Pensions at a Glance 2017

How does CANADA compare?

5 December 2017

Key findings

- Canada undertook important pension reforms over the last two years.
- Previous legislated plans to increase the retirement age from 65 to 67 were cancelled. Hence, while the current retirement age of 65 is one year higher than the OECD average, it will be one year behind in the future.
- Pension benefits from the Canada Pension Plan will be increased significantly. As a result the future net replacement rate from mandatory schemes for a full-career average-wage worker will increase by about 10 percentage points to 53% against 63% on average in the OECD.
- Earnings-related pension schemes are fairly flexible in Canada. This flexibility to retire may correspond to people's wishes for more choice but might also increase retirement income vulnerability.

Overview – Canada undertook important pension reforms over the last two years

Canada was one of the most active OECD countries in reforming the pension system over the last two years, along with the Czech Republic, Finland, Greece and Poland. The recently enacted measures in Canada deal with many different aspects of pension policies.

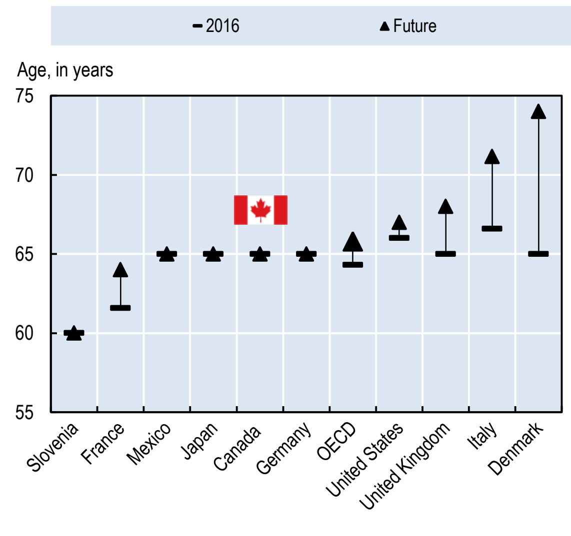
First, the age of eligibility will remain at 65 for the Old Age Security (OAS) pension (basic pension) and the Guaranteed Income Supplement (GIS) (means-tested component). This implies a reversal of the previously planned increase from age 65 to 67 between 2023 and 2029. Canada is among three OECD countries who backtracked from planned increases, along with the Czech Republic and Poland.

As a result, the retirement age for the full pension will remain at 65, while it will increase by slightly less than two years from about 64 to 66 by 2065 on average in the OECD. Denmark, Italy and the Netherlands will have a retirement age at 68 or higher based on current legislation. At the same time, Canada will be ageing at a pace similar to that of the average OECD country; the number of people older than 65 per 100 people of working age (20-64) will increase from 26 in 2015 to 48 in 2050, against 28 and 53 on average in the OECD.

Second, future pensions from mandatory schemes will increase. The Canada Pension Plan (CPP) was enhanced and the benefits are targeted to increase from 25% to 33% of a worker's average monthly pensionable earnings between 2019 and 2025. In addition, the ceiling for pensionable earnings (Yearly Maximum Pensionable Earnings, YMPE) will gradually be raised by 14% up to about 1.25 times the average wage.

The retirement age will stay flat in Canada

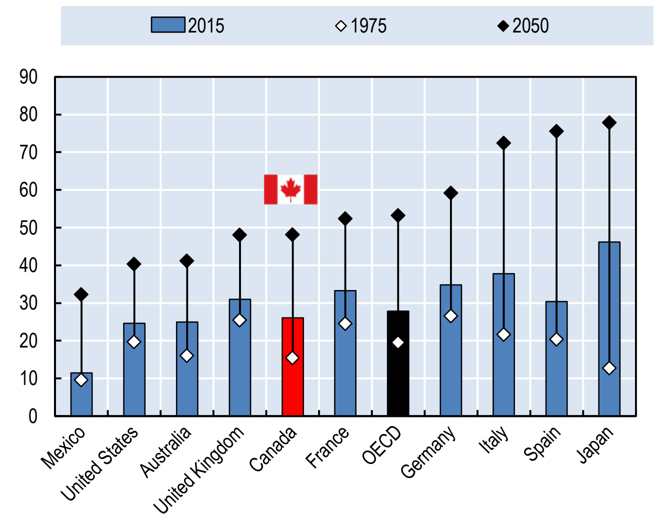
Normal retirement ages for a full-career worker retiring in 2016 and working from age 20 in 2016 (future).



Source: [Figure 1.4].

Canada will be ageing fast as many OECD countries

Number of people older than 65 years per 100 people of working age (20-64), 1975-2050



Source: [Figure 1.1]

Third, Canada as well as Greece and the Slovak Republic, changed the rules concerning minimum and basic pensions. In Canada, the guaranteed income supplement for the lowest-income single seniors was increased by over 10%. To help finance the earnings-related measures, the contribution rates for employers and for employees will gradually increase by 2023 from 4.95% to around 5.95%; the contribution above the old YMPE level will be only 4%. This is accompanied by tax measures to offset the cost for individuals. Currently, mandatory contribution rates for public and private pensions, including both employers and employees, are below 10% only in Australia, Canada, Korea and Mexico.

As a result, the future net replacement rates for a full-career average-wage worker will improve and reach 53% against 63% for the OECD average. Within the OECD, the range is from less than 30% in Mexico and the United Kingdom to more than 100% in the Netherlands and Turkey. The net replacement rate for low-earners (half the average wage) will be higher than at the average wage at 62% in Canada, but still about 10 percentage points lower than the OECD average.

Canada is among eight OECD countries where more than 40% of people of working age have a voluntary pension plan. Contributing to a voluntary pension could increase replacement rates significantly.[i]

Increasing coverage of voluntary schemes is a priority for pension policy in Canada. Over the last two years, five Provinces including Ontario implemented the Pooled Registered Pension Plans (PRPP) Act, providing a legal framework for creating and operating voluntary, low-cost, defined contribution pension plans for employed and self-employed persons who do not have access to a workplace pension. The law largely follows the framework of the federal PRPP legislation that was passed in 2012.

Earnings-related pension schemes are flexible in Canada. Within CPP, individuals in Canada can retire, with a reduced benefit, with their mandatory earnings-related pension from the age of 60. Deferring pensions pays a 7.2% basic pension bonus for each year of deferral in Canada, on top of higher earned entitlements when working. However, the bonus can be partially offset as the income-tested GIS benefit is withdrawn.

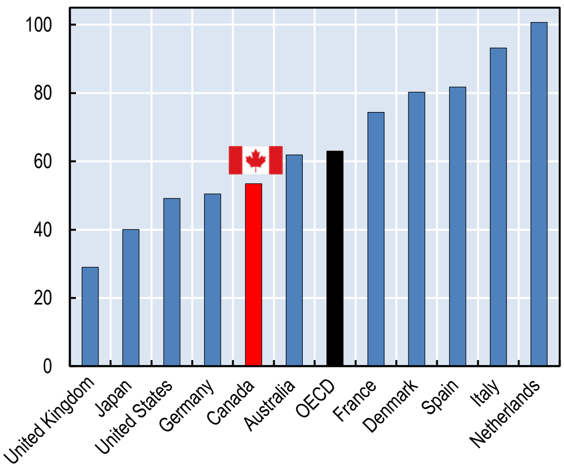
Overall, postponing retirement after the normal retirement age and continuing to work increases monthly mandatory pensions by about 9.5% per year of deferral in Canada compared with an OECD average of about 7.5%. Combining work and pensions is unrestricted and mandatory retirement, i.e.an employer setting an age at which an employee has to retire –was abolished in Canada, like in other Anglo-Saxon countries.

The only restriction to flexible retirement is due to the fact that neither the basic nor means-tested pensions are available before the age of 65, as in most other countries. If an average-wage worker would nevertheless retire one year early, the pension benefit would be 25% lower than at normal retirement age, which is a strong disincentive to retire early.

Voluntary defined contribution occupational schemes can offer gradual retirement schedules, but these options do not appear to be well developed. But they do offer great flexibility typically from age 55, often with lump sum withdrawals, which tend to benefit people with high lifetime earnings who can afford to retire early. However, well-documented short-sightedness might lead workers to underestimate their future needs and increase vulnerability risks at older ages. In that sense, such flexibility might increase old-age inequality.

Replacement rates are below the OECD average

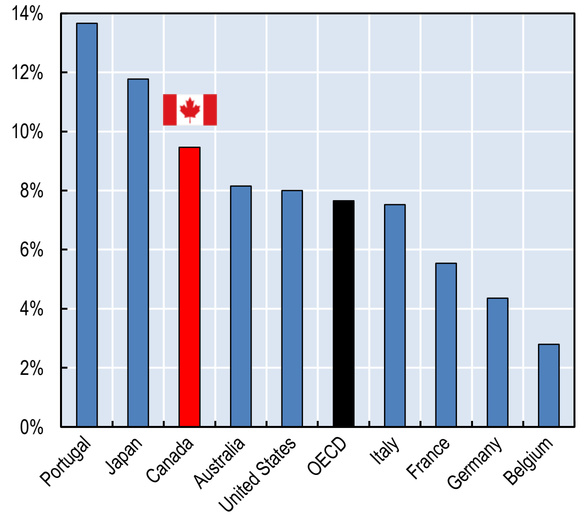
Net pension replacement rates for a full-career average-wage earner from mandatory schemes



Source: [Figure 4.9].

Impact on annual total benefits when working and deferring pensions by three years after the normal retirement age

Per year of deferral, full-career average earners



Source: [Figure 2.12].

i For the average-wage worker, contributing for a full career would raise the future net replacement rate from 53% with only mandatory schemes to 98%. For the purposes of these calculations, membership in a defined benefit pension plan with an accrual rate of 1.5%, including the CPP, is assumed.

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