Fiscal Pulse

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Ontario: A Focus on Retirement Income Security

In the ongoing debate on the adequacy of Canadians' retirement saving, the government of Ontario concludes that more than 35% of provincial households are not saving enough to support their current lifestyle through their retirement. The Province references five other studies whose estimates indicate that 20%-50% of Canadian households are undersaving for their retirement, even after potential income from home equity is included. According to expert opinion, sustaining a standard of living in retirement similar to pre-retirement requires 50%-70% of pre-retirement earnings. Summarized below is Ontario's discussion of four key factors currently leading to inadequate retirement saving.

Increasing longevity

Men in Ontario who are presently 65 are expected to live an additional 19 years, compared with 22 years for women. By 2035, average post-retirement lives are expected to lengthen to 23 years for men and 25 years for women. A group saving plan such as an employer-sponsored pension can pool longevity risk. Offering some offset to increased longevity are the rise in Ontario's average retirement age from 61 in 2002 to 64 years in 2013 and the doubling in labour force participation rates among Seniors age 65 to 68 from 12.5% in 1998 to 27% in 2013.

Limited workplace pension coverage

Only 34% of Ontario workers reported membership in employer pension plans in 2012, lower than the 42% share in the early 1990s *(bottom chart)*. Even if the self-employed are excluded, employer pension coverage in 2012 was 40% compared with 49% in the early 1990s.

Ontario also documents that younger workers are undersaving relative to prior generations given: their later entry into the work force after extended post-secondary education; their higher levels of student debt; current high youth unemployment; less generous pension coverage for new hires; non-standard work arrangements; and, the higher incidence of inconsistent or interrupted earnings. Yet this is the generation that will have to support the outsized baby boom generation in retirement.

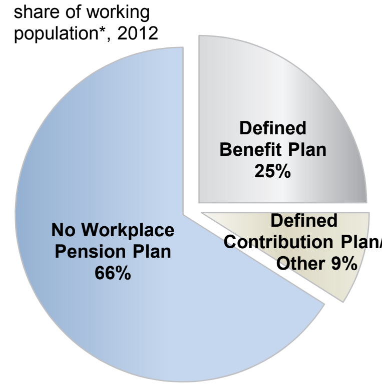
Inadequate Canada Pension Plan (CPP) coverage for middle class workers

To ensure an income floor for retirees, Canada's universal retirement income program consists of the federal Old Age Security (OAS) and Guaranteed Income Supplement (GIS) programs plus provincial top-ups such as Ontario's Guaranteed Annual Income Supplement (GAINS). The OECD estimates a retirement income replacement rate of 80% for Canada's lower-income workers, higher than the 71% OECD average.

But for all Seniors, Canada's public pension and income security programs represent only 40% of their income, compared to a 60% OECD average. Contributing to this low share is the CPP that replaces just 25% of career average pensionable earnings to a maximum of $52,500 in 2014. This compares with the U.S. Social Security system's average 40% replacement rate on maximum earnings of US$117,000. Relative to the $12,500 maximum CPP benefit for 2014, the average CPP annual benefit as of November 2013 was $6,400 nationwide and $6,800 in Ontario. Average OAS and CPP income in Ontario totaled $13,000 for 2013, a fraction of the maximum $19,000. One reason for the average CPP benefit falling well below the maximum is that the CPP does not allow individuals to make up for years of lower earnings during periods of higher earnings.

Employer Pension Coverage In Ontario

share of working population*, 2012



*Working population includes the self-employed. Source: Statistics Canada.

Adequate voluntary saving — challenging for the middle class

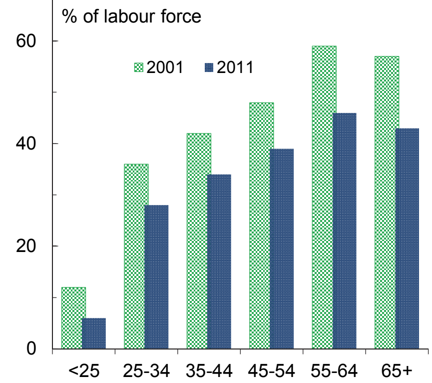
For the 46% of Ontario "middle-class" workers earning $25,000 to $75,000 in 2011, the provincial government indicates that many are likely on private-sector payrolls and are therefore less likely to have employer pension coverage. Only 25% of these workers earning $25,000-$50,000, and 45% of the $50,000-$75,000 income group reported a workplace pension contribution, while their RRSP contributions averaged $2,700 and $4,300, respectively, in 2011. For both income groups, workplace pension coverage and average annual RRSP contributions have declined.

Moreover, nearly 40% of Ontarians with incomes of $25,000 to $75,000 had neither an employer-sponsored pension nor an RRSP *(top chart).* With discretionary and particularly lump-sum RRSP contributions often difficult, savings goals usually are more easily achieved through regular payroll deductions. In addition, individuals saving on their own have difficulty accessing the most appropriate, cost-effective vehicles to provide higher net returns. A further challenge for individuals is accessing, upon retirement, actuarially fair group annuity rates for their accumulated savings.

A recent factor that may help to explain recent lacklustre RRSP contribution trends is Canadians' uptake of Tax-Free Savings Accounts (TFSAs) since their introduction in 2009 *(bottom chart)*. As a flexible, tax-sheltered, life-time financial planning vehicle, TFSAs, in contrast to RRSPs, do not offer tax deductible contributions, but TFSA withdrawals are not taxable. From 2009 to 2011, the number of TFSAs climbed from 5.3 million to 9.8 million, annual contributions averaged $3,800 per individual relative to the $5,000 annual maximum, and four-fifths of TFSA contributors had incomes less than $80,000.

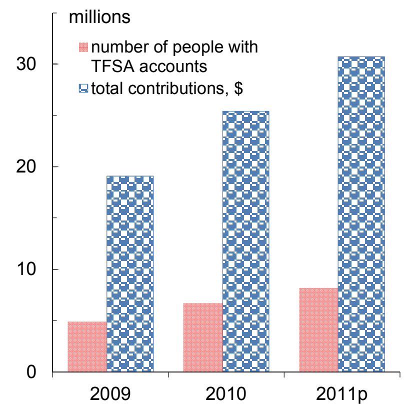
The macroeconomic impact of raising retirement saving
Measures to increase retirement saving necessarily trade off current consumption and real GDP growth for longer-term income adequacy and less intergenerational tension, as Dodge and Dion highlight.[1] Importantly, financing services for the outsized baby boom generation in retirement will be easier if growth in both labour and total factor productivity can be sustainably raised. In turn, for stepped-up productivity gains, greater investment in physical and human capital would be facilitated by a higher rate of contractual household saving. Alternatively, a pick-up in domestic investment could rely upon foreign saving, though this raises its sensitivity to economic and financial events outside of Canada. Thus Ontario defends higher household saving as a path to stronger output and incomes in the future.

Canadian RRSP Contributions by Age Group



Source: Office of the Superintendent of Financial Institutions Canada.

Canadian Tax-Free Savings Accounts



Source: Finance Canada.

[1] David A. Dodge and Richard Dion, *Macroeconomic Aspects of Retirement Savings,* April 2014. http://www.bennettjones.ca/Publications/Guides/Macroeconomic_Aspects_of_Retirement_Savings/

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