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Pensions & Benefits

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Pension *Pulse*

Securing the Future = Expanding the CPP: Ontario Government Releases Consultation Paper

The Ontario government released a pension consultation paper on October 29, 2010. Here is a link to the paper: http://www.fin.gov.on.ca/en/consultations/pension/ris.html. The paper comments on three areas for broad-based pension reform.

- The first is comprised of the government's recent amendments and proposed amendments to *the Ontario Pension Benefits Act* (refer to our Pension Pulses dated June 24, 2010, August 26, 2010 and October 22, 2010 for details of those proposals).

- The second concerns what is described as pension innovation. This includes making defined contribution pension plans available to the self-employed and expanding the role of jointly-governed target benefit pension plans.

- The third and most significant proposal advocates for the expansion of the Canada Pension Plan (and Quebec Pension Plan). This latter proposal could have significant cost implications for employers and employees.

Expansion of the Canada Pension Plan

The concept of expanding the CPP has recently been gaining traction among provincial governments, in advance of the upcoming meeting of finance ministers on December 20, 2010. The report notes that (i) income levels of retirees will not be adequate in future, (ii) fewer employees in the private sector participate in pension plans, and (iii) employees are not taking advantage of existing contribution room in RRSPs and tax-free savings accounts. A solution is needed, and governments are looking increasingly to the CPP to fill the gap.

The report states that when the CPP was first established, it was considered sufficient when looked at in combination with Old Age Security, pension plan benefits and personal savings. The OAS is designed to provide retirement income of 15% of the Year's Maximum Pensionable Earnings level under the CPP. The CPP provides an additional 25%, for a total of 40%. Retirees' remaining retirement income is to be provided from pension plans and private savings.

Much has happened over the past twenty years or so. Firstly, the OAS is no longer a universal plan, available to all persons meeting minimum residence requirements. In 1989, the federal government introduced a claw-back of OAS benefits for retirees earning over a prescribed amount (currently $66,733). Secondly, as noted in the report, few retirees receive a maximum CPP benefit (only 12% of male CPP recipients and 2% of female recipients). Thirdly, there is a declining percentage of employees in the private sector participating in pension plans (fewer than 25%). Fourthly, Canadians are not saving enough for retirement. 87% of total RRSP contribution room is unused.

Given all of these factors, the CPP is viewed as a convenient vehicle to augment retirement income in a broad-based and mandatory manner. The Ontario paper sets out three types of possible benefit enhancements: (i) increase the income replacement rate from 25% of the YMPE to a higher rate such as 35%, (ii) increase the YMPE earnings ceiling (currently $47,200) by 50% or 100%, or (iii) increase both the income replacement rate and the YMPE earnings ceiling.

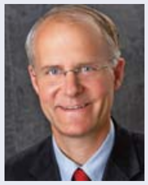
The report illustrates what effect each of these approaches would have on the adequacy of retirement income. Of course, in order to increase CPP benefits, contributions by employers and employees would also have to increase substantially. The report does not indicate what the contribution rate increases would be under any of the scenarios, but simply recommends that the increases to contributions and benefits be phased in over five years and forty years respectively.

The combined employer/employee contribution rate to the CPP was 3.6% of pay up to the YMPE, from the inception of the CPP in 1966 to 1986. Contribution rates were gradually raised between 1986 and 2003 to the current level of 9.9% of pay up to the YMPE. If the YMPE were increased, employers and employees would contribute the same 9.9% of pay to the CPP, but simply based on a higher pay level. Increasing the income replacement rate above the current 25%, on the other hand, would require increasing the contribution rate well beyond the current 9.9%.

Any type of CPP reform will have a potentially significant impact on employers and employees. Regardless how CPP benefits are increased, more money will have to be pumped into the system, by both employers and employees. The questions not addressed by the report are where the money will come from, and what the reaction might be, at a time when payroll and other taxes are already very high.

For example, a possible reaction by some private sector employers to increases to the CPP might be to reduce contributions to other pension and retirement savings plans, so as to maintain current payroll costs for pensions and benefits. This would defeat the government's stated objective of increasing retirement income levels. It could also further increase the disparity between public and private sector retirement benefits insofar as public sector employers would continue to benefit from rich defined benefit pension plans, plus augmented CPP benefits.

The Ontario government has invited feedback on its consultation paper by November 29, 2010. This does not leave a lot of time to respond, considering the significance of the proposal for increased CPP contributions and benefits. If you plan on making a submission, please contact any member of our National Pensions and Benefits Practice. ■



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As a member of our firm's Labour and Employment group, Mark handles all aspects of pensions and benefits law, including governance, regulatory compliance, collective bargaining, litigation, due diligence, mergers and acquisitions, financing agreements, bankruptcy and insolvency, and the tax aspects of compensation, pensions and benefits.

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