

Information Paper

Proposed Changes to the Canada Pension Plan

Proposed by Federal, Provincial and Territorial Ministers of Finance
Ottawa, May 25, 2009

Purpose

Changes to the Canada Pension Plan (CPP) were recommended by federal, provincial and territorial Ministers of Finance on May 25, 2009, as part of the regular reviews of the Plan that they are required to undertake every three years.

The proposed changes are intended to modernize the Plan to better reflect the many different paths people take to retirement today. When Ministers met to review the Plan three years ago, they agreed to examine whether changes needed to be made to the CPP to reflect this. The proposed changes will provide greater flexibility for older workers to combine pension and work income if they so wish; modestly expand pension coverage; and improve fairness in the Plan's flexible retirement provisions. The proposed package is affordable within the current CPP contribution rate of 9.9% on earnings up to average wages and could improve the long-term sustainability of the Plan. The purpose of this Paper is to explain the proposed changes and their impacts on workers in Canada and employers. The proposed changes will begin to come into force in 2011 following approval by the Parliament of Canada and provincial governments. The majority of the proposed changes will be phased in gradually.

Anyone currently receiving a CPP retirement pension, disability benefits, survivor benefits or combined benefits will not have these benefits affected by the proposed changes. This will also apply to anyone who receives their CPP retirement pension or other CPP benefits prior to the proposed changes taking effect, beginning in 2011. Contribution requirements for some CPP retirement pensioners who work, and their employers, will be affected by the proposed changes.

Background on the CPP

The CPP is a public pension plan that was established in 1966 to provide working Canadians and their families with income for retirement and with basic financial protection against the loss of earnings in the event of death or disability. The Plan operates throughout Canada, except in Quebec, where the Quebec Pension Plan (QPP) provides similar benefits.

The CPP is a federal-provincial-territorial partnership. Both levels of government are joint stewards of the Plan, acting on behalf of current and future beneficiaries. Federal, provincial and territorial Ministers of Finance are required to review the Plan every three years to determine whether changes are needed to CPP benefits or the contribution rate. Changes to the Plan require the approval of the Parliament of Canada as well as the approval of at least two-thirds of the provinces with two-thirds of the population of Canada. Since its inception, the Plan has been an excellent example of successful federal, provincial and territorial co-operation.

The CPP replaces up to 25 percent of pre-retirement employment earnings up to a maximum amount. This maximum amount is a five-year average of the Year's Maximum Pensionable Earnings (YMPE) which increases with average wages. The YMPE is \$46,300 in 2009. The pension amount is based on the number of years a person has worked and contributed to the Plan as well as on the salary or wages they earned. The maximum annual retirement pension amount is \$10,905 in 2009. This secure, lifelong pension is paid monthly and is fully indexed to price inflation.

The CPP is financed through mandatory contributions from virtually all workers and their employers, including the self-employed. The contribution rate is 9.9% of earnings between \$3,500, which is the Year's Basic Exemption and the Year's Maximum Pensionable Earnings (\$46,300 in 2009). The contribution rate is split equally between employees and employers so that the maximum amount paid by employees and employers per year is \$2,118.60 (2009) each. The self-employed pay both the employee and employer share of the contributions (maximum contribution of \$4,237.20 in 2009).

The CPP, together with the QPP, is a key pillar of Canada's Retirement Income System. It has played an important role in improving the incomes of Canadian seniors, those who lose their spouse, and those with severe and prolonged disabilities. Canada's Retirement Income system has been internationally recognized for its adequacy and affordability.

Canada Pension Plan Benefits

Retirement pensions are paid monthly to all Canadians who have contributed to the Plan. The normal age of CPP take-up is 65, but reduced pensions are available starting at age 60. For those who delay take up beyond age 65, pensions are increased up to the age of 70. In 2009, the maximum monthly pension amount payable at age 65 is \$908.75.

Disability benefits are paid to contributors under the age of 65 whose capacity to work is affected by a severe and prolonged mental or physical condition and who have made sufficient contributions to the CPP. In 2009, the maximum monthly disability benefit is \$1,105.99.

Survivors' benefits are paid to a deceased contributor's estate, surviving spouse or common-law partner and dependent children. Benefits include:

- **The death benefit** – a one-time payment of \$2,500 to, or on behalf of, the estate of a deceased Canada Pension Plan contributor;
- **The survivor's pension** – a monthly pension paid to the surviving spouse or common-law partner of a deceased contributor. Maximum monthly benefits in 2009 are \$506.38 for individuals younger than 65 and \$545.25 to those over age 65.
- **The children's benefit** – a monthly benefit for dependent children of a deceased contributor. The monthly benefit in 2009 is \$213.99.

Changes Proposed

I. Improved Flexibility

A). Removal of the Work Cessation Test

The Work Cessation Test requires individuals who apply to take their CPP benefit early, (i.e., before age 65) to either stop work or reduce their earnings. After having stopped work or reducing earnings for at least two months, the individual may return to work and/or earn more. There is currently no Work Cessation Test for those who are 65 or older.

Proposed Change

- To remove the Work Cessation Test in 2012. Individuals would be able to take their benefit as early as age 60 without any work interruption or reduction in hours worked or earnings.

This change would not affect existing CPP beneficiaries or those who take their CPP retirement pension before 2012.

Impact of Change

This change would benefit those who would like to take-up their CPP pension while continuing to work either full or part-time. The change could help individuals to use income from their CPP pension to phase into retirement or supplement their earnings. No reduction in work would be required.

Example

Connie turns 60 years old in 2012. She is a nurse at a hospital and she loves her job. Connie would like to continue working past age 60, but is increasingly finding the long shifts of a full-time job too tiring. With the removal of the Work Cessation Test, she will be able to cut down her work from 40 to 30 hours per week and take her CPP pension. Her combined income from the CPP and the hospital job will therefore remain roughly the same as before.

B). Increase in the General Low Earnings Drop-Out

The CPP retirement pension amount is based on the number of years a person has worked and contributed to the Plan, as well as the salary or wages he or she earned. Specifically, it is calculated as 25 percent of an individual's "average career earnings", starting at age 18 and ending at the age of CPP take-up. If, for example, an individual takes the CPP at age 65, the span of the career is considered to be 47 years. If, for example, the CPP is taken at age 60, the span of the career is 42 years.

The average of earnings over the span of the career is calculated allowing for 15 percent of the years where earnings are low or nil for whatever reason (e.g., full-time post-secondary education attendance or spells of unemployment) to be dropped. This provision is called the "general low earnings drop-out". The 15 percent gives individuals who take their CPP at age 65 almost 7 years of low or zero earnings years that can be dropped from the calculation of their average career earnings. In addition, there are drop-out provisions specifically for child rearing and periods spent receiving a CPP disability benefit.

These drop-out provisions are intended to ensure that an individual's average career earnings are not affected by a certain number of years of unusually low earnings that occur in most people's career for various reasons. Virtually everyone benefits from the CPP's drop-out provisions. Without these provisions, virtually everyone's "basic" pension amounts – that is, the pension amount if the CPP is taken-up at age 65 without any adjustments for early or late take-up – would be lower.

Proposed Change

- To increase the general drop-out:
 - To 16 percent in 2012. This would allow a maximum of almost 7.5 years to be dropped.
 - To 17 percent in 2014. This would allow a maximum of 8 years to be dropped.

This change would not affect existing CPP beneficiaries or those who take their benefit before the change comes into effect.

Impact of Change

This change would benefit virtually all CPP contributors and improve their basic retirement pensions. It would also increase the average CPP disability and survivor pensions, as the calculation of these benefits is based on the retirement benefit calculation.

While the change would increase the average retirement benefit of virtually all contributors, it would be particularly helpful to those whose careers suffer more work interruptions for a variety of reasons. For instance, those who pursue post-secondary studies or other educational opportunities, those who reduce their participation in the labour force to provide care to a family member, or those who immigrate to Canada as adults are all more likely to find this measure especially helpful.

Example

Harriet Keane is a high school teacher. She started university at age 18 and completed two post-secondary degrees over five years, then started teaching immediately and always earned more than "average wages". In her late 40s, she took a two-year leave of absence from work to care for her mother. She plans to take her CPP retirement pension after she turns 60 in 2015. Harriet will be able to drop all her years spent in post-secondary education and caregiving from her pension calculation. Her pension amount will be \$8,359 in 2015, and will increase each year with the cost of living. Without the proposed change, her pension amount in 2015 would have been \$8,202 (growing annually with the cost of living).

II. Improved Pension Coverage – Working Beneficiaries to Participate in the CPP (Mandatory before 65 and voluntary after 65)

Currently, those who receive a CPP pension and return to work (i.e., working beneficiaries) do not pay CPP contributions and, therefore, do not continue to build their CPP pension. Virtually all other workers in Canada are required to pay CPP contributions.

Proposed Change

- To require individuals under the age of 65 who receive a CPP retirement benefit and work, as well as their employers, to make CPP contributions that will increase their CPP retirement benefit. This would be voluntary for individuals aged 65 or over, but employers of those opting to participate in the CPP would be required to also contribute.
 - These contributions will result in increased retirement benefits, including persons already receiving the maximum pension amounts.
 - The additional benefits would be earned at a rate of 1/40th of the maximum pension amount (\$10,905 in 2009) per year of additional contributions. The exact amount of the additional benefit would depend on the earnings level of the contributor. The resulting pension could be above the maximum.

Impact of Change

This change would allow working beneficiaries to continue to build their CPP pension – a secure, inflation-protected, lifetime stream of income. This could particularly help those without a CPP pension close to the maximum amount and/or those without other sources of retirement income that are protected against inflation and financial market volatility.

Example

Jean-Philippe Grignon came to Canada at age 36 and was re-certified as a professional engineer. He started working at age 38. In 2012, he will be 65 years old and plans to take-up his CPP pension but continue working. He would like to continue to increase his CPP pension since, with only 27 years of contributions to the Plan, his pension amount will not be at the maximum. In 2012, he earns \$24,800 and makes a CPP contribution of \$1,054. (His employer also contributes \$1,054.) From that contribution, he will get an additional pension amount in 2013 and every subsequent year.

III. Improved Fairness in the Pension Adjustments for Early and Late CPP Take-Up

The normal age of CPP take-up is age 65. If taken-up at this age, the CPP pension amount is calculated based on the number of years a person has worked and contributed to the Plan, as well as on the salary or wages earned. The CPP's flexible retirement provisions allow take-up of the retirement benefit as early as age 60. As well, take-up of the CPP can be delayed beyond age 65. To ensure that there is fairness in the provisions, regardless of the age that the retirement benefit is taken-up, a second step in the pension calculation makes "actuarial adjustments" to the basic amount that would be provided at age 65. These adjustments are made for pensions taken early (before age 65) and late (after age 65). There are no further adjustments for delaying pension take-up beyond age 70. The adjustments are made in order to take account of the fact that, in the case of early benefit uptake, in comparison with the normal retirement age of 65:

1. Contributions to the CPP have been made for a lower number of years; and
2. CPP benefits will be received over a larger number of years.

The converse is true in the case of CPP uptake after the normal retirement age of 65.

The current adjustments reduce the early pension by 0.5% per month for each month that the pension is taken before an individual's 65th birthday to age 60. Thus, if an individual chooses to take the pension at age 60, the basic amount will be reduced by 30%.

The late pension is increased by 0.5% per month for each month that the pension is taken after age 65 up to the age of 70. Thus, if an individual chooses to take the pension at age 70, the basic amount will be increased by 30%.

These adjustments have been left unchanged since 1987 despite significant shifts in the economic and demographic factors that affect their "actuarially fair" levels. The adjustments of 0.5% per month no longer ensure actuarial fairness.

Proposed Change

- To gradually restore the pension adjustments to their actuarially fair levels.
 - The early pension reduction would be gradually increased to 0.6% per month for each month that the pension is taken before age 65. This would be done over a period of five years, starting in 2012.
 - The late pension augmentation would be gradually increased to 0.7% per month for each month that the pension is taken after an individual's 65th birthday, up to age 70. This would be done over a period of three years, starting in 2011.
- To require regular reporting on the actuarially fair level of the pension adjustments at least every nine years, starting in 2016. Finance Ministers will review these adjustments, based on an assessment by the Chief Actuary of the Plan, and recommend whether changes are needed.

This change would not affect existing CPP retirement beneficiaries or those taking their benefit before these changes begin to take effect.

Impact of Change

This change will improve equity in the flexible retirement provisions of the CPP irrespective of the age that the CPP is taken by ensuring that amounts received by early and late retirees reflect contributions made to the Plan and the average duration of benefits.

Examples

Amrita Caceres will be turning 65 in 2014. She enjoys her job as a nutritionist, but plans to retire at age 65. From her CPP statement, she is expecting that her CPP benefit will be \$6,220 in 2014. This amount will then grow with the cost of living.

If she works for another year and delays taking her CPP pension until 2015 when she is 66, her basic pension amount of \$6,410 in 2015 will be increased by 8.4% (rather than 6% without the proposed change). Thus, the annual amount of her pension will start at \$6,948 and will grow with the cost of living.

If Amrita's basic pension amount were at the CPP maximum of \$12,820 in 2015, her increase of 8.4% would put her pension at \$13,897 to grow with the cost of living.

Impacts on CPP Finances and Sustainability

The proposed package of changes is affordable within the current CPP contribution rate of 9.9%. Further, the proposed package is expected to improve the long-term financial sustainability of the CPP.

The Chief Actuary of the CPP is required to assess the long-term financial implications of any changes proposed to the CPP in a Bill tabled by the Government in Parliament if, in his view, the changes materially impact the Plan. Should these proposed changes be tabled in Parliament, the Chief Actuary will be required to make this assessment and table a report on the financial impacts of the changes in Parliament.

Questions or comments regarding the proposed changes outlined in this Paper can be provided by e-mail to CPP2009@fin.gc.ca or addressed to:

CPP Proposed Changes 2009

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The deadline for comments is July 31st, 2009.

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