

An Overview of Canada's Retirement Income System (RIS)

Introduction

Canada has a retirement income system (RIS) that has evolved over time in response to a variety of social, political and economic factors, with the public elements of the system first introduced in 1927. The RIS has both public and private elements, grouped into three pillars that work together to prevent and alleviate poverty in old age and prevent declines in Canadians' standard of living upon retirement. Each pillar has specific requirements (as noted below), however in general, beneficiaries start to receive retirement income at 65 years of age – although many plans allow payments at age 55 and even earlier. Canada's RIS is made up of three main pillars, described below.

Key Elements of Canada's Retirement Income System (RIS)

The First Pillar

The first pillar of the RIS is the Old Age Security (OAS) program, which comprises the OAS basic pension, the Guaranteed Income Supplement (GIS) and the Allowance. The OAS pension is a non-contributory, residence-based benefit paid to virtually all seniors aged 65 years and over who have lived in Canada for at least 10 years. The GIS is an income-tested supplement for low-income seniors receiving the OAS in order to provide them with a basic income guarantee. The Allowance is a monthly benefit paid to those with low-income aged 60 to 64 who are spouses or common-law partners of GIS recipients or survivors. The OAS program is financed entirely from general tax revenues and is available to virtually all Canadian seniors. Additional information is available at the following web site: <http://www.hrsdc.gc.ca/en/isp/oas/oasoverview.shtml>

The Second Pillar

The second pillar of the system is comprised of the Canada Pension Plan (CPP) and its sister plan the Quebec Pension Plan (QPP). The QPP operates in the province of Quebec, while the CPP operates in the rest of Canada. The CPP and the QPP are both contributory, earnings-related social insurance programs that are mandatory and publicly administered. They provide benefits to virtually all employed and self-employed persons. The CPP is jointly controlled by federal and provincial governments, while the QPP is controlled by the province of Quebec (*more information on the CPP is provided in the Appendix and at the following web site <http://www.hrsdc.gc.ca/en/isp/cpp/cppinfo.shtml>*).

The CPP and QPP were brought into force on January 1, 1966. They have been amended several times with the last significant changes occurring in 1998. At this time, the investment policy, benefits and contribution rate were changed to ensure the long-term sustainability of both the CPP and QPP.

The Third Pillar

The third pillar of the system is mainly comprised of private savings vehicles such as Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs), but also includes home equity and rental income, income from other investments (interest/capital gain, inheritances) and employment earnings. An RPP is a contractual arrangement between an employer and employee and is most commonly known as a workplace pension plan. Registered Pension Plans usually form a part of a compensation package and historically have been used to attract and keep employees. RPPs are usually either defined benefit (DB) or defined contribution (DC) plans. RRSPs are voluntary, personal retirement savings vehicles that allow contributors to grow their savings tax-free until retirement.

Pillar	Element	Qualifying Conditions	Coverage	Source of Funds	Benefit Amount	Age of Eligibility
1 (Public, Non-Contributory Income Assistance)	Old Age Security (OAS) (1952)	-Minimum 10 years residence. -Must be a Canadian citizen or a legal resident when applying.	-Approx. 4.3 million Canadian seniors (virtually all seniors) are in receipt of the basic OAS pension (April 2007).	-General tax revenues. -Expenditures (2007) projected at over \$25 billion.	-Maximum monthly, indexed benefit of \$491.93 as of April 2007 with 95% of recipients eligible for the maximum amount.	-Canadian residents age 65+.
		<p>Guaranteed Income Supplement (GIS) (1967) and the Allowance (1975)</p> <p>-For OAS recipients who have little or no other income (excluding OAS). - Allowance for 60-64-year-old spouses or common-law partners of OAS/GIS beneficiaries and low-income survivors.</p>	-Approx. 37% of Canadian seniors (approx. 1.6 million seniors) received the GIS in 2006 and 94,000 received the Allowance.	-General tax revenues. - Expenditure on the GIS is projected to increase to \$7.3 billion and \$546 million for the Allowance in 2007-08.	- The maximum GIS benefit in April 2007 is \$620.91 for single seniors and \$410.04 each for couples. - The GIS benefit is reduced by \$1 for every \$2 of other income (excluding the OAS pension).	-65 + for GIS. -60-64 for the Allowance.
2 (Publicly Administered, Contributory Pension)	Canada Pension Plan (CPP) and the Quebec Pension Plan (QPP) (1966)	-Mandatory for virtually all workers (incl. self-employed). -Both the employer and the employee must contribute (the self-employed must make both contributions).	-Approx. 4.15 million CPP beneficiaries (disability, children's, retirement and survivor benefits) as of Dec. 2006.	-In 2004, there were approx. 11.7 million CPP contributors. -Employer and employee each contribute 4.95% of earnings between \$3,500 and \$43,700 (2007). Self-employed contribute the full 9.9%.	-The average, indexed monthly CPP retirement pension in Feb. 2007 was \$482.37. The max. monthly CPP retirement pension in 2007 is \$863.75 -Retirement pension replaces approx. 25% of life time average earnings.	- Actuarial adjustments reduce or increase one's pension when they retire before or after the age of 65. -Work cessation requirement for commencement prior to age 65.
		Registered Pension Plans (RPPs) (tax-assisted as of 1917)	-Varies significantly depending on the kind of RPP.	-In 2004, approx. 39% of the paid workforce contributed to an RPP. -82% of participants contribute to a defined benefit (DB) plan.	-Generally based on employee and employer contributions. -Contributions are tax-assisted.	-Varies greatly.
3 (Tax Assisted Occupational Pensions, Individual Savings Accounts, Other Assets)	Registered Retirement Savings Plans (RRSPs) (1957)	-Must have employment earnings.	-In 2005, 6.1 million Canadians contributed to an RRSP, with a median contribution of \$2,630.00.	-Voluntary contributions. -Contributions are tax-assisted.	-Varies according to individual contributions.	-Earnings up to age 71.

Performance and Sustainability of Canada's RIS

Performance

Between 1980 and 2004, the average after-tax rate of low income among seniors declined significantly from 21.3 percent to 5.6 percent. This decline has been among all senior family types. While there were other contributing factors such as the growing labour force participation of women and a favourable investment climate, this substantial decline in the rate of low income among seniors was due, in large part, to the maturation of the Canada Pension Plan and a growth in coverage and savings under the private elements of the Canadian RIS.

Type of Senior (65+)	Current Average Income (2004)	Average Annual Income Growth Rate (1980-2004)
Married Couples	\$44,900.00	0.8%
Unattached Women	\$23,200.00	1.2%
Unattached Men	\$25,600.00	0.9%

The net replacement rate for public pensions (OAS, GIS, CPP/QPP) in Canada is highly progressive. It replaces most of the pre-retirement income of those in low-income groups but less than half for high-income groups. Given this design feature, modest to upper income groups need to depend more on workplace pensions and other private savings in order to maintain their pre-retirement standard of living.

Seniors' Pre-Retirement Income Level	Percentage of Income Replaced from Public Pensions (2007)
Half of the average industrial wage	89.4%
Average industrial wage	57.1%
Double the average industrial wage	30.6%

Sustainability

The public pension system is on a strong financial footing. Reforms to the CPP in 1998 have ensured its sustainability in the long term. The CPP is now projected to be sustainable at current contribution rates for the next 75 years. OAS/GIS expenditures are projected to rise to 3 percent of GDP over the next 30 years, from the current 2.4 percent, given demographic projections.

Appendix

Overview of the Canada Pension Plan (CPP)

The Canada Pension Plan (CPP) and its sister plan the Quebec Pension Plan (QPP) were introduced in 1966, as compulsory, contributory social insurance programs funded through contributions from employees, employers and the self-employed.

What the CPP provides

The CPP makes modest levels of income replacement available to workers upon retirement, when they become disabled, and to their dependants when they pass away. The benefits provided are retirement pensions, disability, children's, survivor and death benefits.

- In 2006, 71 percent of all CPP expenditures were comprised of retirement pensions.
- Retirement pensions are worth up to 25 percent of the contributor's lifetime average of annual earnings subject to the Year's Maximum Pensionable Earnings for each year.
- In 2007, the maximum monthly retirement pension is \$863.75.
- The average annual retirement pension payment in 2005 was \$7,123 for males and \$4,221 for females.

Age of CPP commencement

Prior to 1987, the earliest age of eligibility for a CPP retirement pension was 65. In 1987, the CPP was amended to allow for the payment of reduced CPP retirement pensions as early as age 60 and increased benefits as late as age 70.

Pension commencement before age 65 reduces entitlement by 0.5 percent for each month (6% per year) between the month the pension begins and the month following the contributor's 65th birthday. Those contributors who begin receiving a retirement pension at age 60 will receive 70 percent of the usual amount that would be payable at age 65. Delayed commencement after age 65 increases entitlement by the same factor so that those who commence receipt at age 70 will receive 130 percent of the amount payable at age 65.

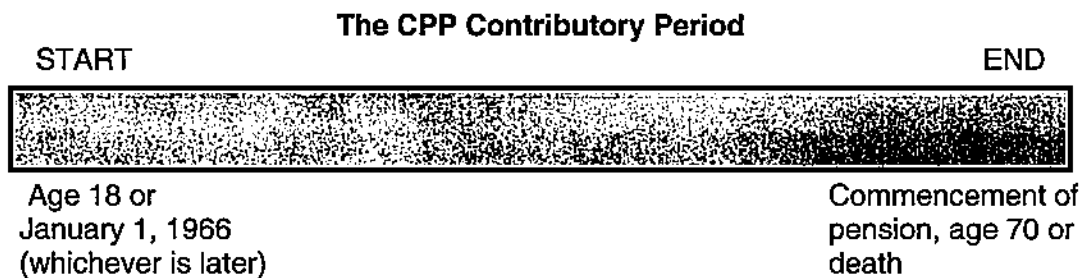
Commencement of New CPP Retirement Pensions, by Age

	Age 60	Aged 61-64	Age 65	Over 65	Total
2006	105,521 44.2%	50,506 21.1%	74,219 31.1%	8,587 3.6%	238,833

Contributing to the CPP

Virtually all workers over the age of 18 make contributions to the CPP (or the QPP in Quebec). The contribution rate is 9.9 percent of pensionable earnings, shared equally by employers and employees. The range of earnings on which contributions are made is between the year's basic exemption of \$3,500 and the average industrial wage in Canada, known as the year's maximum pensionable earnings (YMPE). In 2007, the YMPE is \$43,700.

The period of time one contributes to the CPP is called the "contributory period". The CPP contributory period is the total time in which an individual is eligible to contribute to the Plan. It starts on January 1, 1966, or at the age of 18, whichever comes later, and ends when a person starts receiving a CPP pension, or reaches the age of 70, or dies, whichever comes first. Therefore, the maximum contributory period is 47 years when the CPP is mature. The more years in which one contributes and the larger the amount of the contributions, the greater the entitlement. Generally speaking, contributing for 40 years at the maximum level entitles one to receive a maximum retirement pension.



CPP Drop-Out Provisions

The CPP has provisions that are built into the plan to help protect a contributor's benefits from periods of low earnings or no earnings. The following four provisions protect workers from these periods:

- **Child Rearing Provision (CRP):** Months of low or zero earnings spent caring for children while they were under the age of seven;
- **CPP Disability Drop-Out:** Any month when individuals is eligible for a CPP disability benefit;
- **+65 Drop-Out:** Earning months after the age of 65 can be used to replace lower earnings months prior to age 65; and
- **General Drop-Out:** 15 percent of the lowest earnings in the CPP contributory period.

Stewardship of the CPP

The Government of Canada and provincial governments are joint stewards of the CPP. In order to make any major changes to the CPP, the Government of Canada and two thirds of the provinces with at least two thirds of the population must agree before any changes can be approved.

CPP legislation requires that the CPP be reviewed every three years by federal-provincial Finance Ministers. This is called the CPP Triennial Review. An actuarial report prepared by the Chief Actuary of the CPP forms the basis of this review.

Funding Reforms

With regard to funding, several key reforms were agreed to in 1997. The purpose was to restore the financial sustainability of the CPP to make it fairer and more affordable for future generations. The main reforms implemented were:

- A move to fuller funding by increasing the contribution rate to 9.9 percent;
- Introducing a new investment policy for CPP assets to improve the rate of return on the CPP Fund by investing it prudently and at arm's length from governments, in a diversified portfolio of securities;
- Slowing the growth in costs by tightening the administration of benefits and changing the way some are calculated; and
- Strengthening accountability and stewardship of the Plan.

As a result of these reforms, the Chief Actuary has indicated that during the period 2004 to 2021, CPP contributions are more than sufficient to cover expenditures on benefits. Any surplus of contributions over benefits will be invested in the CPP Fund, so that by 2030 a reserve of five years of benefits will exist. This reserve will represent about 20 percent of assets. Administrative costs of the CPP for 2005/2006 are projected to be \$395.3 million (1.59% of total cost of benefits paid and 1.20% of total income of the CPP). The CPP is now, in effect, a partially funded pension plan.

The Canada Pension Plan Investment Board

The CPP Investment Board (CPPIB) is a Crown corporation that is governed and managed independently of the Canada Pension Plan and at arm's length from governments. The objectives of the CPPIB are to manage CPP funds in the best interests of beneficiaries and contributors and to invest with a view to achieving the maximum rate of return, without undue risk of loss. The CPP fund is administered by the CPPIB.

The CPPIB was a key element of the reforms implemented in 1998 and was an instrumental part of the adoption of a new investment policy for CPP assets. The

CPPIB was incorporated as a federal Crown corporation in December 1997 and began operations in March 1999.

The CPPIB's goal is to maximize returns without undue risk of loss, in order to sustain the future pensions of 16 million Canadians. Income from the money that is invested today will be used by the Canada Pension Plan to help pay pensions beginning in 2022.

The mandate of the CPPIB is set out in legislation with some of the key requirements being that it:

- Invests in the best interests of CPP contributors and beneficiaries;
- Maximizes long-term investment returns without undue risk, taking into account the factors that may affect the funding of the CPP and its ability to meet its financial obligations;
- Provides cash management services to the CPP so that they can pay benefits; and
- Does not conduct any business or activity that is inconsistent with these objectives.

Oversight of the CPPIB is provided by an independent Board of Directors comprised of experienced professionals. The Board, not governments, determines its asset allocation strategy, approves investment policies and makes critical operational decisions, such as the hiring of the President and Chief Executive Officer and the setting of executive compensation. The Board hires the president and CEO who, in turn, hires and leads the management team. These investment professionals make portfolio decisions within policies agreed to by the Board of Directors.

Although the CPPIB operates at arm's length from governments, it is governed by measures to ensure public sector accountability. The Government of Canada and provinces must agree in order to change the legislation governing the CPPIB. By law, the CPPIB must also adhere to very specific accountability requirements, including (among others):

- The tabling of an annual report in Parliament by the federal Minister of finance;
- Being subject to annual audits by an independent external audit firm;
- A review of the CPP and the CPPIB by the federal and provincial finance ministers every three years;
- Special examination of records, systems and practices every six years;
- The holding of public meetings in each participating province every two years and;
- Providing regular and timely information on the Board's website (including the Board's activities and investment performance) at www.cppib.ca.

Assets managed by the CPPIB are invested prudently in a diversified portfolio of securities, subject to broadly the same investment rules as other pension plans.

CPP Fund Composition and Performance

As at December 31, 2006, the CPP fund was \$110.8 billion. Over the next ten years the Chief Actuary of Canada estimates that the CPP fund will grow to approximately \$250 billion. Fund administration fees as of 2005 were \$31.7 million or 0.07 percent as a percentage of managed assets. At December 31, 2006, the CPP fund consisted of:

- Equities: 66.8 percent (\$74.1 billion) of which public equities made up 60.4 per cent (\$67.0 billion) and private equities 6.4 per cent (\$7.1 billion);
- Bonds: 22.6 percent (\$25.1 billion);
- Inflation-sensitive assets: 9.9 per cent (\$10.9 billion); and
- Cash and cash equivalents: 0.7 per cent (\$0.7 billion).

Collection and Payment Administration

The Canada Revenue Agency (CRA) administers collection of contributions via payroll from employers/self-employed. Based on information provided by CRA, Human Resources and Social Development Canada (HRSDC) calculates and provides benefits within parameters established by legislation. HRSDC also has responsibility for policy development and overall administration of the CPP.