Pension Changes in Canada—Implications for Employers

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Agenda

• CPP
• Buy-out Annuities
• Changes in Plan Design and Funding
  – DB Funding
  – Target Benefit Plans
  – DC Evolution
The Canadian Retirement System: A Three-Legged Stool

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<tr>
<th>Public benefits</th>
<th>Employer pensions</th>
<th>Personal retirement savings</th>
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<td>Includes:</td>
<td>Includes DB or DC pension plans offered by some employers</td>
<td>Includes personal savings in tax assisted vehicles such as RRSPs, PRPPs, or TFSAs</td>
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<td>1) CPP / QPP – funded by compulsory contributions by employees and employers</td>
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<td>2) OAS – benefits available to most Canadians over 65 years old, including the Guaranteed Income Supplement</td>
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What is the Canada Pension Plan (CPP)?

• CPP is an earnings-related social insurance program
• Funded by contributions by employees and employers
• Investments are managed by the CPP Investment Board
• CPP benefits include:
  – Retirement income
  – Disability benefits
  – Death benefit
  – Survivors allowances
Current CPP Benefits

• CPP guarantees lifetime pensions based on length of employment and size of contributions

• Currently, CPP is designed to replace $\frac{1}{4}$ of pre-retirement earnings up to a maximum income level (maximum for 2017 = $55,300)

• As of January 1, 2017, the maximum CPP monthly benefit was $1,114.17 per month or $13,370.04 per year

• Average payments tend to be lower than the maximum benefits (average CPP payment is about $550/month)

• Inadequate retirement savings the catalyst for CPP reform
The Path to CPP Reform

- Ontario Expert Commission on Pensions recommends enhancing pension coverage.
- Ontario government introduces Ontario Retirement Pension Plan.
- *Ontario Retirement Pension Plan Act* receives Royal Assent.
- Federal Liberal Party led by Justin Trudeau elected.
- Federal government and eight provinces reach agreement on CPP enhancement. Ontario announces it will scrap ORPP.
- British Columbia agrees to support CPP expansion.
- Federal government introduces Bill C-26 to amend CPP.
- Bill C-26 receives Royal Assent.
- Part 1 of Bill C-26 amending the Canada Pension Plan is proclaimed into force.
## Refresher—Current CPP

### Pensionable Earnings
- Includes earnings between $3,500 (Year’s Basic Exemption) and the YMPE while members contributed between 18-70
- Allows for certain drop-out years when earnings were lower (15% + parental leave)

### Benefit
- CPP benefit aims to replace ¼ of annual earnings up to YMPE for members who contribute over 35-40 years
- Adjustments are made for years with lower earnings
- Adjustments are made if you don’t start CPP at age 65

### Cost
- Employees and employers each contribute 4.95% of pensionable earning
- Total of 9.9% to fully fund current CPP benefit

### Current maximums
- YMPE in 2017 is $55,200 (increases each year)
- Maximum CPP employee contribution in 2017 = $2,564

### Early Retirement
- Eligible for pension as early as 60
- Unreduced at age 65
- Early retirement reduction of 0.6% for each month between 60-65
- Enhanced by 0.7% for each month beyond age 65-70

### COLA
- CPP benefits are adjusted each January based on the increase in CPO

### Other Information
- Can continue to work and collect CPP as long as you are less than age 70
- Married or common-law spouses can share their CPP retirement pensions
- CPP provides disability benefits for those who cannot work any job no a regular basis
- A monthly benefit for dependent children is also available
How Will CPP Change?

1. Annual benefits (on income up to the YMPE) will increase
   - Current: 25% of pre-retirement earnings
   - By 2025: 33% of pre-retirement earnings

2. Maximum income covered by the CPP will increase
   - Current: $55,300
   - By 2025: $82,700

3. Contributions by employees and employers will increase
   - Current: 4.95% of wages
   - By 2025: 5.95% of wages
What Will the Enhanced CPP Look Like?

- **Step 1:** Increase replacement rate to one-third (2019-2023)
- **Step 2:** Extend earnings range by 14% (2024-2025)

- 33.33%
- 25%

Current CPP

Earnings ($)... 114% of YMPE (projected to be $82,700 in 2025)
Meanwhile in Quebec . . .

- Quebec does not participate in CPP
- Quebec Pension Plan (QPP) operates separately
- Changes to QPP have been proposed in light of CPP enhancements
  - Similar contribution levels as enhanced CPP, but lower benefits
  - Similar benefit levels as enhanced CPP, but higher contributions
  - Status quo

Source: Getty Images
CPP—Cross Border Considerations

- Foreign residents working in Canada
- Canadians working in foreign countries

Source: World Literacy Canada
Implications of CPP Enhancement

• In light of changes to CPP, plan sponsors should:
  – Think about how to address increased CPP contributions
  – Consider whether amendments to any employer-sponsored pensions are needed or desired
  – Reassess retirement plan design
  – Consider any collective bargaining implications
As We Approach 2019 . . .

• Employers should be:
  1. Thinking about their goals in terms of costs, but also target benefit coverage for their employees
  2. Updating pension plan texts, booklets and/or websites if changes are needed
  3. Planning how and when to communicate any changes to employees
  4. Updating payroll and pension plan administration processes
     - More complex system (phased in over 7 years)
     - New tax reporting requirements
     - Potentially, more complex pension plan contributions and benefit formulas
Buy-Out Annuities
Buy-Out Annuities

• Buy-out annuities
  – Pension plan transfers its pension liability to the insurer and “buys out” its liability to pensioners
  – Insurer becomes directly liable to pensioners
• Bill C-27
• Which jurisdictions now permit (or propose to permit) a discharge on buy-outs?
• Fiduciary considerations
Plan Design and Funding
Overview of Plan Design and Funding Rule Changes in Canada

- Pension landscape in Canada changing:
  - Pension innovation a hot topic in Canada in response to perceived inadequacies of both DB and DC plan designs
  - Plan sponsors seeking alternatives
  - Trends in Canada consistent with other developments globally (e.g., Dutch CDC model)
Funding Changes—SRAs in British Columbia and Alberta

- Solvency Reserve Account (SRA)
  - A separate account within a pension plan fund that is established to hold solvency deficiency payments made under a defined benefit component of a pension plan
  - Can be established under a separate trust agreement, but a separate agreement is not required
SRAs—How Do They Work?

Solvency deficiency special payments, including transfer deficiency payments

Withdrawal of actuarial excess or surplus, with conditions

Unfunded liability special payments

Normal actuarial cost, plus expense allowance, if applicable

Distribution of actuarial excess or surplus, with conditions

Members’ benefits

Expenses (if applicable)

Total Pension Fund

SRA

Balance of the Fund

Source: BC FICOM Stakeholder Engagement: March 7, 2017: Solvency Reserve Accounts
Funding Changes—Quebec

- Elimination of solvency funding
- Going-concern funding with a “stabilization provision”

Source: Unycyclomedia Commons
Funding Changes—Ontario

• Proposal to eliminate (for the most part) solvency funding
  – Follows an Ontario consultation on solvency funding in 2016
  – Solvency funding requirements are maintained for plans with a solvency funding ratio under 85%
  – Plans at a solvency funding ratio above 85% will be exempt
  – Requires funding on a going concern basis
  – PfAD funding
What is a Target Benefit Plan?

• Target benefit plans (TBPs) provide:
  – Fixed contributions, or target contributions with minimal deviation
  – Targeted, DB-type pension benefit at retirement
  – Ability to adjust benefits
Why TBPs as an Alternative?

• Debate between DB vs. DC does not provide a comprehensive solution
• Target benefits—e.g., multi-employer pension plans
• TBPs/SRPs allow for flexibility of benefits and potentially better intergenerational equity
• TBPs/SRPs pool demographic, investment and longevity risk
• Potential to eliminate sponsor liability beyond contributions and to eliminate solvency funding
• Depending on many factors, TBP preferable design for some sponsors/workforces
Federal TBPs

- Proposed legislation released October 2016
  - Has received first reading October 19, 2016
- TBP provisions would be incorporated in federal PBSA
- Legislation would make TBPs available to federally regulated private sector employees
- Design option
- Enabling legislation
- Must be created anew
- Ability to surrender and exchange accrued benefits for target benefits with consent
- Many details will be in regulations
TBPs Elsewhere in Canada

- Ontario and Nova Scotia—Target Benefit Plan legislation for collectively bargained workforces proposed and no regulations
- Ontario—Recent MEPP TBP framework announced
- BC & Alberta—Target Benefit regime in place
- Quebec—Legislation for Target Benefit Plans in pulp and paper sector
- Saskatchewan—Rely on existing legislation
- PEI—Legislation not yet passed
- New Brunswick—Target Benefit regime (SRP) in place
- Nothing yet in Manitoba or Newfoundland
DC Evolution

- Variable benefits—Ontario + others
- Ontario intent to look at DC rules

Source: Local 793
Plan Design and Funding—Implications for Employers

• Legislation continuing to evolve
  – Continue to monitor
• More options generally available re design and funding
• Jurisdiction shopping?
• Risk management
Questions?

Thank you!