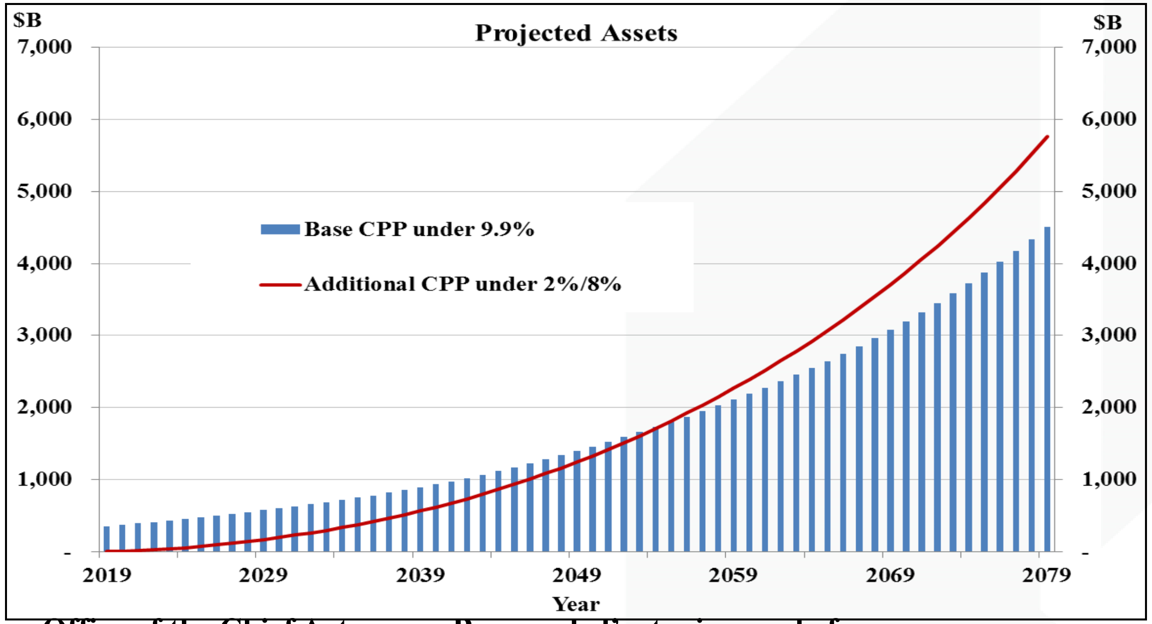
No past service liability is created and current young workers benefit the most from the expansion.

The financing objective of Additional CPP

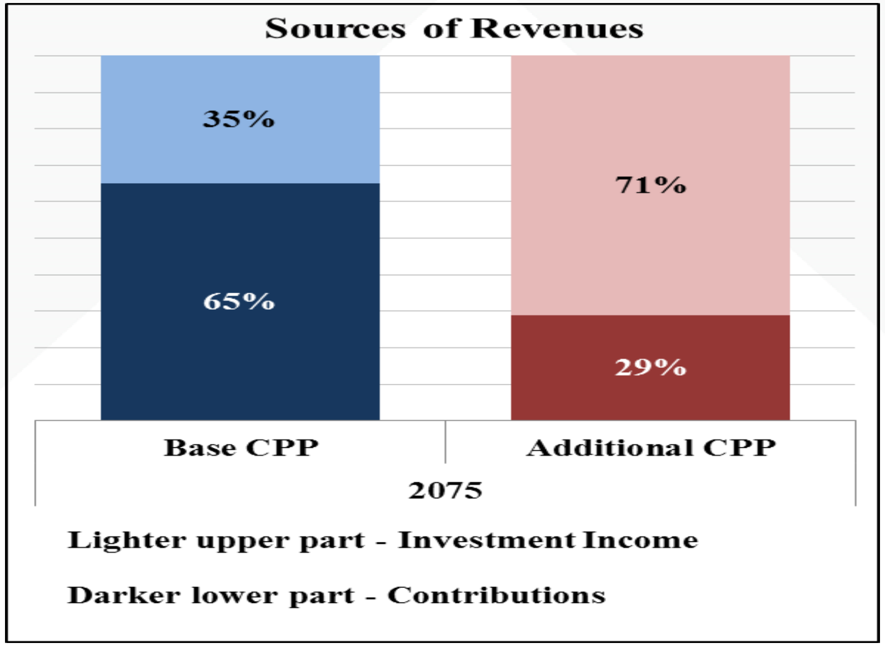
To have <u>constant</u> contribution rates that result in projected contributions and investment income that are <u>sufficient</u> to fully pay the projected expenditures of the Additional CPP <u>over the long term</u>.

Investment income is the main source of revenues for the additional CPP

- Under 2%/8% contribution rates, contributions are projected to exceed benefits up to the year 2058.
  - This will result in the accumulation of sizable assets
- The major source of financing: Contributions for the Base CPP, and investment income for the expansion.



Office of the Chief Actuary Bureau de l'actuaire en chef



CPPIB's sole focus is investing the assets of the CPP. What will be the Additional CPP investment strategy?

Investment objective: to achieve a maximum rate of return without undue risk of loss having regard to the factors that may affect the funding of the CPP.

23.1%
Real Assets

21.5%
Fixed Income

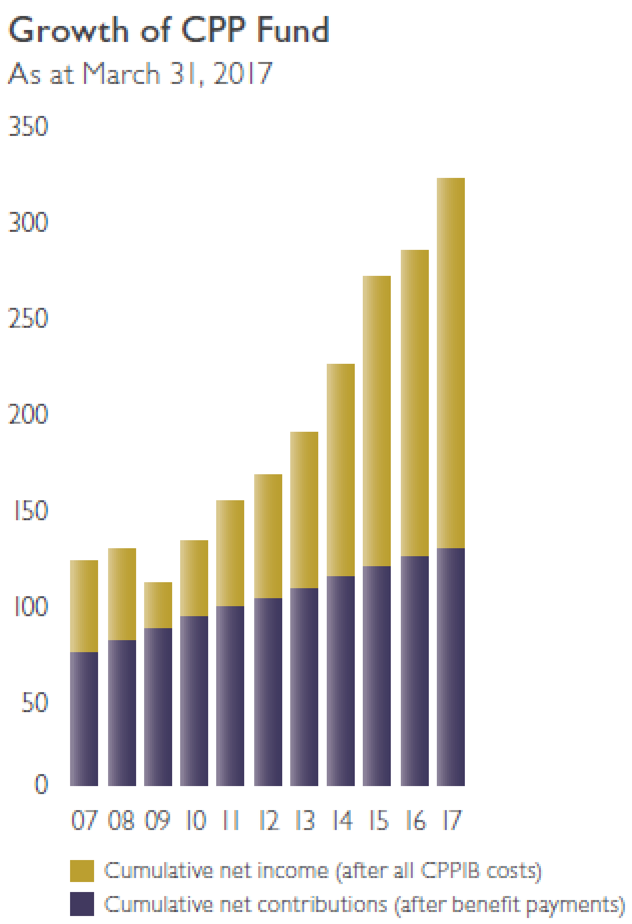
55.4%
Public and Private Equities

47.1%
$149.1 Billion
in Private Assets

$316.7 Billion
CPP Fund Value at March 31, 2017

6.7%
10-Year Annualized Rate of Return (net nominal)

11.8%
Five-Year Annualized Rate of Return (net nominal)



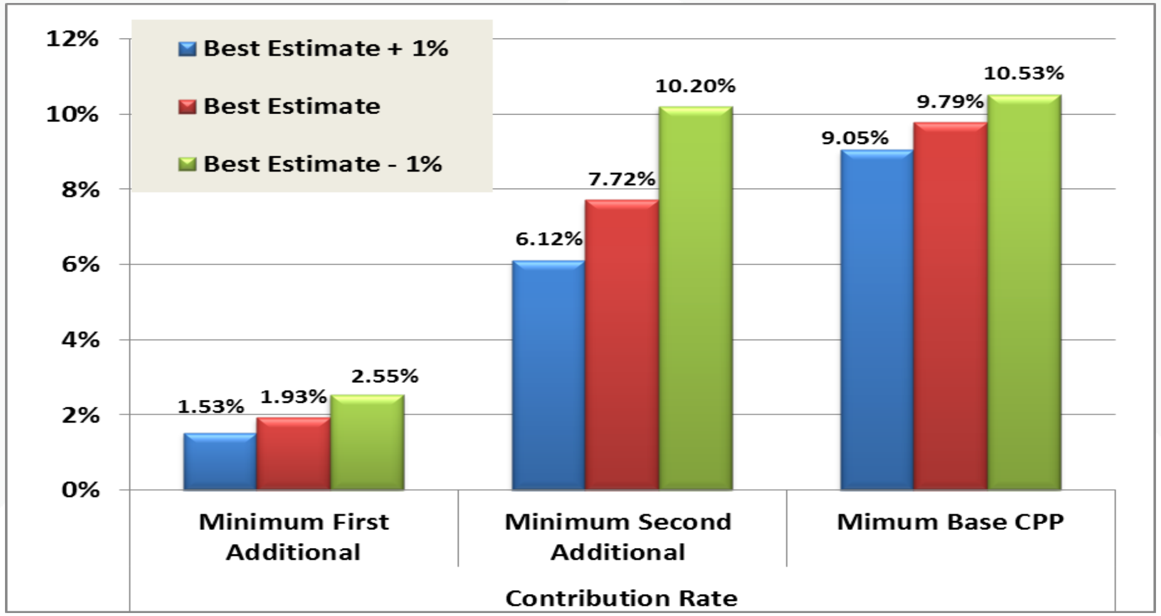
Source: CPPIB 2017 Annual Report

Additional CPP will be more sensitive to investment returns

	Additional CPP	Base CPP
Assumed Assets Allocation	Fixed Income: 50% Equities: 50% Volatility: 9.2%	Fixed Income: 32.5% Equities: 67.5% Volatility: 11.4%
Average real rate of return 2019-2093 (net of expenses)	3.55%	3.98%

The decrease in the best-estimate rate of return of 1%:

- **30%** increase in the minimum additional contribution rates
- **8%** increase in the minimum contribution rate for the base CPP.



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Insufficient rates provisions of Base CPP serve as a safety net in case of political impasse

“ Insufficient Rates” Provisions

If the minimum contribution rate is higher than the legislated contribution rate

AND

if the federal and provincial finance ministers <u>cannot reach an agreement</u>

THEN insufficient rates provisions apply

- <u>Contribution rate</u> increased by ½ of excess over three years
- <u>Benefits</u> frozen until next review (3 years)
- The next review will be performed to determine financial status of Plan

Self-adjustment provisions of QPP touch only contribution rate

- From 2018, if steady-state contribution rate exceeds the legislated rate by at least 0.1%, then
  - the contribution rate for the year is equal to the contribution rate for the previous year plus 0.1%
- The Québec Government may decide that the rate of contribution remain the same as the rate for the preceding year.

Financial stability provisions of the Additional CPP

- For the Additional CPP, if additional contribution rates fall outside prescribed ranges:
  - As for the Base CPP, the first priority is given to the recommendations of Ministers
  - Prescribed ranges and actions with respect to the <u>benefits</u> and <u>contributions</u> will be defined in regulations.

Considerations regarding financial stability provisions of the Additional CPP

- What are the actions triggers?
  - Surplus versus deficit
  - At inception vs maturity
- What are the actions?
  - Surplus versus deficit
  - Contributions vs benefits
- How impacts are shared?
  - Beneficiaries vs contributors vs employers
  - Different generations
- Are actions reversible?
- And many others…

Some examples that can inspire us

- **Sweden**: slowdown in growth of benefits followed by a potential reversal
- **ORPP:**
  - Deficit: reduce benefits up to a certain level. If not enough, increase contributions.
  - Surplus: reverse previous decreases

Figure 4.1 Balancing – Concept description

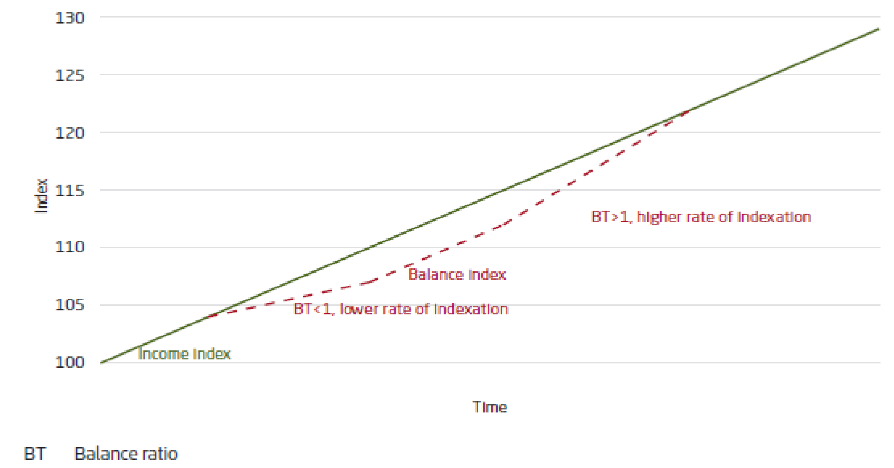
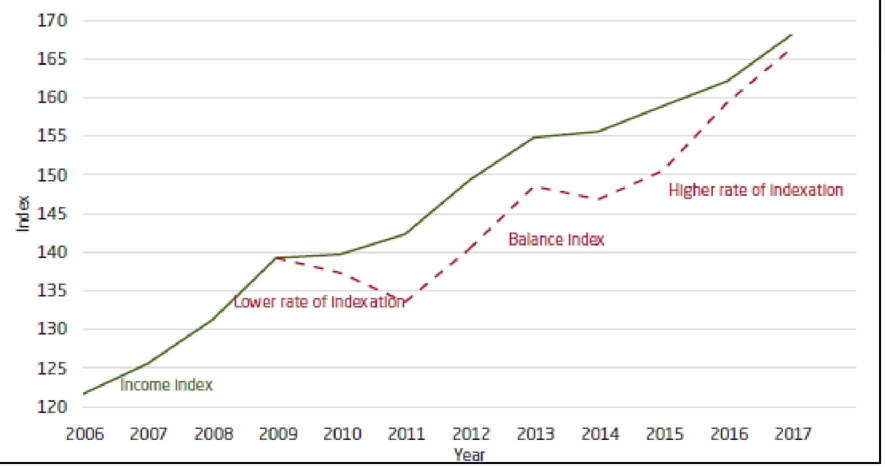


Figure 4.2 Actual balancing



Source: Swedish Orange Report 2016

Conclusions

- The 2016 expansion is aimed at enhancing the adequacy of benefits while respecting intergenerational sustainability
- The upcoming regulations on financial stability of the Additional Plan will be crucial for maintaining financial sustainability of the Plan and ensuring the adequacy of benefits
- Strong governance, political dialogue and sound actuarial analysis serve as a foundation for an efficient second pillar of retirement income system.

THANK YOU!

Appendix

Office of the Chief Actuary

- The OCA is an independent unit within Office of the Superintendent of Financial Institutions (OSFI) .
  - The Chief Actuary reports to the Superintendent;
  - however, the accountability framework of the OCA makes it clear that the Chief Actuary is solely responsible for content and actuarial opinions in reports prepared by the OCA.
- Mandate: conduct statutory actuarial valuations on the
  - Canada Pension Plan (CPP) –**19M members**
  - Old Age Security Program (OAS) - **5M beneficiaries**
  - Federal public sector pension and insurance plans – **0.8M members**
  - Canada Student Loans Program – **0.5M loans**
  - Employment Insurance Program – **17M workers**

Income from all 3 pillars is necessary to guarantee Canadian seniors decent lives in retirement

Decomposing poverty protection for Canadian seniors aged 65+ Percentage of seniors with equivalised household income before taxes below 35% of the average wage (2011)	
Above age 65 (no income)	100%
Basic OAS Income (universal Pillar 1)	100%
+ C/QPP Income - before CPP expansion (Pillar 2)	60%
+ Private Pension Income (Pillar 3)	35%
+ Investment Income	31%
+ Work Income	27%
+ Other Income	25%
+ GIS – before top-up for singles (Income-tested Pillar 1)	13%

27th CPP Actuarial Report: the Plan is expected to be able to meet its obligations over long term

- The minimum contribution rate to sustain the Plan is **9.79%** of contributory earnings for the year 2019 and thereafter

- Under the **9.9%** legislated contribution rate:
  - contributions are projected to be more than sufficient to cover the expenditures over the period 2016 to 2020
  - Total assets are expected to grow from $285 billion at the end of 2015 to $476 billion by the end of 2025
  - In 2050, contributions and investment income are projected to represent 67% and 33% of total revenues, respectively.

Source: the 27th Actuarial Report on the Canada Pension Plan as at 31 December 2015 tabled in Parliament on 27 September 2016