Intelligence MEMOS

From: Bill Robson

To: Retirement savers, employers and pension plan administrators

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Re: **THE FINANCE MINISTERS' STATEMENT ON CPP EXPANSION**

That federal and provincial finance ministers announced agreement in principle to expand the Canada Pension Plan (CPP) at their 20 June 2016 meeting is no surprise. The prospect of a separate Ontario Retirement Pension Plan (ORPP) created a sense of urgency – and while some may privately have felt that Ontario should be allowed to create a mess, and deal with the embarrassing consequences, forestalling it with a bigger CPP clearly won the day.

Some elements of the proposed expansion are also not a surprise. While the existence of a serious retirement saving gap in Canada is a matter of debate – see Malcolm Hamilton, Keith Ambachtsheer, and Alex Laurin, Kevin Moore and myself for various takes on that – improvident people earning more than the CPP's current maximum are most frequently cited as heading for trouble, so raising the maximum was likely to figure in the package. The announcement that at least contributions on the higher incomes will be tax deductible was a bit of a surprise – but a happy one.

Also predictable was the long phase-in. Such reforms are easier with more time to adapt. Concerns that higher payroll levies will kill jobs are widespread; also important, especially among the public-sector employers and unions whose voices are always loud in these discussions, is the need to adjust pension plans whose contributions and benefits are integrated with those of the CPP.

What about financing the package – what investment returns will let the CPP pay those higher benefits from a contribution hike reported to be 2 percent of (soon to be higher) covered earnings? The ministers surely consulted a spreadsheet. Recent projections for the CPP show it needs real returns of about 4 percent, and the ORPP appears to have rested on a similar assumption. That is much higher than the returns now available on sovereign-grade assets. Sadly, however, since nearly everybody likes low contributions and high benefits, an aggressive assumption about returns will be no surprise either.

But there's one big disappointment. Many low-income workers will one day be low-income retirees, who will lose most or all of their CPP benefits to clawbacks of the guaranteed income supplement and other seniors' benefits. Yet the announcement envisions replacing a larger share of working income all the way down to the CPP's minimum of $3500 annually – which means it will impose higher contributions that low-income workers can ill afford, for the sake of benefits that low-income retirees will scarcely enjoy. Pension experts, including federal finance minister Bill Morneau, know this approach is wrong. Seeing it in the package is a nasty surprise.

A final peculiar feature of the announcement is the forced deadline – 15 July 2016 – for formal approval. Surely Ontario's threat to proceed to a potential debacle with the ORPP should not rush the country to something so important. If it takes more time to tweak the package to focus on earnings between the current and proposed new maximums, and spare low-income earners unnecessary pain, it will be time well spent.

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