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CIA Submission on Consultations on a Voluntary Supplement to the Canada Pension Plan

The consultation document contains few details in connection with the design of the Voluntary Supplement to the Canada Pension Plan. In particular, the document does not indicate whether the retirement pension would be on a defined contribution (DC) basis (i.e., the amount of pension is determined only at retirement depending on the value of the accumulated contributions) or whether there will be a defined amount of pension (a defined benefit-type basis) attached to the contributions made each year. A DB-type basis would provide a guarantee on the amount of pension to be paid; the type of the guarantee can take many forms, including conditions associated with the financial situation of the plan.

There are pros and cons to both approaches. We believe many Canadians expect any expansion of CPP would be done on a DB basis, as a DB option would make it easier for Canadians to plan for retirement, since they could be provided with an estimate of the amount of pension attached to their voluntary contributions. However, establishing the amount of pension would raise significant challenges given the voluntary nature of the supplement, and may result in undesirable transfers between generations. We conclude that a voluntary DB plan is likely not feasible, and have assumed that the supplement will operate on a DC basis as described below. The CIA is available to discuss the pros and cons of this choice.

How should the supplement be designed?

Our position is based on the following in connection with this supplement:

- It would be on a DC basis, i.e., there would be no guarantee on the amount of pension attached to a level of contribution;
- It would be self-sufficient, i.e., there would be no subsidies from governments for expenses or risk transfers;

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- There would be no transfer of cost or risk between generations of contributors;
- It would require access to a new administration system separate from the current CPP system for the maintenance of records and payment of benefits;
- It can rely on the current CPP system for the collection of contributions;
- Contributions would be tax-deductible and benefits would be taxable; and
- The contributions would be subject to the overall limit applicable to registered plan contributions.

This supplement would then be very different from the current CPP:

- CPP delivers a locked-in compulsory cost-shared target benefit outside the PA/RRSP limits. Employee contributions are not deductible, but give rise to a non-refundable income tax credit; and
- The supplement will deliver a voluntary employee-pay-all DC benefit subject to PA/RRSP limits. Contributions will be tax-deductible and benefits will be taxable.

The only similarity with the CPP will be

- Investments could be made through the CPPIB; and
- Collection of contributions could rely on the CPP system.

Canadians will have to clearly understand these differences. Contributions to this supplement should be in a separate fund with its own investment policies and financial reports, and not commingled with CPP contributions. The name CPP should not be associated with the supplement, in order to avoid any confusion.

What should the objectives of the supplement be?

The document does not explain the objectives sought by adding the supplement. This is important, and it should be clearly identified. Possible objectives could include the following:

- Increase the level of retirement savings by Canadians;
- Increase the number of Canadians who are saving for retirement;
- Add flexibility for retirement savings;
- Improve the efficiency of the retirement system, in particular the level of fees charged to savings;
- Offer options that are not easily available now; and
- Improve the process of converting capital into income at retirement.

If increased savings or coverage is the public policy objective, we believe there are better ways than a voluntary plan to reach those objectives. An optional supplement would significantly increase coverage, only if Canadians are auto-enrolled with opting-out. This would be difficult to do within the CPP. Such a supplement may be in addition to a mandatory increase in C/QPP, but we would expect that fewer Canadians would make voluntary contributions if mandatory contributions are increased.

Adding flexibility should not be the main objective. Canadians already have a large number of choices for retirement savings available to them, and are struggling with how to make those choices.

We believe that Canadians are looking for a lower cost option for individual savings. Such a supplement would compete with existing savings arrangements, in particular RRSPs. There will be questions as to the impact on the private sector by an increased government role through a DC supplement.

Canadians may choose to contribute to this supplement instead of an RRSP because of

- Ease of contributions through payroll deductions or through tax returns;
- Lower fees through the supplement rather than with some RRSPs. However, it is acknowledged that RRSPs can be managed efficiently with low fees;
- Easier conversion of capital into income at retirement, especially if there is a well-designed default option; and
- Possible indexation of income after retirement.

How many will contribute to the supplement?

How many Canadians will elect to contribute to this supplement rather than RRSPs is uncertain. The pros and cons of this supplement versus RRSP contributions will be compared, and the choice will be affected, among other things, by the fees charged, and locking-in requirements. In the absence of government subsidies, these fees should properly reflect the cost of developing and maintaining the administrative system supporting the supplement, but these costs are not known at this time.

The government will need to decide about the communication/education and promotional aspects of the supplement. In particular, whether this would be an option available to Canadians who will have to decide by themselves if the supplement is more attractive than current available options, or whether assistance should be available to Canadians in making the choice and other decisions related to the supplement.

Any locking-in requirements will significantly affect the choice between RRSP contributions and the CPP supplement. Some would prefer RRSP contributions that are not locked-in. The issue of whether registered contributions should be subject to locking-in requirements is controversial, and there is no consensus among actuaries. Some argue that Canadians should be able to make decisions on how to use retirement capital according to their own preferences. Others argue that the goal of offering a public plan or tax assistance should focus on ensuring life income after retirement, and on reducing the number of poor retirees. However, it will be important to allow the transfer of the account in the supplement to a private savings arrangement, subject to any applicable locking-in requirements.

How to use the accumulated capital in the supplement at retirement?

Those contributing to this supplement should be able to elect to convert the capital accumulated into an annuity. It is acknowledged that the option of the conversion into an annuity will introduce risks, i.e., the price charged to those electing this option will have to be based on assumptions about future returns and mortality that may not be realized. However, we believe that the offer of the conversion into an annuity would correspond to the needs of some Canadians at retirement, especially if indexed annuity options are offered, and that this will justify the risk introduced. This option should be designed so that the risk can be assumed; this would include a separate fund backing these annuities, conditional indexing, and a policy on the treatment of experience gains and losses. Conversion should be done without cross subsidies of cost, i.e. at a price that corresponds to market annuity prices. There should be limited annuity conversion options, in connection with indexation and spousal protection. The indexation formula could be made conditional upon the returns of the fund. A RRIF/LIF type of option could be considered.

In addition to the option of converting into an annuity, contributors could elect a cash-out, a transfer to an RRSP, or to keep the account within the supplement. This would be a difficult decision for contributors who will struggle to find assistance on how to use the accumulated funds at retirement. It would be appropriate to establish a rule that if a decision has not been made by a certain age, for example age 70, the presumption will be conversion into an annuity.

Other issues

Canadians may be interested in transferring accumulated assets in their RRSPs into the supplement, especially if the fees are low and the expected net returns are higher, either or both being because of the access to alternative investment strategies. This may have undesirable effects on current private savings arrangements where it is possible to have access to low fees, and it will be difficult to predict how many Canadians will elect such a transfer. On the other hand, an initial transfer will result in a faster amortization of implementation expenses.

The government will have to decide whether employers should be involved in the collection of employee voluntary contributions. The burden transferred to employers should be assessed carefully, particularly pertaining to tax reporting and to those who want to change their contributions frequently. If such a burden is significant, employers should not be involved. Collection of contributions could be done on-line, through financial institutions or through income tax returns.

It would be important to keep this supplement as simple as possible:

- Only one investment option, which could be a target date fund linked to the date of birth;
- Limited choices at retirement (i.e., cash, transfer to RRSP, annuity conversion);
- Contributions collected through the CPP system or tax return, or direct remission; and
- No spousal RRSPs, access to loans for home purchases, etc.

These restrictions will keep fees low. There will be Canadians who would prefer additional flexibility, but this should be left to the private sector.

This supplement should be managed at arm's-length from the government and the current CPP. There should be an independent and separate board responsible for its operations. In particular, this board should select how assets should be managed, including whether the current manager of CPP should be retained (and whether there is a risk of too much capital concentrated with the current manager of CPP), and should decide on issues such as the returns to be credited on accounts, the price of conversion options at retirement, and on any conditional indexing.

The board will also have to decide whether the fund should invest in alternative and illiquid assets. It will be a challenge to recognize frequently the market value of these assets, and to credit the returns earned to individual DC accounts.

Conclusion

Whether this supplement should be added to the system depends on the number of Canadians who would elect to make those voluntary contributions; this is difficult to estimate, and will depend on the following:

- The fees charged for this supplement;
- The method of collecting contributions;
- The locking-in requirements, if any;
- The option of converting capital into income at retirement;
- How the supplement will be promoted;
- Ability of providers of RRSPs to meet the needs of Canadians;
- Expected higher gross returns because of access to investment vehicles not normally available to individuals; and
- The tax treatment of contributions (deductibility vs. tax credit).

We are not convinced that a voluntary DC supplement will significantly increase contributions to retirement savings, especially if additional new plans such as the Ontario Retirement Pension Plan are introduced. We encourage the federal and provincial governments to work together to seek co-ordinated solutions to Canada's retirement challenges.

Sincerely,

Rob Stapleford
President

Appendix

Answers to the Consultation Questions

1. **Do you believe a voluntary supplement to the CPP should be an option for Canadians to save for retirement? Is this something you would use to increase your retirement savings?**

   Whether a sufficient number of Canadians will elect the option is difficult to estimate, as it depends on the design of the supplement, the promotion of the option, and the ability of providers of RRSPs to improve this offering. Only when the design issues are addressed (see #2), will it be possible to assess whether the number of Canadians who would elect this option, either in lieu of or in addition to RRSPs, will justify the cost of the supplement.

   A voluntary supplement is not likely to change savings habits, as Canadians already have a wide range of retirement savings vehicles. The supplement may be more efficient than current vehicles, and some may prefer the supplement.

2. **How could a voluntary supplement to the CPP be designed to facilitate participation of individuals who may be at risk of undersaving for their retirement?**

   A successful supplement would encourage participation of individuals if

   - Contributions are easily collected;
   - Fees are lower than some RRSPs;
   - The cost of building the system is reasonable;
   - Capital can be converted into income;
   - Managed target date funds are used; and
   - Access to investment funds is not otherwise available.

   It is doubtful that Canadians will increase their savings as a result of this supplement unless it includes an auto-enrollment process.

3. **How much flexibility should there be for individuals who choose to participate? For example, what are your views on locking-in funds for retirement and providing variability in the contribution rates?**

   Canadians should be allowed to elect how much to contribute within tax limits. Various ways of collecting contributions including payroll deductions, through financial institutions and the tax return should be analyzed. There is no consensus among actuaries on whether the funds should be locked-in.

4. **How could a voluntary supplement to the CPP be designed to provide a secure stream of retirement income?**

   Those accumulating assets through the supplement should have access to limited options of conversion of capital into income at retirement, including annuities or RRIFs purchased from life insurance companies, and to features such as conditional indexing and spousal protection. There will need to be a segregated fund with its own investment policy.

5. **What retirement income options should be available upon retirement for savings accrued within a voluntary supplement to the CPP?**

   The options should include

   - Transfer into RRSP, subject to any locking-in requirements;
   - Cash-out if not subject to locking-in requirements; and
   - Limited choice of conversion into annuity or RRIF/LIF type option.

6. **Should transfers between a voluntary supplement to the CPP and other retirement savings vehicles be permitted? If yes, should there be any limits?**

   Canadians should be able to transfer assets from the supplement into RRSPs subject to locking-in requirements. Any decision on whether transfers from RRSPs to the supplement will be allowed would need to be based on a thorough analysis of advantages and disadvantages, and the impact on existing forms of retirement savings.

7. **While employers would not be required to contribute, what would be the appropriate role for employers?**

   Employers could collect contributions through payroll deductions, subject to an analysis of the burden imposed on them.

8. **Who should be responsible for investing the contributions made to a voluntary supplement to the CPP?**

   A separate and independent board; such a board should be responsible for the operations of the supplement and the investments. Investment options should be limited to a target date fund based on the date of birth of the participant.