

## **Pension Reform is Critical to Protect Canadians' Standard of Living: TD Economics**

*Growing number of Canadians likely to have inadequate replacement income for retirement*

TORONTO -- Unless pension reform is pursued, a growing number of Canadians will not have an "adequate" income level in retirement, resulting in a lower standard of living for many seniors over the next four decades according to a new report from TD Economics ([www.td.com/economics](http://www.td.com/economics)).

The report comes days before a meeting of Federal and Provincial Finance Ministers that will discuss Canada's retirement income system.

Canada's current system is comprised of income-tested old-age transfers; mandatory public pensions; and registered self-saving accounts and employer-provided pensions. The system's primary objective is to alleviate poverty among seniors, which has for the most part been met.

However, according to TD's Chief Economist, Craig Alexander, the retirement income system is increasingly falling short in helping individuals accumulate sufficient assets during their working careers to replace enough of their pre-retirement earnings to maintain their standard of living in retirement. While the benchmark for "adequate" replacement income is debated, this report based its conclusions on the most common recommendation of 60% to 70% of pre-retirement earnings.

"Future retirees will face a far different scenario from today. A number of factors including the decline in personal savings rates, rising household debt levels, volatility in asset markets and declining employer pension coverage will negatively impact many seniors' lifestyle," said Mr. Alexander. "Policymakers must act now to mitigate future risks."

Looking ahead, the share of retirees failing to meet the desired savings for 70% replacement is projected to rise from 15% for those born in the 1940s to just over 24% for those born in the 1980s. Dig deeper, Mr. Alexander explains, and the findings show that a disproportionate number of middle income Canadians will end up in this group of 24%. Indeed, they represent the largest growing group of Canadians at risk: 10% of middle income earners born in the 1940s look to fall short, but approximately 25 percent of middle income earners born in the 1980s could be affected.

As well, TD Economics shows that pension coverage is a large factor of whether individuals with similar incomes during working years achieve adequate incomes in retirement. Specifically individuals without employer pensions, earning between \$30,000 and \$60,000 per year, are more likely to experience a greater drop in their standard of living relative to earlier generations of retirees. For those born in the 1940s, around 6% of middle income earners with an employer pension will fail to replace 70% of their pre-retirement income during retirement. However, for those without an employer pension, around 15% will fall short. For middle income earners born in the 1980s, 19 percent of those with employer pensions will fall short, while this would be 35% of those without pension coverage.

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What is behind the future deterioration in the state of retirees' standard of living? In large part it comes down to the way in which Canadians have accumulated their personal savings since the mid-1990s. Simply put, individuals have been saving less out of their pay cheques and have increasingly relied on asset returns – such as the value of their home – to build up their personal wealth. In order to acquire these assets, individuals have increasingly borrowed money to finance their purchases, lifting personal debt levels to a record high. Looking ahead, the low savings rates, combined with modest and volatile asset returns and higher debt service costs, will hamper wealth accumulation. Declining pension coverage also puts more Canadians at risk of a lower standard of living in retirement, since many of those without pension coverage are saving inadequately through personal savings vehicles.

### **TD Economics recommendations**

*Close the information gap:* There are many gaps in our understanding of how Canadians save and accumulate wealth. For instance, the most comprehensive government survey examining the wealth of Canadians was last conducted in 2005. Much has changed with regard to household assets and liabilities since then. “Policymakers overlook or under appreciate the need to collect and analyse statistics on a continuing basis,” said Mr. Alexander. “If we are going to make fundamental and large-scale changes to retirement savings, Canada needs up-to-date information to design those interventions effectively.”

However, the recommendation of collecting additional data and doing more research should not be interpreted as condoning complacency. While additional research is being pursued, there are several immediate actions that can be taken to improve the incentives to save and invest. Broadly, these are:

*Improve financial literacy:* While most Canadians manage their finances effectively, a significant minority appears to lack adequate financial literacy skills, making them vulnerable to poor financial outcomes – particularly during retirement. Governments should undertake a national strategy for financial literacy, promoting lifetime learning.

*Improve RRSPs, TFSAs and defined contribution plans:* The annual limits are set too low, as they underestimate the required savings to reach the same pre-retirement outcomes. They also fail to reflect the fact that there is no ability to invest more to make up for shortfalls when there are market corrections. In addition to higher limits, instituting a lifetime limit rather than an annual limit for contributions to RRSPs and TFSAs is another possibility with considerable merit. (Even though contribution limits are not likely the binding constraint for the majority of taxfilers.) Lastly, raising the age from 71 at which RRSP accumulated funds must gradually start to be withdrawn or rolled into Registered Retirement Income Funds (RRIFs) would also help many seniors to avoid unnecessary tax payouts and provide more years in which to accumulate assets tax free.

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*Improve the efficiency of employer-sponsored defined benefit (DB) plans and help encourage their continued or expanded use:* This could be facilitated by harmonization of the myriad of pension rules that exist across the provinces. The regulatory environment should also be amended – particularly with regard to the ownership of surpluses. In an ideal world, employer-sponsored defined benefit pension plans should be fully-funded over the business cycle and have adequate capital buffers, but such regulatory requirements would need to be implemented over an extended period of time given the present underfunding of many DB plans. We also suggest that employees should have the ability to make contributions to top up benefits in a DB plan.

*Target those in greatest need:* The current pension reform debate has already identified a number of possible policy options to improve pension income. On the basis of the ability to best target the ‘at-risk’ population, TD Economics believes a government supplementary pension plan seems to have the greatest scope to focus on the underlying challenge because there can be default enrollment in the plan for all workers without an employer pension. “However,” Mr. Alexander notes, “there is no reason that a public supplementary pension plan could not be complemented by multi-employer and third-party pension plans being provided by the private sector. More choices are better than fewer. And, if an arrangement could be established to default enroll workers in these new private pension vehicles, it would reduce the need for a public option.”

Mr. Alexander went on to say that “in terms of ensuring that Canada maintains its past success in keeping seniors out of poverty, policymakers might also want to explore the possibility of indexing the benefits from income-tested old-age transfer to inflation plus real wage growth.”

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