THE GLOBE AND MAIL

CPP

A new premium on retirement

Federal, provincial and territorial finance ministers reached an agreement to expand the Canada Pension Plan, but what will the changes mean to you? Janet McFarland and Ian McGugan explain

Federal Finance Minister Bill Morneau is flanked by his provincial and territorial counterparts as he speaks during a news conference after reaching a deal to expand the Canada Pension Plan, in Vancouver, B.C., on Monday June 20, 2016.

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What drove the expansion of CPP?

The biggest single factor was the dire state of the traditional company pension. For decades after the Second World War, workers at most large businesses could look forward to retiring with a regular monthly cheque for a clearly defined amount, fully backed by their employer.

Those defined-benefit pension plans are rapidly disappearing, especially among big industrial employers such as car manufacturers, steelmakers and the like.

Back in 1971, about 48 per cent of men were covered by defined-benefit plans, according to Statistics Canada. By 2011, the portion had fallen nearly by half, to 25 per cent. (Women have also been hit by declining coverage, but more of them work in the public sector, where defined-benefit plans are still the norm, so their slide has been less severe.)

An expanded CPP is designed to address the shortfall in middle-income retirement planning that is opening up as a result of disappearing corporate pensions. Most at risk are workers under the age of 45 with middling incomes – say, families earning about $50,000 to $80,000 a year. Without the defined-benefit pensions that their parents enjoyed, many could hit retirement with little in savings.

Pension experts have warned about the middle-income retirement gap for years, and CPP reform has been on the national agenda since at least 2009. However, expansion proposals always fell short of the necessary level of support. Approval from Ottawa and at least seven provinces with at least two-thirds of the country's population was required to make a deal.

One factor that shook the never-ending talks out of their lethargy was Ontario's determination to go out on its own and launch a supplementary pension plan in 2018. That put an effective deadline on discussions.

Add in a new Liberal government that has made CPP expansion a priority, and this week's meeting finally achieved the necessary consensus. Ontario now says it will fold its own plan in favour of the supersized CPP. The new regime will begin to be implemented in 2019.

What are the major changes?

The deal negotiated between Ottawa and eight of 10 provinces will expand the Canada Pension Plan in two significant ways.

Currently, workers and employers in Canada pay 4.95 per cent of salaries into the CPP, up to a maximum income level of $54,900 a year. When people retire at the age of 65, they are paid a maximum annual pension of $13,110 under the program. People earning more than $54,900 do not contribute to CPP above that level, and do not earn any additional pension benefit.

The first major change announced on Monday will increase the annual payout target from about 25 per cent of preretirement earnings to 33 per cent. That means workers who earn $54,900 a year would receive a maximum annual pension of about $17,500 in 2016 dollars by the time they retire, an increase of $4,390 a year, according to federal finance department estimates.

The second change will increase the maximum amount of income covered by the CPP from $54,900 to about $82,700 when the program is fully phased in by 2025, which means higher-income workers will be eligible to earn CPP benefits on a larger portion of their income.

For a worker at the $82,700 income level, CPP benefits will rise to a maximum of about $19,900 a year in current 2016 dollars.

How will higher benefits be funded?

Contributions to CPP from workers and companies will increase by one percentage point to 5.95 per cent of wages, phased in slowly between 2019 and 2025 to ease the impact.

People earning $54,900 a year will see premiums increase by about $9 a month in 2019, rising to $43 a month when fully phased in.

To ease the hit, the federal government is introducing a tax deduction for worker contributions. When fully phased in, the monthly increased premium cost of $43 will be reduced by $9 by the income-tax adjustments, leaving an after-tax monthly cost increase of $34.

The federal finance department said the portion of earnings between $54,900 and $82,700 will have a different contribution rate for workers and employers, expected to be set at 4 per cent.