



# Joint Colloquium of the IACA, PBSS and IAAHS Sections of the International Actuarial Association

Westin Copley Place Hotel, Boston, U.S.A. – 4-7 May 2008

## Reforms to Canadian Social Security 1996-97

### Ten Years Later: A Report (Card)

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# **AGENDA**

- Outline of Canadian Social Security
- Why reforms took place in 1996-97
- Highlights of the reform
- Record of Canada Pension Plan Investment Board since 1998
- Conclusion

# Canadian Social Security (Retirement Income)

## Three Tiers

### I Guaranteed Income Supplement (GIS):

- Started in 1966 with Canada Pension Plan (CPP)
- A welfare benefit depending on taxable income in previous year (no asset test)
- Benefits clawed back at 50% rate given private income
- As of January 2008  
Max single GIS = \$634.02/month or \$7608.24/year  
(when average annual earnings  $\approx$  \$40,000)
- Benefits funded by general tax revenues
- Benefits indexed to CPI (so decline relative to wages)
- Benefits are not taxable income
- Number of beneficiaries falling due to rise of benefits received from CPP and private pensions

# Canadian Social Security (Retirement Income)

## Three Tiers

### II Old Age Security (OAS)

- Around in some form since 1927
- A demogrant benefit
- Full benefit: 40 years of residency after age 18
- Otherwise pro rata ( $t/40$ ) minimum of 10
- Benefits funded by general tax revenue
- As of January 2008  
Max benefit = \$502.83/month or \$6027.72/year  
(when average annual earnings  $\approx$  \$40,000)
- Benefits are taxable income
- Benefits indexed to CPI (so decline relative to wages)
- Benefit claw back at 15%
- Starts at income = \$64,178
- No OAS if income  $\geq$  \$104,903
- Limits indexed to CPI

# **Canadian Social Security (Retirement Income)**

## **Three Tiers**

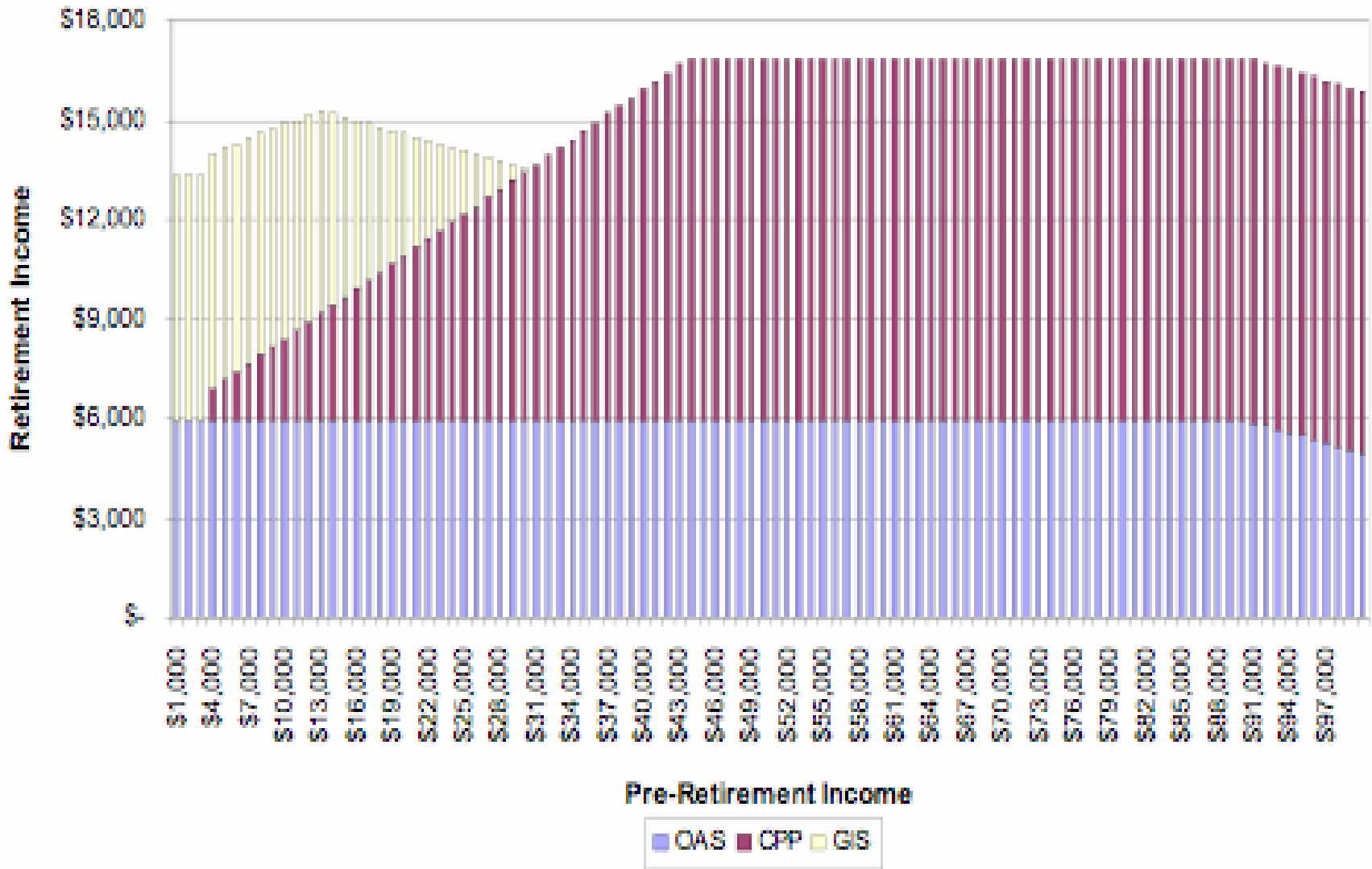
### **III Canada/Quebec Pension Plans (C/QPP)**

- Plans virtually identical (full portability)
- 70% of cash flow to retirement income
- Also: Disability  
Death  
Orphans
- A contributory plan:  
E'ER + E'EE contributions (50/50) total 9.9% of wages  
between \$3500 constant (year's basic exemption) and  
\$44,900 (year's max pensionable earnings)
- YMPE moves up with average wages
- Retirement benefit = 25% of indexed earnings
- Takes 40 years to get max benefit
- Drop out years if disabled or rearing children
- Max benefit (January 2008) = \$884.58/month or \$10,615/year
- Paid as joint and 60% survivor
- Benefit is taxable income
- No claw back

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**Figure 4: 2007 Canadian Retirement Income**



# Why reform in 1996-97?

- All governments running large deficits  
(federal debt = 69% of GDP)
- Pressure to lower taxes (to follow US and UK)
- Growing concern about sustainability of Social Security with rapid population aging  
(baby boom + enhanced life expectancy)
- CPP reserve funds in decline
- CPP actuary projected contribution rate of 14.2% if no changes
- CPP contribution rate had been 3.6% (shared 50/50) from 1966 to 1984
- By 1997 the combined rate was 6%

# Reforms in 1996-97

## Seniors Benefit

- Combined GIS + OAS
- Poor got more (\$120 per year)
- Rich got less (e.g. OAS clawback moved to 20%)
- OAS clawback moved from individual income to family income
- Would cut program cost by 10% by 2030

Plan proposal failed

# CPP Reforms

- A series of benefit tweaks
  - Three major shifts
- Benefits reduced by 9.3% in total
- Total contribution rate moved from 6% in 1997 to 9.9% in 2003
- Reserve funds to be widely invested (versus provincial government bonds)

# CPP Reforms

Benefits reduced 9.3%

- Eligibility for disability income toughened (e.g. Cause must be physically-based)
- Stronger D.I. audits (find recoveries)
- Increased contribution period to qualify
- Retirement income benefit formula changed from indexation to YMPE in last 3-years to indexation to YMPE in last 5-years
- Death benefit reduced to \$2500 constant vs 10% of YMPE
- Year's basic exemption on which no contributions are made frozen at \$3500 vs. 10% of YMPE  
(This means contributions rise faster than benefits.)
- Any new benefits must be fully funded

# CPP Reforms

## Automatic stabilizer

If CPP report says 9.9% is not sustainable,  
and no political solution, then two things happen

- Contribution rate moves half of distance to the necessary sustainable rate
- Benefits are de-indexed until half of the gap is attained

# CPP Reforms

## Contribution rate

- Rate went from 6% in 1997 to 9.9% in 2003.
- 9.9% bigger than necessary under paygo
- By 2017 reserve funds will equal 20% of total liabilities ( $\geq 5$  years expenditures)

# Canada Pension Plan Investment Board

- Prior to 1997, assets were provincial government bonds
- Now CPPIB invests in wide portfolio
- Follows same rules as private pensions
- CPPIB independent and arms length from government ( True ! )
- Recent gross rates of return:

2006-2007: 12.9%

Four years ending March 31, 2007: 13.6%

Portfolio as at March 31, 2007:

Asset class	% of Portfolio
Public Equities	57.8
Private Equities	7.0
Bonds	25.0 (many a legacy from old CPP)
Real Estate	4.9
Inflation-linked Bonds	3.3
Infrastructure	1.9
Money Market	0.1

22nd CPP Report says no cash flow needed from CPPIB until 2020.

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# CPP Reforms: Lessons for OASDI ?

- CPP now sustainable for at least 75 years
- OASDI can be made sustainable by tweaks
  - raise normal retirement age further
  - raise income limit on which contributions made
  - change index for pre- and post-retirement indexation
- Doubt that a cousin of CPPIB could exist in US
  - much less support for government and quasi-government agencies
- But could require that government pay investment returns equal to a proxy balanced portfolio on OASDI reserve balance
- Food for thought

# Q & A

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