Aon Hewitt
Retirement and Investment

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Information Bulletin

In this issue

CPP Reform Marches On

In our previous Information Bulletin about reform of the Canada Pension Plan (CPP), we advised that the federal government and all provinces except Manitoba and Québec had reached an historic agreement-in-principle on June 20, 2016 to enhance the CPP (the "Agreement"). In the months since, several steps have been taken towards implementing these changes:

- On July 7, 2016, Manitoba announced that it had agreed to sign the Agreement based on assurances from the federal government that additional research and analysis would be conducted with respect to amendments proposed by the province
- All provinces except for Québec and British Columbia ratified the Agreement by July 15, 2016 (Québec has its own Québec Pension Plan (QPP) and will not be weighing in on CPP reform)
- The federal government tabled a Notice of Ways and Means Motion on October 3, 2016 to pave the way for tax measures that are part of the Agreement
- On October 4, 2016, British Columbia confirmed its support for the Agreement following a summer of public consultations, which means the federal government now has sufficient support from the provinces to proceed with the CPP enhancement
- Bill 26, *An Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act* received first reading on October 6, 2016

The Mechanics of the CPP Enhancement

As a reminder, the CPP enhancement will apply nationally (with the exception of Québec) and aims to increase income replacement from 1/4 to 1/3 of pensionable earnings for Canadian workers. There will be a tax deduction for employee contributions associated with the enhanced portion of the CPP (as opposed to the tax credit for current CPP contributions). As part of the CPP enhancement, the government plans to increase the federal Working Income Tax Benefit, a refundable tax credit for eligible working low-income individuals and families, to roughly offset the increase in CPP contributions.

Bill 26, which amends the current CPP legislation to provide for the enhancements, contains no big surprises but does provide us with new details about the mechanics of the CPP enhancement.

Three Tiers of CPP Contributions

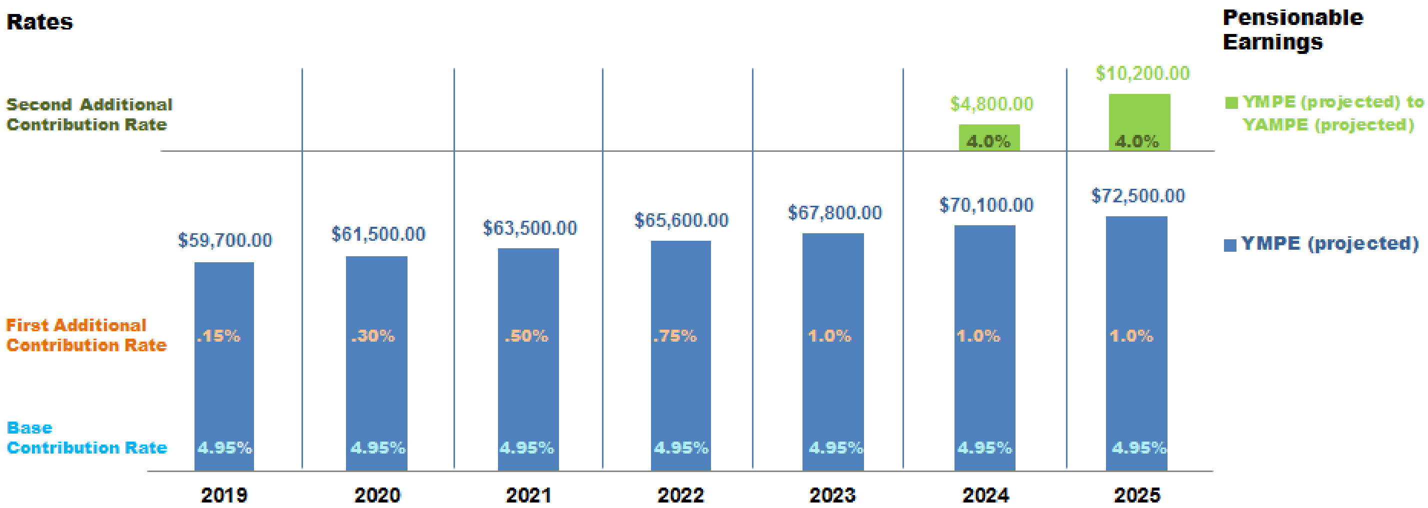
Today, CPP contributions are made on annual earnings between $3,500 and the year's maximum pensionable earnings (YMPE) which is currently set at $54,900. This portion of earnings is often referred to as "pensionable earnings". The contribution rate is currently 4.95% of pensionable earnings per year for employers and employees (for a total of 9.9% per year).

As outlined in the Agreement, there will be an increase to the contribution rate applied to pensionable earnings below the YMPE, which will be phased-in between 2019 and 2023. In addition, there will be an expansion of pensionable earnings through the implementation of a new earnings limit by 2025, which means that employers and employees will be contributing to the CPP on more earnings, if the employee's annual earnings are greater than the YMPE.

In order to accommodate these changes, Bill 26 provides for three tiers of CPP contributions:

- "Base Contributions" are the current contributions of 4.95% of the earnings between $3,500 and the YMPE. Although YMPE increases each year, these Base Contributions will remain at 4.95% for the time being under Bill 26.
- "First Additional Contributions" are an additional 1.0% contribution for employers and employees on earnings between $3,500 and the YMPE. This new contribution will be phased in gradually. In 2019, the first additional contribution rate will be just 0.15%. That will increase to 0.3% in 2020, 0.5% in 2021, 0.75% in 2022, and finally, the first additional contribution rate will reach the full 1.0% in 2023.
- "Second Additional Contributions" are a 4.0% contribution for employers and employees on earnings between YMPE and a new earnings limit called the year's additional maximum pensionable earnings (YAMPE). YAMPE will be 7% higher than the YMPE in 2024 and 14% higher than the YMPE in 2025. In each year following 2025, YAMPE will always be 14% higher than the YMPE of that year.

Three Tiers of Employee CPP Contributions*



*This diagram shows the three tiers of employee CPP contribution rates that will be in effect, as well as the pensionable earnings to which the rates will apply. Employers will be required to contribute the same amount.

Benefit Improvements Phased-In

The Agreement provides for improvements to benefits for employees when they retire, but also for survivors and those in receipt of disability benefits. The benefits will aim to replace 1/3 (or 33.33%) of the employee's income instead of the current 1/4 (or 25%). Full enhanced CPP benefits will be available after about 40 years of making contributions, but partial benefits will be available sooner and will be based on years of contributions.

For purposes of calculating retirement benefits, the legislation describes a three-part formula – one in relation to the Base Contributions, another in relation to First Additional Contributions, and a final calculation in relation to Second Additional Contributions. More specifically, eligible employees' benefits will be:

25% of "average monthly pensionable earnings"
plus
8.33% of "first additional monthly pensionable earnings"
plus
33.33% of "second additional monthly pensionable earnings"

Additional Changes to Implement CPP Enhancement

In addition to establishing the mechanics for the enhanced contributions and benefits, Bill 26 also takes care of a number of other matters. It provides that the *Canada Pension Plan* legislation will be amended:

- To allow for the creation of the Additional Canada Pension Plan Account for receiving the First and Second Additional Contributions and paying the benefits associated with those contributions
- To include the CPP enhancement in the financial review provisions of the CPP legislation, and authorize the Governor in Council to make regulations in relation to those provisions

The Bill also provides that the *Canada Pension Plan Investment Board Act* will be amended:

- To permit the transfer of funds between the Investment Board and the Additional Canada Pension Plan Account
- To require the preparation of financial statements in relation to amounts managed by the Investment Board for the CPP enhancement

Finally, Bill 26 provides that the *Income Tax Act* will be amended:

- To increase the Working Income Tax Benefit
- To provide a tax deduction for employee contributions associated with the CPP enhancement

How Should Canadian Employers Prepare for 2019 and Beyond?

As mentioned in our prior Information Bulletin, as the CPP changes come into effect, employers will need to plan for increased contributions and grapple with new administrative complexities.

Employers should be thinking about their goals in terms of payroll costs, but also in terms of their overall target benefit coverage for their employees. Over the next two years, decisions about integration of the CPP enhancement with employer pension plans will need to be made, and employers should also consider possible impacts on other savings plans such as registered retirement savings plans (RRSPs) and deferred profit sharing plans (DPSPs).

For employers with registered pension plans, CPP integration may be a challenge. Many pension plans have different contribution rates above and below the YMPE, as well as different benefit formulas above and below YMPE. With this CPP enhancement, plans will need to determine whether changes are appropriate to account for the new YAMPE and the enhanced CPP benefits, keeping in mind that the changes phase-in gradually over seven years.

As we get closer to 2019, employers should be:

- planning how and when to communicate these changes to employees
- updating pension plan texts, booklets and/or websites if changes are needed to integrate with the CPP enhancement
- updating payroll and pension plan administration processes (e.g., more complex calculations for CPP contributions, new tax reporting requirements, and where applicable, more complex pension plan contributions and benefit formulas)

Please contact your Aon Hewitt consultant to discuss the impact the new CPP will have on your firm, your employees and your retirement programs.

Contact Information

Should you wish additional information on this topic, please contact your local Aon Hewitt Consultant, or send an email to info@aonhewitt.com.

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