Issues and Reforms

Jean-Claude Ménard

Presentation at the colloquium

Issues for Public Retirement Systems

Sherbrooke, ACFAS Congress

10 May 2011
Purpose of the 25th CPP Actuarial Report

- Tabled by the Minister of Finance on 15 November 2010.

- Inform contributors and beneficiaries of the current and projected future financial status of the Canada Pension Plan.

- Calculate the minimum contribution rate.

- Actuarial report is based on “best-estimate” assumptions over a long period of time (75 years). Although secondary, recent trends are also taken into account.
The 25th Report has concluded that

- Despite the projected substantial increase in benefits paid as a result of an aging population, the Plan is expected to be able to meet its obligations throughout the projection period and to remain financially sustainable over the long term.

- The 9.9% legislated contribution rate is sufficient to cover future Plan’s expenditures for the next 75 years.

The Report has cautioned:

- If recent short-term improvements in life expectancies continue, especially for ages 75 to 89, the long-term assumptions will need to be adjusted accordingly. This will put additional pressure on the minimum contribution rate that could cause the rate to increase above 9.9%.
**Contribution to increase in life expectancy at birth has gradually shifted to elderly, more so since 1985**

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</thead>
<tbody>
<tr>
<td>Infant mortality (&lt;1)</td>
<td>5.8</td>
<td>1.2</td>
<td>0.2</td>
<td>4.6</td>
<td>1.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Child mortality (1-14)</td>
<td>2.5</td>
<td>0.3</td>
<td>0.2</td>
<td>2.5</td>
<td>0.3</td>
<td>0.1</td>
</tr>
<tr>
<td>Young adult mortality (15-44)</td>
<td>2.1</td>
<td>0.6</td>
<td>0.6</td>
<td>3.9</td>
<td>0.4</td>
<td>0.2</td>
</tr>
<tr>
<td>Older adult mortality (45-64)</td>
<td>0.1</td>
<td>1.3</td>
<td>1.5</td>
<td>1.9</td>
<td>0.8</td>
<td>0.7</td>
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<tr>
<td><strong>Elderly mortality (65+)</strong></td>
<td><strong>0.3</strong></td>
<td><strong>1.0</strong></td>
<td><strong>2.6</strong></td>
<td><strong>2.2</strong></td>
<td><strong>2.3</strong></td>
<td><strong>1.7</strong></td>
</tr>
<tr>
<td>Estimated Multivariate Effect</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.4</td>
<td>-0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td><strong>Total Change in Life Expectancy</strong></td>
<td><strong>10.7</strong></td>
<td><strong>4.3</strong></td>
<td><strong>4.8</strong></td>
<td><strong>14.7</strong></td>
<td><strong>4.6</strong></td>
<td><strong>2.8</strong></td>
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</table>
Elderly mortality rates have decreased over the last 80 years, more so over the last 40 years.

Ages 75 to 84

Deaths per thousand

More contributors are expected to reach the retirement age of 65. Retirement beneficiaries are expected to receive their benefits for a longer period.
Canada ranks 3rd and is expected to maintain a similar position over time

Life Expectancy at 65 – Males

Source: 16th International Conference of Social Security Actuaries and Statisticians presentations and reports.

* Projection for Spain is not available.
The working-age population is projected to slightly increase

(in millions)  Population 20-64

Increase of 14%  From 2010 to 2050

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The elderly population is projected to significantly increase.
Evolution of Asset/Expenditure Ratio

9.9% Legislated rate

Minimum contribution rate

Steady-state A/E ratios: 4.7 in 2022 and 2072
Increase in life expectancy puts pressure on CPP contribution rate

Evolution of the Asset/Expenditure Ratio

- **Best Estimate:** LE in 2050 at 65 M: 22.6 F: 24.6
- **Low-Cost:** LE in 2050 at 65 M: 19.2 F: 20.2 (MCR=9.26%)
- **High-Cost:** LE in 2050 at 65 M: 25.2 F: 27.9 (MCR=10.25%)
What is the impact of a particular demographic situation on contribution rate?
(assuming South Korea’s Current Demography)

Evolution of the Asset/Expenditure Ratio

- CPP with legislated contribution rate of 9.9%
- Minimum contribution rate of 11.5%
- Target years 2022 and 2072
- Total fertility rate of 1.3
- Net migration rate of 0%
- PayGo rates:
  - 2025 – 11.4%
  - 2050 – 14.9%
  - 2075 – 17.9%

Legislated contribution rate of 9.9%
What is society expecting from its retirement system?

- Affordable and sustainable system
- Intergenerational equity
- Solidarity: society protects all individuals and collectively ensures a basic level of assistance/standard of living for low-income retirees
- Responsibility: retirement income security is a shared responsibility between the government, society, employers and individuals
  - Maintain standard of living after retirement
- Proper interaction with labour market: incentives to remain in the labour force and flexibility in work-to-retirement transition
Financing approach for public pensions should answer to society’s expectations

• Principal objective: stabilising contribution rate
  – Strengthen the contribution-benefit connection
  – Ensure intergenerational fairness
  – Strengthen fiscal discipline
  – Maintain public confidence

• Secondary objective: minimizing the contribution rate
  – Optimize the financing of a retirement scheme by considering the relation between the rate of return on investments and the rate of increase in wages (implicit rate of return on PayGo schemes).

• A social insurance scheme’s contribution rate is very sensitive to changes in the demographic and economic environments.
Self-adjustment mechanism: if there is no political agreement, CPP default provisions apply

Default Provisions
If the legislated contribution rate is lower than the steady-state rate (excluding full-funding incremental rate)
AND
If finance ministers cannot reach agreement on a solution, then default provisions apply

- Contribution rate increased by $\frac{1}{2}$ of excess over three years
- Benefits frozen until next review (3 years)
- At end of three years, next review performed to determine financial status of Plan.
AROUND THE WORLD,
In Canada, replacement rate for people with lower earnings is higher than the OECD average

<table>
<thead>
<tr>
<th>Country</th>
<th>Individual Earnings, multiple of mean</th>
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<tbody>
<tr>
<td></td>
<td>0.5</td>
</tr>
<tr>
<td>Canada</td>
<td>(%)</td>
</tr>
<tr>
<td>UK</td>
<td>67.5</td>
</tr>
<tr>
<td>U.S.</td>
<td>63.8</td>
</tr>
<tr>
<td>OECD</td>
<td>82.8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>104.5</td>
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</table>

Canada has one of lowest old-age poverty rates, but much higher population poverty rate

Income Poverty Rates of Older People and the Population, mid-2000s, % with incomes of less than half median equivalised population incomes*

## Increase in pensionable age

### OECD: Men’s pensionable age in 2010 and 2050*

<table>
<thead>
<tr>
<th>2010 (average age: 63.0)</th>
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<tbody>
<tr>
<td><strong>&lt; 65</strong></td>
<td><strong>65</strong></td>
<td><strong>&gt; 65</strong></td>
</tr>
<tr>
<td>Belgium (60), Czech Republic (61), France (60.5), Greece (57), Hungary (60), Italy (59), Korea (60), Luxembourg (60), Slovak Republic (62), Turkey (44.9)</td>
<td>Australia, Austria, Canada, Denmark, Finland, Germany, Ireland, Japan, Mexico, Netherlands, New Zealand, Poland, Portugal, Spain, Sweden, Switzerland, UK</td>
<td>Iceland (67), Norway (67), U.S. (66)</td>
</tr>
<tr>
<td><strong>10 countries</strong></td>
<td><strong>17 countries</strong></td>
<td><strong>3 countries</strong></td>
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<table>
<thead>
<tr>
<th>2050 (average age: 64.6)</th>
<th></th>
<th></th>
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<tbody>
<tr>
<td><strong>&lt; 65</strong></td>
<td><strong>65</strong></td>
<td><strong>&gt; 65</strong></td>
</tr>
<tr>
<td>Belgium (60), France (62), Greece (60), Luxembourg (60), Slovak Republic (62), Turkey (62.3)</td>
<td>Austria, Canada, Czech Republic, Finland, Germany, Hungary, Ireland, Italy, Japan, Korea, Mexico, Netherlands, New Zealand, Poland, Portugal, Spain, Sweden, Switzerland</td>
<td>Australia (67), Denmark (67), Iceland (67), Norway (67), UK (68), U.S (67)</td>
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<tr>
<td><strong>6 countries</strong></td>
<td><strong>18 countries</strong></td>
<td><strong>6 countries</strong></td>
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## Increase in pensionable age for women is more pronounced

### OECD: Women’s pensionable age in 2010 and 2050*

<table>
<thead>
<tr>
<th>Year</th>
<th>&lt; 65</th>
<th>65</th>
<th>&gt; 65</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2010</strong></td>
<td>Australia (62), Austria (60), Belgium (60), Czech Republic (58.7), France (60.5), Greece (57), Hungary (59), Italy (59), Korea (60), Luxembourg (60), Poland (60), Slovak Republic (57), Switzerland (63), Turkey (41), UK (60)</td>
<td>Canada, Denmark, Finland, Germany, Ireland, Japan, Mexico, Netherlands, New Zealand, Portugal, Spain, Sweden</td>
<td>Iceland (67), Norway (67), U.S. (66)</td>
</tr>
<tr>
<td><strong>Countries</strong></td>
<td>15 countries</td>
<td>12 countries</td>
<td>3 countries</td>
</tr>
<tr>
<td><strong>2050</strong></td>
<td>Belgium (60), France (62), Greece (60), Luxembourg (60), Poland (60), Slovak Republic (62), Switzerland (64), Turkey (60.8)</td>
<td>Austria, Canada, Czech Republic, Finland, Germany, Hungary, Ireland, Italy, Japan, Korea, Mexico, Netherlands, New Zealand, Portugal, Spain, Sweden</td>
<td>Australia (67), Denmark (67), Iceland (67), Norway (67), UK (68), U.S. (67)</td>
</tr>
<tr>
<td><strong>Countries</strong></td>
<td>8 countries</td>
<td>16 countries</td>
<td>6 countries</td>
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BACK TO THE COUNTRY,
CPP Recent Amendments phased in 2011 to 2016

- Changes to the CPP were announced by Finance Ministers at last CPP triennial review meeting in May 2009.

- The changes are as follows:
  - Remove the Work Cessation Test starting 2012.
  - Increase the general low-earnings drop-out provision to 17% by 2014.
  - Require working beneficiaries under 65 and allow (optional) for those 65+ (up to 70) to contribute to the CPP, with employers also required to contribute. Additional contributions provide additional post-retirement benefits.
  - Introduce actuarially neutral adjustment factors: 0.6% per month before age 65 and 0.7% per month after age 65.
Pension Reform – to date

• Much research and analysis conducted to date:
  – “Options for Increasing Pension Coverage Among Private Sector Workers in Canada” (Colin Hansen - Steering Committee of Ministers on Pension Coverage and Retirement Income Adequacy, January 2010).
Pension Reform – to date (cont’d)

• In June 2010, federal Government proposed increasing retirement income adequacy by:
  – creation of broad-based DC pension plans (Pooled Registered Pension Plans (PRPPs)) aimed at those not covered by workplace RPP;
  – increasing disclosure relating to retirement savings;
  – improving financial literacy;
  – expanding the CPP by way of a modest, phased-in, and fully funded enhancement.
Pension Reform – to date (cont’d)

• In December 2010, six provinces issued joint statement supporting:
  – A modest, phased-in, fully funded enhancement to CPP. Any CPP changes would have to be affordable for both employees and their employer.
  – Pension innovation to provide more Canadians with access to low-cost pensions by way of harmonized nationwide framework.

• Governments agreed to go forward with:
  – PRPPs - framework set out:
    • accessible, straightforward, low cost (large pools of capital), portable, customized per member, education resources provided;
    • fiduciary duty and responsibilities of administrators (regulated financial institutions);
    • default option and manageable number of investment options;
    • full disclosure: plan provisions, account activity, performance, fees, illustrations of retirement income;
    • tax changes and high level regulatory harmonization required.
  – improving financial literacy.
Characteristics of an efficient retirement system

• Diversification of sources of retirement income ✔
• Diversification of funding approaches ✔
• Reasonable economic cost of public pensions (% of GDP) ✔
• Reduction of poverty among seniors ✔
• Reduction of income inequalities ✔
• Maintenance of standard of living at retirement ✔
Issues and Reforms

Thank you

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