ONTARIO NONPROFIT NETWORK

ONN Backgrounder: Pension Basics*

1. GOVERNMENT PROGRAMS

a) Universal programs (all seniors)

- **Federal: Old Age Security (OAS) & Guaranteed Income Supplement (GIS)**
- **Provincial: Guaranteed Annual Income System (GAINS)**

- Paid monthly to all seniors below a certain income, regardless of work history.
- Defined benefit, indexed to CPI – paid for by general taxes.
- Minimum residency requirements (Canada/Ontario). *Canada has social security agreements with many countries.*
- Maximum monthly benefit in June 2015: $563.74
- Qualifying age will remain at 65 *(decision to raise this to 67 has been reversed).*
- OAS paid out to seniors across a broad income range (currently $0 - $118K).
- GIS tops up those with single incomes below $17K.
- GAINS (Ontario) further supplements low-income seniors receiving OAS/GIS.

b) Canada Pension Plan (CPP) - Workforce-wide (all workers)

- Benefit amount depends on how much and how long one contributed on earnings up to the "**year's maximum pensionable earnings**" (YMPE -- $54,900 in 2016) – aims to replace <u>one-quarter</u> of average earnings up to YMPE.
- Defined benefit, indexed to inflation (maximum monthly benefit in 2016 was $1,092).
- Paid by equal employee and employer contributions (9.9% combined).
- Normally qualify at 65, but options to start lower payouts at 60 or higher at 70.
- Provides CPP disability, death benefit and spousal benefits.
- Approximately eight "drop out" years (calculation of benefits excludes these years when income is lowest). Also drop out of child-rearing years while children under age seven.

CPP Enhancement, phased in between 2019 and 2026:

- New contributions:
  - Up to the YMPE: Increase of approximately 1% of pensionable earnings each for employers and employees, rising from 4.95% to about 5.95% of earnings.
  - Contributions will also be made on a higher range of earnings up to the "upper earnings limit" (increased by 14%, which brings the upper threshold to approximately $82,700 at full implementation in 2026--or $62,600 in 2016 dollars). Contributions are expected to be about 4% each (employer and employee) on this portion of earnings.
- New benefits:
  - CPP retirement benefit will replace <u>one-third</u> of earnings, up from <u>one-quarter</u>, for workers who have contributed at the new rate for 40 years (i.e., people who are teenagers today), up to the YMPE. A worker making $54,900 in 2016 dollars will receive the equivalent of $1,458 monthly in 2016 dollars, an increase of $366.
  - For workers with above-average earnings, benefits will also reflect coverage of a larger portion of their income. For a worker making $82,700 (the new upper threshold in 2026), CPP benefits will rise to approximately $1,658 monthly in 2016 dollars.
  - For people already in the workforce today, changes will be phased in so that an individual's benefit will reflect how many years they spent contributing at the old, new, and transitional rates. Workers currently in their 40s to 60s will see very little change.

* *Information sources available upon request. Last updated Oct. 12, 2016*

2. WORKPLACE PROGRAMS

There are three basic plan types: DB, DC, or TB.

✓ **Defined Benefit (DB) Pension Plans**

- Defined retirement benefits (income), based on a formula (often based on salary and length of service).
- Employee contribution may be required.
- *Pooled risk* – longevity risk, investment risk, and expenses are shared.
- *Employer is responsible to fund the plan – assumes most of the risk EXCEPT in a "member-funded" pension plan (less common) where employees bear most of the risk.*

✓ **Defined Contribution (DC) Plans**

- Defined contribution formula for employees and employers. Retirement income depends on amount of contributions and individual account investment performance.
- Employees are often provided with investment choices.
- If an annuity is purchased upon retirement, the retiree's income depends on purchase rates.
- *Individual employee assumes most of the risk.*

✓ **Target Benefit (TB) Pension Plans**

- Often multi-employer plans.
- A target benefit (income) is determined based on a formula but it is a "target" so benefits may be reduced if the pension plan does not perform as well as expected.
- Employer contributions are generally fixed. Once those contributions have been made, the employer has no obligation to make up a shortfall because the benefits are adjusted rather than paid in full.
- *Pooled risk* – longevity risk, investment risk, and expenses are shared.
- Benefit can be portable across workplaces if agreements in place.

The following are the main types of workplace plans:

– **Registered Pension Plans (RPPs) – may be DB/DC/TB**

- Single- or multi-employer.
- A contract between employee and employer.
- Subject to pension legislation as well as Canada Revenue Agency (CRA) rules.
- Employer contributions are not considered part of employee's taxable income.
- If employee contributes, then employee contributions are deductible.

– **Group Registered Retirement Savings Plans (Group RRSPs) - DC**

- The contract is between employee and funding agency (insurance co., bank or trust co.).
- Employer contributes, but is just a facilitator.
- Subject to CRA rules.
- Employer contributions are taxable income to employee – subject to payroll taxes such as income tax, CPP, EI. However both employer and employee contributions are deductible.

– **Pooled Registered Pension Plans (PRPPs) – DC** *(new in Ontario in 2015)*

- Similar to group RRSPs, but contains several Registered Pension Plan (RPP) features.
- Participation is optional for employers, and for employees of participating employers.
- Employer may contribute – not considered income for the employee (like RPPs).

3. INDIVIDUAL SAVINGS

– **Registered Retirement Savings Plans (RRSPs) - DC**

- Voluntary individual savings mechanism (not tied to a workplace) with tax incentives.
- *Individual assumes all the risk*.
- Subject to CRA rules including maximum RRSP contribution room.

– **Other savings and investments (Tax-Free Savings Accounts, property, etc.)**