

Assessing Pension Reform Options

Institute for Research on Public Policy

May 4, 2010

Keith Horner

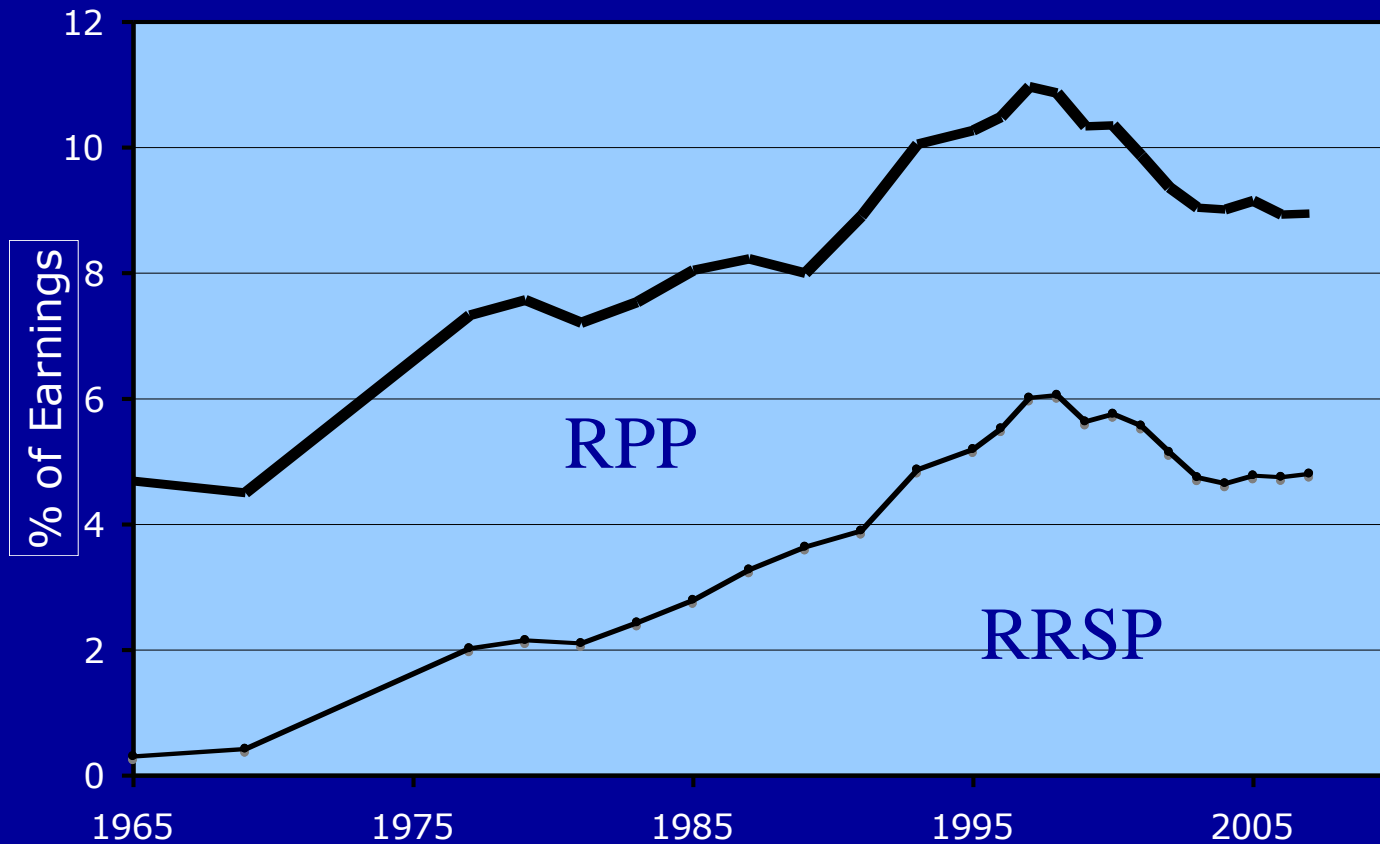
Outline

- The case for reform
- Future effects of TFSAs
- Three reform options
- Assessment
- Possible reform package

The case for reform

- 25% - 30% of modest/middle earners not saving enough
- Pension coverage declining
- RRSP savings rate down
- Low investment returns in retail plans
- Increasing need for savings

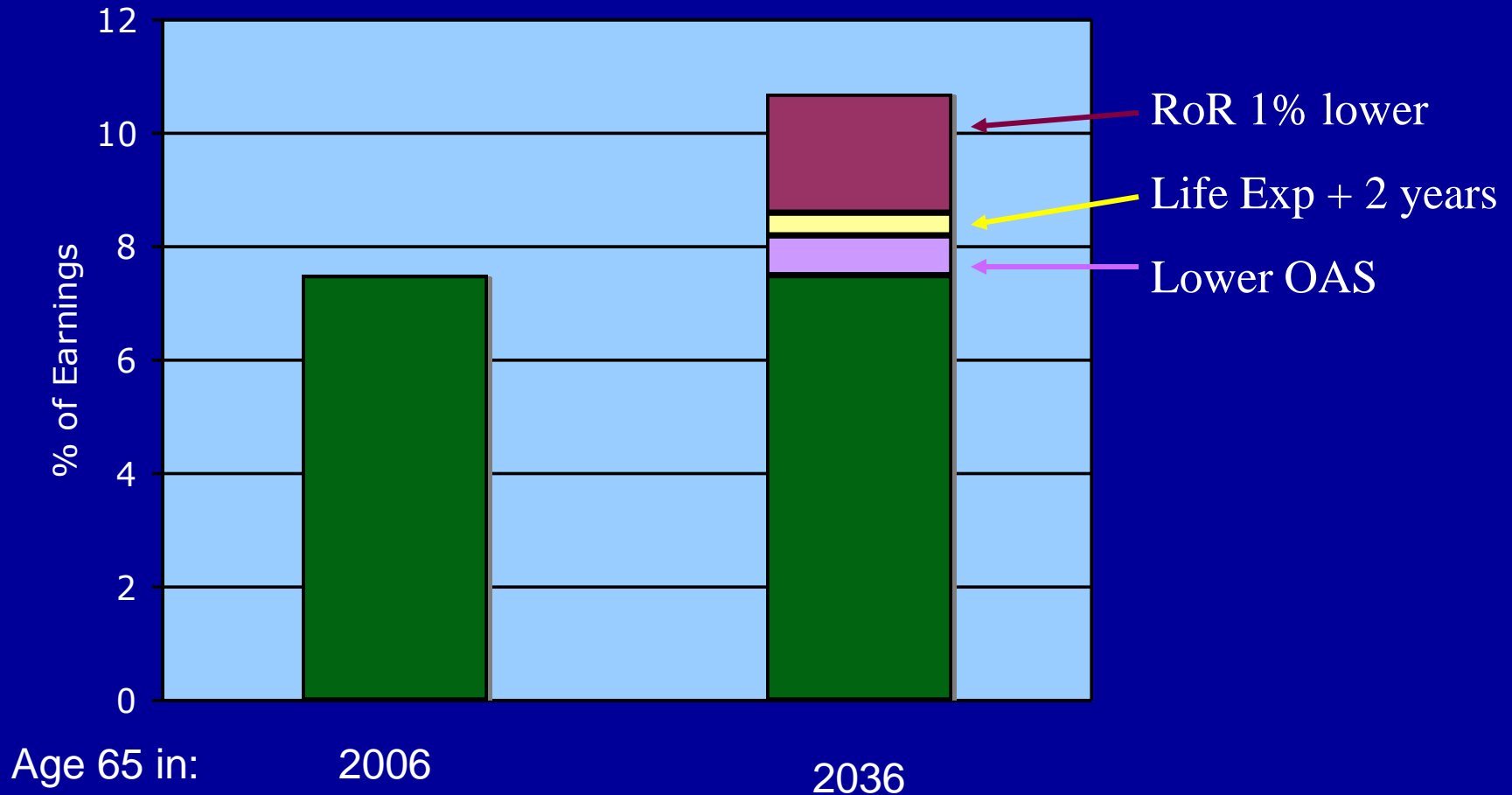
RPP + RRSP savings rates



Note: RPP saving represented by PA amounts since 1993

Increasing need for savings

Single homeowner, Earnings = \$40,000

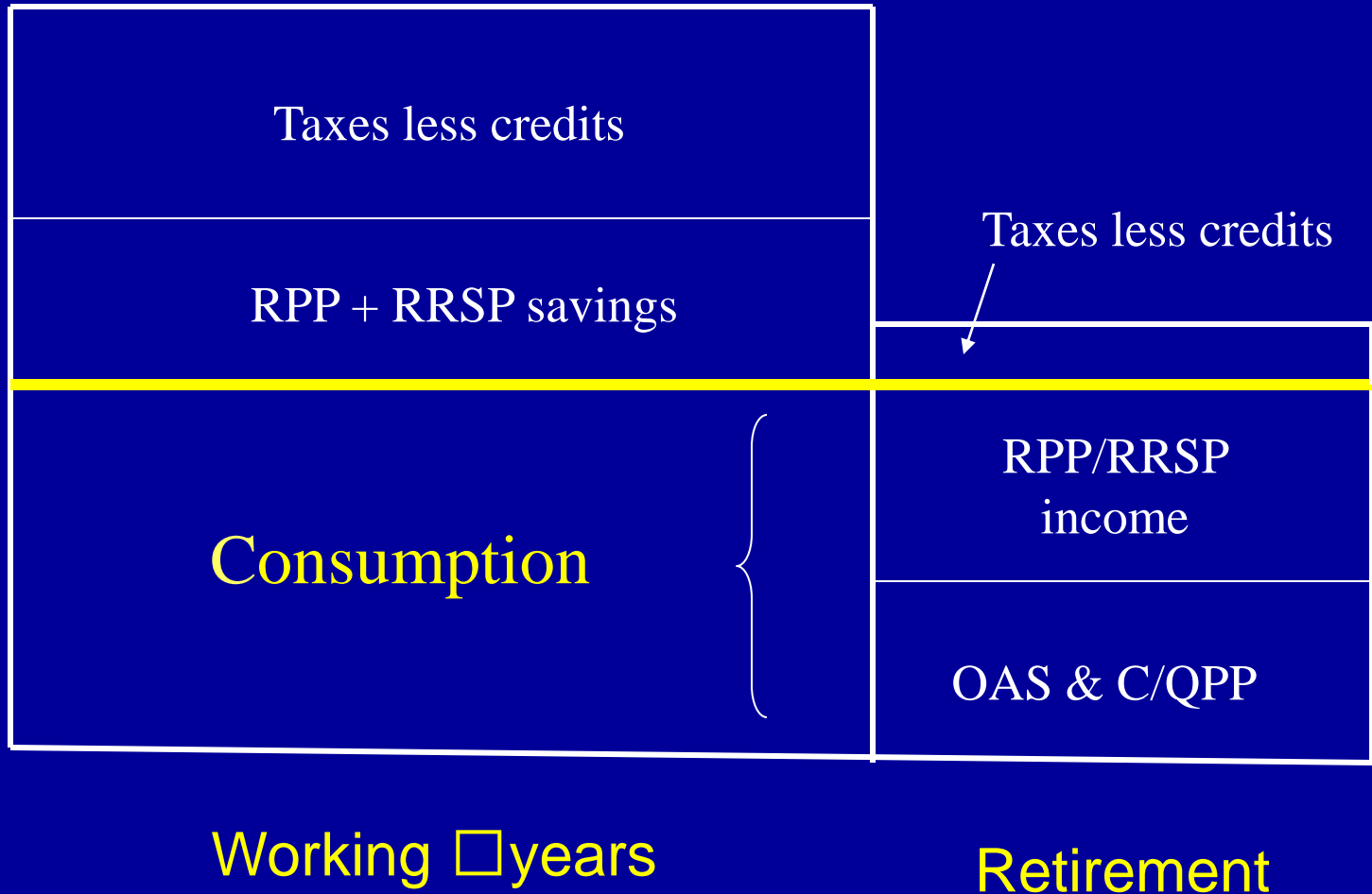


At earnings = \$80,000, rate increases from 12.7% to 17.0%

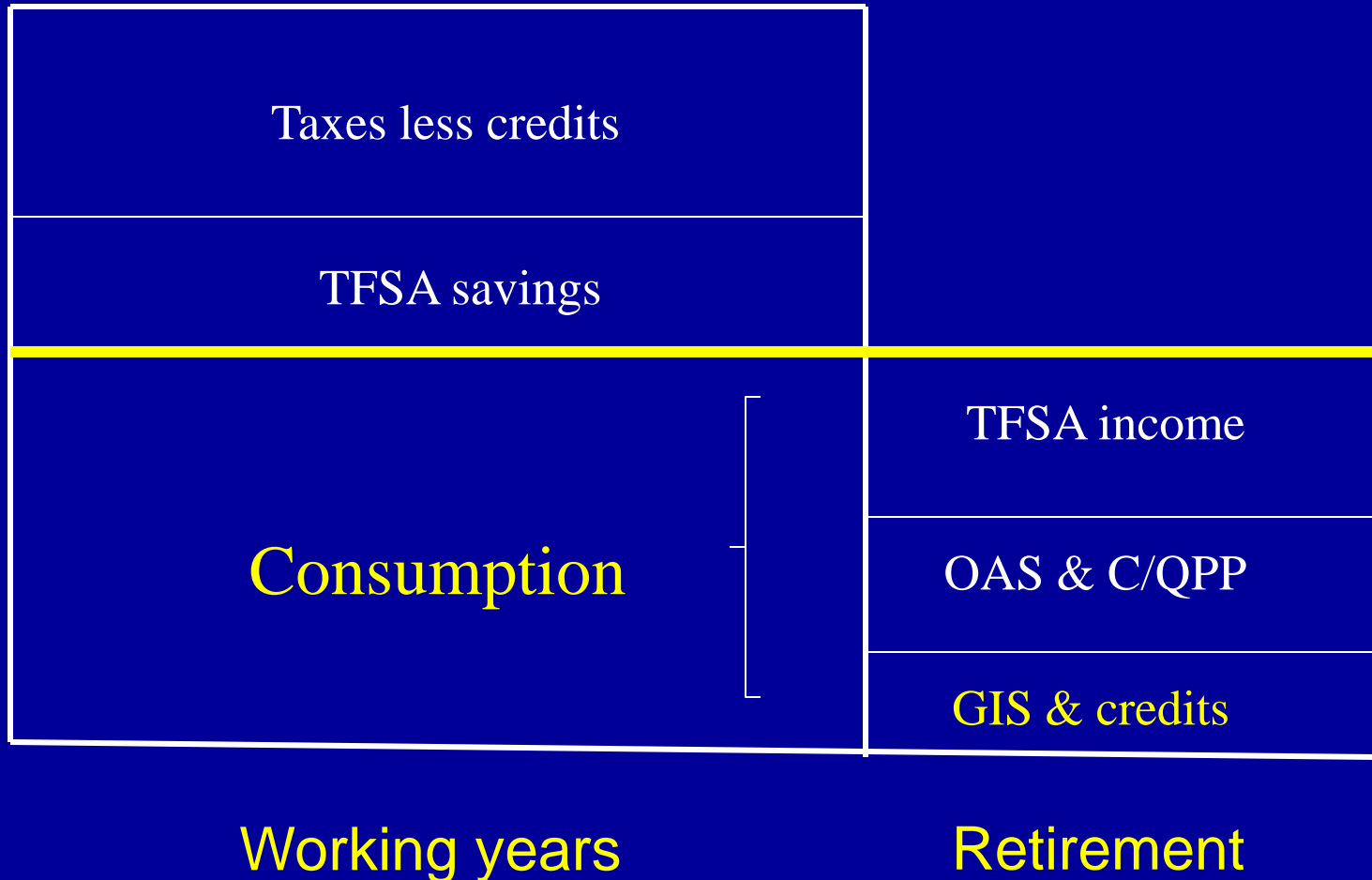
TFSA effects

- TFSAAs
 - No deduction, benefits tax-free
 - Benefits fully excluded from income in determining eligibility for GIS and refundable credits
- Results based on lifecycle model that predicts who should use TFSAAs
- 4.7 million taxpayers contributed \$15.8 B in first year

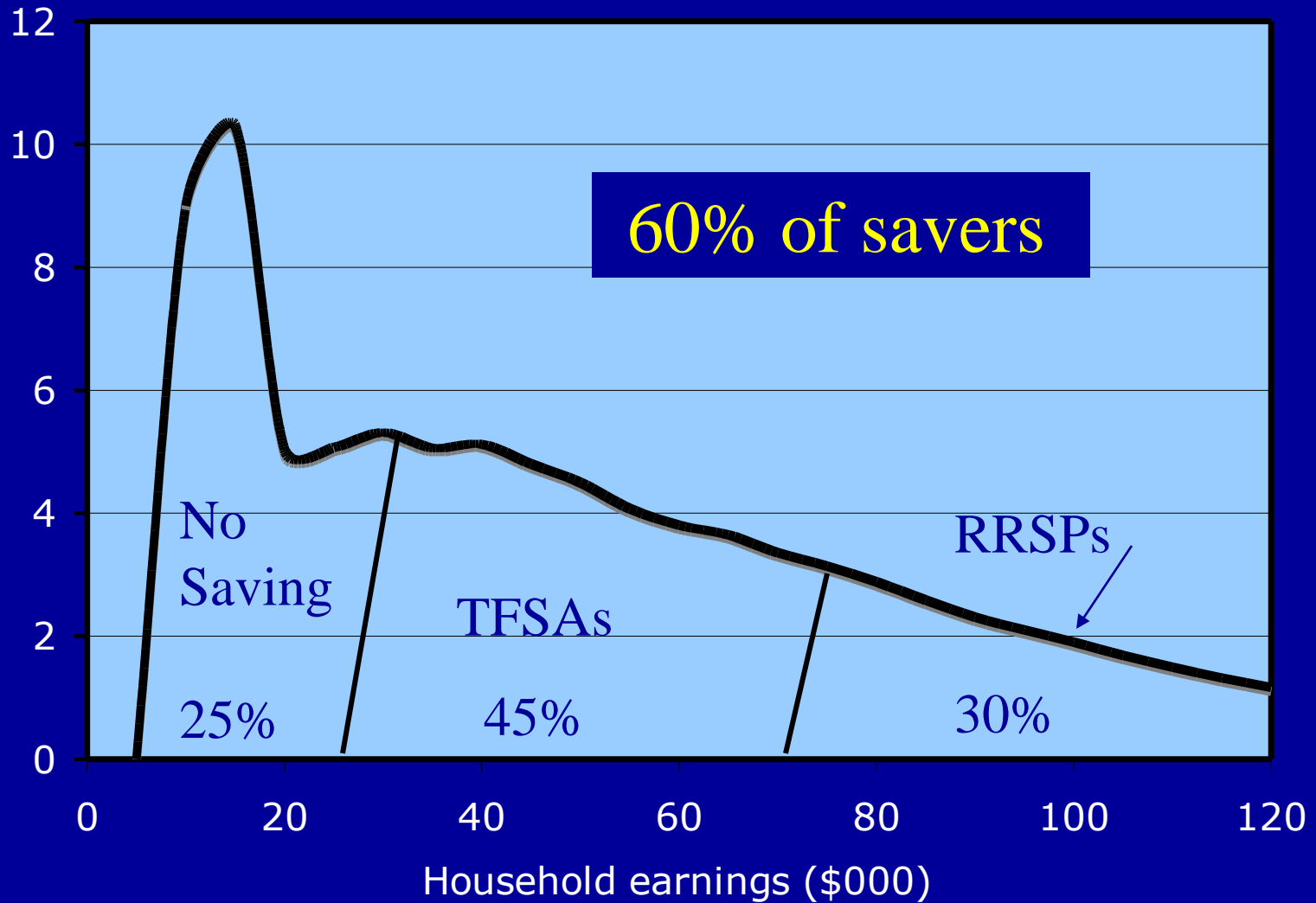
Consumption replacement in retirement



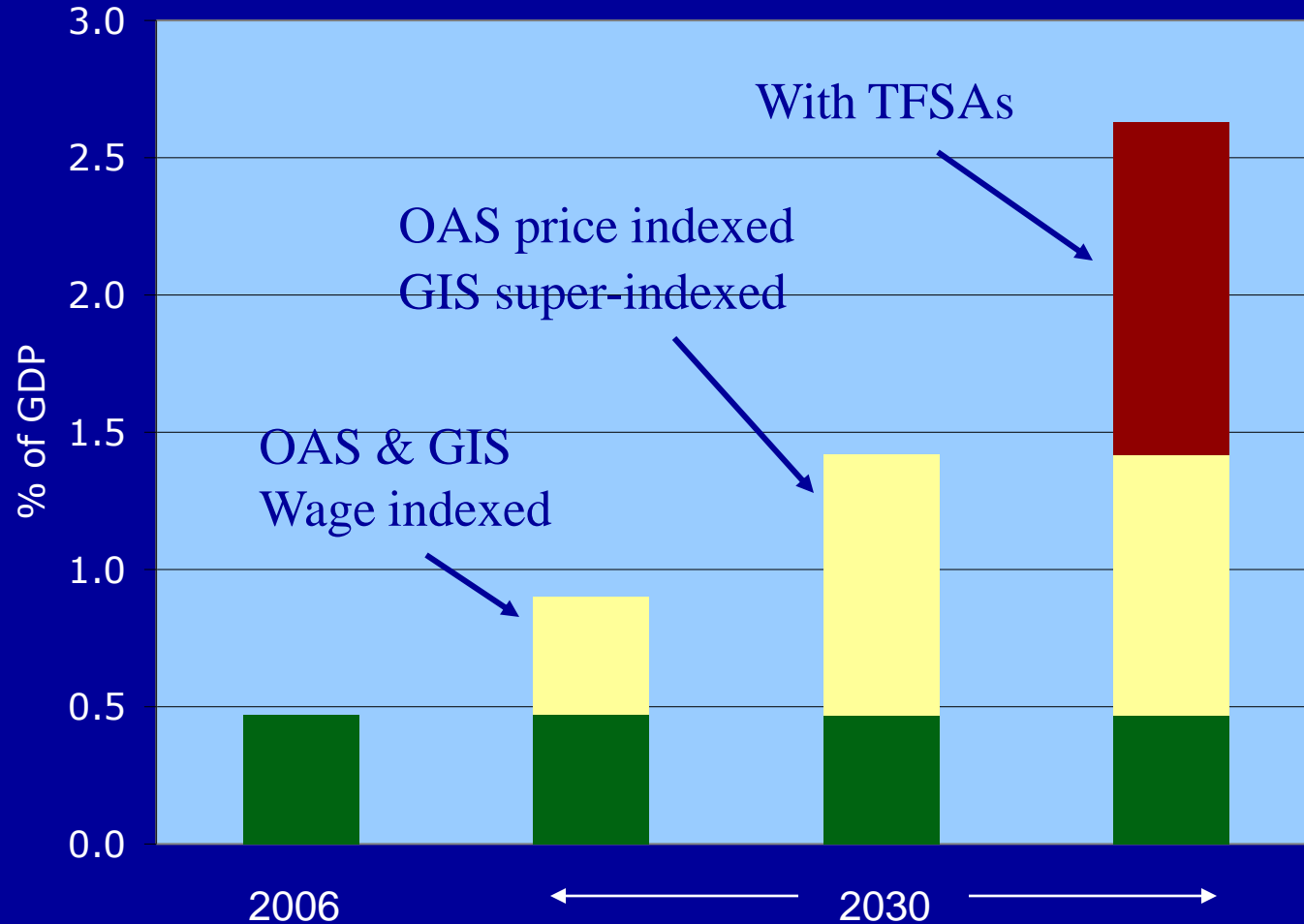
Consumption replacement with TFSAs



Who will use TFSA's ?



GIS Costs in 2030 with TFSAs



Key choices for reform options

- DB vs DC
- Mandatory vs voluntary
- Scale and targeting

Narrowing the list of options

- DB must be mandatory -- adverse selection
- Mandatory plan should be national
- Trade-off in scale & targeting of mandatory plans:
 - Increased retirement income security
 - vs.
 - Welfare costs of inflexible, forced saving

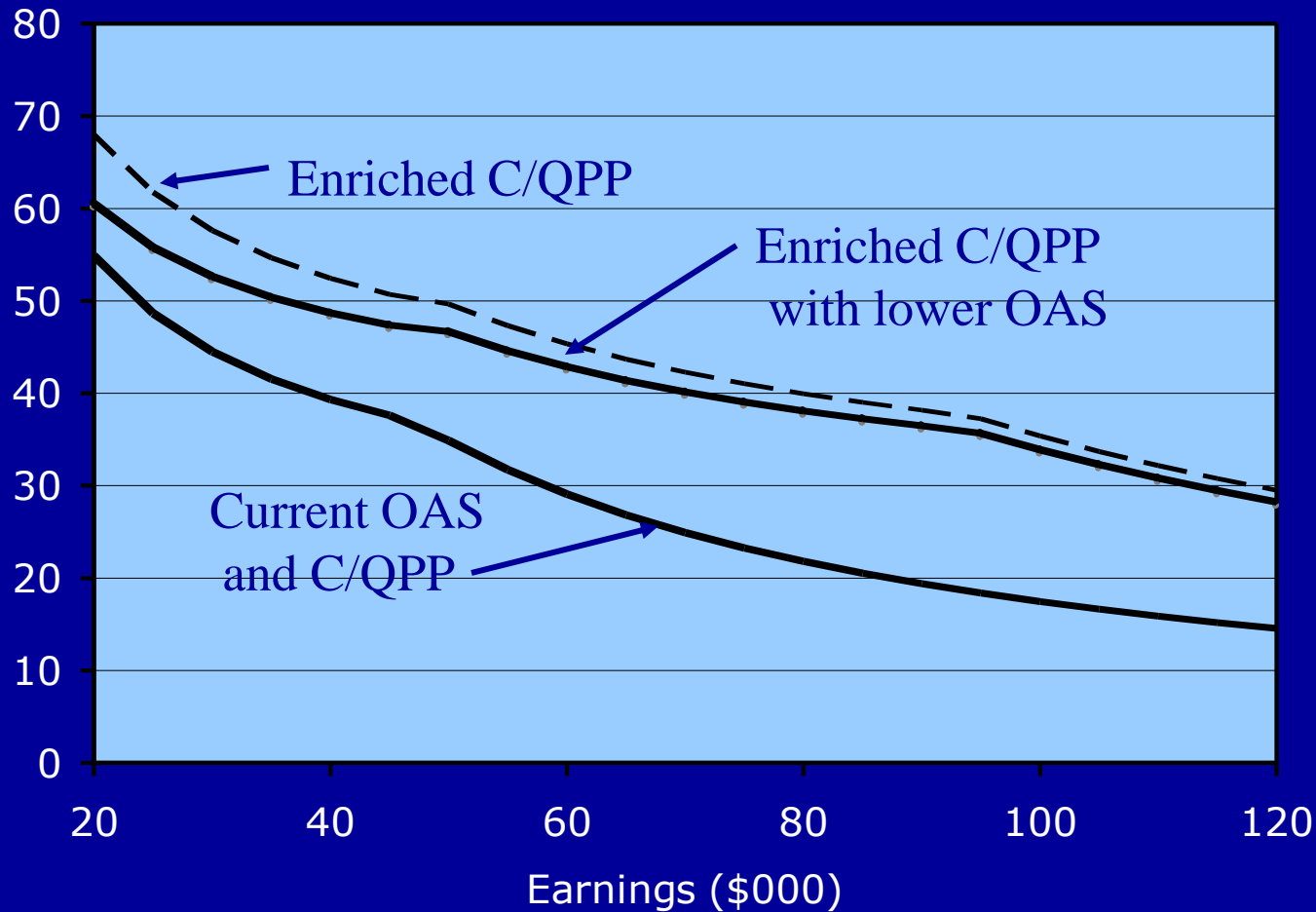
DB option: Enriched C/QPP

- Or could be stand-alone plan
- Fully-funded benefits; no past service
- Benefits contingent on funding status
- **New benefits**
 - 15% of earnings to YMPE
 - 25% of earnings from one to two times YMPE
- **Contributions** (employer plus employee)
 - 3.6% on earnings from YBE to YMPE
 - 6.0% on earnings from one to two times YMPE

Assume same contribution structure for mandatory & voluntary DC plans

Options leave room for discretionary saving

Replacement rates generally below 50%



Single individual. OAS 24% lower by 2030.

Estimated contribution flows

	<i>C/QPP Enrichment</i>	<i>Mandatory DC</i>	<i>Voluntary DC</i>
		<i>(\$ billion)</i>	
Total contributions	20.3	11.6	7.2
Less: RPP offset	- 9.8	- 1.4	- 1.3
Less: Limit offset	- 2.2	- 2.2	- 1.2
Less: RRSP offset	- 1.7	- 1.7	- 1.1
Net new saving	6.6	6.3	3.6
Savings gap reduction	3.3	3.1	1.5
Target efficiency (%)	50	49	41

Target efficiency = Savings gap reduction as a % of net saving

Estimates based on 2006 taxation data

Assessment

- Mandatory options most effective in boosting retirement incomes, but impose some welfare costs
 - Voluntary DC could supplement DB option
- DB plan should outperform mandatory DC plan
 - Risk pooling reduces dispersion of outcomes
 - Inter-cohort risk pooling allows less liquid, somewhat riskier investment portfolio -- raises expected returns
 - Some risks cited with DB plans (job change, employer bankruptcy) don't apply to a national plan
 - C/QPP history suggests that risks can be managed

Assessment (2)

- Mandatory, national plans have best labour supply effects
 - Benefits portable for job changers
 - No early retirement incentive with DC plan or updated career average DB plan with benefits adjusted for early retirees
- Labour supply effects better for DB than DC plan
 - Because it replaces about 35% of RPP benefits rather than exempting RPP plan members

Assessment (3)

- Labour supply effects of contributions (or payroll taxes) under the mandatory options
 - Problematic, especially for low-wage jobs
 - Can be alleviated under a C/QPP expansion by restructuring how ‘legacy costs’ are financed
- Proposal: spread the legacy costs over all covered earnings (eg, up to 2 x YMPE)
 - Legacy cost funding fairer
 - Reduces contribution increase for modest-earners
 - Restore deductibility of employee CQPP contributions

Legacy costs of the C/QPP:

*Contributions above those needed to fund the benefits earned in the year
-- about 4% points out of the 9.9% contribution rate.*

Assessment (4)

- DB plan reduces future fiscal costs of TFSA's
 - Under DC plan, might be pressured to offer TFSA treatment
- But not enough
 - In 'net income' used for income testing, should have 50% exclusion of TFSA contributions and 50% inclusion of TFSA benefits

Possible reform package

1. Introduce the Enriched C/QPP option
2. Sponsor and/or encourage supplemental voluntary, multi-employer DC plans
 - Eg, ABC plan, plans run by Ontario Teachers, Quebec SIPP-type plans
3. Restructure C/QPP premiums to spread the legacy costs across a bigger earnings pool, and make all contributions deductible
4. Amend the TFSA rules to have a 50% exclusion of contributions, 50% inclusion of benefits for income-testing purposes
5. Use the replacement of RPP benefits to reconsider the extent and organization of benefits regulation