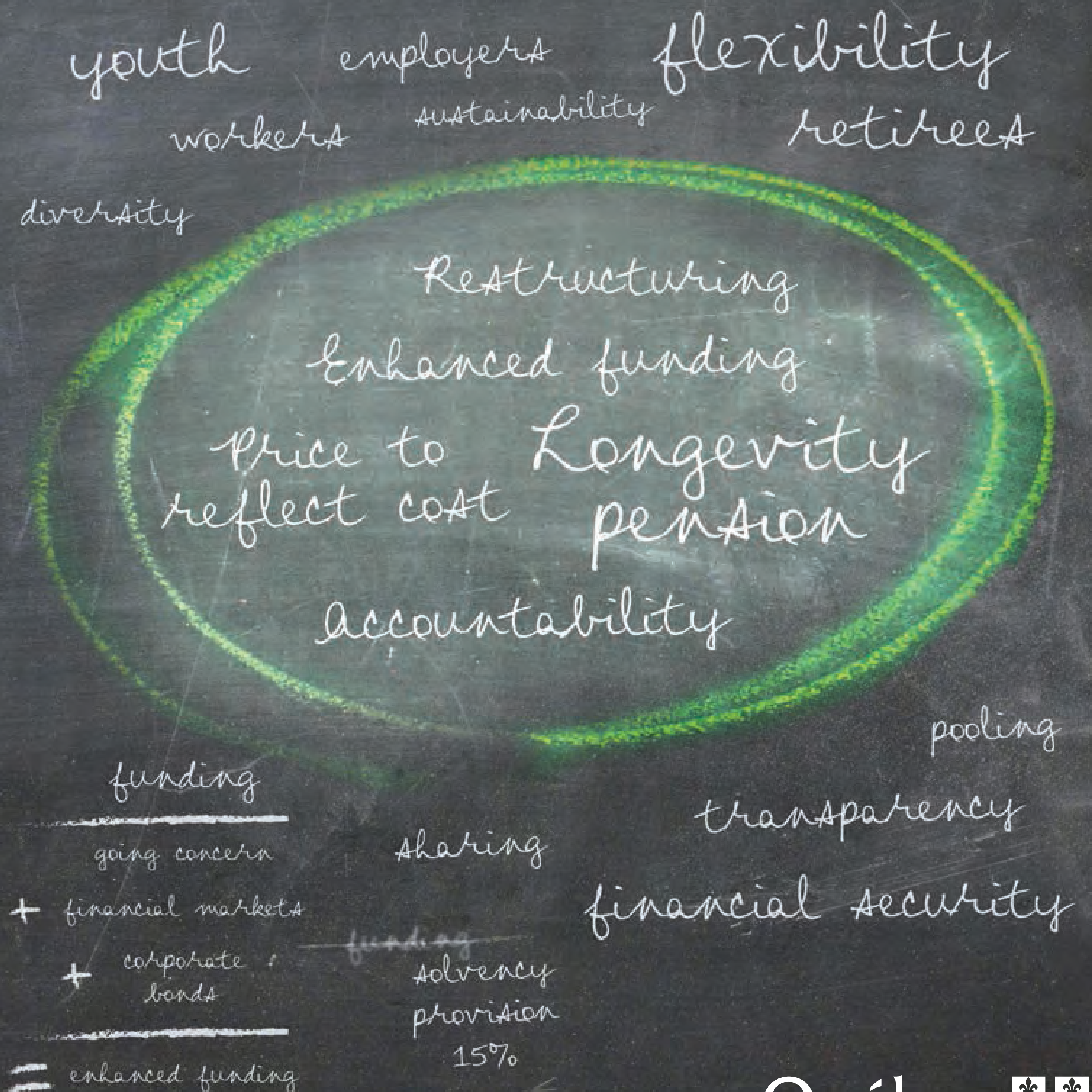
Summary

Innovating for a Sustainable Retirement System

A Social Contract to Strengthen the Financial Security of All Québec Workers



Québec

Innovating for a Sustainable Retirement System – Summary
Expert Committee on the Future of the Québec Retirement System

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The report *Innovating for a Sustainable Retirement System* is the result of work undertaken by the Expert Committee on the Future of the Québec Retirement System, at the request of the Gouvernement du Québec. The following summary presents the highlights of the full report.

❑ The Committee's terms of reference

The Gouvernement du Québec gave the Committee the mandate to study the supplemental pension plans, in particular defined benefit plans, which are on the "third storey" of our retirement system structure and fall under the supervision of the Régie des rentes du Québec.

CHART 1

Components of the Québec retirement system

3rd floor	VOLUNTARY
Private initiatives Supplemental pension plans and personal savings (covering almost 2.1 million workers who participate in some form of group savings)	
2nd floor	COMPULSORY FOR WORKERS
Québec Pension Plan (4.0 million workers covered and 1.5 million retirement pension beneficiaries)	
1st floor	MOST PEOPLE
Old Age Security (federal) (99% of the population covered, 1.3 million beneficiaries)	

Note: In addition to supplemental pension plans and personal savings, private initiatives include several types of retirement pension vehicles, such as group RRSPs and deferred profit sharing plans (DPSPs).

Source: Régie des rentes du Québec (most recent available data).

Initially, the mandate covered plans supervised by the Régie des rentes du Québec whose employers are in the public sector – mainly municipal and university pension plans. However, the mandate excluded public plans that are not under the supervision of the Régie des rentes du Québec, that is, plans whose employer is the Government (plans under the supervision of the Commission administrative des régimes de retraite et d'assurances – CARRA).

A mandate that changed over time

As time went by, it became obvious that the Committee's work should be integrated into a global vision of financial security and its embodiment in the retirement system. This broadening of the Committee's terms of references was requested by the stakeholders who met with the Committee and was supported by the Government.

The Committee's members decided to focus their work on the third level of the retirement system, that is, the private components, including supplemental pension plans (both defined benefit and defined contribution plans) and personal savings (particularly registered retirement savings plans and tax-free savings accounts).

The Committee chose a 40-year horizon for its work in order to take into account the changes in Quebeckers' retirement financial security over a long period.

The members of the Committee

The Committee was chaired by Mr. Alban D'Amours, President and CEO of the Desjardins Group (2000-2008).

The other members of the Committee were Mr. René Beaudry, actuary and Partner, Normandin Beaudry; Mr. Luc Godbout, tax specialist, Université de Sherbrooke; Mr. Claude Lamoureux, actuary, President and CEO, Ontario Teachers' Pension Plan (1990-2007); Mr. Maurice Marchon, economist, HEC Montréal; Mr. Bernard Morency, actuary, Executive Vice-President, Caisse de dépôt et placement du Québec and Mr. Martin Rochette, lawyer, Senior Partner, Norton Rose.

The Committee's work was supported throughout by two resource teams, one from the Régie des rentes du Québec and one from the Ministère du Conseil exécutif.

Seven points

The Expert Committee on the Future of the Québec Retirement System presents its analysis and conclusions in seven points.

1. The public plans provide very good protection for beneficiaries whose incomes are low, but the protection drops rapidly as income increases.

❑ Good plans for low-income workers, but the situation changes as income increases

Compared with other developed countries, the Québec public system provides **better retirement financial security** for individuals whose **incomes are low**.

In Québec, the gross replacement rate for public retirement plans is 81.6% for an income equal to half the average income, compared with 56.1% in the G7 countries and 57.2% in the OECD countries.[1] The Québec and Canadian systems are recognized around the world for their capacity to ensure income replacement after retirement for individuals with the lowest incomes.

TABLE 1

Gross replacement rates for public pension plans at age 65 – 2008
(as a percentage of individual earnings)

Individual earnings compared with average earnings	**50%**	**100%**	**150%**
Québec	81.6	47.0	31.9
Canada	76.6	44.4	29.6
Germany	42.0	42.0	42.0
France	55.9	49.1	41.3
Italy	64.5	64.5	64.5
Japan	47.9	34.5	30.0
United Kingdom	53.8	31.9	22.6
United States	51.7	39.4	35.3
G7 countries average	**56.1**	**43.7**	**37.9**
OECD average	**57.2**	**42.1**	**36.5**

Note: Replacement rates were calculated using 2008 parameters and salaries. The average earnings used are $43,000 for Canada and $39,900 for Québec.

Sources: OECD, *(Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries*, 2011) and Régie des rentes du Québec (*Évaluation du système québécois de sécurité financière à la retraite par rapport à celui d'autres pays industrialisés – 2011* (Evaluation of the Québec System of Financial Security at Retirement in Relation to that of other Industrialized Countries – 2011).

However, **the situation changes rapidly as income increases**. For average incomes, the public plans provide lower replacement rates.

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[1] Gross replacement rates for public pension plans at age 65, in 2008. These are the most recent data available.

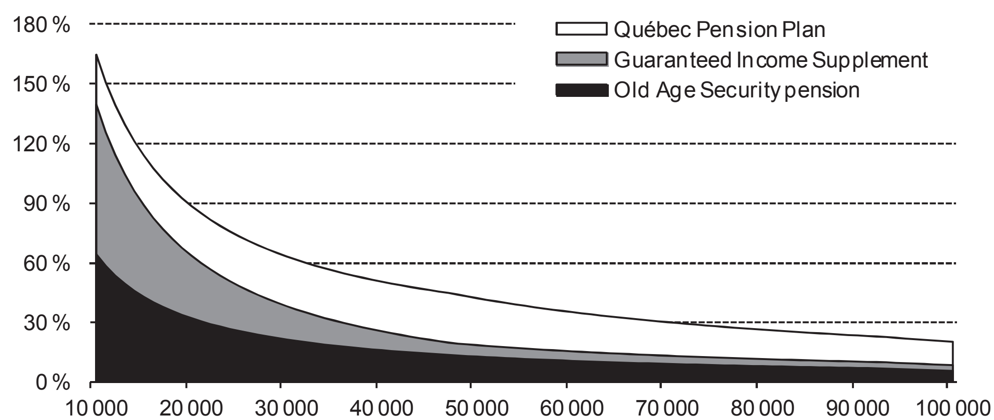
❑ The basic federal plan does not keep step with income growth

Within 40 years, the role of the basic federal plan in retirement income replacement will decline progressively as a result of the indexation method used for the Old Age Security pension and the Guaranteed Income Supplement.

Chart 2 shows the situation in 2012. For an income of $40,000, the public programs replaced 51% of income. At age 65, the Québec Pension Plan provided income replacement that represented 25% of pre-retirement pensionable income. At that age, under the Old Age Security pension, the income replacement rate represented 26% of pre-retirement income.

CHART 2

Income replacement levels for public plans – person living alone with no other retirement income who applies for pensions at age 65, in 2012
(income replacement as a percentage of pre-retirement income in dollars)



Note: The increase in the Guaranteed Income Supplement announced in the federal budget of June 6, 2011, is not reflected in this chart. The increase can reach $600 a year but applies only to very low income retirees.

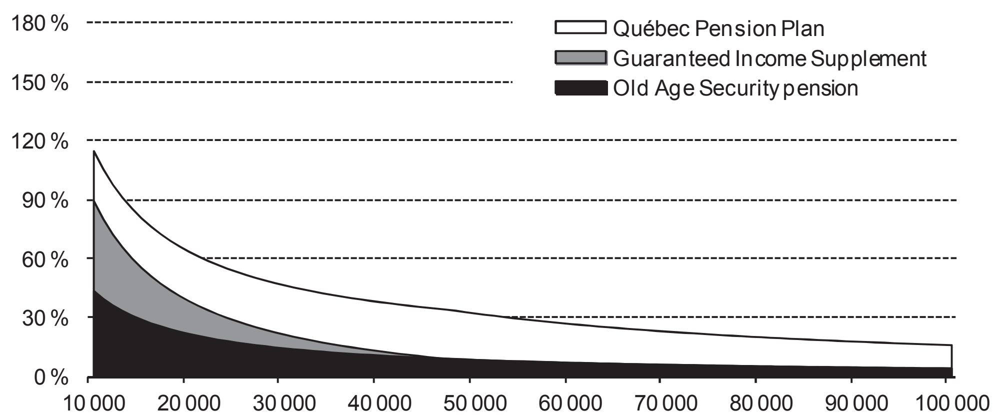
Source: Régie des rentes du Québec.

Chart 3 is a projection showing the situation in 2052. It is assumed that incomes will increase at a rate that is 1% above inflation, and the increase in the retirement age to 67 for the Old Age Security pension and the Guaranteed Income Supplement is not taken into account.

- The result is as follows: in 2052, at age 65, the Québec Pension Plan will still replace 25% of pre-retirement pensionable income. However, the federal Old Age Security pension and Guaranteed Income Supplement will replace only 13% of income.
- Overall, because of the indexation method used for the basic federal plan, the income replacement rate after retirement will decrease from 51% to 38% over the 40-year projection period.

CHART 3

Income replacement levels for public plans – person living alone with no other retirement income who applies for pensions at age 65,[(1)] in 2052
(income replacement as a percentage of pre-retirement income expressed as a 2012 income equivalent, in dollars)



(1) To simplify the comparison with the current situation, the scheduled increase in the eligibility age from 65 to 67 for the Old Age Security pension and the Guaranteed Income Supplement is not taken into account. The situation shown would, in fact, apply only as of age 67 but that does not change in any way the illustration given here.

Note: Normally for this type of chart, the abscissa is expressed as a percentage of the maximum pensionable earnings (MPE), but to make the chart easier to read, it is given here in terms of today's income.

Source: Régie des rentes du Québec.

2. For average and above-average incomes, savings are often insufficient to ensure retirement financial security.

It must be pointed out that there is no consensus on the retirement income replacement rate required to ensure retirement financial security. For the Committee, a replacement rate between 50% and 70% was considered acceptable. In its work, the Committee used a rate of 60% for illustrative purposes.

The distribution of workers by type of plan shows the inequality in the protection levels that Québec workers have under the various plans when they retire.

Above low income levels, that is, for workers' whose incomes are average or above-average, the protection provided by the public plans must be supplemented by supplemental pension plans or personal savings – or both – for them to reach the desired objectives with respect to financial security. In that regard, all workers are not adequately protected.

❑ The majority of Québec workers do not have a supplemental pension plan

Most Québec workers do not have a supplemental pension plan, or they have a plan that provides weak retirement financial security. Almost 1.9 million workers (47%) do not participate in any type of group plan (defined benefit, defined contribution, group registered retirement savings plan, etc.).

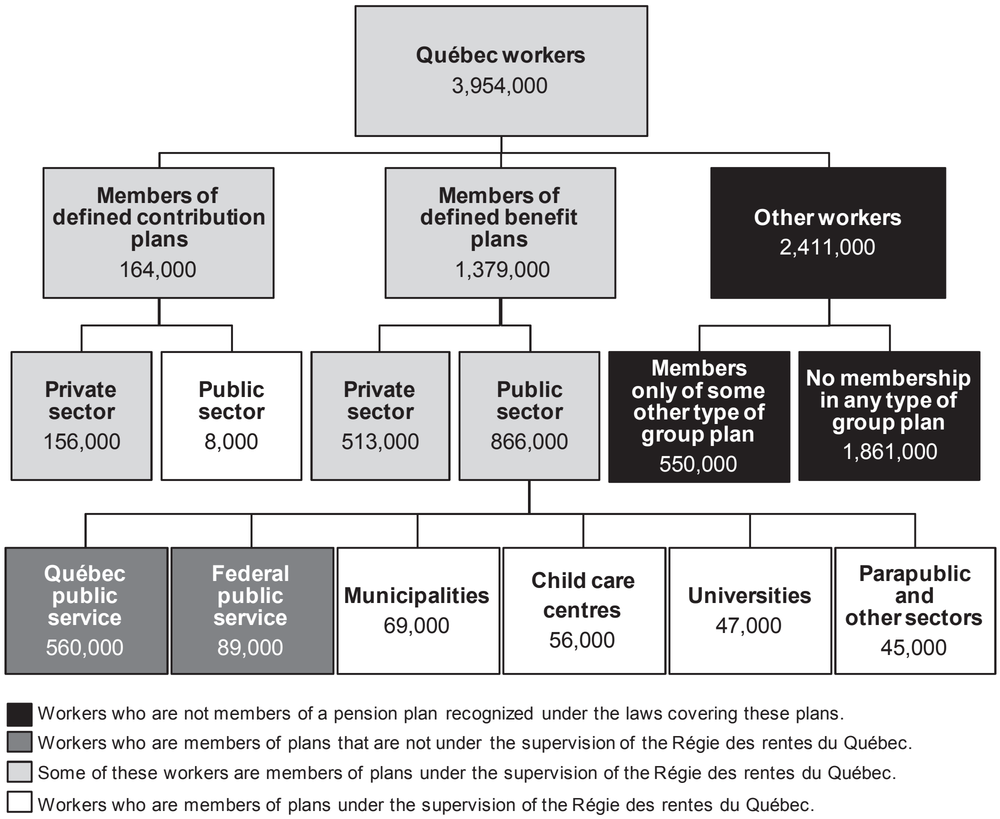
Overall, 61% of Québec workers (2.4 million) have neither a defined benefit plan nor a defined contribution plan. The plans that provide the best financial security, that is, defined benefit plans, cover only 35% of workers, of whom almost two thirds work in the public sector.

A growing number of workers – particularly the youngest among them – do not have a plan ensuring real financial security because of the replacement of defined benefit plans with defined contribution plans and private savings.

The latter plans are, of course, ways to save for retirement. However, they provide lower net returns and do not guarantee a pension. Defined benefit plans provide better protection and at a lower cost.

CHART 4

Distribution of Québec workers[1] by plan type
(by number of workers)



(1) Employed and self-employed workers.

Notes: The data are rounded to the nearest thousand. The number of Québec workers is the average, during 2011, of the number of workers living in Québec, obtained from Statistics Canada's monthly *Labour Force Survey*.

The number of Québec workers who are members of a defined benefit or defined contribution supplemental pension plan includes members of plans that are not under the supervision of the Régie des rentes du Québec, but whose pension benefits are governed by the *Supplemental Pension Plans Act*. According to information on page 24 of the Régie des rentes du Québec's *Rapport annuel de gestion 2011* (Annual Management Report for 2011), there are 578,000 members of defined benefit plans and 115,000 members of defined contribution plans (including simplified pension plans) in plans supervised by the Régie des rentes du Québec, for a total of 693,000 workers. This data and the distribution of workers is based on the most recent data available when this report was published.

The number of members only of some other type of group plan includes members of group RRSPs, deferred profit sharing plans (DPSPs) and any plan other than those shown on the chart. That number is given in *Portrait du marché de la retraite au Québec* (Study on the Québec Retirement Market), published in 2010 by the Régie des rentes du Québec. The survey made at that time has not been repeated since.

To distinguish between public sector and private sector entities, the main determining factor is the intervention of public authorities. Such authorities are characterized by their power to tax, to manage public funds and to control and regulate activities.

Source: Régie des rentes du Québec.

❑ Studies with convergent results

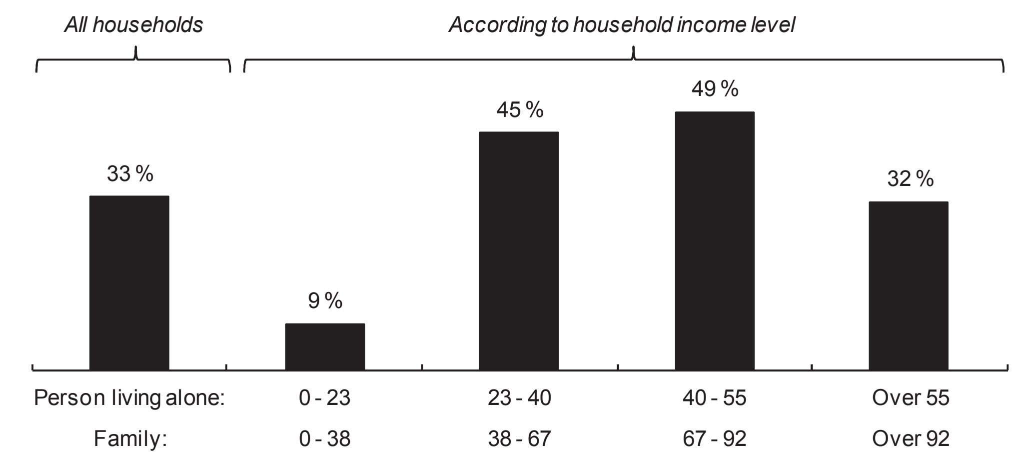
Studies confirm that for people with average or above-average incomes, savings are often insufficient to ensure retirement financial security.

The various studies carried out do not come to identical conclusions as to the exact number of households that do not have sufficient savings to ensure retirement financial security, but one can generally estimate that between a fourth and a third of households are in that situation.

According to a report published by the Régie des rentes du Québec in 2010,[2] 33% of Québec households are not putting aside enough money to reach an income replacement rate of 60%, if retirement is taken at age 65. The rate is 45% for a family with an income between $38,000 and $67,000 and 49% for a family with an income between $67,000 and $92,000.

CHART 5

Proportion of households for which the income replacement rate at retirement will be less than 60% following retirement at age 65
(as a percentage of annual income in thousands of dollars for person living alone or a family)



Source: Régie des rentes du Québec, *Constats et enjeux concernant le système de retraite québécois* (Facts and Issues concerning the Québec Retirement System), 2010, p. 36

2 *Constats et enjeux concernant le système de rente du Québec* (Facts and Issues concerning the Québec Retirement System), 2010, p. 35.

Other studies corroborate to varying degrees the findings of the Régie des rentes du Québec: in Québec, as in Canada as a whole, a large fraction of workers are not saving enough to ensure themselves of a certain replacement rate for their pre-retirement income.

In particularly, we can cite the following studies:

— *Summary Report on Retirement Income Adequacy Research,* made by Jack M. Mintz in December 2009 (the report summarizes the results of the research carried out for the Research Working Group on Retirement Income Adequacy set up by the federal, provincial and territorial ministers of finance);

— *Are Canadians Ready for Retirement? Current Situation and Guiding Principles for Improvement*, a 2012 report published by McKinsey & Company;

— *Projecting the Adequacy of Canadians' Retirement Incomes,* a 2011 study by Michael C. Wolfson, Institute for Research on Public Policy (IRPP).

❑ **A phenomenon already pointed out by the Gouvernement du Québec**

The lack of sufficient retirement savings has previously been pointed out by the Government. The lack of retirement planning by a large proportion of households, particularly households with average incomes, was strongly emphasized in the Gouvernement du Québec's 2011-1012 Budget.

In a Budget paper on the retirement system,[3] we can read the following:

> "Despite adequate average replacement rates, a certain proportion of retirees must come to terms with retirement income that is insufficient to maintain their standard of living. According to estimates by the Régie des rentes du Québec, the earned income replacement rate of between 30% and 40% of Québec workers will be less than 60%.
>
> The situation is particularly worrisome for workers with earned income between $20 000 and $60 000.
>
> – A relatively high proportion of workers in this income bracket have saved little for retirement.
>
> – However, a low replacement rate for these workers means that they may be in financial difficulty at retirement, unlike higher-income households."

Although it is difficult to precisely evaluate the scope of the problem, we conclude that the current situation is worrisome.

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[3] Gouvernement du Québec, *A Stronger Retirement Income System*, 2011-2012 Budget, March 2011, page 7.

❑ Additional concerns going forward

The situation is even more worrisome considering that it is based on an examination of the retirement system as it currently exists. The concerns voiced by the Committee increase when we make a projection with a 30 to 40 year horizon.

Several factors come together in such a way that the situation can only get worse in the future, unless the retirement system undergoes major changes.

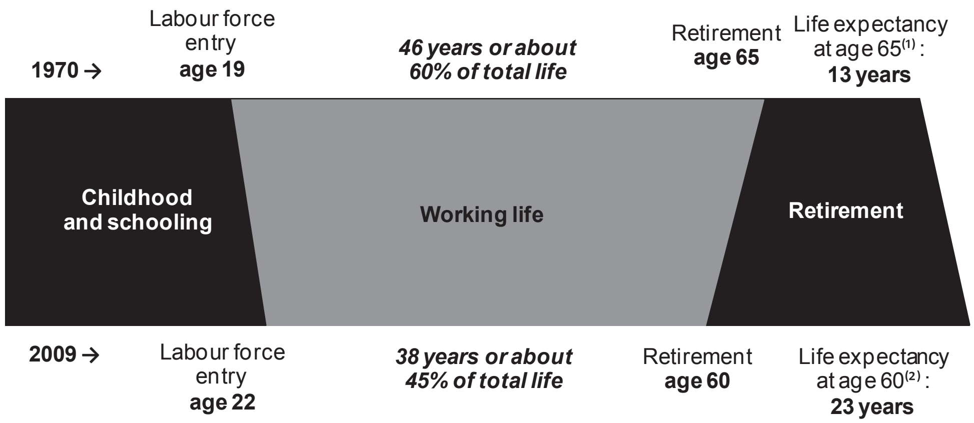
- Defined benefit pension plans have been weakened, and their commitments are based on uncertain rates of return.
- The protection provided by the basic federal plan is gradually diminishing because of the indexation method adopted.

Demographic pressures add to the need to save more for retirement.

- Life expectancy is steadily increasing. Between 1971 and 2011, life expectancy at age 65 in Québec has increased by slightly over five years for women and by almost six years for men. At the same time, the working life has become shorter; workers enter the labour force at a later age and take retirement earlier. Since 1970, the working life for men has decreased by eight years.
- Workers are working fewer years to prepare financially for a longer retirement. In Québec, between 1970 and 2009, the working life as a proportion of total life has decreased from around 60% to 45%.
- The uncertainty surrounding future changes in life expectancy is also a growing factor in the need to save for retirement. It is a question of covering what is called the "longevity risk", that is, the risk of living longer than the period covered by retirement savings, in other words of outliving our savings.

CHART 6

Changes in the length of the working life between 1970 and 2009



(1) Life expectancy for men is used here to better reflect the composition of the labour force. For women, life expectancy at age 65 in 1970 is 17 years.

(2) Life expectancy for men is used for comparison with life expectancy in 1970. For women, life expectancy at age 60 in 2009 is almost 26 years.

Sources: Ministère des Finances et de l'Économie du Québec, Institut de la statistique du Québec, Régie des rentes du Québec and Statistics Canada.

❑ How much savings is needed for retirement?

According to calculations made by the Régie des rentes du Québec, a worker who is 22 years old and who expects to earn $50,000 on the eve of retirement must save 17% of his or her earnings to be able to retire at age 60 with a retirement income that represents 60% of his or her pre-retirement income (assuming an annual 2% real rate of return). The worker must put that much aside each year until he or she retires.

The savings needed decrease to 15% of income if retirement is taken at age 62 and to 11% if retirement is taken at age 65.

Table 2 shows these results and another example, which applies to a worker who is 30 years old. The savings needed is more than in the first example, which is to be expected. In the second example, the worker has a shorter period of time to accumulate the savings needed to ensure the desired retirement income. The table also shows a scenario where the real return on savings is 3% a year.

TABLE 2

Savings needed for retirement(1) – to replace 60% of a pre-retirement income of $50,000
(savings rate as a percentage of income)

	Retirement at age 60		Retirement at age 62		Retirement at age 65	
Age when saving begins	**22**	**30**	**22**	**30**	**22**	**30**
Savings needed(2) at a 2% real rate of return	17	23	15	19	11	14
Savings needed(2) at a 3% real rate of return	13	18	11	14	8	10

(1) Savings needed over and above the coverage provided by the public plans (Old Age Security and Québec Pension Plan).
(2) Personal savings where the person does not have a supplemental pension plan to cover needs.

Notes: For the purpose of making calculations, it is assumed that the person is currently earning $50,000, stops working and takes retirement at the ages shown in the table. The savings rates were calculated by taking into account a 1% real rate of salary increase and depending on the scenario, a 2% or 3% real rate of return, before and after retirement.

Income from private savings was determined by assuming that an Old Age Security pension begins at age 67 (with no adjustment to reflect eventual changes to the program) and by assuming that a retirement pension under the Québec Pension Plan begins at age 65.

It is also assumed that the person began contributing to the Québec Pension Plan at 20 years of age.

For simplification purposes, there is no mortality assumption before or after retirement. Death is assumed at age 90.

Source: Régie des rentes du Québec.

3. Defined benefit plans, which provide the best financial security, are under significant pressure

The position of the retirement system has been worsened by the significant pressure on the plans that provide the highest degree of financial security: defined benefit plans.

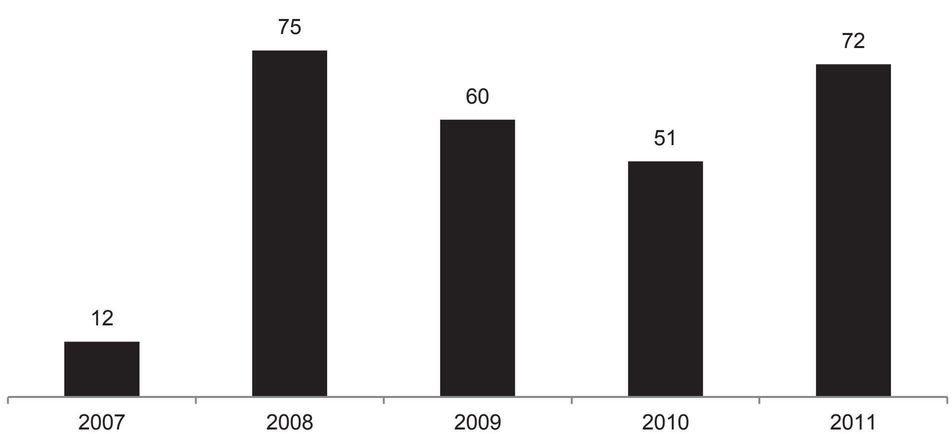
- Flaws resulting from structural weaknesses have rendered these plans fragile. In particular, the Committee has pinpointed faulty risk management, an imbalance between the risks taken and the benefit of exposure to these risks, inaccurate valuations of plan liabilities, definitions of plan commitments that have not been taken into consideration and a legal and regulatory framework that is too restrictive.
- Increasing life expectancy, early retirements, an aging population, the decrease in interest rates and financial market volatility have made the weaknesses blatantly obvious. The situation has been compounded by contribution holidays and improvements made to the plans in the 1990s.

❑ The deterioration of the degree of solvency of defined benefit pension plans

A rapid deterioration in the degree of solvency of defined benefit plans has been seen in recent years.

CHART 7

Proportion of defined benefit plans whose degree of solvency is less than 80%
(as a percentage)



Source: Régie des rentes du Québec.

In 2007, 12% of defined benefit plans had a degree of solvency that was less than 80%, which means that the assets of these plans covered less than 80% of their commitments at the time of the valuation.

In 2008, the proportion rose sharply to 75% due to the financial crisis and its impact on the value of the investments made by pension funds. After dropping in 2009 and 2010, the proportion rose again in 2011. According to projections, the degree of solvency of 72% of defined benefit plans was less than 80%.

Had the plans all been terminated as at December 31, 2011, the benefits of fewer than 20,000 members would have been fully funded on a solvency basis whereas the benefits of over one million members would have been funded at less than 80%. The benefits would have been at risk in the event of the employer's bankruptcy or insolvency.

❑ The situation of municipal sector plans

The situation is particularly worrying for public pension plans (essentially plans in the municipal and university sectors) under the supervision of the Régie des rentes du Québec.

Between December 31, 2006 and December, 31 2011, the median degree of solvency of private pension plans dropped from 90% to 75%. During the same period, the median degree of solvency of public (essentially municipal and university sector) plans plummeted from 93% to 67%.

At December 31, 2011, the total funding deficiency for municipal pension plans was just over 4 billion $ (close to 9 billion $ for solvency deficits). At the same date, the total funding deficiency for university plans slightly exceeded 1 billion $ (just over 4 billion $ for solvency deficits).[4]

❑ The forsaking of defined benefit pension plans

A further threat: many defined benefits plans have been converted to defined contribution plans in recent years. Forsaking defined benefit plans has raised fears that future retirement incomes will be reduced.

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4 Régie des rentes du Québec.

❑ **The illusion of a market turnaround**

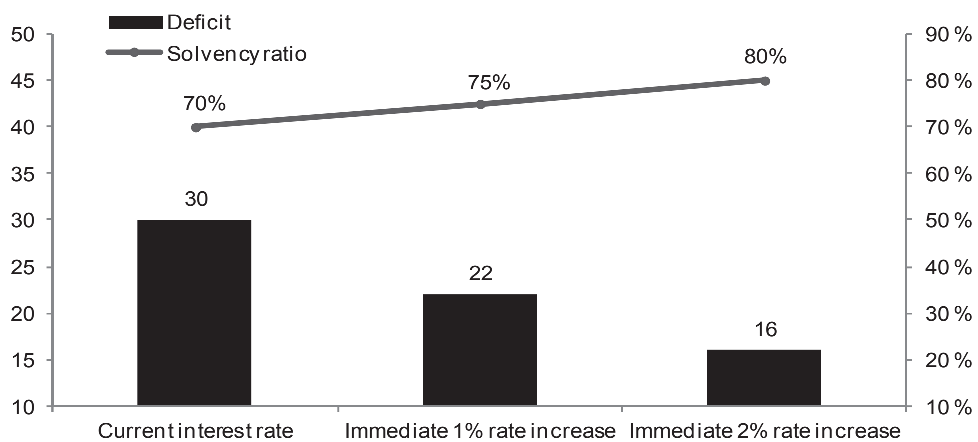
It has been said by some that a sustained and significant market turnaround would provide a long-term solution to the problem; therefore, patience is all that is required. As charts 8 and 9 show, such a turnaround is an illusion.

Those expecting a sudden rise in interest rates should understand that such a rise would not constitute a solution to the problems facing defined benefit pension plans any more than high returns on market investments would.

The solution cannot in fact be envisaged without looking at the cost-benefit equation.

CHART 8

Effect of a variation in interest rates on the solvency deficiency of a defined benefit pension plan – best-case scenario, interest rate changes neutral on the stock markets
(deficiency in millions of dollars at left and degree of solvency as a percentage at right)

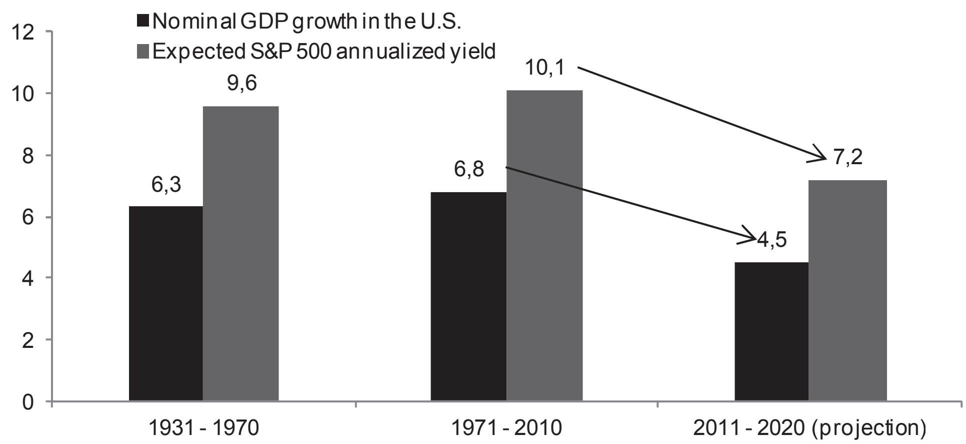


Note: Assumption based on a pension plan with liabilities of 100 million $ distributed equally between the group of active members and the group of retirees and beneficiaries. Plan assets are divided equally between fixed income securities (bonds) and variable income securities (shares).

Chart 8 shows how a rise in interest rates would help sponsors of defined benefit pension plans, but still not be enough to solve the funding problems of these plans.

CHART 9

Expected rate of return - financial markets
(as a percentage)



Source: Caisse de dépôt et placement du Québec.

Historically, the relationship between stock market returns and economic growth has been strong. In the near future, experts expect economic growth to remain moderate.

4. The objectives, principles and values recommended by the Committee

Two objectives

The social partners are of like mind on **two** essential objectives:

- A retirement system must provide financial security in the strictest sense: it must ensure **sufficient** and **realistic** retirement income for the greatest number of retirees.
- The retirement system must be designed and funded **so that it endures**. The guarantee of sufficient and realistic retirement income must be provided in conjunction with pension plans whose sustainability is ensured, as sustainability cannot be dissociated from the security the system is meant to provide.

Values and principles

The Committee has identified three **values** and four **principles** that must be universally agreed upon. The values and principles retained by the Committee stem from the various messages received by the committee.

Intergenerational equity

The Committee has placed intergenerational equity, which affects us all, in the forefront of these values. The retirement system must be designed so that it takes into consideration:

- the retirees whose former employers (public or private) are in financial difficulty;
- the workers who are actively contributing to the system;
- the young workers entering the workforce, on the assumption that they will remain active for several decades.

Transparency and accountability

In analysing the current situation and drafting its recommendations, the Committee retained two additional values: transparency and accountability.

Four principles

The Committee has identified four principles, based on consensus, which correspond to the Committees own conclusions:

- the actual cost of funding retirement income must be respected;
- the diversification of retirement income sources must be maintained;
- the legal framework must provide leeway;
- risk pooling must be promoted.

Swimming against the current

In the Committee's opinion, returning to the veritable objectives of pension plans involves bucking current trends.

- The sustainability and viability of defined benefit pension plans must be ensured.
- At the same time, the greatest number of workers should participate in defined benefit plans. Innovations for this purpose should be made without hesitation.
- Workers must be assisted in their efforts to save more for retirement. In this regard, pension plans other than defined benefit plans have an essential role to play.

5. The Committee proposes a core innovation: the longevity pension.

The Committee has made three series of recommendations.

❑ **The first series of recommendations**

First of all, the Committee has proposed a core innovation that would **provide all Québec workers with a longevity pension** that would be **fully funded and defined so as to bring it in line with its true costs**.

The proposal means that the Québec retirement system would have a new component, situated on the second storey of the system's structure, next to the Québec Pension Plan. As of age 75, all workers would have the benefits of a defined benefit pension. It would allow all to better manage the longevity risk by concentrating the need to use personal savings on a period from retirement to age 75.

CHART 10

Components of the Québec retirement system – with the longevity pension

3rd floor **Private initiatives** Supplemental pension plans and personal savings	VOLONTARY
2nd floor **Longevity pension** **and** **Québec Pension Plan**	COMPULSORY FOR WORKERS
1st floor **Old Age Security (federal)**	MOST PEOPLE

Note: In addition to supplemental pension plans and private savings, private initiatives include other types of retirement pension vehicles, such as group RRSPs and deferred profit sharing plans (DPSPs).

Source: Régie des rentes du Québec.

❑ Two objectives

The longevity pension has two main objectives:

- **Pooling the longevity risk** for the benefit of all Québec workers;
- **Make it easier for all Québec workers to plan personal savings in preparation for retirement,** knowing that the longevity risk would be at least partially assumed as of age 75.

Age 75 was chosen as the starting date for benefit payments so that the implementation of the longevity pension would not encourage early retirement and would have no impact on the labour market.

❑ Characteristics of the longevity pension

All Québec workers between the ages of 18 and 74 would be covered. Thus, the longevity pension would cover the entire workforce, regardless of income levels. Workers with the lowest incomes would not be excluded from the longevity pension even though they already have a good protection under the public plans. Excluding them would suppose that they would always remain in the same income category.

Like the Québec Pension Plan, the longevity pension would be administered by the Régie des rentes du Québec, and its governance would be modeled after that of the Québec Pension Plan, with assets managed by the Caisse de dépôt et placement du Québec.

■ Funding the longevity pension

The funding of the longevity pension would be based on contributions from employers and workers. However, unlike the Québec Pension Plan, the longevity pension would be fully funded so as to ensure intergenerational equity. From its start, benefits under the longevity pension would gradually accrue, at a rate corresponding to the contributions made to fund it.

The longevity pension proposed by the Committee is defined for future years. It would be of most benefit to those who contribute to it for a long time, that is, for workers who begin contributing at a young age.

According to evaluations made by the Régie des rentes du Québec, the plan's cost is estimated to be 3.3% of earnings up to the maximum pensionable earnings. The cost would be shared equally by employers and workers. The longevity pension could be implemented gradually over five years so as to minimize the impact that funding it would have on companies and workers.

The real additional cost for employers and workers

Compared with current contributions, the real additional cost would depend on the plans in which employers and workers participate.

In the case of defined benefit plans, where longevity risk is already covered and if such plans are coordinated with the longevity pension, we would see a transfer of a portion of the share of the contribution corresponding to funding the risk.

For defined contribution plans and personal savings, the cost could be partially or totally covered if employers and workers agreed to redirect to the longevity pension a portion of the contributions currently earmarked for defined contribution plans and personal savings. The additional cost would be largely offset by the advantages of the longevity pension.

Illustrations of various strategies that a worker could choose to adopt

Charts 11 to 15 illustrate various strategies that a worker could choose to adopt so as to reach a particular income replacement objective following retirement, in the current system and in a system where the longevity pension has been implemented.

- In the illustrations given, a worker retires at age 60 or 65.
- The charts make it possible to determine the value of the private initiatives needed to maintain a retirement income equal to 60% of a worker's pre-retirement income.
- We see that the implementation of the longevity pension would help workers make their savings plans to prepare for retirement.

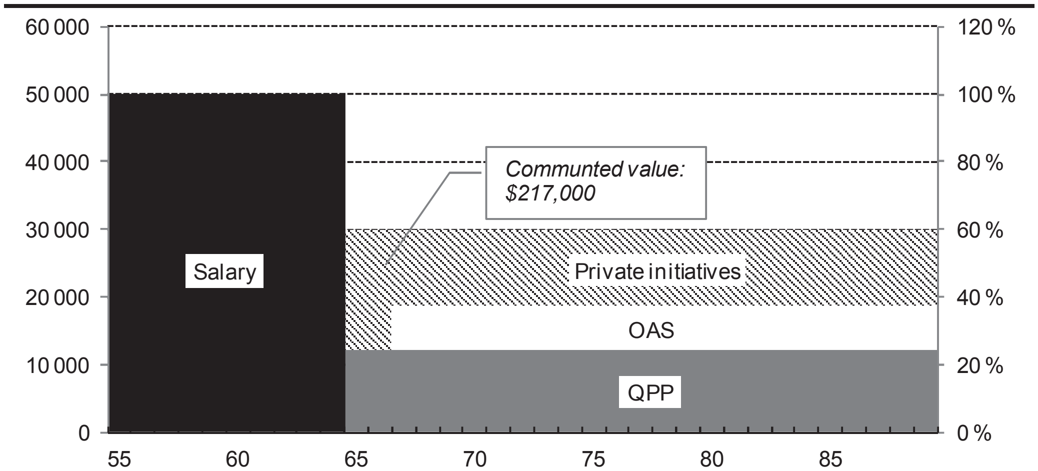
■ **First two scenarios: retirement at age 65**

The **first two scenarios** correspond to the situation of an individual who retires at the normal retirement age (65) and applies at that moment for a pension under the Québec Pension Plan.

In the **first scenario** (the current system[5]), illustrated by Chart 11, the commuted value of private initiatives to fund the individual's retirement is roughly **$217,000**, if he or she retires at age 65.

CHART 11

Sources of retirement income by age – retirement at age 65 under the current system
(in constant dollars at left and as a percentage of salary at right)



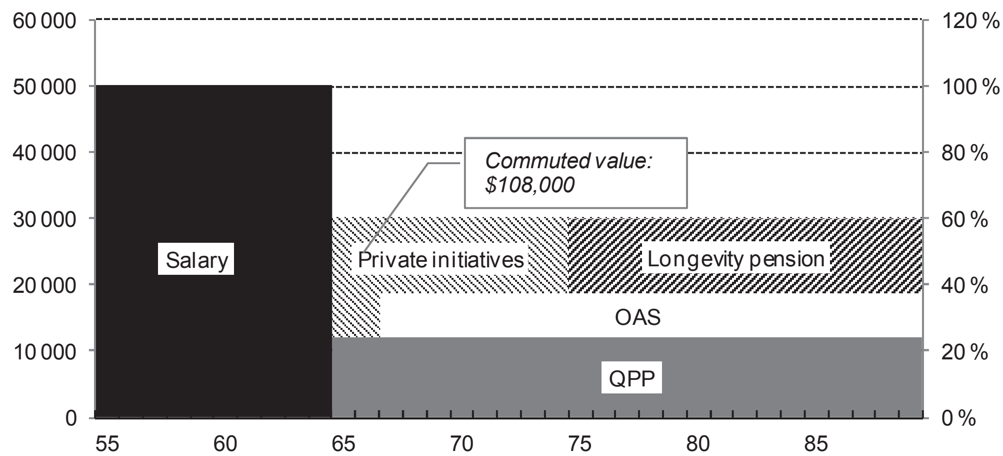
Source: Régie des rentes du Québec.

5 Excluding the postponement of Old Age Security benefits to age 67, which has already been announced.

In the **second scenario**, illustrated in Chart 12, individuals can include the longevity pension in their retirement planning. Note the benefit it provides. In this scenario, the commuted value of private initiatives to fund the individual's retirement is almost **$108,000**.

CHART 12

Sources of retirement income by age – retirement at age 65 under the system with the longevity pension
(in constant dollars at left and as a percentage of salary at right)



Source: Régie des rentes du Québec.

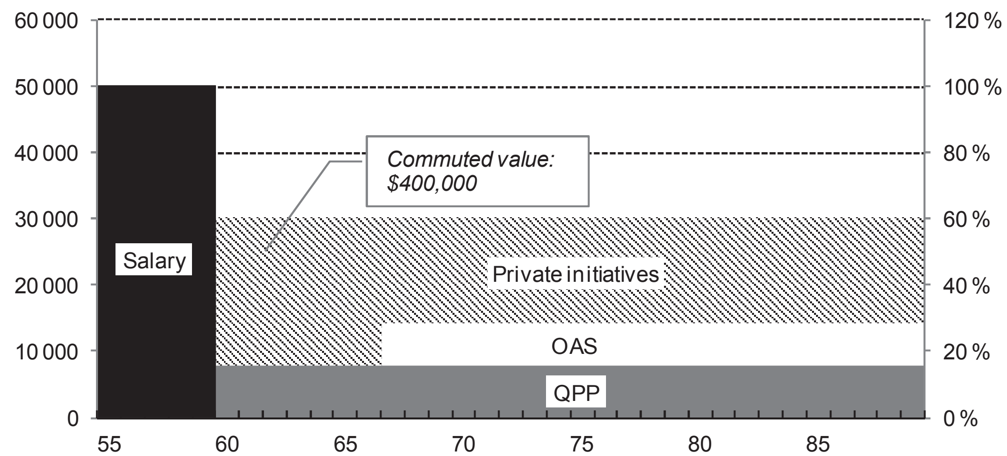
■ **Three following scenarios: retirement at age 60**

In the **third, fourth and fifth scenarios**, individuals choose to retire earlier, at age 60. The three scenarios show that, even with early retirement, the longevity pension would enable individuals to better plan their retirement, especially if they make strategic use of all tools available.

The **third scenario**, illustrated in Chart 13, is identical to the first scenario, except that the individual chooses to retire at age 60. In this scenario, the commuted value of private initiatives to fund the individual's retirement is around **$400,000**.

CHART 13

Sources of retirement income by age – early retirement at age 60 under the current system
(in constant dollars at left and as a percentage of salary at right)

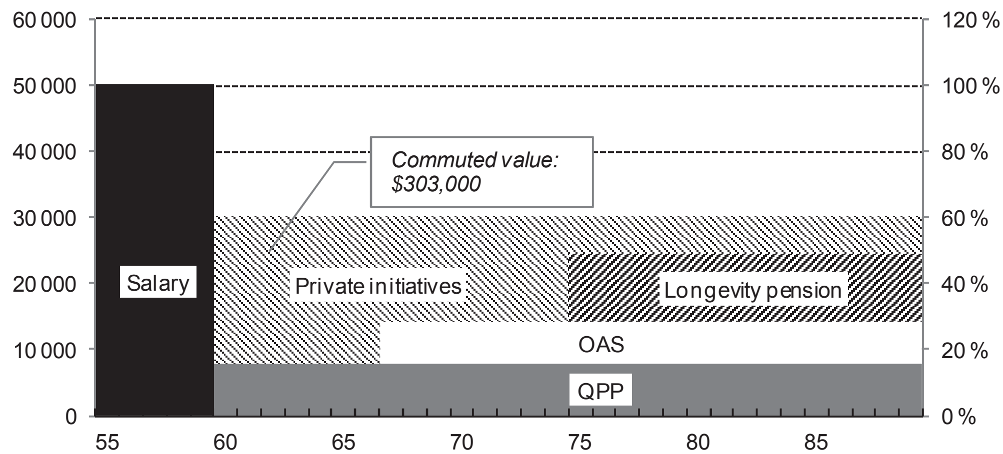


Source: Régie des rentes du Québec.

In the **fourth scenario**, illustrated in Chart 14 and similar to the third scenario, the individual chooses to leave the labour force at age 60 and immediately apply for an early pension under the Québec Pension Plan. In this scenario, the commuted value of private initiatives to fund the individual's retirement is around **$303,000**.

CHART 14

Sources of retirement income by age – early retirement at age 60 under the system with the longevity pension
(in constant dollars at left and as a percentage of salary at right)

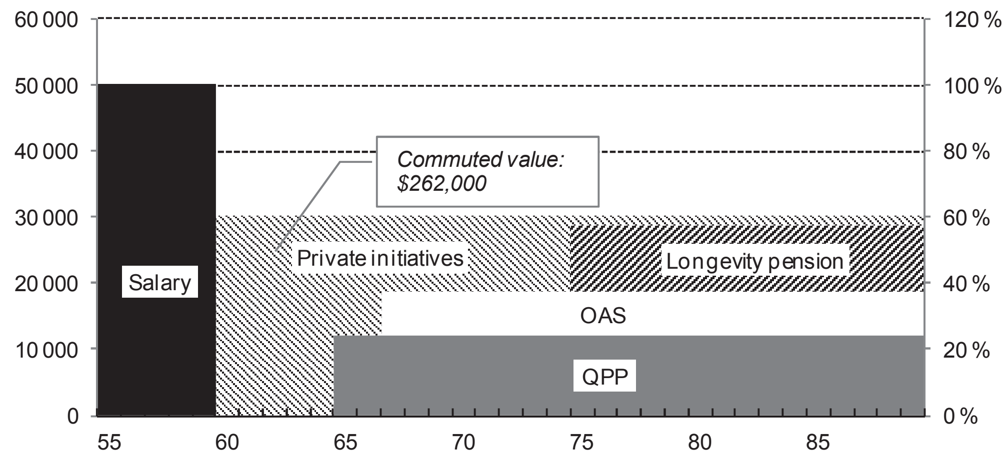


Source: Régie des rentes du Québec.

In the **fifth scenario,** illustrated in Chart 15 and similar to the fourth scenario, the individual leaves the labour force at age 60 but decides to postpone from 60 to 65 the age at which he or she applies for a retirement pension under the Québec Pension Plan. In this scenario, the commuted value of private initiatives to fund the individual's retirement is around **$262,000**.

CHART 15

Sources of retirement income by age – early retirement at age 60 under the system including the longevity pension, pension under the Québec Pension Plan at age 65
(in constant dollars at left and as a percentage of salary at right)



Source: Régie des rentes du Québec.

Two findings and one conclusion

Two findings come out of the five scenarios described above:

- In all cases, the longevity pension is good news, regardless of whether the individual retires at age 65 or 60.
- The scenarios show the value of separating the age of retirement from the age a pension is drawn under the Québec Pension Plan.

The longevity pension would secure retirement benefits for all workers by guaranteeing them a set income starting at age 75 and expanding the planning options available, while also changing retirement behaviours. Such a pension would meet the needs of workers who do not have access to an employer-sponsored pension plan and those whose defined benefit pension plan is threatened.

Additional benefits

The longevity pension would provide persons age 75 and over with a stable income, enabling them to pay for health care and quality lodging without relying on the youngest generations.

With the increase in life expectancy, the probability that a retiree outlives his or her previous employer is increasingly high. The longevity pension would sever this link and make retirees less vulnerable to employer bankruptcies.

The longevity pension would also protect members following a change of employer.

Recommended changes to the Québec Pension Plan

The Committee recommends that certain changes be made to the **Québec Pension Plan**. In this regard, the Committee supports the government's decision to modify the adjustment factor to encourage individuals to postpone the age of retirement. The Committee's recommendations concerning the Québec Pension Plan aim to:

- end the unintentional effects of the rule applicable to employment earnings after age 60;
- fully fund any future improvements, as with the longevity pension proposed by the Committee.

The Committee makes **no specific recommendation regarding the age of retirement** and proposes no coercive measures to that effect. Workers must remain free to choose the age at which they retire, provided they accept the consequences of their choice.

In addition, the Committee supports the government's decision to modify the adjustment factor to encourage individuals to postpone the age of retirement.

6. To protect the basic commitments of defined benefit plans, the Committee recommends ensuring that funding more closely reflects actual costs, as well as giving plans more leeway to improve plan governance and enable them to restructure.

Secondly, the Committee has proposed a series of measures aimed at **protecting the basic commitments of defined benefit plans**.

❑ Staying the course

The Committee believes the current situation is no reason to give up. Defined benefit plans provide the type of financial security that should be emphasized, since only they make a commitment, along with the basic federal Old Age Security program and the compulsory Québec Pension Plan for all workers. No other supplemental pension plans or personal savings vehicles can provide members with the same level of financial security, mainly because they make no specific commitments, deliver poor returns and do not pool risks.

Steps should therefore be taken to determine how best to ensure the sustainability and viability of defined benefit plans.

The Committee makes **three recommendations**.

❑ Ensure funding more closely reflects actual costs

To ensure **funding more closely reflects costs**, the Committee recommends using a single valuation method—an "enhanced funding" method—for all pension plans under the supervision of the Régie des rentes du Québec.

This method would be more stringent than the current funding method required for all plans for which the employer is a public body (mainly municipalities and universities).

The enhanced funding method would relax the criteria used for most other plans under the jurisdiction of the Régie des rentes Québec, specifically plans where the employer is in the private sector and for which the solvency method is currently used.

❑ Provide more leeway to enhance plan governance and management

Further to comments by stakeholders, the Committee recommends a series of measures to **enhance plan governance and management**, with the specific goal of giving partners more leeway to share costs as well as address asymmetric benefits and risks.

❑ Eliminate plan deficits

To **eliminate plan deficits**, the Committee recommends that parties to a pension plan be able to restructure plans over a five-year period.

The exact restructuring mechanisms would be negotiated by all parties and would **reformulate the concept of vested rights**. Some benefits could be re-evaluated during negotiations depending on the employers' and employees' capacity to pay.

However, the basic commitment of defined benefit plans—namely, a pension determined as a percentage of salary and according to the number of years worked—would be protected. In addition, pensions in payment would in no way be reduced.

If no agreement is reached within three years, the employer could, in the last two years of the five-year period, make unilateral amendments to plan indexation, subject to certain specific conditions. One such condition would oblige the employer to make a payment that would reduce the deficit in proportion to the impact of any indexation changes.

7. The Committee recommends helping workers save more for retirement and making the system more effective.

Thirdly, the Committee has made recommendations in order to **support workers in their efforts to save more for** retirement and to **make the retirement system more effective**.

The Committee has found that the implementation of the longevity pension and the efforts that have gone towards ensuring the sustainability of defined benefit plans will not suffice to increase savings to the desired level. Under the renewed retirement system proposed by the Committee, supplemental pension plans other than defined benefit plans have a key role to play: provide a predictable way for workers to meet their savings needs from the time they leave the labour force to the time payment of the longevity pension begins.

❑ Two recommendations

There are a number of ways to improve saving for retirement. The Committee makes two recommendations for supplemental plans other than defined benefit plans, specifically

— speedy implementation of **voluntary retirement savings plans**, with a few adjustments;

— loosening of the legislative framework so as to make the **withdrawal of retirement savings** more flexible.

In the Committee's view, the government should improve current voluntary retirement savings plans by exempting employers that offer a group tax-free savings account (TFSA) from the obligation to offer a voluntary retirement savings plan.

The retirement system should also be made more effective by allowing for greater flexibility in the withdrawal of retirement savings. To that end, our recommendations target defined contribution plans, retirement accounts and life income funds (LIFs), as well as registered retirement savings plans (RRSPs).

Conclusion

With its recommendations, the Committee has laid the groundwork for an exciting and ambitious project involving the government and all Québec workers: renewing the Québec retirement system and ensuring its sustainability in order to establish what could be called an “intelligent retirement system.”

The new system proposed by the Committee would, over time, bolster the financial security of all workers.

- For many workers, it would provide access to an improved retirement plan.
- It would take into account the fact that all employers do not have the financial means to offer a defined benefit plan.
- It would give defined benefit plans options for ensuring their sustainability.
- It would promise future retirees a pension that is financially sustainable by members and employers, that is, one whose funding reflects actual costs.
- It would strengthen other supplemental pension plans that numerous workers and employers rely on.

Because of its very nature, this project should be part of a true **social contract** whose universal goal would be to strengthen the financial security of all Québec workers.