Submission

Consultation on the Québec Pension Plan

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Canadian Institute of Actuaries

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Introduction

The CIA's position on the expansion of public pension plans was released last spring and called on policymakers to seize the opportunity to conclude, in 2016, the debate on the expansion of public plans and implement a national solution in the near future with all provinces, including Ontario, which had proposed its own plan.

The CIA also recommended that such expansions

- Target those who do not save enough, i.e., the middle-income group, acknowledging that low-income earners are adequately covered; and
- Be modest enough to leave room for individual responsibility and thus meet a wide variety of needs.

In particular, the key design elements for a possible increase of C/QPP benefits suggested by the CIA included the following:

- Benefit formula and covered earnings: Set a 15 percent pension target after a full career, based on indexed average earnings above a minimum earnings threshold. Set the minimum covered earnings at 50 percent of the year's maximum pensionable earnings (YMPE) and the maximum covered earnings at 150 percent of the YMPE.
- Contributions: Set equal employee and employer contributions and consider staggered contribution rates based on age to minimize generational transfers.
- Benefit features: Fully fund those new benefits by providing gradual pension accruals, and adjust indexing if necessary so that this new plan remains self-sufficient.
- Administration: Use the existing C/QPP structures for collecting contributions, for administering benefits, and for investment functions.
- Retirement age: Address the issue of retirement age before the effective implementation date of any C/QPP expansion. Continue to let Canadians choose the date at which the retirement pension is payable.

Context

The government's proposal recognizes that the Québec pension system is performing well, but refers to measures that may indicate that Québec residents are not saving enough for retirement (especially those who are not covered by a workplace pension plan). The number of people who currently do not save may not be a good indicator of the situation at retirement, in that many people simply choose to save later or to retire later. We believe that the behaviour of Québec residents will change and that they may be up to the challenge of the supposed insufficiency in savings.

However, it must be acknowledged that the system is having difficulty effectively meeting certain retirement needs of Québec residents, in particular for those relying on individual savings (RRSP), and those participating in defined contribution plans when they must convert their assets at retirement into retirement income. Many are also concerned about whether Québec residents have a good understanding of the fees on individual savings. The CIA would be pleased to suggest possible measures to address those deficiencies.

We have also conveyed our concerns on the effect of the Guaranteed Income Supplement (GIS), which deters many from saving for their retirement because of the clawback rate.

CIA's Comments on the CPP and Québec Scenarios

We have analyzed in detail the consultation and support documents, including the high-quality *Observations on Retirement in Québec* and provide the following comments.

CPP Scenario

We acknowledge the agreement between the federal government and the other provinces, which is consistent with a number of our suggestions and proposes a roundabout way to compensate low-income earners' contributions through the federal government's working income tax benefit (WITB).

The CPP scenario has the advantages of uniformity with the other provinces, of increasing benefits for middle-income earners in line with our previous proposal, and of being a reasonable compromise; namely, a modest increase while having a significant impact on savings. This approach however has several weaknesses:

- The WITB will be paid before retirement to some people who will not be receiving the GIS after retirement, while the opposite is also true (i.e., some people will not receive the WITB before retirement but will receive GIS after retirement);
- This benefit will be paid in the near to medium term and could change a number of times before the GIS is paid in the long term;
- The amount of tax benefits is still not known and will likely be complicated to apply as a direct offset for the CPP changes;
- The disincentive effect of the GIS on retirement savings remains;
- Some low-income earners will receive a retirement pension that will generate very high total retirement income in relation to their employment income, and many low-income earners may prefer not contributing for retirement, but consume more of their earnings before retirement; and
- Many low-income earners would be better off to contribute to a tax-free savings account (TFSA).

Québec Scenario

The Québec proposal is well targeted (i.e., at those in the middle class), acknowledges low-income earners are adequately covered, and takes into account the gap between Québec and other provinces on payroll taxes. However, the Québec proposal has a number of weaknesses:

- The lack of uniformity with the other provinces.
- The differences between Québec and the other provinces will give rise to complications for those who have part of their career outside Québec and for national employers. Although those complications can be managed, they are unwelcome.
- The impact on the middle class is far less than with the federal proposal, given that the pension credits are proposed to increase by the same 8.3 percent but only on earnings above half the YMPE. One has to wonder whether it is worthwhile to implement a major reform, whose cost is only 1 percent (i.e., 0.5 percent for employees and 0.5 percent for employers) for a salary equal to YMPE.
- We recognize the merits of proposing an exemption for the GIS. We note that it may encourage savings for low-income earners. However, we believe that this exemption, like the tax benefit, should be uniform across Canada. We expect that there might be significant difficulties in convincing the federal government to implement the proposed GIS changes, as well as other difficulties in implementing a new provincial program to accomplish this.

The Québec consultation document also touches on a number of other questions:

- The difference between the Québec Pension Plan (QPP) and Canada Pension Plan (CPP) contributions: This gap results from several factors, including the effect of the Québec population aging more rapidly than the rest of Canada (ROC). Various factors will have an impact on this gap, such as different birth rates, employment rates, or longevity. If CPP and QPP benefits and conditions are to remain almost identical, we must accept some difference in contribution rates.
- The gap in payroll taxes for Québec vs. the rest of Canada: The effect on employment is beyond our purview. But we are concerned that the additional contribution required for the funding of the proposed benefit improvements (which is retirement savings) are amalgamated with payroll taxes, and consequently treated by employers as current expenditures. Contributions for a retirement program are not expenses but are instead savings that serve to postpone consumption to a future date.
- Employers' capacity to absorb an increase in contributions: This relatively modest increase would be phased in over the next seven or eight years. It seems to us that employers will have enough time to adjust, including by reviewing pension plan costs and other elements of employee compensation.
- The reduction in employer plan benefits: There is reason to expect employers who have a workplace pension plan or savings plan to analyze the merits of scaling back their plans to reflect the improvements to the public plan. This analysis will take into account the amount of the additional contribution and additional pension of the public plan. It seems to us that

this contribution, according to the Québec proposal, could be so low that some employers may choose to ignore it.

- The risk of an increase in the contribution to the QPP: The actuarial valuation shows a contribution in excess of 10.8 percent, while illustrating the risk associated with certain assumptions (e.g., the return on risky investments). We agree that this should be a concern.

Answers to Summary Questions

With regard to adapting the Plan to its socio-economic and demographic environment:

- ***Given the current system of financial security in retirement and the changes it will undergo, are you in favour of maintaining the status quo or of improving retirement income for young workers?***

  The CIA is in favour of improving public pension plans, consistent with our position published in spring 2016 and given that the federal government and all other provinces have decided to apply enhancements to the CPP.

- ***If the enhancement of the system of financial security at retirement were favoured, what would be the optimal approach for increasing the retirement income of future generations and the approach to adopt with regard to the different income categories?***

  The CIA would have preferred that the federal or Québec proposals for expansion of public pension plans would be more in line with our earlier position. Both proposals have weaknesses. The federal proposal is not well targeted and relies on a complicated tax adjustment. The Québec proposal will not change retirement income significantly and includes some uncertainty about the proposed GIS adjustment.

  However, if the Québec government were open to changes to the Québec scenario, the CIA would recommend doubling the 8.3 percent rate and applying it to earnings above half YMPE, with contributions being increased accordingly. Such a modification would make the Québec option equivalent to the CPP approach for those earning the average wage and would be a lot closer to the 2016 CIA position.

  If the CIA were asked to choose between the federal and the Québec proposals, the CIA would prefer the federal one because the Québec proposal will not make a significant difference to middle-income earners.

- ***Are you in favour of the proposed changes to QPP disability benefits?***

  We agree with what is presented in the proposal.

- ***Are you in favour of the proposed changes to QPP survivors' benefits?***

  We agree with what is presented in the proposal because it brings the QPP more in line with CPP provisions and reflects demographic changes.

- ***Are you in favour of an increase in the minimum age of eligibility for early retirement pensions under the QPP as a solution to the demographic and socio-economic challenges and with the objective of strengthening the Plan's sustainability?***

  Québec residents should have the flexibility of choosing the date on which they begin receiving their retirement pension. We acknowledge the high percentage who opt to receive their retirement pension from age 60; some could be making a poor choice, depending on where they obtain information. Then again, individual choices must be respected. We would prefer if Retraite Québec communicated more clearly the dangers of burning through one's retirement savings too early. Unless there is evidence that Québec residents are making a poor choice, we would support no increase in the minimum age.

- ***Do you have other suggestions on how to adapt the QPP's various pensions and benefits?***

  The maximum age for deferring a pension should be increased to, say, 75, thus allowing better management of longevity risk. Such a change would reflect to a certain extent recommendations made in the D'Amours report and would help Québec workers who rely more and more on defined contribution (DC)-type plans to manage their longevity and investment risks. In addition, it may be appropriate to revise, now and in the future, the adjustment factors used to calculate the pensions that begin to be paid before or after age 65, so that the adjustment reflects an equivalent value based on updated factors such as improved longevity.

With regard to ensuring a stable, sustainable rate of contribution to the Plan:

- ***Are you in favour of full funding of improvements to the QPP, as is the case for the CPP?***

  We support the principle whereby future improvements must be fully funded; however, there are different ways of defining such an objective, which is not as clear as it may sound to many people.

  Defining full funding is a critical step in the establishment of the funding policy and there are many options possible. We propose that Retraite Québec's actuaries present different options on the definition of full funding to policymakers. For example, it is not clear how the proposal contained in the document to spread the cost of past service improvements over 15 years may be consistent with a definition of full funding. The CIA would be happy to comment on this.

- ***Are you in favour of introducing a longevity factor for the QPP?***

  We note the difficulty of making assumptions in connection with future increases in longevity, but we do not believe that this assumption should be treated differently than other assumptions.

  We also note that the contribution rate is estimated on the basis of expected future longevity improvements for the current generation of workers. Eventually, the contribution rate will have to be revised (up or down) to reflect whether future generations of workers may live longer or not than expected.

It is not clear to us why the longevity factor is being proposed.

1) If it is to reduce the cost of QPP because such a cost is deemed to be too high and/or to be more in line with the cost of CPP, then this is not for us to judge as this decision should be made by policymakers.

2) If it is to control cost if the increase in longevity is greater than expected, then we think the following:

   There could be some merit in a pension reduction if the increase in longevity is greater than expected in calculating the contribution rate. We also understand that the effect of any assumption that is not met could affect either the contribution rate or the future indexation rates after retirement, which would serve to absorb the effect of greater longevity. Care must be taken in deciding whether to treat the longevity risk similarly to or differently from other risks. Since the illustration on the longevity factor shows a very small impact (e.g., a difference of 1.1 percent for those retiring in 2030 vs. 2025), it may be more appropriate to reflect it through measures mentioned in our answer to the last question below, namely adjusted indexation and adjustment to contribution rates.

   If increases in longevity are treated as actuarial gains or losses and are to be part of the cost adjustment measures of the plan, better and simpler approaches could be used. Cost control measures could include increasing the eligibility age for retirement and applying conditions on indexation of benefits. Longevity risk is directly linked to the duration of benefits and contributory periods. We reiterate that longevity risk can be managed through adjustments and benefits rather than increases to contribution rates (see the answer provided to the last question below on contribution rates).

3) If it is to reflect the increase in life expectancy, then we think the following:

   If this adjustment is an introduction to the concept of adjusting retirement benefits as life expectancy rises, we agree that such a change could be used to mitigate or nullify the impact of cost increase factors on future contribution rates. Many would argue that recent and future increases in longevity justify raising the normal retirement age, a measure that has been adopted by many countries in the developed world. We note that such a change would have significant implications, including the impact on other social programs, private plans, and the age at which workers will retire. We encourage governments to study soon the possibility of raising the age 65 criterion and how to smoothly implement such a fundamental change. It will be easier for governments to make such change acceptable to the population, and to implement and communicate it, if it is based on a thorough and solid analysis of its implications. The CIA is open to assist Canadian governments in such an important task.

- ***Are you in favour of indexing current pensions to inflation in Québec?***

  We recognize that if Québec pensions were indexed to inflation in Québec, it would match up better with the wage increase affecting the plan's sustainability. Although Québec inflation has lagged behind Canada's in recent years, this does not mean that it will in the future. Moreover, Québec pensioners receive federal benefits indexed to Canadian inflation, and the reason for a different form of indexation would have to be explained. Slight advantages of Québec indexation do not seem to warrant this change.

- ***Do you have other suggestions on how to ensure the stability of QPP contribution rates?***

  We support an automatic adjustment mechanism if there is a cost increase. We note that the federal government has approved such a mechanism, which shares responsibility between contributors and pensioners. Given the fact that the pensioner burden is heavy for the QPP, that contributions are high, and that the risk of a cost increase is also high, taking into account an adjustment in pension indexing would give more flexibility to those who will decide. We believe that pensioners should assume part of the risk of a variation in the contribution rate. It should be noted that adjustments such as a reduction in contribution rates or catch-up for past indexation can also be made pursuant to favourable plan conditions and experience.

Conclusion

Although we would have preferred that the proposed measures were more in line with our spring 2016 position, we support an expansion of the QPP and have presented our views on these measures above.

The CIA encourages the government to conclude the debate on the expansion of public pensions and would be pleased to provide assistance with any future development in the enhancement of the QPP.