



LIBRARY of PARLIAMENT
BIBLIOTHÈQUE du PARLEMENT

BACKGROUND PAPER



Changes to the Canada Pension Plan Retirement Pension

Publication No. 2011-54-E
20 May 2011

André Léonard

Social Affairs Division
Parliamentary Information and Research Service

Changes to the Canada Pension Plan Retirement Pension **(Background Paper)**

HTML and PDF versions of this publication are available on IntraParl (the parliamentary intranet) and on the Parliament of Canada website.

In the electronic versions, a number of the endnote entries contain hyperlinks to referenced resources.

Ce document est également publié en français.

Library of Parliament ***Background Papers*** present and analyze various aspects of current issues in an objective, impartial manner. They are prepared by the Parliamentary Information and Research Service, which carries out research for and provides information and analysis to parliamentarians and Senate and House of Commons committees and parliamentary associations.

CONTENTS

1	INTRODUCTION.....	1
2	CALCULATING THE RETIREMENT PENSION PRIOR TO THE CHANGES	1
3	CHANGES TO THE CANADA PENSION PLAN RETIREMENT PENSION.....	3
3.1	Low Earnings Drop-Out Provision.....	3
3.2	Pension Adjustment Factors	3
3.3	Work Cessation Test.....	4
3.4	Working Beneficiaries	4
4	CANADA PENSION PLAN: OTHER IMPACTS AND POTENTIAL CHANGES	4
4.1	Other Impacts.....	4
4.2	Other Potential Changes.....	5
5	CONCLUSION	5

CHANGES TO THE CANADA PENSION PLAN RETIREMENT PENSION

1 INTRODUCTION

The Canada Pension Plan (CPP) provides a retirement pension, disability and survivor benefits (death benefit, survivor's pension and children's benefit). The program is funded through contributions by employees, employers and self-employed workers.

In May 2009, as part of the triennial review of the CPP, the federal, provincial and territorial ministers of Finance recommended various changes to the CPP retirement pension.¹

The purpose of this document is to explain these changes, which were set out in Bill C-51. This legislation was adopted during the 2nd Session of the 40th Parliament, and received Royal Assent on 15 December 2009.² The changes are to be phased in gradually from 1 January 2011 to 1 January 2016, and apply only to those who have not begun to receive the pension when the changes took effect.

People working in Quebec contribute to the Quebec Pension Plan (QPP), which is similar to the CPP and administered by the Government of Quebec through the *Régie des rentes du Québec*. In its 2011 budget, the Quebec government announced plans to introduce some of the changes made to the CPP. It also announced its intention to implement a slight increase in the contribution rate, a measure not planned for the CPP.³

2 CALCULATING THE RETIREMENT PENSION PRIOR TO THE CHANGES

Before examining the changes to the CPP retirement pension, we will first look at how CPP retirement pension is calculated. A contributor to the CPP can begin receiving a retirement pension at any time between the ages of 60 and 70, inclusive. The pension is paid until the contributor's death and the initial amount is indexed to Statistics Canada's Consumer Price Index.

The calculation of the initial amount is based on the recipient's contributions during the contributory period. This period begins at age 18 or as of 1 January 1966 (the start of the CPP) if the recipient turned 18 before this date. The period ends the month before the first pension payment is made or no later than when the recipient reaches age 70.

In 2011, the contribution rate for employees and employers is 4.95% of annual earnings between \$3,500 (the basic exemption) and \$48,300 (the year's maximum pensionable earnings, or YMPE).

The initial monthly pension is calculated as follows:⁴ earnings for each month in the contributory period are expressed as a percentage of the annual YMPE, which is divided by 12 to arrive at a monthly maximum pensionable earnings. This percentage is 100% when monthly earnings are equal to or in excess of the monthly maximum pensionable earnings.

The next step is to calculate the average of these percentages for the entire contributory period. This average (e.g., 60%) is multiplied by the replacement rate of 25%. The new percentage (in this case, 15%) is multiplied by the average of the last five YMPs (including the current year). The result is divided by 12 to arrive at a monthly benefit.

Consider the example of a person whose contributions were consistently above the YMPE (an average of 100%). This person would receive a monthly benefit equal to 25% of the average of the last five YMPs, divided by 12.

Certain periods of low earnings during the contributory period are dropped out of the initial pension calculation. For example, months in which the contributor received a CPP or QPP disability pension are dropped out. Some periods in which earnings stopped or were reduced can also be dropped out if this increases the amount of the benefit. These low-earning periods can include those during which the person was over 65 years old and those during which the person cared for children under the age of seven.⁵

In addition to these specific cases, the general drop-out provision can be used to remove from the benefit calculation a period of up to 15% of the contributory period, during which time earnings were lower than average (in relation to the YMPE). For example, if contributors start to receive the CPP retirement pension at age 65 and have a contributory period of 47 years, they can drop out approximately seven of the lowest earning years in relation to the YMPE.

The amount of the pension is also adjusted based on a contributor's age when payments begin. Contributors who are under the age of 65 see their pension reduced by 0.5% for every month between the commencement of payments and their 65th birthday. If contributors are over 65, their pension is increased by 0.5% for every month that has gone by since their 65th birthday.

This means that contributors who start to receive a CPP retirement pension at age 60 have their initial pension reduced by 30%, but those who start to receive the pension at age 70 have their initial pension increased by 30%.

Take, for example, a person who was eligible for a monthly pension of \$500 before the age adjustment. That person would receive \$350 a month if the retirement pension began at age 60. The pension would then be indexed to the Consumer Price Index. However, if the person decided to wait until age 61 to start receiving the pension, that person would receive \$380 each month. In addition, if the person worked during this additional year when no pension was received, the basic amount (\$500) could also increase if earnings during this time were higher than the average career earnings (in relation to the YMPE).

3 CHANGES TO THE CANADA PENSION PLAN RETIREMENT PENSION

3.1 LOW EARNINGS DROP-OUT PROVISION

Under the general drop-out provisions, the percentage of low-earning months that can be dropped out of the benefit calculation will increase to 16% from 15% on 1 January 2012, and to 17% on 1 January 2014. This means that, from now on, contributors who start to receive the CPP retirement pension at age 65 will be able to drop from the benefits calculation about eight (rather than seven) years of lower earnings in order to increase their initial pension.

This change will enhance the initial pension for almost all pensioners, and in particular for those who began working later in life (e.g., people who immigrated to Canada after age 18, or attended school longer) or whose careers were interrupted (e.g., through unemployment or career change).

3.2 PENSION ADJUSTMENT FACTORS

The age-based pension adjustment factors will come into effect according to the schedule shown in Table 1.

Table 1 – Schedule of Changes to Pension Adjustment Factors (%)

Date	Pre- Age 65 Downward Monthly Adjustment Factor	Post- Age 65 Upward Monthly Adjustment Factor
Before 1 January 2011	0.50	0.50
1 January 2011	0.50	0.57
1 January 2012	0.52	0.64
1 January 2013	0.54	0.70
1 January 2014	0.56	0.70
1 January 2015	0.58	0.70
1 January 2016	0.60	0.70

Source: Office of the Superintendent of Financial Institutions Canada, [24th Actuarial Report supplementing the Actuarial Report on the Canada Pension Plan as at 31 December 2006](#), Ottawa, October 2009, Table 1, p. 12.

These changes make it less advantageous to start receiving the CPP retirement pension before age 65 and more advantageous to start receiving it after age 65. The new adjustment factors were set based on an actuarial study which showed that rates of 0.5% per month (pre- and post- age 65) were insufficient and needed to be even higher after age 65.⁶ The new method of calculation offers a more equitable approach in terms of life expectancy and the duration of the pension.

3.3 WORK CESSATION TEST

Currently, individuals must have stopped working in order to receive the CPP retirement pension before age 65. In practical terms, to meet the work cessation test, they must stop working or reduce their earnings to below the maximum monthly retirement benefit for people aged 65, which is \$960 in 2011.⁷ The cessation test applies during the month before the first payment and the month of the first payment. The test is no longer applicable after these two months, and individuals' employment earnings can be as high as they want. The work cessation test does not apply to people 65 years of age and older.

The work cessation test will be eliminated as of 1 January 2012. This step will encourage older workers to stay employed and to phase in their retirement, without having to eliminate or greatly reduce their employment earnings for two months.

3.4 WORKING BENEFICIARIES

At present, individuals who return to work after starting to receive their retirement pension cannot increase the amount of their pension by contributing further to the CPP.

As of 1 January 2012, individuals under the age of 65 who receive a CPP retirement pension and continue to work will be required to make CPP contributions (as will their employers). These contributions will be voluntary for individuals aged 65 to 69. The contributions will go toward a post-retirement benefit equal to 1/40 of the maximum pension amount (\$11,520 in 2011) per year of additional contributions. An adjustment will be made based on the contributor's earnings level (in relation to the YMPE) and age.

4 CANADA PENSION PLAN: OTHER IMPACTS AND POTENTIAL CHANGES

4.1 OTHER IMPACTS

Calculations for disability and survivor benefits are based partly on calculations for the CPP retirement pension. For example, the survivor's benefit for an eligible person between the ages of 45 and 64 consists of a flat-rate portion and a variable portion equal to 37.5% of the deceased contributor's retirement pension. As a result, changing the way in which the retirement pension is calculated will have an impact on calculations for the survivor's pension, death benefit and disability benefit.

The first evaluation conducted by the Chief Actuary of the Office of the Superintendent of Financial Institutions Canada indicated that the changes to the CPP would not require changes to the contribution rate: "a legislated contribution rate of 9.90% for years 2010 and thereafter is sufficient to financially sustain the Plan over the next 75 years."⁸ In fact, the changes might improve the plan's financial health to some degree. In 2050, benefits are expected to be almost \$1 billion lower and contributions almost \$3.3 billion higher than without the changes.

4.2 OTHER POTENTIAL CHANGES

Some groups and analysts support increased CPP benefits. In its November 2010 report on the federal government's role in reducing poverty, the House of Commons Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities recommended that "the federal government increase the Canada Pension Plan replacement rate."⁹

The Department of Finance Canada held consultations on the retirement income system in early 2010.¹⁰ In June 2010, federal Finance Minister Jim Flaherty stated, "I believe that we should consider a modest, phased-in and fully funded enhancement to defined benefits under the CPP in order to increase savings adequacy in the future."¹¹ In December 2010, Finance Canada introduced the idea of pooled registered pension plans as a way to give Canadians another option for saving for their retirement. This type of plan would allow workers without an employer-sponsored pension plan to access a defined-contribution group plan.¹²

5 CONCLUSION

Some of the changes implemented as of 1 January 2011 are designed to give Canadians greater flexibility and encourage them to extend their working lives, while making the system fairer. These changes should not have a major impact on the viability of the CPP, and they might encourage older workers to remain in the labour market for a longer period.

However, other changes could be introduced that would have a more significant impact on the private and public pension systems and, consequently, on the overall financial preparation for retirement.

NOTES

1. The proposed changes are outlined in Department of Finance Canada, "[Information Paper: Proposed Changes to the Canada Pension Plan](#)," News release, Ottawa, 25 May 2009.
2. The latest order bringing these changes into force is dated 4 August 2010 ([P.C. 2010-1003](#)). It fixes 1 September 2010 as the day on which sections 30 and 31, subsection 32(2), and sections 33, 34, 41 and 42 of the *Economic Recovery Act (stimulus)* (Bill C-51) come into force. It also fixes 1 January 2012 as the day on which sections 25 to 29, subsection 32(1), and sections 35 to 40 of the same Act come into force.
3. Changes to the QPP are described at Régie des rentes du Québec, [Changes to the Québec Pension Plan](#), March 2011.
4. Benefit calculations are explained in Human Resources and Skills Development Canada, [The CPP & OAS Stats Book 2010](#), Schedule B, p. 135.
5. Service Canada, [General Information About the Canada Pension Plan](#).
6. Office of the Superintendent of Financial Institutions Canada, [Canada Pension Plan: Actuarial Adjustment Factors Study](#), Actuarial Study No. 2, March 2003.

7. Service Canada, [*The Canada Pension Plan Retirement Pension*](#), March 2011, p. 12–13. The maximum monthly retirement pension amount was taken from Service Canada, [*Canada Pension Plan – Payment Rates: January – December 2011*](#).
8. Office of the Superintendent of Financial Institutions Canada, [*24th Actuarial Report supplementing the Actuarial Report on the Canada Pension Plan as at 31 December 2006*](#), Ottawa, October 2009, p. 8.
9. House of Commons, Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities, [*Federal Poverty Reduction Plan: Working in Partnership Towards Reducing Poverty in Canada*](#), Seventh Report, 3rd Session, 40th Parliament, November 2010, p. 161.
10. Department of Finance Canada, [*Ensuring the Ongoing Strength of Canada's Retirement Income System*](#), 24 March 2010.
11. Ontario, Ministry of Finance, [*Securing Our Retirement Future: Consulting with Ontarians on Canada's Retirement Income System*](#), 2010, p. 14.
12. Department of Finance Canada, [*Framework for Pooled Registered Pension Plans*](#), December 2010.