REFORMING CANADA’S RETIREMENT SAVINGS SYSTEM – SOLUTIONS FOR A NON-EXISTENT PROBLEM?

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ABSTRACT

During the past five years in Canada, issues concerning the adequacy of the Canadian retirement system has been debated with increasing intensity amongst politicians, economists, academics, policy analysts, think tanks and unions. This paper contributes to this important theoretical and public policy debate by reviewing and analysing existing research and presenting and reviewing additional empirical evidence. The central issue in this debate is whether or not Canadians are saving and investing enough through government, employer and private savings to provide an adequate income in retirement. And if a retirement income adequacy problem does exist, is it a universal problem for most Canadians or does it only affect some income groups or age cohorts? The third major question concerns the appropriate policy response. The paper also reviews and questions whether the current and proposed policies properly address the challenge and provides some recommendations.

The paper shows that the larger part of this debate actually hinges on assumptions surrounding savings and the definition of savings. Those who claim that Canada faces a national pension and savings crisis only consider government and private savings pension plans whose assets are approximately only one third of total household wealth in Canada. However, this narrow definition of savings exclude all savings and investments held outside of recognized pension plans and thus exclude investments in stocks, bonds etc. as well as private homes and secondary residences which can provide for an important source of retirement income. However, there are a small number of Canadians that are or will be below the poverty line and this calls for a targeted policy response rather than an across the board reform of the Canada Pension Plan or provincial programs such as the newly proposed Ontario Retirement Pension Plan (ORPP) which may actually be viewed as a payroll tax. Based on the evidence and analysis, the paper concludes that most Canadians do not face an inadequate income during retirement and no new government policy response is needed.
1. INTRODUCTION

In the current political and economic climate in Canada, one issue that has come to the forefront of political debate amongst politicians, economists, policy analysts, think tanks and unions concerns the adequacy of the Canadian retirement system.\(^1\) The relatively recent interest in this issue may be the result of major changes to the overall global and Canadian macro-economic environment due to the 2008 global financial crisis.

Our intent in this paper is to contribute to this important theoretical and public policy debate by providing and analysing existing evidence and positions undertaken by various parties including governments and question whether there is a retirement income adequacy challenge in Canada and whether it requires a public policy response. We review and question whether the current and proposed policies properly address the challenge. In addition, we provide our own overview and recommendations.

We will show that the crux of the argument rests on the definition of savings to be considered as a source for income during retirement and the amount of income required during the post-retirement period. Accordingly, the two essential questions that need to be analysed and discussed are whether or not all household assets less debt (net worth) be included as potential savings for retirement or the focus should only be on personal savings and funds invested in group or individual registered pension funds pursuant to the Income Tax Act? Any ambiguity in these two areas has the potential to lead to the wrong policy response.

The paper is organised as follows. In the next section, we provide a brief but necessary background and definitions that are important to understand the Canadian retirement savings environment, evidence and issues. Next, we briefly describe and review the key components of the current system that are central to our understanding concerning retirement income adequacy. Then, we provide the available and ample empirical evidence. The evidence presented in that section allows us to reflect on the abundant recent statistics and published studies available in order to dissect various arguments that argue for or against any changes to the current system including those proposed by the various provincial governments; we do not believe that additional evidence or research is necessary to reach conclusions. Accordingly, in

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\(^1\) This is obvious just by noting the various conferences and bulletins and funded research papers on this topic organized by various research groups and public policy academics. These include: McKinsey Canada, “Building on Canada’s strong retirement readiness”; Philip Cross, “The reality of retirement income in Canada”, Fraser Institute, 2014; Kevin Milligan and Tammy Schirle, “The retirement income system and the risks faced by Canadian seniors”, CLSRN Working paper 120, April 2013.
the last section, we provide our own observations and recommendations. Our intent in this section is to rely on the data and facts provided in the earlier part of the paper and not from any particular political philosophy.

2. OVERVIEW OF CANADA’S RETIREMENT SYSTEM

Canada has a very rich history to ensure that Canadians as a whole have access to a broad and diverse menu of savings vehicles to plan for their retirement years. This history began with the introduction of the Old Age Pensions Act that established a small flat benefit in 1927 that was means-tested for those 70 years and with costs shared between the federal and provincial governments. This was replaced by the Old Age Security (OAS) Act of 1952 that transformed the pension to a universal pension for all Canadians at 70 or above supported exclusively by the federal government from general taxation revenues (although an account was nominally established in the Consolidated Revenue Fund). This became known as the first pillar while the second pillar – the Canada Pension Plan – was established as a statutory mandatory contributory pension plan in 1967. Actually, the current regime consisting of five pillars and is described in more detail below.

To further address elder poverty, in 1967 Canada added the Guaranteed Income Supplement (GIS), a means-tested benefit for low-income retirees funded out of general revenues. Then in 1968, the eligibility age for an Old Age Security pension was reduced from 70 to 65 where it remained at 65. In the 1970s, payments made from the se programs were indexed to inflation. The GIS program was originally contributory, but it has been funded from general revenues since 1973. The GIS was also expanded several times between 1971 and 2006 to further target low income elders who were below the poverty line.

Overall, GIS has been expanded several times in its forty eight year history, which has had a substantial impact on the incomes of those at the bottom of the senior income distribution. Collectively, GIS and OAS are considered to be the first pillar of the pension system that is designed to provide for adequate retirement for all Canadians. These programs have contributed


3. The Canadian Government recently announced plans to move the eligibility age to 67 starting in 2023.

4. For example, some seniors age 60 to 64 are eligible for a supplemental non-taxable benefit in two particular circumstances. The Allowance benefit is paid if someone is married to an Old Age Security recipient or if someone is a widow or a widower. The Allowance was introduced in 1975 and was increased each time the Guaranteed Income Supplement amount was increased as well.
to the significantly lower overall poverty rate in Canada for elder poverty which declined from over a third of Canadian elders at the time to less than 5% after these programs were introduced.

The second pillar consists of government-sponsored and managed compulsory contributory earnings-related plans. Starting in 1965, the federal government began building a multi-tiered system with the phase-in of the Canadian Pension Plan (CPP), a social insurance program that, like Social Security in the United States, provides a pension benefit during retirement years funded by equal compulsory payroll contributions made by the worker and the employer over that worker’s lifetime that is based on earnings. In general, benefits under CPP depend on annual earnings up to a cap called the Year’s Maximum Pensionable Earnings (YMPE) and the contributory period starts at age 18 and goes until benefits are taken up, or age 70. The benefits during retirement years are calculated using three components: the basic replacement rate (25% of covered earnings), the average ratio of earnings to the Year’s Maximum Pensionable Earnings and the average of the last five Year’s Maximum Pensionable Earnings numbers. The pension payments are treated as taxable income and the main eligibility age for the Canada Pension Plan is 65.

In 1987, an early retirement provision was put in place allowing for benefits to be taken up as early as age 60 and as late as age 70 but with an actuarial adjustment. CPP also has a spousal survivor benefit that is paid to the surviving spouse in the event of death. The survivor benefit is 60% of the benefit that was received by the deceased spouse for those whose age is 65 and over, and 37.5% of the benefit plus a flat amount for those under age 65. However, when the surviving spouse also has a Canada Pension Plan pension of his or her own, the combined benefit cannot exceed the maximum Canada Pension Plan payment annually.

The third pillar includes employment-related pension plans which can be either Defined benefit (DB) plans or Defined contribution (DC) plans similar to the 401(k) plans in the United States. These are tax-assisted plans wherein contributions made to these plans are tax deductible and subject to an annual cap/limit and tax on investment income on assets while in these plans is deferred and is taxed only when withdrawn or received. The income received from these plans through withdrawals also impacts eligibility for the income-

5. The province of Quebec operates a parallel similar plan called the Quebec Pension Plan (QPP). In this paper, we focus on the Canada Pension Plan since the design of QPP parallels that of the CPP.

6. Note that OAS and GIS is funded from general taxation while CPP is funded by premiums and is solvent until 2075 according to actuarial analysis. For a very detailed analysis, see http://www.osfi-bsif.gc.ca/eng/oca-bac/as-ea/pages/ascpp.aspx.
tested guaranteed income supplement benefits. This pillar also includes sav-
ings made under individual tax-assisted plans for those individuals who do
not participate in employer-sponsored plans. These are of two kinds: Regis-
tered retirement savings plans (RRSP) which are treated the same for tax
purposes as the DB or DC plans and a plan introduced in 2009 called Tax-
Free Savings Accounts (TFSA) where there is no tax deduction for contribu-
tion to the plan but neither investment income while in the plan nor the with-
drawals from the account are subject to income tax. Both plans have annual
caps or limits which are indexed and are cumulative in nature.\footnote{As of 2014, the limits for contributions to RRSP were 18\% of taxable income with a max-
corresponding limit for TFSA account was $5,500, recently raised to $10,000. TFSA is
similar to the Roth plan in the United States.}

What is interesting concerning this “mixed” or hybrid public and private
pension plan system that constitutes these three pillars in Canada, is the im-
licit design principle that no Canadian should live below the poverty line.
For example, the first pillar is a pure social welfare program as no contribu-
tions are necessary, the two programs - OAS and GIS - are funded out of
general taxation revenues. The second pillar, the compulsory CPP, has a
forced savings component built into it with compulsory premiums of 9.9\% of
salary by both the employer and the employee, and the caps or limits placed
on contribution levels ensure that the savings component is not excessive so
as to impact consumption but sufficient enough to provide a reasonable
amount of retirement income.

The third pillar maintains neutrality between those who are self-
employed or without participation in either a DB or DC plan while maintain-
ing flexibility with respect to timing of contribution and individual trade-offs
between current versus deferred consumption and tax planning.

To provide the relative importance of these programs in the overall re-
tirement savings statistics concerning DB versus DC, private versus public
sector are summarized below.\footnote{Source: \url{http://www.statcan.gc.ca/daily-quotidien/140828/dq140828d-eng.htm}.} The total Canadian population in 2012 was
approximately 35 million with a working population of 18.5 million. Mem-
bership in public sector pension plans rose 0.6\% to 3,179,300, while the
number of members in private sector plans increased 1.7\% to 3,005,700. The
public sector accounted for 51.4\% of total membership in RPPs. The pension
coverage rate, the proportion of all employees covered by an RPP, was
38.4\% in 2012, virtually unchanged from the previous year. More than
4,422,800 employees were in defined benefit pension plans, down 1.2\% from
2011. They accounted for 71.5\% of employees with an RPP, compared with
more than 84\% a decade earlier. Membership in defined contribution plans,
the other most frequent type, increased 2.7% or 27,000 to 1,030,300. These plans accounted for 16.7% of all RPP membership. Nearly 86% of members in defined contribution plans work in the private sector. Other plans, such as hybrids or composites, continued their upward trend. In 2012, over 731,800 employees belonged to these plans, up 15.5% from 2011. Overall, approximately eight million or 41% of working population belongs to DB or DC plans.

In the recent debates on retirement income adequacy or savings for retirement, the focus has been mostly on these three pillars while mostly ignoring the important fourth and fifth pillars described below. Therein lies the fundamental difference between those who argue for major reform and a need for additional government intervention as opposed to those who do not believe that there is a “savings problem” or a “pension problem” for the entire population.

The remaining two pillars are central to our overall understanding of retirement income adequacy and their implication on and importance to public policy. The fourth pillar consists of all financial assets including equity investment by individuals in private companies that are not part of pension assets under pillar three above. These assets are subject to the standard treatment of dividend and capital taxation and consist of all traditional investment vehicles such as bonds and stocks held either directly or indirectly through mutual funds or insurance.

The fifth pillar represents non-financial assets such as an individual’s primary residence and for some investment in secondary real estate such as a cottage or a rental property. This fifth pillar is an important part of potential income in retirement as it can be “consumed” either through the tax free sale of the primary residence and then downsizing or moving to a smaller house in areas where house prices are lower or through a reverse mortgage type financial instrument to augment retirement income from the first four pillars. It should be noted that the home ownership is considerably higher in Canada compared to other OECD countries. According to a Statistics Canada analysis using 2011 data, ownership rate by age of primary household maintainer and household total income shows ownership range from 61.6% for age range between 55 to 64 years and household income range $20,000 to $39,999 to a high of 91.2% for income range above $100,000. This indicates that the consideration of principal residence in the retirement adequacy debate is vital and that even in households in modest income range, this asset has “wealth” implications.

Figure 1. Assets held outside of pension plans by Canadian households, 1991–2013


Table 1. Total Assets of Canadians (in Canadian Dollars) Excluding Governments and Incorporated Businesses

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<td>Total assets</td>
<td>4,500</td>
<td>100%</td>
<td>6,400</td>
<td>100%</td>
<td>9,400</td>
<td>100%</td>
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<td>Personally managed retirement assets</td>
<td>536</td>
<td>12%</td>
<td>675</td>
<td>11%</td>
<td>959</td>
<td>10%</td>
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<td>Employer pensions</td>
<td>773</td>
<td>17%</td>
<td>1,200</td>
<td>19%</td>
<td>1,900</td>
<td>20%</td>
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<tr>
<td>Financial assets outside pensions</td>
<td>554</td>
<td>12%</td>
<td>665</td>
<td>10%</td>
<td>1,000</td>
<td>11%</td>
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<tr>
<td>Non-financial assets including primary residence and real estate</td>
<td>2,170</td>
<td>48%</td>
<td>3,200</td>
<td>50%</td>
<td>4,700</td>
<td>50%</td>
</tr>
<tr>
<td>Equity in Small and Medium Enterprises</td>
<td>449</td>
<td>10%</td>
<td>671</td>
<td>10%</td>
<td>789</td>
<td>8%</td>
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Figure 1 provides trends in the growth of various assets, while Table 1 provides a snapshot across three specific years of all types of assets. As can be seen, non-financial assets including primary residence and real estate con-
stitutes approximately 50% of Canadian personal wealth as reported by the quarterly Statistics Canada National Balance Sheet. In comparison registered pension assets are only $1.9 Trillion of the $9.4 Trillion or roughly 20% of aggregate gross personal wealth of Canadians as of 2012.

Thus, any public policy that ignores the implications of the fourth and fifth pillars is bound to result in sub optimal or wrong policy that can do more harm than good with regard to society’s choice between current and deferred consumption.

3. EMPIRICAL EVIDENCE

In this section, we provide the additional data and evidence to provide context to the various aspects of the current debate along with our own observations. As noted earlier, we maintain that there is sufficient available evidence and research to reach policy conclusions; any additional research may provide very limited, if any, additional insights.

We start the section with a focus on the evolution of the overall savings rates in Canada. As shown in Figure 2 below, Statistics Canada data shows that the overall savings rate has indeed dropped from the levels of 1990s but has recovered from the lows of the early 2000 time frame. It also shows that the forced savings component – one that includes primarily the government pension plan (CPP-QPP the second pillar) and impact of the various contributions has increased.

Figure 2. National saving rate by sector, Canada, 1926–2011
Viewed as is, this figure may lead to the observation that the overall personal savings rate has declined and as such it may have negative consequences on the adequacy of income during retirement. However, according to Horner (2009), there are problems with the National Accounts savings rate as a guide to wealth accumulation by households. It ignores wealth increases through capital gains, it ignores saving through the purchase of consumer durables, and it is distorted by inflation. When adjusted to overcome these problems, the personal sector savings rate, though volatile, is higher and has no significant downward trend. Horner notes that this is consistent with the view obtained from personal sector asset and debt trends. They show that, despite strongly growing levels of consumer debt, the net worth of households has grown appreciably over the long term. Even after last year's market crash, the ratio of total net worth to total earnings remains considerably higher than it was in the early 1990s or any time before that. Moreover, in the same paper, Horner’s demonstrates that simulations using 3.5 or 2.5% real rate of return on all assets indicate that there is no challenge in ensuring retirement income adequacy to Canadians. It also assumes that the historical savings rate is the optimal savings rate for retirement income adequacy. More importantly, the natural policy response may be to design mechanisms to ensure a higher (forced) level of savings. As we argue below, a singular focus on this aggregate statistic leaves out many other forms of savings and would lead to wrong public policy.

Next, we turn our attention to the net wealth and total assets of individuals, as these assets can generate income during retirement. Although somewhat dated, Baldwin et al (2014) used data from the Statistics Canada 1999 Survey of Financial Security to focus on potential income that includes all assets. The authors determined that the inclusion of the annuitized values of net wealth significantly increases the level of financial well-being of retirement-age households relative to working-age households, with most of this increase coming from housing wealth. Their analysis showed that the mean before-tax income per adult in households headed by seniors aged 65 to 74 was 74% of that of households headed by 45- to 64-year-olds. When non-

10. A comparison of savings rates across countries for years 2000-2014 is available in https://data.oecd.org/hha/household-savings.htm. It shows that Canada’s savings rates are lower than United Kingdom and United States but have improved considerably in recent years.

11. Horner (2009), The most interesting part of this paper us that it uses data on household savings which permits savings patterns to be examined on a household or family basis, something that has not often been done in Canada.

12. There is nothing magical about retirement at sixty-five. Currently, one in four Canadians between 65 and 70 years old are still working past what until recently was the statutory age of retirement—an increase from roughly one in eight just 13 years ago. Note that delaying retirement allows both more time to accumulate assets and delays the draw-down of these assets.
housing wealth is considered, this ratio rose to 82%, and when housing wealth was included, it increased to 88%. Calculations using after-tax income rather than before-tax income yielded an even greater improvement in the relative position of retirement-age households. The mean after-tax income per adult of households headed by 65- to 74-year-olds was 79% of that of households headed by 45- to 64- year-olds. When non-housing wealth was considered, this figure increased to 95%, and when housing wealth was included, it increased to 105%. If these wealth adjustments are considered, the income distributions of retirement-age households exceeds those of working-age households. This may indicate that if there is an income adequacy issue, it is not a particular problem for those who are retired or near retirement. Given increases in overall housing prices in Canada in the last fifteen years and low interest rates in the last eight years, we can safely conclude that there is no issue about retirement income adequacy in retirement-age households.

Even for those retirement-age households who could not accumulate wealth or investment in primary residence, there is additional complementary evidence that even in those cases, one need not worry about retirement income adequacy. More specifically, according to the OECD’s “Pensions at a Glance” 2013 report and as per Figure 3 below, Canada has enjoyed the third lowest level of elder poverty in the entire OECD for many years at approximately 7.5% of elders as a result of various government social security and pension programs such as Canada Pension plan (CPP), Old Age Security (OAS) and most importantly, GIS, designed to explicitly lift up low income seniors above the poverty line.

**Figure 3. Elderly Poverty rates across OECD countries**

![Elderly Poverty rates across OECD countries](http://www.oecd.org/canada/OECD-PensionsAtAGlance-2013-Highlights-Canada.pdf)

However, more often than not, aggregate statistics sometime hide issues confronted by specific segments of the population; this is also the case here. In a recent paper, Bazel and Mintz (2014) review this issue and show that
there is one specific sub segment of the current senior population where some changes to public policy may be desirable. Their analysis shows that elderly singles living alone face significantly higher rates of income inadequacy than their peers. These elderly singles are overwhelmingly female, and are twice as likely to be below Statistics Canada’s Low Income Cut-Off (LICO) threshold than the general population, and four times as likely to be below the threshold as the elderly population as a whole. These data alone indicate that any debate concerning retirement income adequacy needs to be focused on future retirees rather than the current retirees except for this specific sub-segment of the elderly population.

We now turn attention on households which are not retirement age households and their retirement income adequacy. This requires us to establish some key terms and definitions; while seemingly simple; these definitions are often lost in debates on this issue.

Retirement income adequacy or lack thereof in retirement years is directly affected by two components. The first component relates to the accumulated individual or household wealth and annual retirement income or transfers such as those paid from statutory government programs or employer-established pension plans. We have addressed these above.

The second component, underlying the definition of income adequacy requires an assumption concerning the consumption needs of the individual during retirement years and the number of years in retirement. Indeed, there has been a vigorous debate concerning the level and adequacy of what that number (or percent) should be. Traditionally, economists and pension experts have used a term called “income replacement ratio” to define this number. Some have claimed that the annual amount required for consumption relative to the pre-retirement income is about 70%. Some recent research indicates that individuals do not require 70% but can live comfortably in retirement as low as 55%. Unless some consensus is reached about this “income replacement ratio”, it is difficult to reach any conclusion on retirement income adequacy.


14. Bazel and Mintz provide two specific and targeted recommendations that could directly target benefits to help the single elderly living alone who are below the low income cut-off (LICO threshold). One is to modify the Guaranteed Income Supplement (GIS) top up strictly for elderly people living alone. Another would be to simply expand the survivor benefit clause in the current Canada Pension Plan (CPP) from 60 per cent of the deceased entitlement to 100 per cent.

An important critique of both the number and more importantly, its definition in Baldwin et al, 2011, have argued that a better understanding to assess income adequacy requires a different metric, referred to as "potential" income. Potential income is defined as the sum of realized income and the income that could be realized from owned assets such as mutual funds and housing which individuals accumulate over their life time. If these assets and the potential annuitized income that can be received from these assets are not included in the determination of retirement adequacy, then it may underestimate the potential income available to support retirement.

The second aspect of adequacy of retirement income is influenced by years of retirement. A paradox of our times is that as life expectancy skyrocketed in Canada and OECD countries, the average age of retirement decreased as shown by the figure 4 below. Indeed, the OECD has expressed increased concern over the enormous burden represented by increasing longevity and decreased working years. Yet, the OCED table below reveals that most OECD governments have not yet moved to increase minimum pensionable age to a range of 67 to 70, as advocated by the OECD.

![Figure 4. Average Retirement Age (Statistics Canada calculations), 1976–2011](source: Statistics Canada CANSIM Table 282-0051)

In the 2012 federal budget, the Government of Canada announced it would increase the age of eligibility for the old age pension from 65 to 67 commencing in 2023. It also increased the age of pension eligibility for federal public servants from 55 to 65 for all public servants hired after Dec. 31, 2012, which will reduce the unfunded liability in the federal pension plan account for federal public employees.

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In addition to these aggregate empirical data on savings, rates of returns and wealth accumulation, there have been surveys of individual Canadians measuring their own perception concerning adequacy of savings for their own retirement. In most of these polls, a majority of Canadians state that they are not saving enough towards retirement. This has provided another reason for a desire to address this perception through public policy intervention.

The explanations provided above may explain the relatively recent trend in delayed retirement that is pushing up the average age of retirement since 2008. However, it should be noted that 2008 coincides with one of the most savage recessions since the Depression. This trend was thoroughly explored in a recent Statistics Canada study.17

However, a very recent 2014 study by McKinsey casts doubt on these perceptions.18 First, the McKinsey survey found similar perceptions. When queried concerning their top three financial concerns, about 60% of Canadians across all income quintiles selected “not having enough money for retirement”. However, according to the study authors, their analysis of other responses in conjunction with Statistics Canada data indicates that a strong majority (83%) of Canadian households are actually on track to maintain their standard of living in retirement based on their assets in the first four pillars. When 30% of equity in the fifth pillar (primary residence) is included then the percentage of Canadian households on track for retirement increases to as high as 87%. This contradiction between households’ retirement readiness and their level of financial worry can be explained in part by an overestimation of consumption needs during retirement years by the respondents. It also may be due the persistence media coverage and advertisements by the country’s financial sector on this issue where Canadians may have been led to believe that they are not saving enough for retirement.19

The remaining 17% of the nation’s households that seem to be financially unprepared for retirement seem to fall into two groups: mid- to high-income households that have access to a DC plan or group RRSP but do not contribute enough, and mid to high-income households that do not have access to an employer plan and have below-average personal savings.

18. McKinsey & company – April 2015 “Building on Canada’s Strong Retirement Readiness”. This report is based on a survey covering approximately 9,000 working households and approximately 3,000 retired households across Canada.
19. With one exception. Scotia bank actually has a slogan “you are richer than you think”.
However, this reduced rate of savings may have more to do with their inability to save because their income levels compared to their consumption needs are low or they do not include mortgage payments as part of their savings. This reduced saving rate may not imply their unwillingness to save given sufficient tax incentives are in place for them to increase their savings, if they wish to do so. The study authors recommended a targeted approach to focus on these much smaller numbers that leaves the rest of the pension system intact and maintains fairness for all Canadians.

The overall conclusions from the available data and research as reviewed in this section can now be summarised. First, we need not be particularly concerned about retirement income adequacy of most current retirees or those who are close to retirement (as approximately 85% of those Canadians are “pension ready”) except for elderly singles who mostly constitute the 7.5% elders still below the poverty line (females in particular where a targeted policy response may be warranted (such as an increase in the GIS). The recent proposal by the federal government demonstrates the targeted policy approach. Second, although personal savings rates have been low in recent years, the total savings rate has increased due to the forced savings component. Third, overall net wealth of Canadians has grown significantly as 69% of Canadians own their homes while over half of Canadians are mortgage with a mean age of 62. Fourth, the survey data indicates that although Canadians seem to worry about retirement, the data in fact shows that they need not worry about it except for some specific sub-segments of the population. The overall conclusion from this section may be that prior to introducing new policies related to retirement adequacy, there needs to be a careful assessment of this evidence to precisely identify and target those who need assistance.

4. CURRENT POLICY ENVIRONMENT

As noted in the earlier part of the paper, there has been a considerable disagreement amongst politicians, policy makers, pension experts and economists about the available data and research and their public policy implications. A number of proposals have been debated and/or implemented or being implemented across Canada, including a desire for general CPP expansion, the Ontario Retirement Pension Plan (ORPP) in Canada’s largest province and a similar plan in the Province of Quebec termed as the Voluntary Retirement Savings Plan (VRSP).

Before describing these initiatives and their rationale, it is instructive to document comments of six individuals who were recently identified as experts by a Not – for - Profit organisation – the Public Policy Forum which organised a conference on this very topic early in 2015. These comments
show that we do not need more data or research, what we may need is a proper interpretation of the data and research.

- “The first important fact to establish is that there is no crisis for the current generation of retirees. The current retirement income system serves the vast majority of Canadians very well.” — Philip Cross, *The Reality of Retirement Income in Canada*, April 2014.

- “People are not saving enough for retirement and if we let this go unchecked we’re going to face a huge economic crisis.” — Kathleen Wynne, Premier of Ontario, November 12, 2013.

- Canada’s three-legged stool – Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) for low-income Canadians, the national Canada Pension Plan (CPP) and workplace pensions or savings – is facing a crisis.” — Jim Leech, Former CEO, Ontario Teachers’ Pension Plan, February 2014.

- “There is a widespread perception in Canada that the country is on the brink of a major retirement crisis. A more considered view is that while most recent retirees are faring reasonably well, Canada faces a slowly deteriorating situation in which a growing population of future retirees will experience a substantial drop in their standard of living.” — Fred Vettese, Chief Actuary, Morneau Shepell, May 29, 2013.

- “I am persuaded that Canada does have a looming retirement savings problem. Specifically, a significant proportion of middle-income, private sector workers without workplace pension plans will likely face material drops in their standard of living and that is a public policy issue. It suggests the need for a retirement savings facilitation initiative.” — Keith


Ambachtsheer, President & Founder, KPA Advisory Services Ltd. and Director Emeritus, Rotman International Centre for Pension Management, October 2014.

- “There is no pension crisis in Canada – not now, not 10 years from now, not even, so far as we can foresee, in the more distant future. In fact, elderly couples have become the wealthiest family category in Canada. And it doesn’t look as if that’s going to change any time soon.”

  Michael McCullough, Managing Editor (Western Bureau), Canadian Business Magazine, April 8, 2011.

Needless to say, there is a considerable difference in these opinions ranging from “no crisis of retirement adequacy” to a “cry for major changes due to an imminent and potentially serious crisis.” In the executive summary of that conference, the organisers state that “While a majority of Canadians (70-80%) are preparing adequately for retirement, a significant number of middle-income earners and young Canadians working in the private sector are not sufficiently saving. A sizeable proportion of these demographic groups lack access to, or are not participating fully in, workplace pension plans. Government programs, designed to support low-income Canadians in retirement, will not provide enough income replacement to these “at-risk groups.” Without an effective and targeted policy response, they are disproportionately more likely to experience a declining standard of living in their post-work years.” However, the organisers made no attempt to quantify the seriousness of the situation faced by these seemingly “at risk” groups nor was any data provided to quantify “declining” standard of living.

Based on the evidence presented in this paper – and assuming that the assets of the 4th and 5th pillars are included – we do not see a savings or pension crisis for most Canadians excepting a small segment in the current retirees (single females who could not and have not saved enough and may require additional assistance) and two other segments in the current worker population who despite the availability of tax assisted vehicles for retirement savings say that they are not saving enough or are excluding mortgage payments from their definition of “Savings”. Nonetheless, the two largest provinces in Canada, Ontario and Quebec introduced generic (non-targeted) programs to address the perceived retirement adequacy challenge. Since the two programs are similar, we only review the program introduced by the Province of Ontario – the proposed Ontario Retirement Pension Plan (ORPP). 26


26. This was unveiled in the Ontario government’s budget as a supplement to the Canada Pension Plan (Ontario, May 1, 2014) and was passed as Bill 56, Ontario Retirement Pension Plan Act, 2015 on April 29 with a proviso that the Minister of Finance is required to prepare
In effect, the ORPP program is an extension to the Canada Pension Plan (CPP) for residents in the Province of Ontario. The Ontario Retirement Pension Plan (ORPP) would require workers to contribute 1.9% of their earnings up to $90,000, matched by a 1.9% contribution from employers and would be targeted to those who do not have “comparable workplace pensions” (presumably defined benefit plans offered by employers) as well as the self-employed and lower income workers would be exempt. The recent pronouncement by the Ontario government indicates a phased approach starting with larger corporations to smaller enterprises over a 5 year period.27

Even if the program is yet to be costed and introduced, we know enough about it to provide some comments, excluding the administrative complexity and costs, in light of the evidence introduced in the earlier part of the paper.28 We believe that there are at least eight issues that are somewhat troubling about this type of a public policy response.29 First, it is based on a questionable assumption that replacement ratios must achieve 70% of pre-retirement income. Second, there is no rationale provided by the government for this program to be contributory; if the government believes that workers are not savings enough, it could mandate a non-contributory program. There is a large body of research that demonstrates that employer contributions are funded through an adjustment to the wage rate as with payroll taxes more generally.30 Third, the program does not allow for individual choices for investment vehicles; the amounts would be invested by the government which would determine asset mix and investment policies. Fourth, the estimated retirement benefits per individual would eventually be up to $12,815 a year which is not a significant amount for many. Fifth, a reduction in approxi-

27. On August 11, 2015, the Ontario government announced eagerly awaited details on the proposed design of the Ontario Retirement Pension Plan (ORPP) which stated that Employees of large employers (at least 500 employees) who do not sponsor a RPP will join on January 1, 2017, Employees of medium employers (at least 50 but less than 500 employees) who do not sponsor a RPP will join on January 1, 2018, employees of small employers (less than 50 employees) who do not sponsor a RPP will join on January 1, 2019.


29. We are not the only one worrying about this program. Please see Cross (2014) for a very detailed review.

30. Not surprisingly, about 100 Ontario companies are expressing "serious reservations" about the new provincial pension plan and its impact on jobs and the economy. The Chamber of Commerce says the economic impact of the provincial pension remains the primary concern of employers, warning that 44 per cent of its members say they will reduce their payroll or hire fewer workers. Other critics stated that this could cost up to 40,000 jobs. The Canadian Press, Sep 23, 2015.
mately 4% of earnings would impact consumption and thus economic growth. Sixth, although the program may sound as if it is targeted towards those who need it the most, it is still a very non-targeted program and it would impact about three million workers in the Province of Ontario. Seventh, the program is compulsory with no opt-out provision which indicates that it is in effect an additional tax which is going to be invested separately from general tax revenues but can be used for funding other government programs through investing in Ontario government bonds with potentially lower returns. Eighth, and most importantly, many in the bottom two quintiles are typically employed in SMEs – most of which do not offer employer pension plans – and thus qualify for the Guaranteed Income Supplement. Those in the bottom two quintiles who receive GIS would have half of the proposed ORPP pension clawed back from GIS under the income rules that govern GIS.

5. OVERALL SUMMARY AND RECOMMENDATIONS

The intent of the paper was to review the status of the retirement system in Canada and the current policy regime with a particular focus on data and existing research and provide our own observations and recommendations for possible improvements. We believe that no additional and new research is required but what is more important is a clinical analysis of existing data and research and their implication on public policy. As noted, Canada has a rich history of public policies related to retirement adequacy focused on ensuring that financial conditions of Canadians in their retirement years is sound and secure. The five pillar system described in the paper is a result of a judicious mix of social programs such as the Old Age Security (OAS) and Guaranteed Income System (GIS) that focus on minimising and eliminating poverty levels amongst seniors. In addition, there are earnings-based government programs such as the Canada Pension Plan and Quebec Pension Plan that are mandatory for those who earn employment income with limits and caps that results in a trade-off between forced savings and financial prudence for retirement. In addition, there are tax-assisted programs covering defined benefit and defined contribution plans as well as those in which individuals can contribute on their own; these include Registered Retirement Savings Plans (RRSP) and Tax Free Savings Accounts (TFSA). Individuals are also free to save more outside these tax-assisted vehicles and accumulate financial assets such as equities, bonds and real estate as well in primary residence, which can then be “consumed” in retirement years through instruments such as reverse mortgages.

31. Ontario government estimates that the total annual amount under this program would be approximately $3.5 billion.
We provide considerable empirical and analytical evidence in the paper that leads us to believe that the retirement system has served Canadians well and will continue to do so in the future. Overall poverty levels are much lower in Canada for seniors and those closer to retirement have more than adequate assets to cover their retirement years. Not only has this generation over-saved, it will leave significant sums to the younger generation so much so that the younger generation may actually reduce its own savings rate in acknowledgment of this impending trillion dollar intergenerational transfer.

We also provided aggregate evidence indicating that Canada now has one of the lowest poverty rates amongst elderly; its seniors and those who are close to retirement have sufficient savings for their retirement years even in the presence of increasing longevity. Moreover, they are working longer years not necessarily for money but because they are able to do so both mentally and physically. We also question the often quoted 70% income replacement ratio both in terms of the definition and evidence. Also questionable is reliance upon public opinion survey evidence about retirement income adequacy when data shows otherwise than the data. We refer to recent studies that indicate the danger in such policy design framework. We reject the omissions of financial assets held outside of registered pension plans and real estate ownership in debates on retirement income adequacy.

However, we also acknowledge that aggregate data hide specific sub segments of the population where there may be a need for concern. We believe that it is essential to deal separately with the situation of current retirees (or elders) and those close to retirement from those who are in the 30 to 55 years age bracket – the working population. With respect to the first group, empirical evidence indicates that the elderly singles living alone and predominantly females face significantly higher rates of income inadequacy than their peers. For that group, we endorse targeted measures such as those advocated by Bazel and Mintz (2014) and applaud the current government in addressing it with a targeted measure. For the current workforce that is planning for retirement, we believe that a singular focus on increasing savings rate through compulsory and contributory deductions at source such as being advocated by the Ontario Retirement Pension Plan (ORPP) in the province of Ontario and the Voluntary Retirement Savings Plan (VRSP) in the province of Quebec is too narrow and limited in achieving long term objectives. We believe that ensuring retirement adequacy requires a multifaceted and long term approach. We end this paper with five specific observations and recommendations.

First, we believe that public policy needs to explicitly acknowledge that savings are significantly influenced by earnings power and the most important measure to increase overall earnings power is to ensure not only an educated workforce but a workforce with the right type of education. This
requires governments to focus on policies that increase the GDP growth rate rather than focusing on savings rate. Savings would follow increased incomes and opportunities that would result from increased growth.

Second, although we do not show data or evidence on the investment returns on savings, we recognise that improved financial education may be necessary to ensure that investors invest their savings properly through low cost diversified investment options such as exchange traded funds without negatively impacting rates of returns. Since many savers invest through mutual funds, policies must be in place for more disclosure about these costs, these costs have been shown to be costly. The proposed disclosure rules for mutual fund industry by the Ontario Securities commission starting July, 2016 is long overdue and is a welcome initiative in that regard.32

On a related note, as of now, the market value of non-pension assets of Canadians in mutual funds exceeds $500 billion which includes embedded capital gains of unknown magnitude. A high percentage of these are invested in mutual funds with high management expense ratios (MERs). However, shifting these assets into lower cost index or exchange traded funds would invoke capital gains tax as investors need to liquidate their investment in these funds prior to moving them into low cost funds. The resulting tax liability may be much higher than the present value of savings arising from the reduction in relative annual fees. One tax policy approach would be to allow for tax free transfer across mutual funds if funds are transferred within a reasonable time period (e.g. thirty days). This would increase future net returns on these assets and increase retirement income.

Third, financial education is also needed to ensure that citizens effectively utilise tax assisted vehicles such as RRSPs and TFSAs. There is evidence that this is in fact happening. There is evidence that among those who should be saving for retirement in 2012, an estimated 94% did so via RRSPs, pension plans, TFSAs or a future inheritance.33 However, there is still a large unused RRSP contribution room as of 2011 amounting to over $680 billion. That means even if many Canadians are saving though these vehicles they could save more and those who could save more can also enjoy tax deductibility of contributions and non-taxability on investment income prior to withdrawal. As noted earlier, this unused RRSP contribution room may have more to do with inability to save rather than reluctance to save.

32. For a detailed analysis on implications of investment returns on retirement adequacy, see Jog (2009).
33. This is quite contrary to the often cited number that only 24% of Canadians are investing through RRSPs and TFSAs. For an excellent short analysis on the reason for this discrepancy, please see, “Why our RRSP participation rate is so much better than it looks”, Fred Vettese, Financial Post, April 11, 2014.
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Fourth, Canadians continue to invest in primary residence and their primary residence can act like any other financial asset during the retirement years. Public policies are needed to ensure that proper reverse mortgage regulation and tax issues are in place to facilitate consumption of “primary residence” during retirement years.34

Fifth, if some provincial governments still want to introduce partially non-targeted plans such as the ORPP, they should at least ensure that these are non-contributory with opt-out possibility; the assets are invested through low cost market based mechanisms (e.g. by leveraging existing institutions like CPPIB/OMERS/OTPP or companies like vanguard/Blackrock) with a maximum costs of ten to fifteen basis point for investment management and leverage existing CPP administrative mechanism for benefit payment.

Our overall conclusion is that Canadian retirement system and retirement adequacy for Canadians is as good as any other country in the world. We recognise that the system can be further improved with some specific and targeted public policy initiatives to address the 7.5% of elders below the poverty line but even if left as it currently stands, the system is fully sustainable and will continue to serve Canadians well.

REFERENCES


34. In the U.S., reverse mortgages are offered under the home equity conversion mortgage (HECM) program administered by HUD and insured by the FHA. A new version of the program was introduced in 2013 offering three alternatives – line of credit (LOC), payments for set periods, or a tenure option. For more details, see New Research: Reverse Mortgages, SPIAs and Retirement Income, April 14, 2015 by Joe Tomlinson, Advisor Perspectives, Inc. In Canada, reverse mortgages have been available for over twenty five years and many financial institutions currently provide up to 55% of the value of the home on a tax free basis under the Canadian Home Income Plan (CHIP). The current size of the market for reverse mortgages in Canada is unknown.


