



FEI Canada Policy Forum  
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# ORPP versus an expanded CPP: What is the best option?



leadership beyond finance

## **ORPP versus an expanded CPP: What is the best option?**

The recent federal elections put a new face on debates about expanding the Canada Pension Plan (CPP) and the planned implementation of the Ontario Retirement Pension Plan (ORPP). The new federal government has advocated an expansion of CPP, whereas the previous government was clearly opposed to mandatory expansion. At the same time, the Ontario government has been planning a provincial solution, the ORPP.

### **The Ontario Retirement Pension Plan (ORPP)**

Ontarians want and deserve income security in retirement. However, workplace pension plan coverage is low, the workplace is changing, and experts agree that people are not able to save enough. Ontario has taken action because retirement savings challenges will worsen without a strong plan for the future.

The ORPP is designed to help workers without a workplace pension plan and those who are at risk of not being able to save enough. It will complement existing workplace plans and other voluntary retirement savings arrangements for Ontarians to maintain their standard of living in retirement. The goal of the ORPP is to strengthen Ontario's retirement income system by creating a pension plan with a lifetime benefit and locked-in funds. It is built on the principle of fairness with mandatory matching employer contributions, emulating the Canada Pension Plan (CPP). The implementation of the plan also takes into account the needs of employers.<sup>1</sup>

The Ontario government's plan for the ORPP is to require that all Ontario businesses without adequate pension plans contribute to a newly formed ORPP. Generally, employers will be exempt if they have a defined benefit (DB) plan, or a defined contribution (DC) plan in which minimum contributions are 8%, of which at least one-half must be from the employer. It will be capped at a combined 3.8 per cent of an employee's annual salary up to \$90,000.<sup>2</sup> By comparison, CPP contributions are made up to the yearly maximum pensionable earning (YMPE) amount of \$54,900 in 2016. The ORPP is designed to provide an income replacement of approximately 15% after a 40-year period of contributions. While the ORPP is well intended, it presents a host of potential problems with high costs of implementation and on-going administration costs.

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<sup>1</sup> Ontario Ministry of Finance - <https://news.ontario.ca/mof/en/2015/08/the-ontario-retirement-pension-plan.html>

<sup>2</sup> Benefits and Pensions Monitor Online

### **What will Employers Need to Do?**<sup>3</sup>

The Ontario government understands that business needs time to adjust in order to begin planning. In order to help with this adjustment, the Ontario government's plan is to begin enrolling employers in stages, starting with the largest first and phasing in contribution rates over time. Enrolment in the ORPP will be staged in four waves between 2017 and 2020. These waves are:

- Wave 1: Large employers (500 or more employees) without registered workplace pension plans. Contributions to start January 1, 2017.
- Wave 2: Medium employers (approximately 50- 499 employees) without registered workplace pension plans. Contributions to start January 1, 2018.
- Wave 3: Small employers (50 or fewer employees) without workplace pension plans. Contributions to start January 1, 2019.
- Wave 4: Employers with a workplace pension plan that is not modified or adjusted to meet the comparability test, as well as employees who are not members of their workplace's comparable plan. Contributions to start January 1, 2020.

The ORPP will offer inflation-protected benefits, consistent with the sustainability of the plan, in order to provide a predictable source of retirement income for life. Benefits to plan members will begin in 2022.

### **The Case for Expanding CPP**

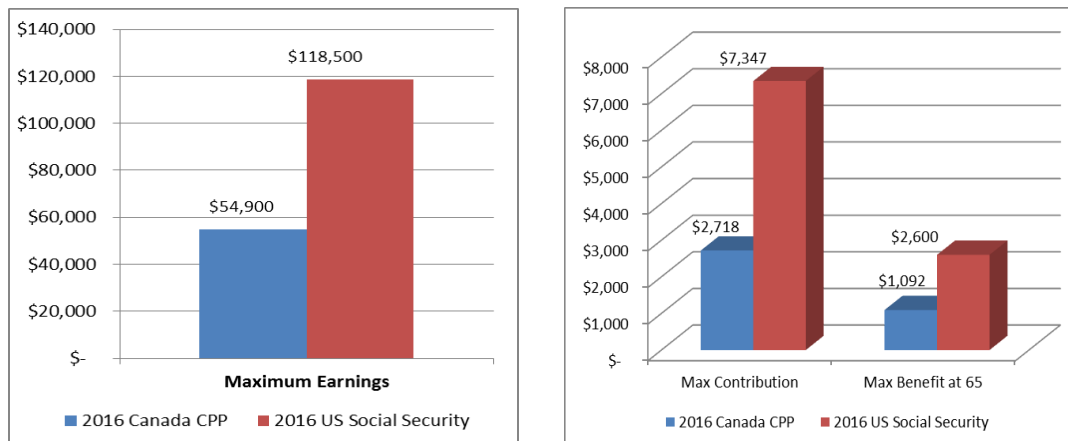
FEI Canada has previously advocated a gradual expansion of CPP benefits and contributions, notably in the white paper [CPP Expansion: A critical part of the solution](#). Currently a large proportion of working Canadians do not have an employer-sponsored pension plan, and individual savings rates are leaving many Canadians financially unprepared for retirement. The one constant for working Canadians, the CPP, is an efficient and effective way of saving:

- It provides for mandatory contributions equally by employees and employers
- Investment returns are higher than those achieved by the average individual investor, leading to higher benefits per dollar of investment.
- The contrast between the CPP and the US Social Security system is stark. In the US, Social Security contributions by employees and employers are 6.20% compared to CPP rates at 4.95%. In the US, contributions apply to employment earnings up to a maximum of \$118,500 US compared to CPP of \$54,900 CDN. As a result, maximum monthly US Social Security benefits approximate \$2,600 US surpassing the CPP maximum amount of \$1,092 CDN. Canada's taxpayer also provides Old Age Security (OAS), currently at \$570

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<sup>3</sup> Ontario Ministry of Finance - <https://news.ontario.ca/mof/en/2015/08/the-ontario-retirement-pension-plan.html>

per month, which provides a significant benefit to lower-income Canadians, and makes up part of the shortfall for middle-income earners.



At the same time, a rapid adjustment to CPP contributions could hit hard, to both employees and employers, whereas a phased-in approach can be more easily absorbed. In the period 1986-2003, CPP contributions were increased from 1.80% to 4.95% to solve a serious underfunding situation of CPP assets. This increase was gradual, and necessary — a gradual increase in the CPP YMPE, and perhaps contributions, is again warranted; where a rapid increase would cause disruptions to employers and employees alike. A gradual, phased-in approach to expanding CPP is a “middle ground”, considering the wide range of recommended actions on CPP; e.g. labour groups that propose a rapid increase in benefits without the necessary contributions to fund increased benefits; and business groups that recommend no increases to CPP citing higher employment costs that could reduce employment, contributing to a reduction in employees’ discretionary income that will reduce spending in the economy.

The Pension Committee’s white paper on CPP expansion advocates a more gradual approach, one that can be managed by employers and employees. For instance, doubling the YMPE to ~\$100,000 over a 10-12 year period would mean annual increases in contributions of perhaps 4% over existing annual increases. We also recognize that an expansion of CPP may take decades to increase the CPP benefit to a significant level or a minimum standard of living for more Canadians... so getting started sooner is better than later.

Additional reasons supporting the gradual expansion of the CPP include:

- Leveraging the CPP across Canada allows seamless retirement planning in support of labour mobility.
- As a non-voluntary expansion of CPP, all workers will receive expanded future benefits. This can provide an appropriate level of retirement income to the majority of Canadians who are not part of company sponsored pension plans, and are not saving effectively for retirement.
- If employers have a mandatory retirement plan, there should be an option to delink employee and employer matching contribution rates.
- Increases in future benefits would be based on a “fully-funded” model on an actuarial determined basis.
- Professionally managed, the CPPIB has access to large alternative funds that can secure higher returns, improving plan performance and funding status.
- Enhancing the CPP would have minimal implementation costs as the current infrastructure is already in place.

### **ORPP – A Laudable Idea**

The ORPP is a laudable initiative, but may cause significant issues. **First**, these immediate contributions will have a direct impact on employment and spending – for an employee earning \$60,000 and not exempt from ORPP, the employer’s cost increases by \$1,140 per year and the employee will have an immediate reduction of \$1,140 (before tax) in their disposable income. At \$90,000 of income, employer and employee contributions will be \$1,710 each. Employment and spending in the economy could be impacted, as well as personal savings for affected employees. **Second**, this Ontario-based solution would create an uneven retirement system between Ontario and the other provinces, as well as an incentive for employers and employees to invest and live in other provinces. It also adds additional complexity for employers who have one pension plan for all employees across Canada in the event they modify their plan for Ontario employees to help offset the cost of the ORPP. **Third**, the ORPP will be costly to implement, with unofficial estimates of \$.5 – \$1 billion, costs that Ontario can ill afford. **Finally**, many employers with DC Plans or Group RRSP’s that don’t meet the ORPP exemption threshold, may scale back contributions or even close existing pension and retirement savings plans.

### **Recent developments**

The new federal government has already promised to make the Canada Revenue Agency available for the implementation of the ORPP — this had been one of the obstacles for ORPP. This may significantly reduce implementation costs but the ORPP will still cause regional disparities and create an immediate burden on employers and employees. More

recently, in February 2016, the Ontario and federal governments announced a one-year delay in the implementation of the ORPP; the federal government stated that it intends to continue discussions with the provincial and territorial governments, with an aim to reach a collective decision on possible CPP enhancements by the end of 2016.<sup>4</sup>

Our recommendation is to focus on a gradual expanded CPP solution. A phased-in approach that is based on the current funding and investment approach should make this a much more sustainable approach for Ontarians and other Canadians to support. Recalling that current maximum contributions to CPP are only a fraction of those to US Social Security, the focus should first be on increasing the YMPE level above the current \$54,900, **before** looking at any increases to the current contribution rate of 4.95%.

The basic premise of the ORPP is excellent – to create a pool of retirement savings for workers (the majority) who do not have an employer-sponsored pension plan. However, the ORPP may cause significant incremental disruption by increasing costs to employers and employees in an already fragile economy, duplicating effort and operational costs that can be avoided by leveraging the infrastructure already in place for CPP. As a final point, the ORPP does not address the retirement savings concern or provide a pension solution at the national level. A comment by Ms. Wynne.....*with two-thirds of Ontarians not having any workplace pension plan, enriching retirement benefits is essential. “This is not just an Ontario problem,” she said. “It’s a national problem.”*<sup>5</sup>

### **Don’t Wait**

A gradual expansion of CPP offers an alternative solution that already has the systems and infrastructure in place to improve the minimum standard of living in retirement for workers both in Ontario and across Canada. An expansion of CPP may take decades before CPP benefits are increased to a more appropriate minimum standard of living for more Canadians in retirement. There should be no misconception about the eventual costs to both employers and employees as the program is funded over the years, and perhaps decades. As such, an orderly and gradual phasing-in of (1) an increase to the CPP YMPE and (2) future minimum contribution rate adjustments as required, leading us to a practical and efficient solution addressing the retirement savings problem that currently exists for too many Canadian workers.

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<sup>4</sup> [http://www.bpmmagazine.com/benefits\\_news](http://www.bpmmagazine.com/benefits_news)

<sup>5</sup> Benefits and Pensions monitor Online

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