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New Supplementary Pension Plan Needed to Fill Gap in Canadians' Retirement Saving: C.D. Howe Institute

Toronto, May 29 – Shortcomings in workplace pensions and individual retirement saving plans mean millions of Canadians face large declines in living standards when they retire. The answer, according to a *Commentary* released today by the C.D. Howe Institute, is a major new supplementary pension plan for Canadians. In the study, *The Canada Supplementary Pension Plan (CSPP): Towards an Adequate, Affordable Pension for All Canadians,* author Keith Ambachtsheer outlines the factors that jeopardize the ability of Canadians to put away adequate retirement savings and proposes a practical solution to the problem – the CSPP.

The existing shortcomings are twofold, he says. First, an estimated 3.5 million Canadian workers have no workplace pension plan, and are not accumulating sufficient retirement savings to maintain a decent post-work standard of living. The second shortcoming relates to the 5.5 million Canadian households who currently have their retirement assets invested in retail products with high sales and management costs. These costs make it difficult for many of the 5.5 million households to generate adequate pension income at affordable saving rates.

Ambachtsheer argues that the first two "pillars" of Canada's retirement income system – the universal tax-funded Guaranteed Income Supplement (GIS) and Old Age Security (OAS) systems on the one hand and the payroll-deduction-funded Canada and Quebec Pension Plans (CPP/QPP) on the other – should replace 30-40 percent of working income at the national median wage. Pillar 3 arrangements – private retirement saving through work-place, registered pension plans (RPPs) and individual retirement saving plans (RRSPs) – should lift the total income replacement rate to at least 50-70 percent of pre-retirement income, and preferably higher yet. For many Canadians, however, low saving and high costs mean Pillar 3 will fall well short of this goal.

To address the inadequacy of Pillar 3 saving by so many Canadians, Ambachtsheer proposes the Canada Supplementary Pension Plan (CSPP). The CSPP would have automatic enrolment, investment and annuitization features that would help individuals overcome some well-established obstacles to retirement saving. By putting the individual accounts under a pension institution modeled on the CPP Investment Board, it would build on Canada's successful track-record in creating solid arms-length public investment vehicles. As Ambachtsheer points, out, such a model would ideally be nation-wide, but can also work on a subnational or provincial level.

Creating the CSPP is the logical next step for Canada, Ambachtsheer concludes, as it strives to build the best retirement income system in the world.

Key elements of the CSPP include the following:

- *Automatic enrolment of all non-covered workers into the CSPP:* to address the identified pension coverage problem, all Canadian workers who are not members of a workplace-based pension plan are (subject to certain opt-out provisions) automatically enrolled in the CSPP. This implies a joint federal-provincial plan; however, separate provincial initiatives are a feasible alternative.
- *Use the CPP/QPP payroll deduction mechanism:* to maximize simplicity and minimize costs, contributions to the CSPP are collected using the same mechanism used to deduct CPP/QPP contributions. CSPP contributions are directed into personal retirement saving accounts set up for, and owned by, each CSPP participant.
- *Operate within the existing tax and regulatory regime for pensions:* to further maximize implementation simplicity, the CSPP would operate within the current three Canadian pension pillars and the current tax/regulatory regime regarding pensions. So, for example, CSPP contributions would be subject to the current maximum tax deductibility rule of 18 percent of earnings up to a maximum contribution of $20,000. This implies $111,111 is the current earnings ceiling to which the full 18 percent deduction applies.
- *Target a 60 percent post-work earnings replacement rate:* in principle, CSPP contributions should be set so that a post-work 60 percent earnings replacement rate becomes a realistic goal (integrated with both OAS and CPP/QPP benefits) for all working Canadians.
- *Set an earnings floor and ceiling for CSPP deductions:* the 60 percent replacement target implies establishing an earnings floor below which no automatic CSPP deductions are made. Given Canada's current Pillars 1 and 2, that floor might be $30,000. At the other end, a simple ceiling for automatic CSPP deductions might the current $111,111 maximum earnings tax deferral ceiling.
- *Set an automatic default CSPP contribution rate:* again, in the interest of implementation simplicity, the automatic CSPP contribution rate between $30,000 and $111,000 might be set at 10 percent of earnings. The CSPP contributions of lower income earners (say in the $30,000 to $45,000 tranche) could go to TFSA-type accounts. Setting the optimal default contribution rate will be one of the most challenging aspects of setting up the CSPP. Higher saving rates now lead to higher standards of living later, but at the cost of a lower standard of living today.

- *Provide an opt-out option:* employers/employees share the automatic default CSPP contribution deductions equally. However, if a complete non-compulsion philosophy is maintained, either or both employers and employees can opt out of this particular plan feature.
- *Provide an opt-in option:* employers/employees who choose to opt out of the CSPP's automatic default contribution mechanism can still use the CSPP infrastructure to accumulate retirement savings in personal retirement saving accounts in any manner they choose within the existing tax/regulatory structure.
- *Provide an RRSP assets transfer option:* Canadians also have the option to move their accumulated RRSP assets into their CSPP personal retirement saving account.
- *The CSPP operates at arms-length from government:* the CSPP operates as an arms-length, expert entity similar to the CPP Investment Board. It has sufficient scale to operate at low unit cost (e.g., at or even below 0.3 percent of assets/yr.).

The CSPP offers all Canadians a realistic chance to achieve post-work income adequacy in a transparent, fair, cost-effective, and portable manner, says Ambachtsheer. In addition, the creation of a new arm's-length, expert pension delivery organization would add importantly to Canada's already-strong financial intermediation and global investment management capabilities.

The study *The Canada Supplementary Pension Plan (CSPP): Towards an Adequate, Affordable Pension for All Canadians*, is available at www.cdhowe.com

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