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

Additional Canada Pension Plan Sustainability Regulations

Presentation to CD Howe Pension Council

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OSFI BSIF

Canada

Setting the Stage: Base and Additional CPP are Different

- Investment income is the main source of revenues for the additional CPP while contributions are the main source of revenues for the base CPP
  - *Calculation of Contribution Rates Regulations, 2018:* Methodology to calculate minimum additional contribution rates
  - **Sustainability Regulations** aim to preserve the financial sustainability of the additional CPP while avoiding excessively frequent adjustments

- Intergenerational equity is addressed differently between the two Plans
  - **Sustainability Regulations** aim to:
    - have a similar impact on different generations of participants, and
    - ensure that future generations of Canadians are being treated fairly.

Setting the Stage: Base and Additional CPP are Different (cont'd)

- The additional CPP will not mature for decades to come while the base CPP is a mature plan
  - Wish to minimize the chance of application of default provisions during early years of the Additional Plan without jeopardizing its financial sustainability.
  - The Regulations are to be reviewed every nine years or more frequently, if needed.

Additional CPP Sustainability Regulations are default actions

- The financial sustainability provisions would only be invoked in the event that:
  - a significant deviation arises between the AMCRs and their respective legislated additional rates and
  - the federal and provincial Ministers of Finance take no action regarding the deviation.

Similar to the Base CPP, Ministers bear the primary responsibility for the financial state of the additional CPP

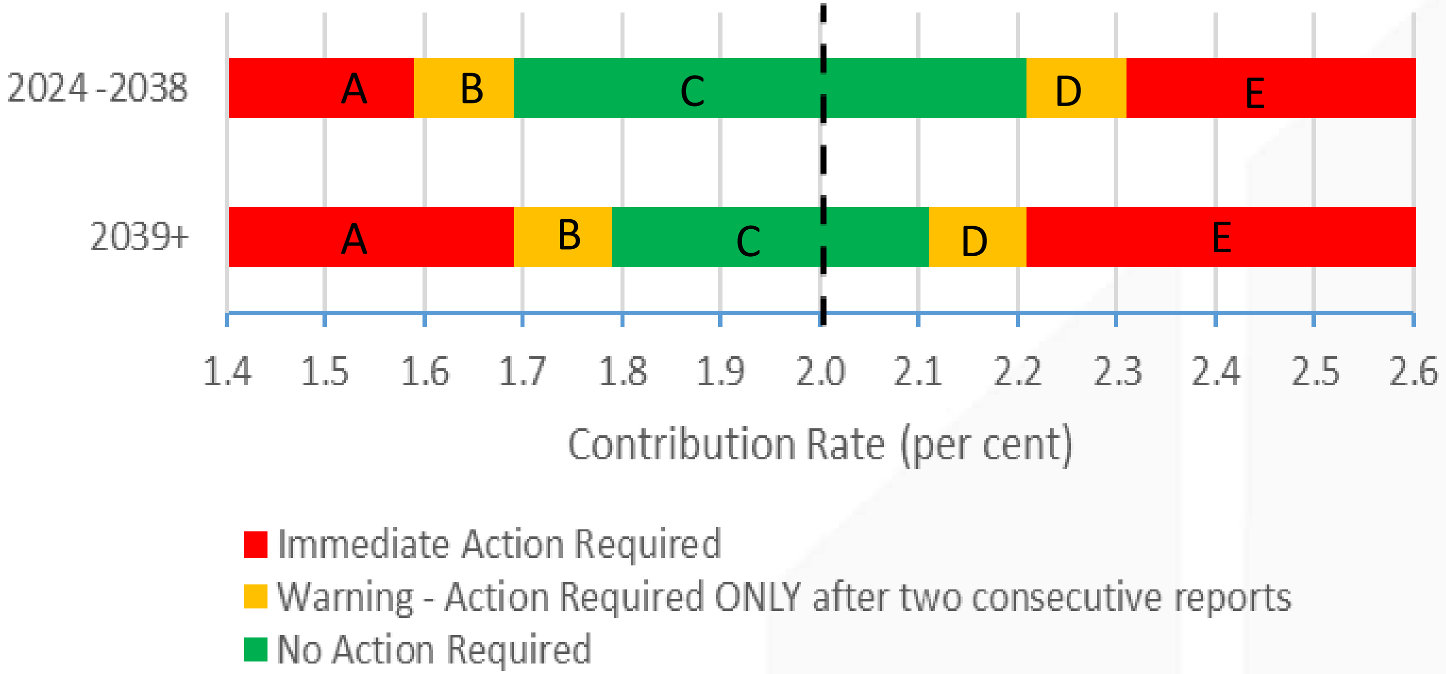
The Financial Sustainability Provisions Aims at:

- Preserving the financial sustainability of the additional CPP (i.e. preventing <u>both</u> substantial underfunding and overfunding),
- Ensuring stability of contribution rates, and
- Reducing the risk of future reductions in benefits and/or increases in the contribution rates.

Financial Sustainability Provisions for the additional CPP – Action Triggers

By how much, and for how long, can the additional minimum contribution rates (AMCRs) deviate from the legislated rates before action is required?

Three trigger zones: from the green to the red

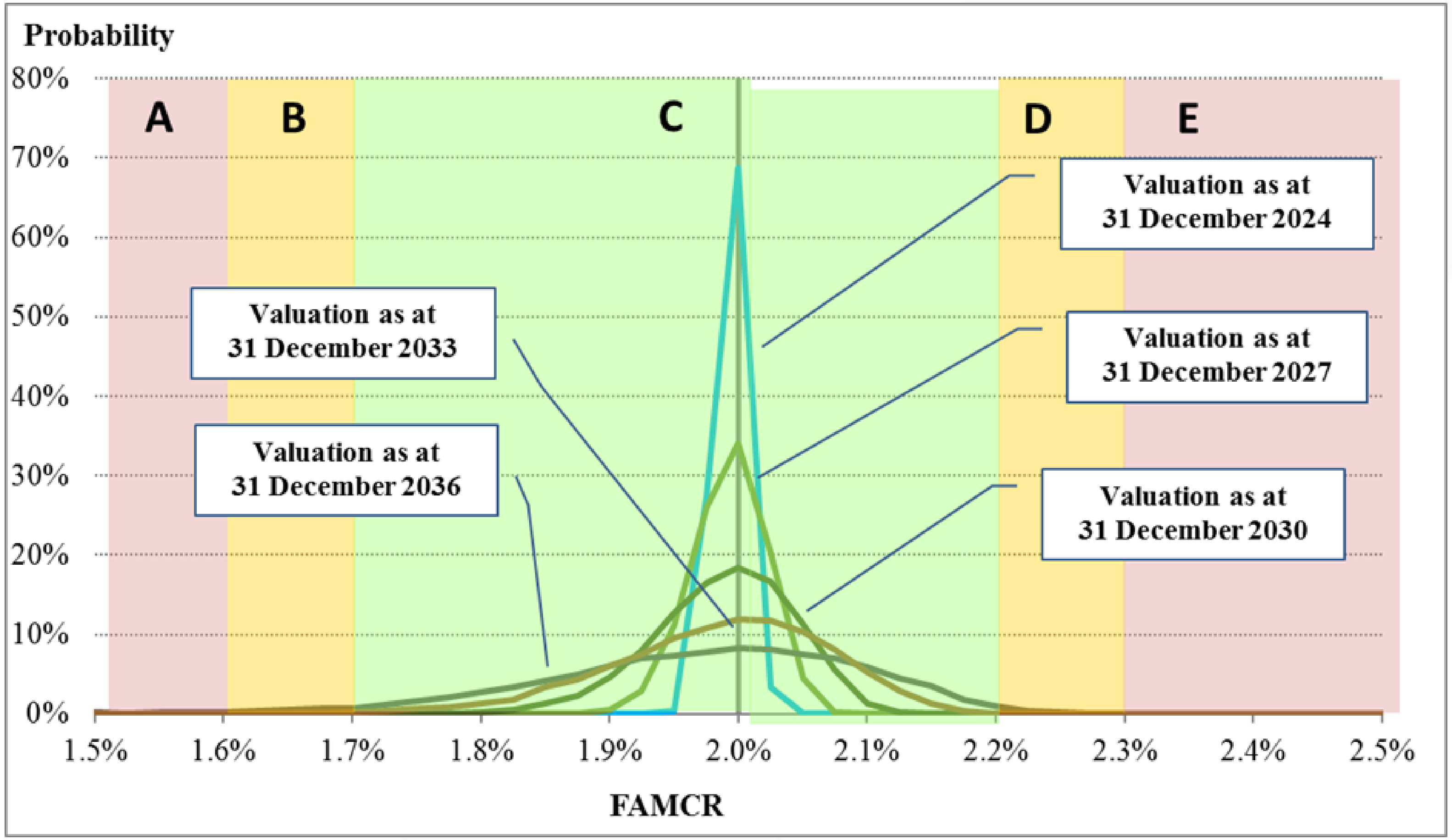


Wider green ranges in early years minimize the frequency and magnitude of adjustments

Wider green ranges in surplus mitigate the risk of reductions in benefits and/or increases in contributions.

In the early years, investment experience is expected to have limited impact on the financial status of the Plan

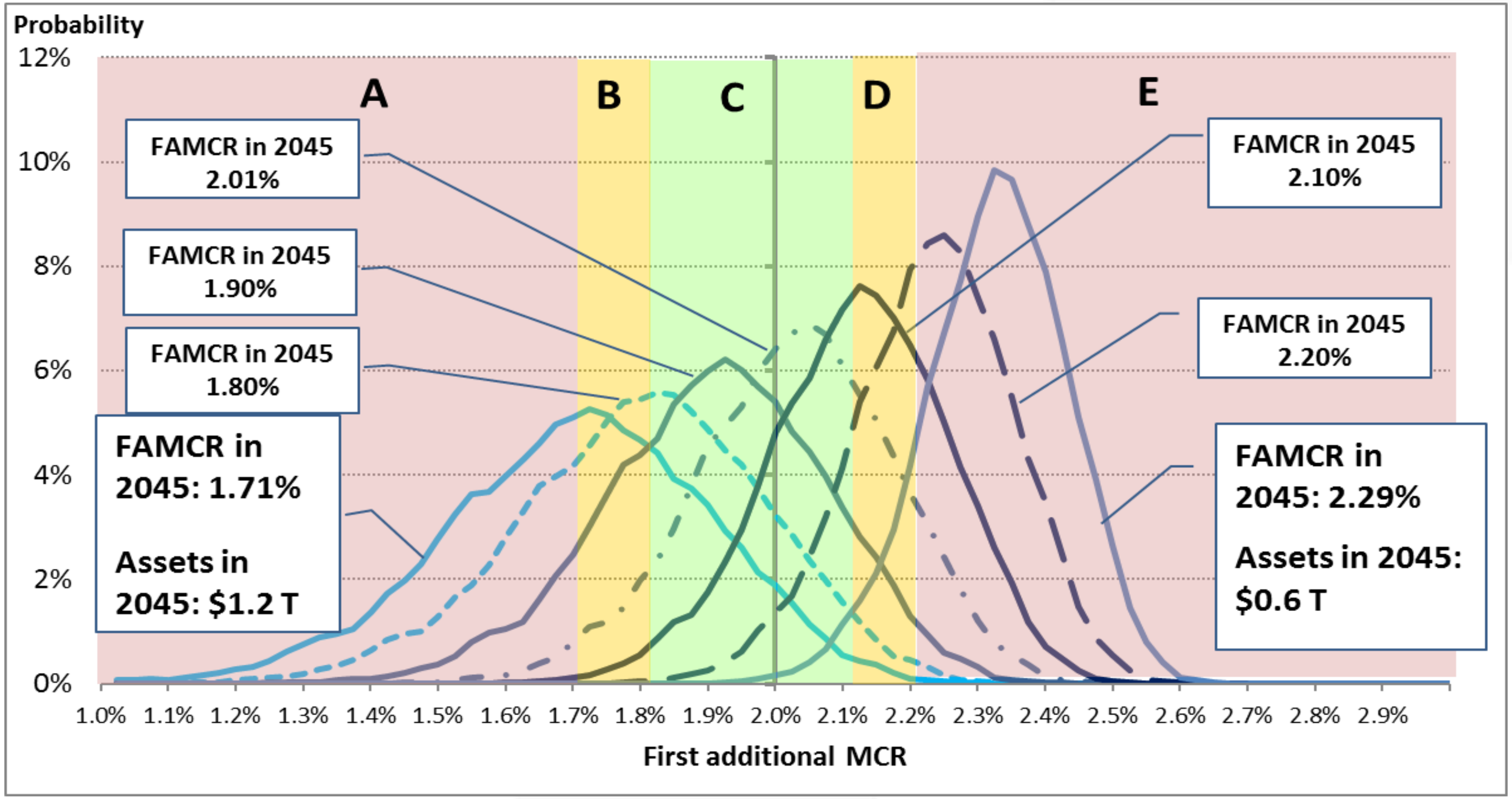
Illustration: Distribution of FAMCRs as at 31 December 2024, 2027, 2030, 2033 and 2036



Note: The letters A to E in the chart refer to the FAMCR defined ranges. Based on CPP29 (1.98% / 7.92%).

As additional CPP matures, investment experience drives results

Illustration: Distribution of FAMCRs **as at 31 December 2048** given Different FAMCRs as at 31 December 2045



As at 31 December 2045, FAMCR based on the best-estimates is 1.94% and assets are $0.9T

Note: The letters A to E in the chart refer to the FAMCR defined ranges. Based on CPP29 (1.98% / 7.92%).

If the AMCRs are in the green zone in 2045, there is a probability of about 50% that the AMCRs in 2048 will remain in the same zone

		FAMCRs as at 31 December 2045						
		1.71%	1.80%	1.90%	2.01%	2.10%	2.20%	2.29%
		Probability as at 31 December 2048 of FAMCRs being within a Range						
A	≤ 1.69%	52%	32%	13%	3%	0%	0%	0%
B	1.70% to 1.79%	20%	21%	16%	6%	2%	0%	0%
C	1.80% to 2.10%	27%	44%	61%	65%	47%	18%	**4%**
D	2.11% to 2.20%	1%	3%	7%	17%	28%	28%	13%
E	> 2.21%	0%	0%	2%	9%	23%	54%	**84%**

Sustainability Provisions for the additional CPP – Required Actions

IF

- the AMCRs deviate from the legislated additional contribution rates by too much and/or for too long,

and

- Finance Ministers do not reach agreement on the course of actions

Main adjustment mechanisms

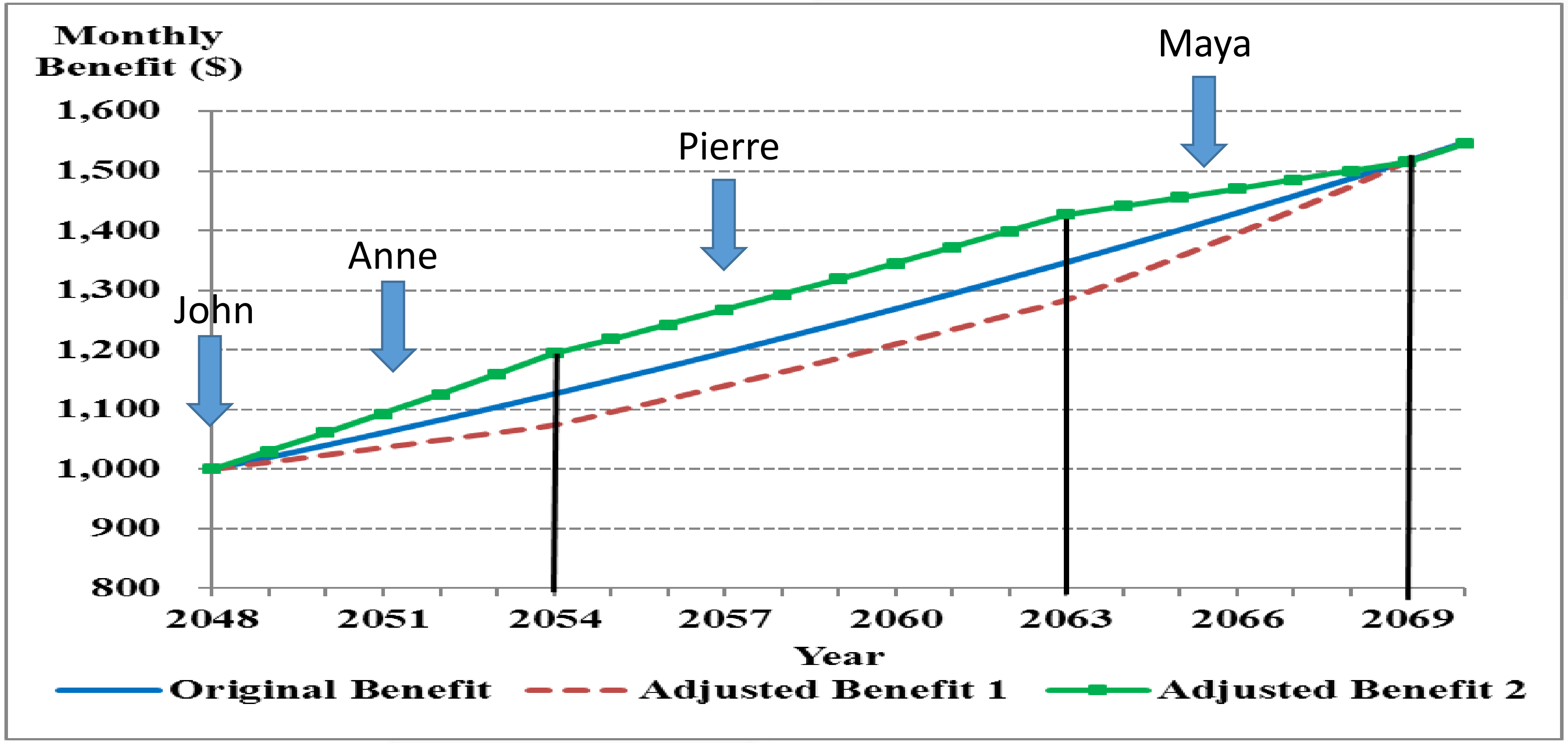
- Adjusting benefits of current beneficiaries
  - Modify indexation of benefits in pay for a specified period (6+ years)
  - Limits on indexation adjustment: 60% - 200% of CPI
  - Benefits are not reduced from one year to the next
- Adjusting benefits of future beneficiaries (current contributors)
  - Multiplying starting amount by “benefit multiplier” (depends on the year of uptake)
  - Benefit multiplier is aligned with the value of extra/forgone indexation
- Increasing additional contribution rates – last resort in the case of deficit

Adjustments may be reversed

- The first action to be taken when the sustainability provisions are activated is a reversal of any previous adjustments in an opposite direction made to the additional Plan.
  - Such reversal should be done to the extent that the AMCRs are restored to the legislated levels as defined by Schedule 2 of the legislation.

Benefits in pay cannot be reduced only the future indexation may be adjusted

Example of Evolution of Original Benefits and Adjusted Benefits with Later Reversal of Adjustments



Conclusion

- The additional CPP Sustainability Regulations are aimed at
  - preserving the financial sustainability of the additional Plan (i.e. preventing both substantial underfunding and overfunding),
  - ensuring the stability of the additional contribution rates, and
  - reducing the risk of future reductions in benefits and/or increases in the contribution rates.
- The additional CPP Sustainability Regulations are a default mechanism.
- The design of the additional CPP Sustainability Regulations shares adjustments between current beneficiaries, contributors and their employers.
  - It aims at minimizing intergenerational transfers to be consistent with the design and financing objectives of the additional Plan, and provides to all generations of Canadians the confidence of being treated fairly.

THANK YOU!

Regulatory Impact Analysis Statement

- *Additional CPP Sustainability Regulations* aim to ensure that the enhanced portion of the Plan is appropriately funded over time while respecting intergenerational equity, consistent with the full funding principle underpinning the CPP enhancement.

Projected financial position 24 years after the inception As at 31 December 2042

- As at 31 December 2042 under the CPP29 assumptions and legislated contribution rates of 2%/8% :
  - Projected Additional Plan Assets: $730 billion
  - Assumed average annual real rate of return 2019-2042 (24 years): 3.4%
  - AMCRs: 1.95% / 7.80% (down from initial AMCRs of 1.98%/7.92%)

Six assumed medium-term investment paths (2043-2045) to move from 2042 FAMCR of 1.95%

Projected Average Real Rates of Return, Assets, and FAMCRs determined **as at 31 December 2045**

Average real rate of return 2043-45 [3 years]	11.9%	8.8%	5.3%	1.0%	-2.5%	-7.2%	-11.8%
Average real rate of return 2019-45 [27 years]	4.3%	4.0%	3.6%	3.1%	2.7%	2.2%	1.6%
Projected Assets under legislated additional contribution rates ($billion)	1,155	1,068	970	864	777	677	591
FAMCR 31/12/2045	1.71%	1.80%	1.90%	2.01%	2.10%	2.20%	2.29%

B

C

D

E

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Projected under CPP29 as at 31.12.2045:
Assets: $928 B; FAMCR: 1.94%

Principal design features - deficit

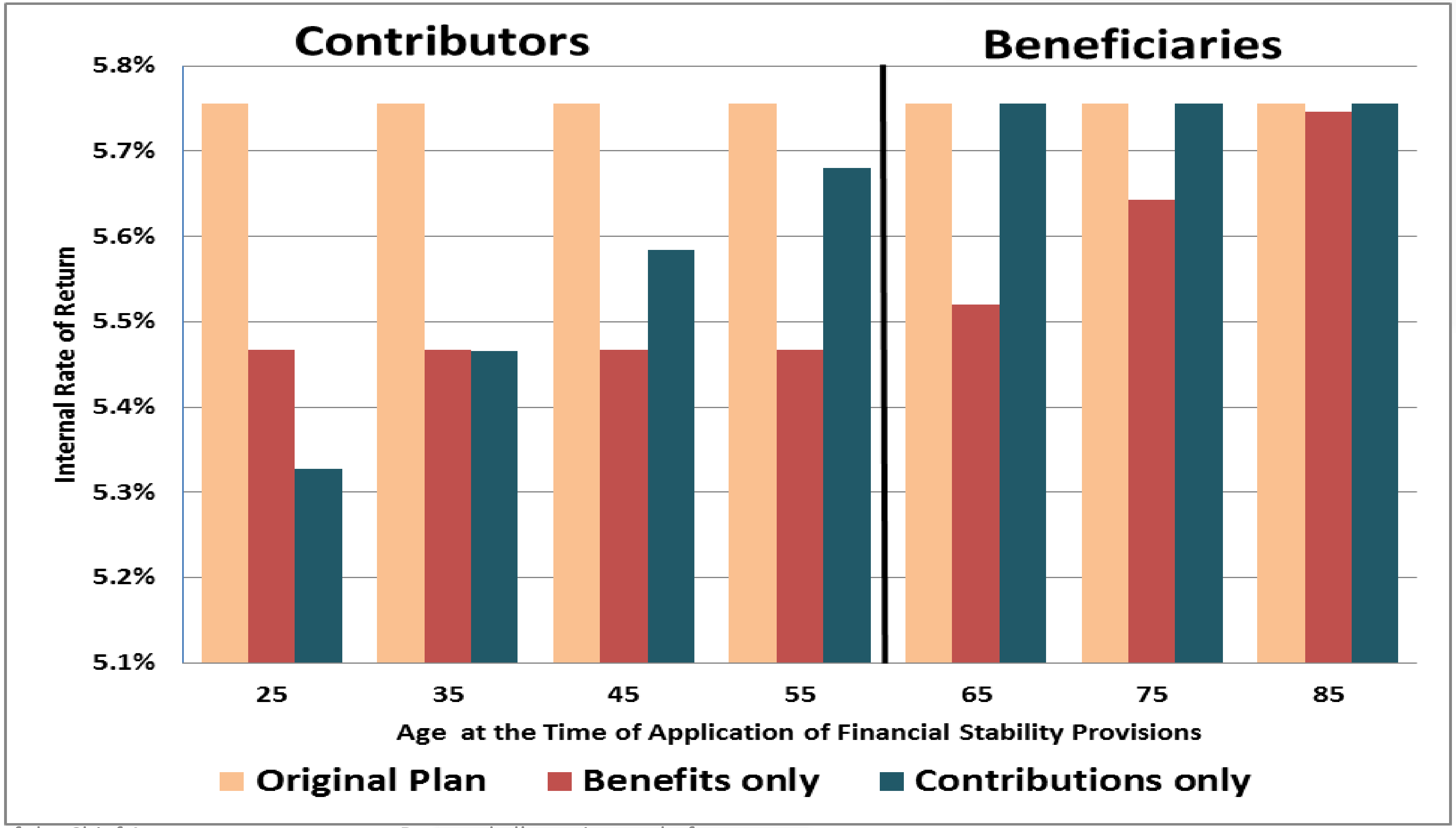
- The benefits for both current and future beneficiaries (retirement, disability, and survivor) would first be adjusted to a certain specified limit
  - Maximum adjustment corresponds to providing indexation at **60%** of CPI for **six** years

- If such an adjustment to benefits is not sufficient to restore the AMCRs to their respective legislated values, then the additional contribution rates would deemed to be increased.

Principal design features - surplus

- Increasing benefits for both current and future beneficiaries (current contributors).
- Aim is to bring the AMCRs to target values below the legislated rates: 10 bps and 40 bps lower than the first and second additional legislated contribution rates, respectively
  - AMCRs are more likely to remain close to the legislated rates for a certain time.
- Contribution rates are not affected.

Nominal Internal Rate of Return at Age 25 by Age at the Time of Adjustment (FAMCR of 2.3% determined as at 31 December 2075)



Nominal Internal Rates of Return at Age 25: Additional CPP Sustainability Regulations, Contributions Only and Benefits Only Approaches (FAMCR of 2.3% determined as at 31 December 2075)