Better financed pension plans in a well balanced system

Presentation to the Canadian Pension and Benefits Institute

10 September 2002
Presentation

- Mandate of the Office of the Chief Actuary
- Actuarial report on the Canada Pension Plan
- Actuarial reports on the Public Sector Pension Plans
- Future challenges
Mission of OSFI
(Office of the Superintendent of Financial Institutions)

• Primary regulator in Canada of federal financial institutions and pension plans.
  – protects policyholders, depositors, and pension plan members against any undue loss
  – provides services and actuarial advice to the Government of Canada through the Office of the Chief Actuary
Mandate of Office of the Chief Actuary

- Prepares actuarial reports showing long-term financial projections for the Canada Pension Plan, the Old Age Security and the Canada Student Loans (22 mars 2002)
- Prepares actuarial reports on the financial status of the public sector pension plans: Public Service, Canadian Forces, RCMP, Judges and Members of Parliament
- Prepares actuarial reports for the public sector insurance programs
- Provides actuarial advice to our clients
Canadian retirement system with mixed funding approaches is well recognized in the world for its capacity to adapt rapidly to changing conditions.

- Full funding (RPP/RRSP)
- Partial funding (CPP/QPP)
- Pay-as-you-go funding (OAS/GIS)
Old Age Security Program

- Tabled by the Minister of Human Resources Development on 19 June 2002
- Beneficiaries increase from 3.8M to 8.4M in the next 30 years
- GIS Beneficiaries increase from 1.5M to 2.3M
- Annual expenditures increase from $25 to $36 billion in 2010
GIS Single
(866,000: 80% are women)

July 2002

More than 50% of single females aged 80 and over receive GIS

Total Earnings at Cut-Off Point: $17,960

Guaranteed Minimum Income: $11,700

GIS Cut-Off Point: $12,670

- OAS

- GIS

- OTHER

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Between 2010 and 2030, the ratio increases from 2.4% to 3.2% of GDP, driven largely by the retirement of the babyboomers.
• Tabled by the Minister of Finance on 16 December 2001

• Inform on the current and projected future financial status of the Canada Pension Plan

• Calculate the Steady-state contribution rate
Assumptions
(Pension Plans with different funding methods)

- Fertility, Migration and Mortality
- Participation rates
- Annual employment increase
- Unemployment rate
- Inflation rate
- Increase of average employment earnings
- Rate of return and asset mix
- Retirement rates
- Disability rates, etc…

- **Consistency among assumptions**
Fertility Rate

1950-1974: 3.2

1975-1999: 1.7

Assumption OAS & CPP report: 1.64
Fertility Rate

Average age of motherhood would continue to increase

---|---|---|---
15-29 | 2.12 | 1.16 | 0.89
30-44 | 0.44 | 0.63 | 0.75

83% | 65% | 54%
Migration
(1986-2000)

- Emigration: -60,000
- Immigration: +196,000
- Returning: +16,000

Net: +152,000, 0.53% of population
Mortality rate

- In Canada and U.S., the leading causes of death are circulatory diseases (40% of deaths), cancer (20% of deaths) and accidents (9% of deaths).
- How long can we live?
- Can we reach 100 years old?
- From 130,000 years ago until 1900, life expectancy remained approximately at the same level.
- It has increased by three decades since 1900 from 49 to 79.
- Analysts argue that further progress will come more slowly because we are approaching lower limits to death rates and we have already won the easier medical battles.

Yes, but…
It requires to eliminate all mortality risks before 80.
Mortality rate

Females aged 45–64

Improvements in %

<table>
<thead>
<tr>
<th></th>
<th>Canada</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Last 50 years</td>
<td>1.5%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Last 25 years</td>
<td>1.8%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Last 15 years</td>
<td>2.2%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Last 10 years</td>
<td>2.4%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Last 5 years</td>
<td>2.5%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>
Mortality rate

Females aged 65-79

Improvements in %
Canada   US
Last 50 years 1.5%  1.2%
Last 25 years 1.3%  0.7%
Last 15 years 1.0%  0.5%
Last 10 years 0.7%  0.5%
Last 5 years 0.2%  0.2%

Recent improvements at a slower pace for 80 years and over
Increase of 150%

Increase of 275% for 80+

65+

Number

% CPP17th

% CPP18th

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Population of Canada

(in millions)


Δ 1960-1980 +1.6%
Δ 1980-2000 +1.1%
Δ 2000-2020 +0.8%
Δ 2020-2040 +0.5%
Δ 2040-2060 +0.3%
Future Labour Shortage
(More people leaving than entering)

Ratio of 60-64 over 20-24
(Canada)

For every 6 who leave, 10 enter
Female Participation Rates (Canada)
Female Participation Rates (Canada)
Job Creation Rate (Canada)

-4%  -3%  -2%  -1%  0%  1%  2%  3%  4%  5%

2.6% in 2000

CPP report: 1.0% in 2003-2012, reducing to less than 0.5% in 2015

Ultimate unemployment rate of 6.5% attained in 2015
Real Increase of Total Employment Earnings

17th report

2000-2015
2.8%

2015-2025
1.3%

2025-2050
1.5%
Information sources on real rate of return

On CPPIB Assets (CPP 18th) (without the Operating Balance)

This assumption presumed a defined asset mix.
# Real rate of return on CPP Assets (by asset class)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>18th CPP Actuarial Report</th>
<th>Bill C-58</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Asset Mix</td>
<td>Return</td>
</tr>
<tr>
<td>Bonds</td>
<td>46%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Short-Term</td>
<td>4%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Canadian equities</td>
<td>26%</td>
<td>4.5%</td>
</tr>
<tr>
<td>US Equities</td>
<td>12%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Foreign equities</td>
<td>12%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Fixed / Variable</td>
<td>50%:50%</td>
<td>4.20%</td>
</tr>
<tr>
<td>Net of Investment expenses</td>
<td>4.16%</td>
<td></td>
</tr>
</tbody>
</table>

Independent actuaries indicated the assumption was reasonable, but they would have chosen an higher assumption by 0.5% to 0.75%.
American Risk Premium
(10 years moving average 1960-2001)

CPP Assumption: Equity Risk Premium of 2.0% on US and Foreign Stocks

Risk Premium = Return on Stocks – Return on Bonds
Canadian Risk Premium
(10 years moving average 1957-2000)

CPP Assumption: Equity Risk Premium
of 1.5% on Canadian Stocks

Risk Premium = Return on Stocks – Return on Bonds
Historical Market Return Analysis
(Average real rate of return : Canada 1941-2000)

Portfolio: 50% LT Bonds
25% Canadian Equities
25% American Equities

σ (volatility): 8.8%

53% over 1 year
60% over 10 years
64% over 20 years

-21.6% -12.7% -3.9% 5.0% 13.8% 22.7% 31.5%

4.25%
Main Findings

• From 2001 to 2020, contributions are more than sufficient to cover expenditures and assets are expected to more than triple over the next 10 years.

• Under the current schedule of contribution rates (9.9% for 2003 and thereafter), the funding rate will increase over the next 20 years.

• The report confirms that the contribution rate of 9.9% is sufficient to sustain the Plan as larger numbers of Canadians reach retirement age and longevity continues to increase.
Contribution rate

Steady-state contribution rate is 9.8%

• Lowest rate that can be maintained over the foreseeable future and that will result in a Asset/expenditure ratio generally constant over a long period of time.

• The steady-state rate is the lowest rate that can be charged that is sufficient to sustain the plan without further increase. A funding level of 20%-25% is sufficient to meet that condition.
Evolution of Asset/Expenditure ratio

Bill C-58

9.9% legislated rate

9.8% steady-state rate

Expected CPP Assets in 2008: $115B
Public sector Pension Plans

Average age at retirement and number of years of service
45 and 24
60 and 24
48 and 27

60,000 members
240,000 members
20,000 members
Purpose of the actuarial reports

- Public Sector Pension Plans are compulsory
- Defined Benefit Pension Plans
- Benefits are defined in the law; assumptions must be used to determine the current and projected cost
- Estimate the assets, liabilities, actuarial surplus/deficit and the amortization amount
- Actuarial opinion to qualify the data, methods and actuarial assumptions used
- Reasonable and appropriate assumptions
- Explicit note if the data are incomplete
Principles underlying the Investment Policy

• Since April 1st 2000, contributions of employees and employer are invested in a diversified portfolio managed by the Public Sector Pension Investment Board
  www.investpsp.ca

• Assets will equal liabilities if the realized investment return equals the actuarial interest assumption (real 4.25%).

• The three plans currently have similar characteristics, therefore, they have a common Investment Policy.

• Contributions are expected to exceed benefits for next 25 years.
### Normal Cost of the Pension Plans

**For 2000 to 2003**

<table>
<thead>
<tr>
<th></th>
<th>Public Service</th>
<th>Canadian Forces</th>
<th>RCMP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total contributions</strong></td>
<td>$1,900M</td>
<td>$700M</td>
<td>$200M</td>
</tr>
<tr>
<td><strong>Total cost of the plan</strong>*</td>
<td>17%</td>
<td>22%</td>
<td>21%</td>
</tr>
<tr>
<td><strong>Member contributions</strong></td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Government cost</strong></td>
<td>12%</td>
<td>17%</td>
<td>16%</td>
</tr>
<tr>
<td><strong>Proportion paid by Employer</strong></td>
<td>71%</td>
<td>77%</td>
<td>75%</td>
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</table>

*Relative to pensionable earnings*
Evolution of Net Cash Flows of Funds
(Funds managed by the Investment Board)

($ billion)

Expected Net Cash Flow of $3.0B

Contributions
Benefits
Net Cash Flows

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Evolution of Net Cash Flows (Funds + Accounts)

($ billion)

Expected Net Cash Flow of -$4.0B
Evolution of the Total Liabilities

($ Billion)

Fund breakdown
Public Service: 70%
Canadian Forces: 22%
RCMP: 8%

Liabilities of Funds
Liabilities of Funds and Accounts

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Future challenges

• Retirement is a reality for a vast majority of Canadians.

• The aging is expected to be more severe in Canada than in United States, our main commercial partner.
Future challenges

• The expected aging of the working labor force and the resulting labor shortage that could occur will represent one of the biggest challenge in the coming years.

• To some extent, the aging of the working labor force will create pressure on the:
  – Migration rates
  – Participation rates
  – Retirement rates
  – Inflation rate
  – Real wage increases
International comparisons of pension programs
Organization for Economic Cooperation and Development

FINANCIAL SITUATION OF THE ELDERLY

<table>
<thead>
<tr>
<th></th>
<th>France</th>
<th>UK</th>
<th>Germany</th>
<th>Netherlands</th>
<th>Canada</th>
<th>USA</th>
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</thead>
<tbody>
<tr>
<td>Poverty among retirees</td>
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<td>Income of retired and non-retired persons</td>
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<tr>
<td>Disparities among retired persons</td>
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<tr>
<td>Difference men/women</td>
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- **Good performance**
- **Average performance**
- **Poor performance**

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Future challenges

The OECD has recognized the solid performance of the Canadian model by showing that the structure is meeting its objectives in terms of:

1) reducing poverty
2) preserving people’s standard of living during transition from labour market to retirement
3) maintaining the balance of income between men and women

Our challenge: Maintain this performance and do the adjustments due to the aging of the labor force