Dentons' Employment and Labour Seminar

May 25, 2018

Toronto

Changes to the Canada Pension Plan

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CANADA PENSION PLAN ("CPP")

a "state-funded" defined benefit pension scheme

What's happening?

higher payroll contributions will be required for employers & employees

higher CPP benefits will be paid to retired workers

What should you know?

- Exactly what's changing?
- When?
- Why?
- What are other employers doing?
- What should YOU do?

What does the CPP look like today?

WHAT GOES IN:

- employees and employers **each** pay 4.95% of their annual employment income amount that falls between $3,500 and $55,300 ($55,300 is the 2017 YMPE)

- employees who earn *more* than the YMPE do not contribute to the CPP, and do not get any extra benefit, regarding their earnings above the YMPE

  (spoiler alert: this is where a significant change will happen)

What does the CPP look like today?

WHAT COMES OUT:

- CPP is meant to provide retired Canadians with an annual income that will replace 25% of the worker's **career average** earnings
- ***not*** 25% of the individual's ***actual*** earnings, and ***not*** 25% of his ***final*** year of earnings
- 25% of average work earnings up to a maximum earnings limit *(Year's Maximum Pensionable Earnings = "YMPE")* which changes every year *($55,300 is the YMPE in 2017)*

What is typically paid out of the CPP?

- *average* benefit for a 65-year old commencing to receive CPP in 2017 is **$8,221 per year**
- *maximum* benefit for a 65-year old commencing to receive CPP in 2017 is **$13,370 per year**
- *average* annual CPP payment to *current retirees* is approximately **$8,000 a year**

Exactly how will the CPP be . . . “enhanced”?

GOAL for the higher CPP benefit:

provide a retirement income that will replace **a third** of pre-retirement income (up from the current 25% target)

higher **contributions** to the CPP will be phased in gradually, in two phases, **over 7 years**

- phase 1 of higher CPP premiums applies to everyone
  starts January 1, 2019

- phase 2 of higher CPP premiums applies only to higher-income earners
  starts January 1, 2024

The higher contributions will be fully in place by the end of 2025.

PHASE 1 of higher CPP contributions:

January 1, 2019 through to 2023

starting January 1, 2019, CPP contributions for employers and employees will ***gradually*** increase every year

employers and employees will continue to contribute equal amounts

by 2023, the contribution rate for employers and employees will be 5.95% of earnings below the YMPE (up from current 4.95%)

tax treatment of contributions: Employer contributions with respect to earnings up the YMPE are tax deductible. Different for employees: employee contributions are subject to a non-refundable tax credit rather than a deduction.

PHASE 2 of higher CPP contributions:

two-year implementation starting January 1, 2024

new, two-tiered contribution system:
higher income-earners (i.e. who have actual earnings above the YMPE) will start to contribute more, with a different % contribution rate & different tax treatment for those additional contributions

* new* concept of YAMPE: year's ***additional*** maximum pensionable earnings

- contributions will be required regarding the employee's actual earnings above the YMPE, up to a maximum amount referred to as YAMPE
- will apply only to workers whose actual earnings are above the YMPE
- additional employer and employee contributions will be required equal to 4% (each for employer and employee) of earnings between the YMPE and the YAMPE

What will the YAMPE amount be? A specified % above the YMPE (14% higher than the YMPE by 2025). Contributions for the higher-income earners are projected to be:

2024: additional 4% EE + 4% ER contributions projected for earnings between $70,100 and **$74,900**

2025: additional 4% EE + 4% ER contributions projected for earnings between $72,500 and **$82,700**

tax treatment of contributions: Both employer and employee contributions with respect to earnings above the YMPE will be tax deductible. *Result:* employee's CPP contributions are subject to two different tax treatments: below the YMPE, it's a tax credit, but above the YMPE, up to the YAMPE, it's a deduction.

Examples of impact of higher CPP contributions

2017

YMPE $55,300

Employee A: <u>salary of $50,000</u>:

employee and employer contribution each = 4.95% x ($50,000 minus $3,500) = $**<u>2,301.75</u>**

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Employee B: s<u>alary of $100,000</u>:

employee and employer contribution each = 4.95% x ($55,300 minus $3,500) = **<u>$2,564.10</u>**

2023 (estimates)

YMPE $67,800

Employee A: <u>salary of $50,000</u>:

employee and employer contribution = 5.95% x ($50,000 minus $3,500) = **<u>$2,766.75</u>**

*→ $465 increase for **each** of the employer & the employee, compared to 2017*

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Employee B: <u>salary of $100,000</u>:

employee and employer contribution each = 5.95% x ($67,800 minus $3,500) = **<u>$3,825.85</u>**

*→ $1,261.75 increase for **each** of the employer & the employee from 2017 (due to ↑YMPE and ↑ contribution rate)*

2025 (estimates)

YMPE $72,500
+ * new * YAMPE $82,700

Employee A: <u>salary of $50,000</u>:

employee & employer contribution = 5.95% x ($50,000 minus $3,500) each = $**<u>2,766.75</u>**

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Employee B: salary of <u>$100,000</u>:

employee and employer each contribute re the YMPE: 5.95% x ($72,500 minus $3,500) = <u>$4,105.50</u>
plus * new *
each contribute re the **YAMPE**:
4% x ($82,700 YAMPE minus $72,500) = <u>$408.00</u>
total for each = **<u>$4,513.50</u>**

*→ $1,949.40 increase for **<u>each</u>** of the employer & the employee from 2017 (due to ↑YMPE and ↑ % contribution rate and new YAMPE concept)*

When do retired workers get the higher BENEFIT payable from the CPP?

"Each year of contributing to the enhanced CPP will allow workers to accrue partial additional benefits. Full enhanced CPP benefits will be available after about 40 years of making contributions. Partial benefits will be available sooner and will be based on years of contributions."

[Department of Finance, September 2016]

- A teenager entering the workforce now will gain the most from the government's push to hike CPP contributions, while current retirees, and those on the cusp of retirement, will see no increase to their benefits.
- A 50-year-old worker earning $50,000 a year is entitled to less than $500 more a year after retiring at age 65 under the new, more generous CPP.
- CPP maximum payout will also rise to nearly $20,000 when fully implemented. (Benefits are indexed to inflation.)

WHY is this happening?

- Kathleen Wynne was serious about the ORPP.
- Justin Trudeau also cares about retirement income security.
- All provinces were persuaded.

What about Quebec?

- harmony! (February 21, 2018 Quebec National Assembly confirmed)
- both employer and employee contributions will increase from 5.4% to 6.4%, on earnings up to the YMPE
- and for earnings that are above the YMPE, up to the * new * YAMPE, the same, entirely new contribution of 4% (both employer and employee)
- same timing for implementation as CPP (i.e. two phases)

What does the Office of the Chief Actuary (federal government) say about the ***sustainability*** of the CPP?

Contributions to the CPP are projected to be more than sufficient to cover the benefits that will be payable from the CPP over the period 2016 to 2020.

Total assets of the CPP are expected to grow from $285 billion at the end of 2015 to $476 billion by the end of 2025.

It is projected that in 2050:

- 26% of investment income will be required to pay for expenditures – meaning that the majority of investment income can be plowed back into the assets of the CPP
- total revenues to the CPP will be comprised of approximately 66% contributions, and 33% investment income

What are Canadian employers doing about this?

Well. . . what COULD they do? Answer: cut back the contributions to DC plans or Group RRSPs, or reduce the promised DB pension, to "flatten" the impact of the enhanced CPP.

We have no data.

Public sector pension plans that offer defined benefit pensions may be doing **nothing**. Actuary Fred Vettese (of Morneau Shepell) has publicly commented that:

- many public-sector DB plans promise gross income replacement ratios of 70% for long-service employees; the net-replacement ratio following CPP enhancements will end up being 120% or higher
- members of many public-sector DB plans + their employers will contribute more than 30% of annual pay toward retirement – this may be a tough sell to the rank & file, as well as the general public that has to foot at least half the bill

What should you do?

- ***At the very least, know the numbers.*** Populate a table that illustrates the increase in employer contributions in each of the years 2019 through 2025. Identify the employees, or % of your workforce, who are likely to have earnings over the YMPE and therefore will experience a significant increase in employee and employer contributions starting 2024.
- ***Costs can be contained.*** Consider making this a “wash”. Consider changing existing workplace retirement & savings plans by reducing the employer and employee mandatory contributions to existing plans, so that there’s no change to net employee take-home pay or employer costs. (This gets a bit tricky because of the unique tax treatment that will be applied to the higher CPP and QPP premiums payable by employees whose salaries are above the YMPE.)
- ***Impact on pension plans with a C/QPP offset.*** Do you have pension plans that promise a benefit that is somehow “integrated” with the CPP and QPP, i.e. refers to the CPP or QPP regarding contributions or promised benefits? Act now to understand how the higher CPP and QPP contributions and benefit amounts will affect your pension plans, and consider amending them now.

What should employers do about the CPP changes?

- ***Collective agreement implications.*** Are you in, or approaching, bargaining with unions? You should immediately consider the changes, so as not to lock your employer into a future expense that could be managed now. Perhaps unions will be pleased with a re-vamp of retirement and savings plans that produce a "wash" for employees.

- ***Brace the higher-income earners for the increased CPP and QPP premiums.*** Any total comp modelling, employment contracts and other comp issues for the longer term (commencing 2024) must take into account the higher CPP and QPP premiums that employers and employees will have to contribute, where earnings will be above the YMPE.