2015 Pension Policy Notes

CANADA

- **Raise mandatory contributions targeted at middle-income earners or at least introduce effective auto-enrolment of this population group into private schemes.**
- **Streamline private schemes by enhancing pooled occupational plans and lowering fees in individual plans.**

The three-pillar system tends to generate good outcomes. The first pillar, Old Age Security (OAS), provides an effective safety net for individuals who recorded low incomes during their working life. The second pillar (Canada, and Quebec Pension Plan, CPP and QPP) is a public mandatory earnings-related scheme with limited scope as it targets a gross replacement rate of 25% up to a wage threshold close to the average wage. The combination of these two pillars generates long-term replacement rates that are high for low-wage earners but decline steeply with wages. The third pillar, optional and private, is made of both occupational pension plans, either DB or DC, and individual savings plans. Coverage has been declining, with a marked heterogeneity in participation across income levels. For example, the share of the employed men covered by registered pension plans declined from 46% to 38% between 1977 and 2012. Yet, the relative average income of people aged over 65 (compared to the whole population) is among the highest in OECD countries. The old-age poverty rate is among the lowest in the OECD, and substantially below the poverty rate for the total population. These outcomes are achieved with low public and total pension expenditure in OECD comparison.

Key indicators: Canada and OECD average

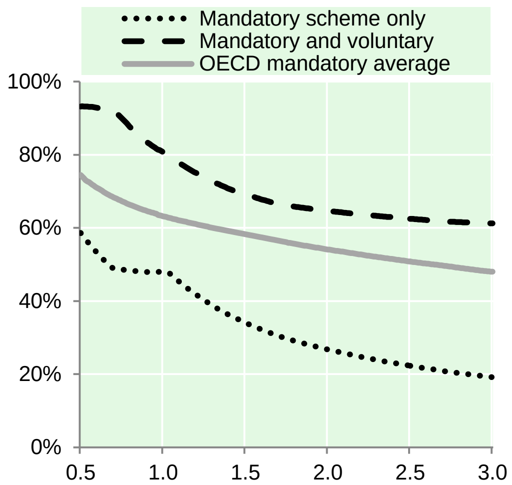
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	67.0	65.0	65.0	65.0		67.0	
Retirement age	67.0	65.0	65.0	65.0	62.9 (61.8)	67.0	64.6 (64.4)
Net replacement rate, avg earner						47.9	63.2 (62.7)
Total mandatory contribution rate		5.4	9.9	9.9	19.1		
Total pension spending, % of GDP	5.5	8.1	8.2	7.6	10.3		
Public pension spending, % of GDP	3.7	4.7	4.0	4.3	8.4		
Public debt, % of GDP	67	104	76	96	115		
Employment rate 55-64, %	62.8 (30.8)	53.3 (33.3)	63.1 (46.8)	65.0 (56.0)	66.1 (49.1)		
Labour-market exit age	63.6 (62.8)	62.5 (60.1)	63.3 (61.5)	64.5 (62.4)	64.6 (63.1)		
Old-age poverty rate, %	8.3	1.4	5.1	6.7	12.6		
Life expectancy at 65, years	15.1 (19.3)	16.1 (19.9)	18.1 (21.2)	19.7 (22.3)	18.4 (21.5)	23.9 (26.4)	22.9 (25.9)
Old-age dependency ratio	0.17	0.20	0.21	0.26	0.28	0.53	0.57
Fertility rate	1.6	1.6	1.6	1.6	1.7	1.7	1.8

Note. The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

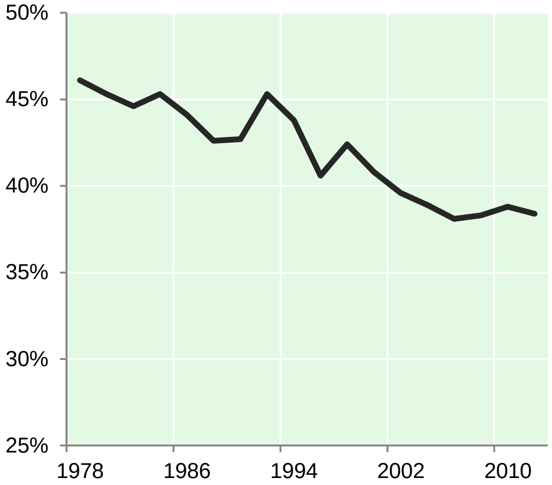
Plans to expand the second pillar through higher wage thresholds for contributions and/or higher replacement rates were rejected by the federal government in 2013. However, the scope of the mandatory scheme was broadened in Quebec while Ontario plans to introduce an additional mandatory scheme for workers not covered by private plans in 2017. Financial incentives to work longer were increased in the CPP, and combining work and the CPP/QPP benefit was allowed from age 60. Moreover, the eligibility age for the basic pension will increase from 65 to 67 between 2023 and 2029. Federal legislation also created pooled occupational retirement saving plans as a way to boost portability, reduce fees and lower the risks supported by employers. It is based however on optional participation by employers and auto-enrolment of employees within sectors governed by the federal legislation. A few provinces adopted similar legislation and others are expected to do so.

While fiscal sustainability does not seem to be at risk there are growing concerns that some middle-income earners might face a shortfall in old-age replacement income. Canada will be subject to a similar pace of population ageing as most OECD countries. The funding level of DB schemes and the growing share of DC schemes place the country in a relatively comfortable fiscal situation although the low interest-rate environment might create pressure. Yet, middle-income groups who do not opt for private schemes are likely to have low replacement rates. Moreover, the private pension landscape is very fragmented which generates complexity and inefficiencies; as in many countries, employers' interest in occupational defined benefit plans is waning and administrative fees in individual plans are high.

Long-term net replacement rates (%), by earnings level



Private pension coverage, % employed people



Sources: OECD pension models, Statistics Canada, Statistics Canada. Table 280-0017 & Table 282-0012, CANSIM (database).

Streamlining private schemes and improving adequacy of pensions for middle-income earners are the policy priorities. The pension system offers a diversified stream of income and relies more than in other OECD countries on private optional instruments. Reducing inefficiencies in private plans, mainly in terms of obstacles to portability and high fees, might increase their attractiveness. However, to improve the prospects of middle-income earners, a more forceful intervention might be needed through either higher mandatory contributions or at least auto-enrolment in private pensions with targeted financial incentives. Canada could benefit from the experience of New Zealand with its KiwiSaver plan. Moreover, basic pension benefits are indexed to inflation and not to earnings growth, which might weaken basic protection. Increasing the employment rate of older workers should also be part of an overarching strategy to improve adequacy. While Canada records good employment performance for prime-age workers, the employment rate of people aged over 60 is low, though slightly above the OECD average. The retirement age for the second pillar should be increased in line with that for the first pillar, and contributions to the second pillar should benefit from a full tax deduction rather than being credited at the lowest marginal income tax rate.

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