

The Canada Pension Plan in Transition

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In May of 2009, the federal, provincial and territorial ministers of finance, as joint stewards of the Canada Pension Plan, announced changes to the plan which start taking effect in 2011. This article reviews the changes and the economic and demographic forces that drove the transition.

Changes in the Workforce

The CPP was designed in the early to mid 60's. Fifty years later, Canadians are healthier, better educated and living longer. In particular, Canadians are working later in life and deferring retirement. As well, the retirement experience is changing from a single event, usually at 65, to a process that can extend over many years. The critical demographic development is the "age wave" of the boomers moving past their 65th birthdays. This wave starts to build in 2011 and will not crest until 20 years from now. It is important to address any imbalances and inequities in the design of the CPP sooner rather than later.

The economy and the labour markets have gone through enormous changes in the last fifty years. The historical pattern of employment has changed. A long career with a single employer has been replaced with short periods with many different employers. Careers are interrupted frequently and often involuntarily.

In 2008, legislative changes were introduced that permit members of defined benefit pension plans to collect retirement benefits while they are working and to continue to accrue pension benefits. Some of the changes to the CPP make the plan consistent with these developments. They provide increased flexibility for older workers. They more fairly compensate individuals for deferring their retirement. They provide improved equity for older workers willing to work longer.

Recalibrating Early and Deferred Retirement Factors

These factors have been adjusted to reflect improvements in mortality, particularly for people over age 75. The existing factors subsidize early retirement and penalize deferred retirees. Current experience is that 65% of eligible contributors start their CPP retirement benefit before age 65, 31% at age 65 and 4% after age 65.

Retirement Age	Current	New
60	30% reduction	36% reduction
70	30% increase	42% increase

The new factors ensure that the choice of retirement age is financially neutral to the funding of the CPP. The new early retirement factors are staged from 2012 to 2016. The new deferred factors are phased in more quickly, from 2011 to 2013.

Staged Implementation

Early Retirement Factors

Year of Retirement	Monthly Adjustment Factor
2011	.50%
2012	.52%
2013	.54%
2014	.56%
2015	.58%
2016	.60%

Deferred Retirement Factors

Year of Retirement	Monthly Adjustment Factor
2010	.50%
2011	.57%
2012	.64%
2013	.70%

Enabling Phased Retirement

Under the existing rules, it is not possible to work in paid employment while collecting the CPP retirement benefit. In our experience, these rules are honoured more in the breach than in the observance. Certainly, it is not possible to collect the retirement benefit, continue to contribute and to accrue more benefits. The CPP is being changed to make it consistent with the rules for defined benefit plans. It will now be possible to continue to work, to contribute to the CPP, to earn additional benefits and to collect the CPP retirement benefit, all at the same time.

The changes are:

- The work cessation rule has been dropped.
- Workers will now be able to contribute up to and including age 70 while they are receiving the retirement benefit.

Between age 60 and 65, workers and their employers are required to contribute, even if they are receiving the CPP retirement pension. Between age 65 and 70, workers may contribute voluntarily while receiving the pension. If they do so, their employers will be required to contribute as well.

The additional benefits accrued are not subject to the existing maximum benefit rules. The only benefit affected by the changes is the retirement benefit. Survivor and disability benefits do not change. The additional benefit is one fortieth of the maximum retirement pension adjusted for age.

Example

It is 2013. Mary is 66 years old and is collecting her CPP retirement benefit. She has decided to work for another year and is trying to decide whether to contribute to the CPP and to accrue additional benefits. If

Mary chooses to contribute, her employer will have to match her contribution. Assume that the YMPE in 2013 is \$49,300 and that the average of the YMPE's from 2009 to 2013 is \$47,980. In 2013, Mary's contribution will be

$$(49,300 - 3500) \times .0495 = 2,267$$

In 2014, Mary will start collecting an additional benefit of

$$47,980 \times .25 / 40 \times (1 + 12 \times .007) = 325$$

Ignoring the effects of compound interest, Mary will break even in

$$2,267 / 325 = 7 \text{ years}$$

Mary is confident that her life expectancy is higher than age 73 and makes the decision to contribute.

Reflecting Changing Work Patterns

The relationship between the labour markets and the work force has changed significantly. It is common now for a career to span multiple employers with many work interruptions, not all of which are voluntary.

Fewer than 10% of retirees receive a maximum CPP pension. In December, 2010, the average CPP benefit at 65 was \$504.88. The maximum retirement benefit was \$960.00. The general drop out provision is being increased in two stages to add, by 2014 an additional year, raising the provision from 15% or 7 years to 17% or 8 years. These numbers are based on a 47 year contributory period from age 18 to age 65.

Year	Dropout %	Years Dropped
2010	15	7.0
2012	16	7.5
2014	17	8.0

Summary of Changes

2011

- Deferred pension increase rises to 34.2% at age 70

2012

- Deferred pension increase rises to 38.4% at age 70
- Early pension reduction increases to 31.2% at age 60
- Work cessation rule removed
- CPP recipients must (under 65) or may (over 65) continue to contribute
- General drop out provision increases to 16%

2013

- Deferred pension increase rises to 42% at age 70
- Early pension reduction increases to 32.4% at age 60

2014

- Early pension reduction increases to 33.6% at age 60
- General drop out provision increases to 17%

2015

- Early pension reduction increases to 34.8% at age 60

2016

- Early pension reduction increases to 36% at age 60

Final Thoughts

Over the years, rules of thumb have been developed, to help people decide when to start collecting their CPP retirement benefits. Over the next five years, the changes described above, complicate this decision. In future articles, we will share with you, our thoughts on the “new” rules of thumb.

About William Jack



William Jack is co-owner of Longhurst and Jack Inc. He specializes in helping clients develop integrated life style and financial plans for retirement.

William joined Longhurst and Jack after a career of more than three decades with a leading financial services company. He is a Fellow of the Canadian Institute of Actuaries and a Certified Financial Planner.