Intelligence MEMOS

From: Bob Baldwin

To: Canada's Pension Regulators

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Re: **LEARNING FROM CPP VALUATION REPORTS**

When it comes to Canada's retirement income system, the Canada Pension Plan is the elephant in the room.

At the provincial and federal level, debates are active on issues such as the adequacy of CPP benefits, the eligibility age for CPP retirement benefits, the distributional impact of CPP benefits and the rate at which benefits are being phased in.

The political stewards of the CPP should add another issue to the agenda: the financial sustainability of the plan under various risk scenarios. As I outline in my recent C.D. Howe Institute **Commentary**, I have deep-seated concerns that the risks involved in managing the CPP are poorly understood. If unanticipated negative risks materialize, the Plan will be subject to significant political as well as economic risks.

The best place to look for evidence of risks are the valuation reports prepared by the Office of the Chief Actuary (OCA) that serve as working documents for the federal, provincial and territorial ministers of finance who exercise CPP stewardship responsibilities. Every three years, these Actuarial Valuation Reports (AVRs) assess the long-term adequacy of the legislated contribution rate to the CPP, based on best-estimate assumptions about the future.

They also provide estimates based on alternative plausible assumptions that provide an insight into the range of possible financial futures for the CPP. Importantly, they also estimate the minimum-contribution rate required from employees and the employers to keep the Plan in good health.

Trouble arises if this minimum-contribution rate goes higher than the legislated rate.

My findings about the implications of these valuation reports, past and present, focused on the 30th AVR, the latest, issued in December 2019.

- On best estimate assumptions, the minimum contribution rate is very close to the legislated rate and exceeds it with variations in most assumptions.
- Over both short and longer term futures, investment returns falling short of best estimate assumptions involve the greatest risk of causing the minimum rate to exceed the legislated rate.
- CPP history provides interesting examples of the long-term future appearing quite different today than when the Plan was established. Fertility, mortality and wage growth provide examples. The valuation reports reviewed imply the need for regular CPP adjustments as does the actual history of the Plan. The legislation that governs the CPP is highly detailed, and the need to change the detail through legislation can limit the ability to adapt quickly.

The legislation should be reviewed to determine what aspects could be moved safely to regulations while maintaining the Plan's joint federal-provincial character. Canada's retirement income system has a number of component parts that interact with each other – sometimes in ways that are complementary and sometimes not. They are also subject to a variety of demographic, labour market, financial and economic influences. There is a need to understand what happens to the whole system in the face of varying circumstances.

Meanwhile, the sustainability of the entire retirement income system depends on managerial technical competence and a sense among stakeholders that the plans are fair and provide reasonable incomes at a reasonable cost. I have deep-seated concerns that the risks involved in managing the CPP are poorly understood. If unanticipated negative risks materialize, the Plan will be subject to significant political as well as economic risks.

A significant outreach effort is needed to enhance public understanding of our retirement income system. This means more than putting information on a website. Direct engagement with stakeholder groups is required. The OCA can make an important contribution to this process.

Bob Baldwin has worked for more than 40 years in various pension management and research roles. He is a former chair of the Canada Pension Plan Advisory Board.

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