Modernizing Canada's Retirement Savings System

The Canadian Bankers Association's comments on the issues facing Canada's pension and retirement system

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Table of Contents

Introduction 1

CBA research 1

Canadian households and financial decision making 2

Creating the right incentives for tax-assisted savings plans 4

Recommendations for a more effective Pillar 3 retirement savings system 5

Improving the tax-assisted private savings system 5

"Fixing" the employer-sponsored pension system 7

Moving forward 8

Appendix – CBA research on Canadian family savings behaviour 10

How families respond to savings needs and opportunities 16

Observations 17

Introduction

The Canadian Bankers Association shares concerns that have been recently expressed by governments and a range of stakeholders about the adequacy of Canadians' savings in general and retirement savings in particular. As sponsors of defined benefit pension plans, providers of retirement savings vehicles such as RRSPs, and a source of asset management and financial literacy expertise, the banking industry has been actively exploring ways to strengthen and extend Canada's retirement savings system. As we have pursued some research in this area, it has become evident to us that (a) the reasons why many Canadians have inadequate retirement savings are varied and complex; (b) the needs of individuals and families are both diverse and constantly evolving as they progress through the normal family life cycle and as external circumstances change; and (c) an exclusive focus on a single, public sector solution does not appear to be the most effective response to the variety of challenges currently facing the retirement savings system. Indeed, further research and analysis are needed before the retirement savings issue in Canada can be clearly understood and comprehensive policy solutions can be identified.

At the same time, however, it is also evident to us that, while there are no simple "one-size-fits-all" solutions, there are some urgently needed fixes to out-of-date and unduly restrictive rules that do not reflect the reality of today's demographics, labour markets or the needs of Canadian households. Coordinated action by governments across Canada to modernize these rules – particularly regarding tax-assisted savings vehicles, employer-sponsored pension plans, and the flexibility that is needed to introduce more innovative pension plans with a broader reach – would strengthen the ability of the private sector to help Canadians save for retirement and could avoid the need for new public sector plans that could unnecessarily duplicate systems and infrastructure that are already in place. The adequacy of retirement savings is a national issue, and requires national public policy solutions that will enhance the ability of individual Canadians to save.

This paper consists of two parts:

- An overview of new research that the CBA has undertaken on the Canadian households and their savings profiles, as well as data on the use of Canada's newest tax-assisted savings vehicle, the Tax Free Savings Account. Although this is preliminary research, it does raise some questions that policy makers need to consider – and points to further research that needs to be undertaken – before new policy directions should be pursued.

- In areas where fixes to current rules are urgently needed, our recommendations for how governments across Canada can take concrete steps to strengthen the retirement savings system in Canada.

CBA research

To help contribute to the public policy discussion on this important topic, the CBA has conducted some preliminary research on household savings and has also examined recent trends in the take up of the new Tax Free Savings account. In both cases, the research suggests that we need to know more about what influences particular savings decisions before embarking on new institutional structures:

- Our analysis of Canadian household assets and liabilities (aimed at understanding how different households structure their finances) suggests that families engage in a wide range of asset accumulation in addition to employer pension plans, that new government programs may not always have the intended effects, and that individuals could, if given the right incentives, increase their savings voluntarily.

- Data on the take-up by Canadians of the new Tax-Free Savings Account (TFSA) suggests that, if properly designed with the right incentives (as we believe is the case with the TFSA), individual tax-assisted savings products could be made more effective in helping to address concerns about savings levels in general and retirement savings in particular.

Canadian households and financial decision making

It is sometimes assumed that because some Canadians do not have an employer-sponsored pension plan ("EPP"), the easiest course of action would be to create a new public plan that would ensure that they would be better prepared financially for retirement. Our analysis of the most recent (2005) Statistics Canada *Survey of Household Security* as well as trends in the take up of the Tax Free Savings Account (TFSA) paints a somewhat more complicated picture. Our analysis of the data focuses on two areas: (a) families in which the major income earner has an EPP compared to those without, and (b) a more complete financial picture of families, not just their 'retirement' and 'pension' assets. It is important to note that (a) the *Survey of Household Security* is a snapshot view at a point in time and that a trend-line analysis is not possible (since it is produced sporadically, with the most recent, previous being in 1999) and (b) the analysis is not intended to determine the extent to which Canadians are prepared for retirement but merely to compare the relative positions of families with an EPP and those without. Even so, the research does raise a number of questions and points to areas where further research is needed:

- Families without an EPP tend to be younger (almost twice as likely to be under 35) and earn a lower income (two-thirds earn less than $40,000 after tax whereas only 30% of families with an EPP earn that amount). *Some questions that arise here are whether access to an EPP is, at least in part, a function of age and career status (i.e. younger families with lower incomes) and whether this picture could change significantly as these families move through the usual "life-cycle" of moving into higher income positions as they get older. Alternatively, this could be highlighting the new reality of labour markets where younger workers are likely to spend much of their careers in jobs without an EPP.*

- Families without a pension are less likely to have full-time employment, almost three times as likely to be unemployed or to engage in unpaid work, and three times as likely to be self-employed. *The question here is whether this employment status (and lack of an EPP) is temporary, or whether it is a more fundamental question of a lack of attachment to the full-time workforce (i.e. a broader social issue that pension reform may not address).*

- With the exception of the highest income families, families with an EPP tend to have a higher net worth than peer families without an EPP. *This indicates that, all else being equal, families working for (or having worked for) an employer offering an EPP are better prepared for retirement, and suggests that public policy should be directed to ensuring that EPPs remain attractive and viable options for employers large and small across the country.*

- On average, families without an EPP engage in more discretionary net savings than do families with an EPP. Consequently, looking just at retirement or pension-type assets understates their true preparedness for retirement. At the same time, however, that additional discretionary net saving is not sufficient to offset the lack of an EPP. Furthermore, the composition of assets at retirement may not be appropriate to provide for an adequate income stream at retirement. *What this may mean is that families without an EPP recognize (and act on) the need to save more, but that measures that assist or encourage further individual savings would be beneficial. As well, better financial literacy is called for to help families without EPPs (and indeed other Canadians) prepare for retirement and to ensure that their mix of assets can provide the income they need over the course of their life in retirement. The government can play an important role in marketing and promoting the need for retirement planning as part of the government's financial literacy initiatives.*

- Families without an EPP tend to be less likely to invest in RRSPs and other retirement savings vehicles. *From a policy point of view, this means that there is a class of families who need to save for retirement but who find the existing tax-assisted savings vehicle less than useful. In this regard, the recently introduced Tax Free Savings Account – which did not exist at the time of this survey and which has proven to be a popular savings options in the short time that it has been available – might be an appropriate and appealing vehicle for these families. What remains to be assessed, however, is whether the TFSA is actually being used by those families who appear to under save, especially those who find the RRSP unattractive. It also suggests that examining the RRSP system to identify whether there are unnecessary disincentives to savings and whether this vehicle could be made more attractive, would be a useful contribution to the public policy discussion now underway.*

- Older families without EPPs who use the RRSP for retirement savings tend to do so more intensively than EPP peers. *This suggests that it is important to provide more flexibility in tax-assisted savings plans – such as a life-time approach to calculating savings room – that would allow individuals to accumulate more savings room over time.*

- The take-up rate for the TFSA has to date been quite strong when compared to the more well-established RRSP. It has the potential to represent a significant addition to the basket of tax-assisted savings vehicles. *Before pursuing other reforms, it would be worthwhile to determine: (1) if the TFSA represents an addition to the RRSP or a substitute, (2) whether it increases net savings or merely replaces one form with another, and (3) whether it proves to be particularly attractive to certain family types for whom inadequate savings is a concern.*

More detail on our research can be found in the Appendix to this submission. What this research points to is that the net savings profile of households in Canada is highly complex and that individual savings takes place in a variety of ways. A one-size-fits-all approach to increasing savings may not be appropriate and indeed may not produce the expected results. For instance, requiring younger people to belong to a new contributory public retirement plan could have the effect of diverting income they need for other purposes such as near term savings objectives and also may not result in actual increases in overall savings rates. In addition, focusing only on a single, quasi-public approach could have the effect of inhibiting the development of new private sector savings and retirement products targeted to different phases of an individual's lifecycle, and thereby could limit the options available to Canadians. Instead, the focus should be on making better

use of the resources, expertise and advisory skills of the private sector to develop and provide the products that meet the savings needs of families over their entire life. Preserving and promoting a diverse and competitive source of savings opportunities, at both the level of the individual and employers, also helps to ensure that prices for these services are at competitive levels. Given the right structures, incentives and opportunities – as well as a more focused effort to promote financial literacy and the importance of retirement planning – Canadians can be encouraged to save more on a voluntary basis using existing private sector channels.

Creating the right incentives for tax-assisted savings plans

It is sometimes argued that the under-utilization of registered retirement savings plans is a key reason for exploring new, public-sector retirement systems. It is true that RRSPs are not fully utilized by Canadians – in 2007, only 27% of eligible taxpayers made contributions (with contributions amounting to about 42% of the new contribution space for that year), and there exists a very large amount of cumulative contribution room that has gone unused. On the other hand, at about $35 billion annually, contributions into RRSPs are approximately equal to employer and employee contributions into the CPP. In our view, however, the issue is not an inherent flaw in the reliance on individual tax-assisted savings plans such as the RRSP, but rather out-of-date restrictions that act as a disincentive to Canadians' making the most effective use of these retirement vehicles.

Although it is not a registered retirement savings vehicle *per se,* the new Tax Free Savings Account recently created by the federal government shows that, if properly designed with appropriate incentives, tax-assisted private savings plans can be very successful in helping Canadians save. Some features that make the TFSA attractive:

- Withdrawals in one year create further savings room in subsequent years. Consequently, while savings into these TFSA accounts may be used for a variety of purposes over the course of one's lifetime the fact that withdrawals create subsequent savings room means that the use of a TFSA for non-retirement savings does not detract from its value as a retirement savings vehicle.

- When viewed as a retirement savings plan, the TFSA constitutes a substantial increase in tax assisted retirement savings. For those in the highest tax bracket and subject to the $22,000 annual RRSP limit, the $5000 TFSA is equivalent to more than a 35% increase in RRSP contribution limits.

- Deposits into TFSAs do not generate tax deductions up front but correspondingly do not create any tax liabilities on income earned or withdrawals. Because withdrawals are not treated as income, those retirees who are eligible for the Guaranteed Income Supplement will not have any of their benefits reduced from savings in a TFSA the way they would from savings in an RRSP.

- In addition, there are no requirements that TFSA accounts be closed at a certain age, such as the 71 year rule that applies to RRSPs.

The TFSA has been in existence since the start of 2009. According to an Ipsos Reid survey, a total of almost 3.6 milllion accounts have been set up in the first six months of 2009, with a total of $12.4 billion deposited –

the average is just over $3400. End of year totals for the TFSA overall should be well above the figures cited above.

The point here is that the success of the TFSA indicates that (a) well-designed tax-assisted savings vehicles can encourage Canadians to save, and (b) while it is still very early days, the TFSA itself could prove to be an important retirement savings tool in its own right – indeed the TFSA is likely to attract as much deposits every year on a voluntary basis as a supplemental pension plan might attract on an involuntary basis. But, as the TFSA is still in its infancy, we still need to learn who makes use of it and what impact it has on the composition and magnitude of savings. We do know from the Ipsos-Reid survey, however, that the TFSA was initially most popular among older Canadians (age 55 to 64) but that the popularity grew among all age groups in the second quarter. This suggests to us that, rather than creating new government programs for retirement savings, it may be more effective for governments in Canada to work together to improve the private-sector tax-assisted system. Below we suggest some fixes that can be made to the private retirement system that would both remove disincentives to save and make it more likely for employers to offer EPPs. We feel it is important that the provincial governments work collaboratively to urge the federal government to make improvements in this area. As we have noted above, retirement savings is a national issue and requires national approaches.

Recommendations for a more effective Pillar 3 retirement savings system

Concerns about the gaps and flaws in Canada's out-of-date private sector savings system have prompted comments from a wide range of interested organizations and individuals including government appointed task forces and consultations. Among the most thoughtful examinations is the C. D. Howe Institute's "Pension Papers Program" which has generated at least 13 papers with detailed analysis of the current system and recommendations for change. In particular, the paper by James Pierlot, *A Pension in Every Pot: Better Pensions for More Canadians* (C. D. Howe Institute Commentary, November 2008), sets out substantial and compelling recommendations for improving on a number of key provisions in the pension regulatory framework for the Canadian private sector, which, as noted below, we support as ways of strengthening the retirement savings system in Canada.

Improving the tax-assisted private savings system

Converting retirement savings into income streams

Canadians who save for retirement face the risk that a retirement "nest egg" may not generate a stream of income that is needed. This may be due to the fact that market conditions are not favourable when savings are being cashed out; investors find their savings withdrawals being taxed at higher rates than expected; or investors do not have access to convenient and efficient means of converting savings into income streams. All of these may be compounded by rules that restrict individuals' flexibility as to when these conversions may be made. There are a number of ways in which older Canadians can get more "retirement income bang from their savings buck":

- The age at which RRSPs must be closed out is once again 71 years, up from 69 years to where it was lowered in 1997. This is more consistent with the greater life expectancy of Canadians but is also more consistent with expectations that Canadians will be working longer. Raising the age limit further would provide Canadians with additional years to make contributions and will increase the future annual income that those savings can generate.

- The minimum rate at which funds must be withdrawn from Registered Retirement Income Funds (RRIFs) could be lowered to extend the life of RRIF assets.

- RRSP withdrawals are fully treated as income for tax purposes. These withdrawals do not benefit from the favourable treatment provided to dividend income or capital gains, even though that may have been the way in which those savings were generated. If governments believe that Canadians have not saved enough for retirement, one approach would be to increase the after-tax income generated by those savings by taxing it at more favourable rates. This would have the added benefit of encouraging greater use of RRSPs.

- In addition, Canadians who have held their savings in a bank and who wish to convert those savings into a life annuity should have the ability to do so at a bank branch.

Providing adequate tax-assisted savings room for all Canadians

Retirement experts are increasingly of the view that a lifetime ceiling on tax-free retirement savings is preferable to annual limits so that individuals could make up for a lack of savings in some years by topping up savings in other years. This lifetime approach recognizes that families have changing needs over their life-cycle. The RRSP and the TFSA effectively take such an approach but rules governing defined contribution pension plans are too restricted. The U.K. has addressed the need for greater flexibility - new provisions that became effective in 2006 established entitlement to a lifetime allowance of tax free retirement savings up to 1.5 million pounds (1.8 million in 2010) along with tax-free allowances up to 100% of earnings on an annual basis (Pierlot, p.21). The broader issue is, however, to ensure that Canadians have sufficient tax assisted savings room and that all have access to the same tax assisted room. Some suggestions:

- Allow all workers to have the tax-assisted retirement savings room they need whether they work in the public or private sector and regardless of the type of plan (e.g., traditional employer-sponsored plan, RRSP or multi-sponsor pension plan) and they should be able to make use of that room in the plan of their choice. Workers should be able to top up contributions or accumulate savings room so that those with fluctuating incomes or who leave the workforce temporarily for parental leave can save sufficient amounts for retirement. Governments might consider similar top up provisions in the CPP/QPP.

- Allow self-employed individuals and workers who do not have an employer-sponsored plan to save substantially more through an RRSP, TFSA or other tax-assisted vehicles than they can currently.

- Allow workers who are unable to save in certain periods of their lives (e.g., early in their careers) to catch up when they are in a position to save more. Similarly, employees who experience a period of unemployment or parental leave (which decreases their contribution room for that year) should be allowed to continue to accumulate contribution room as if they still had the same level of income. This would allow an individual to "catch up" on their savings (Pierlot, p21).

- As the TFSA is a new product which will be of less cumulative value to older Canadians than younger ones, those born before a certain date could be granted additional TFSA room. Constructed this way, it would constitute a transition provision that would disappear over time.

- As needs change, families may find that they should be saving in a different registered plan. Governments should consider ways to allow transfers between registered plans (e.g. from an RESP into an RDSP).

"Fixing" the employer-sponsored pension system

Harmonize pension laws

The existing retirement/pension/savings regulatory regime varies across provinces and contains numerous elements that do not permit easy transition as needs change. There is a wide range of differing requirements by province re beneficiary designations, locked-in plans, spousal contributions, withdrawals, and a host of related areas. This multiplicity of pension requirements across the federal and provincial jurisdictions acts as a significant disincentive for companies operating in more than one province to consider offering plans to their employees. The Ontario Minister of Finance has stated that Ontario will undertake some pension reforms with a view to harmonizing with the federal government's recently released proposals for modernizing the regulatory framework for federally regulated plans. This is clearly a step in the right direction, and we urge other provinces follow suit. Harmonization is one of the most logical and appropriate issues for the federal-provincial working group to address and would foster a more user friendly regulatory environment for inter-provincial medium sized employers as well as large ones.

Improving existing employer pension plans

Current federal and provincial laws impose unnecessary burdens and disincentives for employers offering (or considering) pension plans because of the costs and risks they face and the inflexibility of rules. In addition, the federal *Income Tax Act* rules limiting the ability to build up sufficient surpluses to guard against under-funded plans could lead to retirees receiving fewer benefits than anticipated. These disincentives weigh particularly heavily on small and medium-sized business enterprises – these companies are the main source of job growth yet their employees are the least likely of workers to have access to an employer pension plan.

We were pleased, therefore, to see the proposals released by the federal Minister of Finance on October 27th that are intended to modernize and strengthen the regulatory framework for federally regulated pension plans, (i.e., the *Pension Benefits Standards Act, 1985* and its regulations, and the *Income Tax Act*). In particular the proposal to increase the *Income Tax Act* pension surplus threshold of 10% of plan liabilities to 25% starting in 2010 will help enable large defined benefit pension plan sponsors to manage their pension funds more effectively through both highs and lows of the business cycle. Plan sponsors would be able to build more substantive "cushions" or margins in their pension funds to help weather economic downturns. The CBA urged such a step in our submission to Finance Canada's consultation paper of last January.

At the same time, however, we have a number of concerns about the federal proposals: First, the proposed measures do not go as far as we believe are necessary to make pension plans more attractive and viable (e.g. the proposals would not eliminate *all* quantitative limits on investments and so not provide sufficient

flexibility with respect to contribution holidays if a plan is not underfunded). Second, and most importantly, we remain concerned that the October 27th proposals do not address the lack of clarity around ownership of surplus even though they do address the issue of surplus size. The lack of clarity around surplus ownership is, in our view, a fundamental flaw in the existing regulatory regime and is one of the reasons why employers are reluctant to maintain or initiate new defined benefit plans.

Facilitating the creation of new types of pension plans

As James Pierlot notes in his November 2008 paper, the right to offer pension plans should be de-linked from the employment relationship. By amending the *Income Tax Act* rule which requires that pensions be based on income from employment with an employer ("service as employees") the federal government could set the stage for the development of new types of pension plans in Canada. We strongly encourage the provincial governments to work closely with the federal government to develop a system that would extend the right to establish and offer pension plans beyond employers or associations of employers to include trade associations, professional associations, financial institutions and other third party providers who can meet certain qualifications (Pierlot, p. 20). Such plans would:

- "Permit individuals to contribute from their employment compensation to *any* pension arrangement whether linked to an employer or not", make it unnecessary for individual employers to sponsor plans, and permit them "to contribute on behalf of their employees to *any* pension plan(s) in which the employees may participate". (Pierlot, p. 20). This would mean that employers in small and medium size businesses could encourage or require their employees to participate in third party plans and could contribute on their behalf without the costs and administration.

- Achieve economies of scale. Multi-employer/multi-sponsor and third party pension plans provide the means of achieving desirable and significant economies of scale with large, pooled funds. There are models of private sector, multi-sponsor pension plans in the U.S., one of the largest and most successful being the Teachers Insurance and Annuity Association, College Retirement Equities Fund (TIAA-CREF). With assets under management of over $350 billion it is the retirement savings plan of choice for individuals in the academic, cultural and athletic fields.

- Introduce further competition into the system. Providing more flexibility and choice in the pension system (for individuals and employers) could also help introduce more competition among plan and product providers aimed at attracting members. In addition to providing for innovation in the system, additional competition can help ensure that prices associated with retirement services can be as low as possible.

Moving forward

The CBA believes that the savings system in Canada is not broken and there is not a pressing need for a new one-size-fits-all retirement savings program that would duplicate systems and infrastructure that are already in place. While more research is needed to fully understand the complexities of the retirement savings situation in Canada and to identify the public policy approaches that may be appropriate, some conclusions are already clear. Canada has a strong private sector retirement system that, with some targeted fixes, could

be even more effective in helping Canadians plan and save for retirement. We have suggested some key areas that need attention:

- RRSPs and TFSAs are key elements of the individual savings system, but improvements are needed to make RRSPs more attractive.

- Clearly there is a need for enhanced financial literacy as it relates to savings in general and retirement savings in particular. The federal government has taken on a role in promoting financial literacy and sound financial planning for retirement should be a key part of it. In this regard, the banking industry is very much looking forward to working with the federal government's Financial Literacy Task Force as it undertakes its deliberations in this area.

- Employer-sponsored pension plans remain a critical element of the retirement system, but are facing significant pressures largely as a result of out-of-date rules. While key policy changes – particularly regarding the ownership of plan surplus – would go a long way to making more attractive for existing sponsors to retain plans, there are other changes that we feel would help expand coverage for Canadian workers. For example, the law should allow for and facilitate the establishment of multi-sponsor or third party plans that can develop large professionally managed funds building on economies of scale in order to offer superior returns, be open to employees who do not have EPPs, and remove the administrative challenge of pension fund management from employers and from governments.

As we noted at the outset, the adequacy of retirement savings is a national issue, and requires national public policy solutions that will enhance the ability of individual Canadians to save. We hope that our research has helped to further policy makers' understanding of the issues confronting the retirement system in Canada and to point the way for further research and analysis as governments across Canada work together on this important issue.

Appendix – CBA research on Canadian family savings behaviour

Much of the discussion about the adequacy of Canadians' preparedness for retirement focuses on the acquisition of financial resources in pension or retirement savings vehicles. Do employees belong to an employer sponsored pension plan (EPP)? Is the plan sound? Do Canadians save in RRSPs and do they save enough? These are of course important questions and they do contribute significantly to understanding whether Canadians are well prepared for retirement. For instance, statistics show that over half of families do not belong to an EPP. Moreover, Canadians do not appear to make full use of the RRSP room that the tax system provides. In 2007, the most recent year for which data are available, just over a quarter of taxfilers made RRSP contributions, far less than the number who had RRSP room. And while contributions used up about 42% of all new RRSP contribution room in 2007, almost $500 billion of accumulated RRSP room remained unused.

It is facts such as these that lead some to conclude that Canadians need some type of automatic, supplemental pension plan into which they, and their employers, would make contributions to build up a retirement nest egg that they would not have in the absence of such a supplemental pension plan. It is this assertion that is the starting point for the following discussion.

We believe, however, that focussing only on pension or retirement savings vehicles may be unduly narrow. In our view, it is useful to look at families' savings positions more broadly, that is over the entire lifespan, because these earlier decisions can have an impact on their preparedness for retirement. There are a variety of ways in which families can build up a strong family balance sheet. They can pay off their homes, invest in financial assets outside of the retirement system or invest in businesses and farms. The following analysis looks at the total net worth of Canadian families (retirement related and non-retirement related financial assets, non-financial assets, debts, etc.) and, as such, takes a broader view of the financial position of Canadians. It should be recognized though that while all of these assets contribute to financial security, they are different in terms of liquidity and tax consequences, and may play different roles over a family's lifetime.

The following analysis draws upon data in the 2005 Statistics Canada Survey of Financial Security. This is the most comprehensive look at the financial position of Canadian families. Unfortunately, it is only undertaken periodically. Given the importance of sound data to understand the adequacy of family savings, and given the volatility in financial asset values in recent years, we believe Statistics Canada should produce such a survey on an annual basis.

These data are informative but they leave a number of questions unanswered that could only be answered with further research. We believe it is important that these issues be addressed before taking any steps to create new institutional structures.

The analysis makes clear that the EPP is an important component of the overall net worth of families who have access to it. For these families, the value of the EPP constitutes anywhere from 28% to 39% of total family net worth, depending upon the income category. For families approaching retirement, it can represent almost half of family net worth for some types of families. Not surprisingly, therefore, the lack of an EPP is

considered to be a serious impediment to a family's financial security. It is useful to point out here that the Statistics Canada data do not take into account the tax liabilities associated with assets such as EPPs and RRSPs. The value to families of these assets is overstated as a consequence and while this appendix makes no attempt to assess the overall adequacy of savings, the Statistics Canada data overestimate actual savings, especially with respect to EPP families.

The data make clear that those families with an EPP tend to be better off financially than those families without an EPP. By this we are not suggesting that the families with EPPs necessarily have adequate savings for retirement. We are simply comparing the financial positions of two groups of families to determine if access to an EPP leads to a higher level of financial security. But the analysis also suggests that we should be cautious about drawing conclusions about what access to an EPP means for the financial position of a household and consequently what might be the effect of a new supplemental pension plan.

The Statistics Canada Survey of Financial Security indicates that in total approximately half of all families have access to an EPP while half do not. This is where similarities cease. By virtually all other measures, the two sets of families are very different. Families without access to an EPP are less likely to be economic families[1] and more likely to be unattached individuals – in fact these families are almost twice as likely to be an unattached non-elderly household. Not surprisingly, they are less likely to have more than one income earner.

Families without an EPP are younger (almost twice as likely to be under 35 yrs of age) and earn a lower income – two-thirds earn less than $40,000 after tax whereas only 30% of families with an EPP earn that amount. Families without an EPP have a lower educational achievement, are less likely to have full-time employment, three times as likely to be self employed and, for the non elderly, almost three times as likely to be unemployed or to engage in unpaid work.

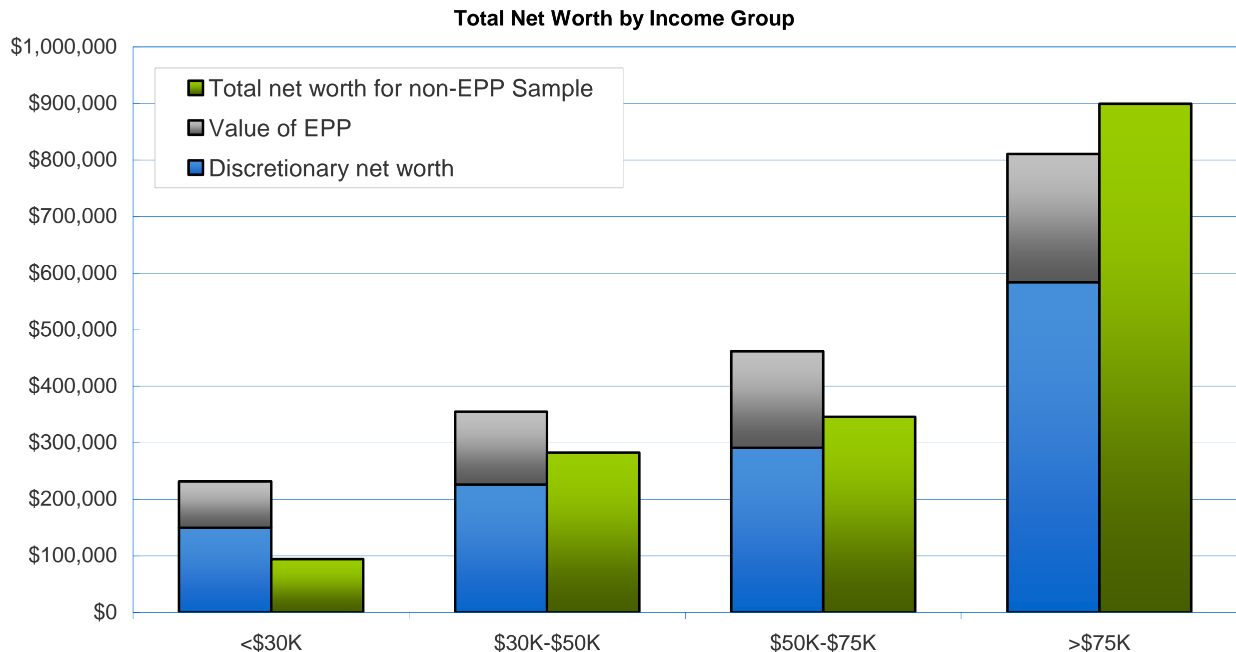
FAMILY CHARACTERISTICS		
	Families with EPP	**Families without EPP**
Number of families	6.5 million	6.9 million
	% of Total families	**% of Total families**
Economic families	75%	57%
Unattached non-elderly	16.4%	34%
Under 35 yrs	17%	32%
Under 44 yrs	39%	54%
Less than $40,000 after tax income	31%	70%
More than $75,000 after tax income	29%	9%
High school or less education	40%	54%
Major earner full time	62%	46%
Major earner self employed	5%	15%
Unpaid or not employed non elderly	8%	21%
Unpaid or not employed total	29%	35%

[1] An economic family is defined as a group of two or more persons who live in the same dwelling and are related to each other by blood, marriage, common-law or adoption.

In the following analysis, the net worth of families with and without EPPs are compared and contrasted. Recognizing that the two samples are very different with respect to income and age, the following tries to hold those these factors constant to provide a more accurate analysis of the two groups of families.

Figure 1 presents a comparison of family net worth for EPP and non-EPP families by income category. For families without an EPP, we present only total net worth figures whereas for families with an EPP, the total net worth is disaggregated into the value of the EPP and the remainder, which is referred to as discretionary net worth. By definition, all net worth for families without an EPP is discretionary.

FIGURE 1



It is very clear from Figure 1 that families with an EPP are generally better off financially than families without an EPP – i.e. they have a higher net worth in total. For families earning less than $30,000 after tax, access to an EPP almost doubles the family's net worth compared to a comparable family without an EPP. As income increases, the EPP becomes relatively less important although it still enables those families to have a higher net worth than families without an EPP.

Families with income in excess of $75,000 prove to be the exception to this rule – the existence of an EPP proves to provide no financial advantage.

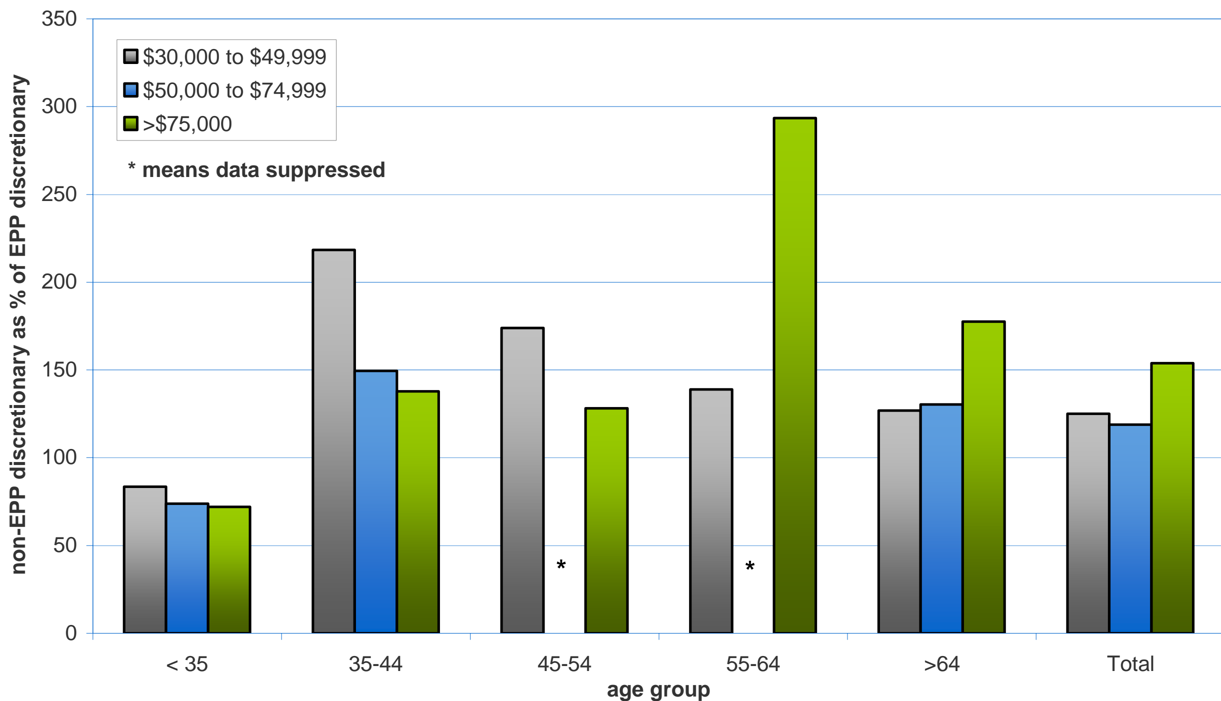
It is also clear from Figure 1 that families without an EPP have higher discretionary net worth than do families with an EPP – that is, they choose to engage in more net savings than do EPP families with respect to discretionary net savings. There are two possible ways to interpret this. 1) Families without an EPP recognize that they need to save more (acquire less debt), and consequently they do. 2) Families with an EPP may be less inclined or less able to undertake discretionary savings because they feel less need to do so or have less capacity to do so. While families without an EPP may be inclined to save more, they do not do so sufficiently to offset the lack of an EPP. And while families with an EPP may be inclined to save less,

they do not do so in a sufficient manner to offset all of the advantages of having an EPP. The overall conclusion is, however, that enrolling workers in an EPP might have a smaller than anticipated impact on their preparedness for retirement and providing families with better incentives to save might enable them to better deal with a lack of an EPP.

Figure 1 is based on a highly aggregated look at families in various income categories. Figures 2 and 3 provide a further refinement by disaggregating the data by age within each income class. Figure 2 looks at discretionary net worth while Figure 3 looks at total net worth. It should be noted here that Statistics Canada cautions that the data become less reliable as they get disaggregated into finer detail.

FIGURE 2

Comparison of Discretionary Net Worth: Non-EPP and EPP Families

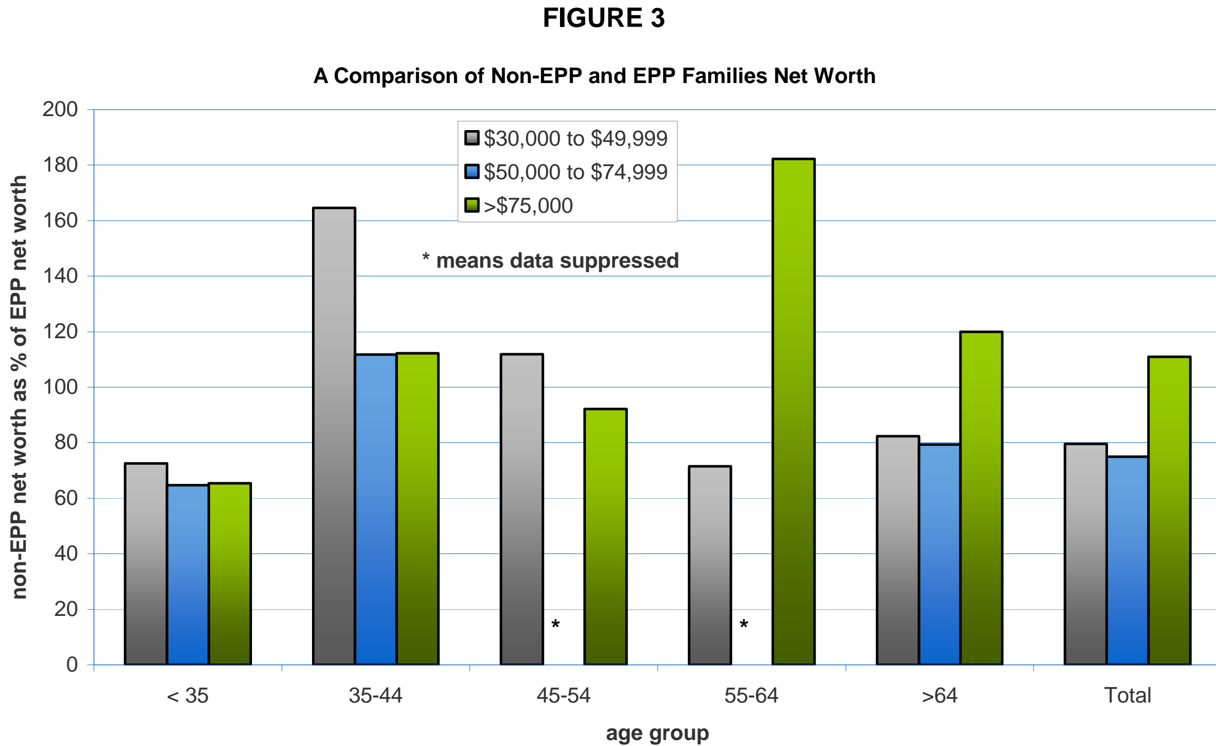


The data in this chart measure the extent to which the net savings of families without an EPP exceed the discretionary net savings of families with an EPP. The chart looks at the behaviour of families in three different income categories and breaks down the results by age group.

Within the youngest age group (under 35 years) those families without an EPP tend to do little saving. Their net savings are considerably less than the discretionary net savings of those families with an EPP. And this behaviour is true of all income groups, low and high. For older groups, the pattern reverses itself and families without EPPs tend to engage in relatively higher amounts of net saving. With the exception of the youngest families, those families without an EPP tend to have more discretionary net worth than those families with an EPP. In total, those families with the highest income (i.e. greater than $75,000) tend to be the best savers vis-à-vis their EPP peers.

Figure 3 performs the same kind of analysis but considers total net worth rather than just discretionary net worth. While it may be useful to know that non-EPP families engage in greater discretionary savings, what impact does that have on their overall net worth?

FIGURE 3



In general, families without an EPP have a lower total net worth than do peer families with an EPP. The youngest families tend to be at the greatest disadvantage, although that disadvantage tends to diminish somewhat with age. For families earning an after-tax income in excess of $75,000, the lack of an EPP is not a liability at all as these families have a higher net worth on average than their EPP peers. For the other income groups, the lack of an EPP means that total net worth, averaged across all age categories is 20% to 25% lower than it is for families with an EPP, which is a significant difference. This essentially represents the relative position of the two groups once they reach normal retirement age.

Given the fact that non-EPP families tend to engage in greater discretionary net savings than do EPP families, an obvious question to consider is in what form those savings take place. If the focus of that savings is for retirement, one would expect it to be in some alternative retirement savings vehicle such as the RRSP.

Because of the constraints associated with the quality of the data, the following analysis aggregates all non-EPP retirement savings vehicles, including RRSPs into one – for simplicity these funds will be referred to as "RRSPs". Figure 4 plots the average value of savings in "RRSPs" for those who actually have investments in these savings vehicles. The results are arranged by age.

The data show two distinct results, one surprising and one not surprising. The surprising result is that families without an EPP are significantly less likely to save in an "RRSP" than are families with an EPP. Only about

half of families without an EPP have investments in an "RRSP", and this proportion increases only slightly as we consider older age categories. By contrast, approximately 80% of families with an EPP also have savings in "RRSPs".

On the other hand, we see that the older age categories of non-EPP families who do have "RRSPs" have relatively higher amounts of RRSP investments than do EPP families.

FIGURE 4

Actual Investments in RRSPs and Other Retirement Assets

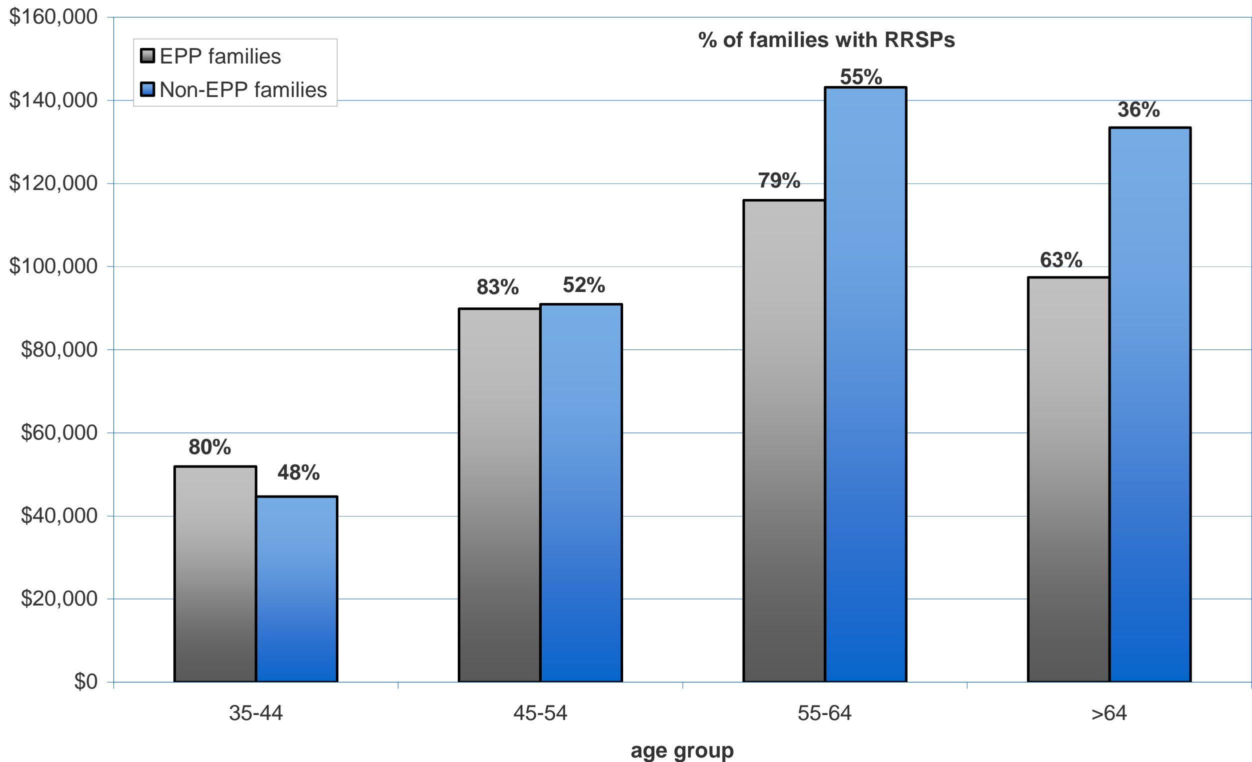
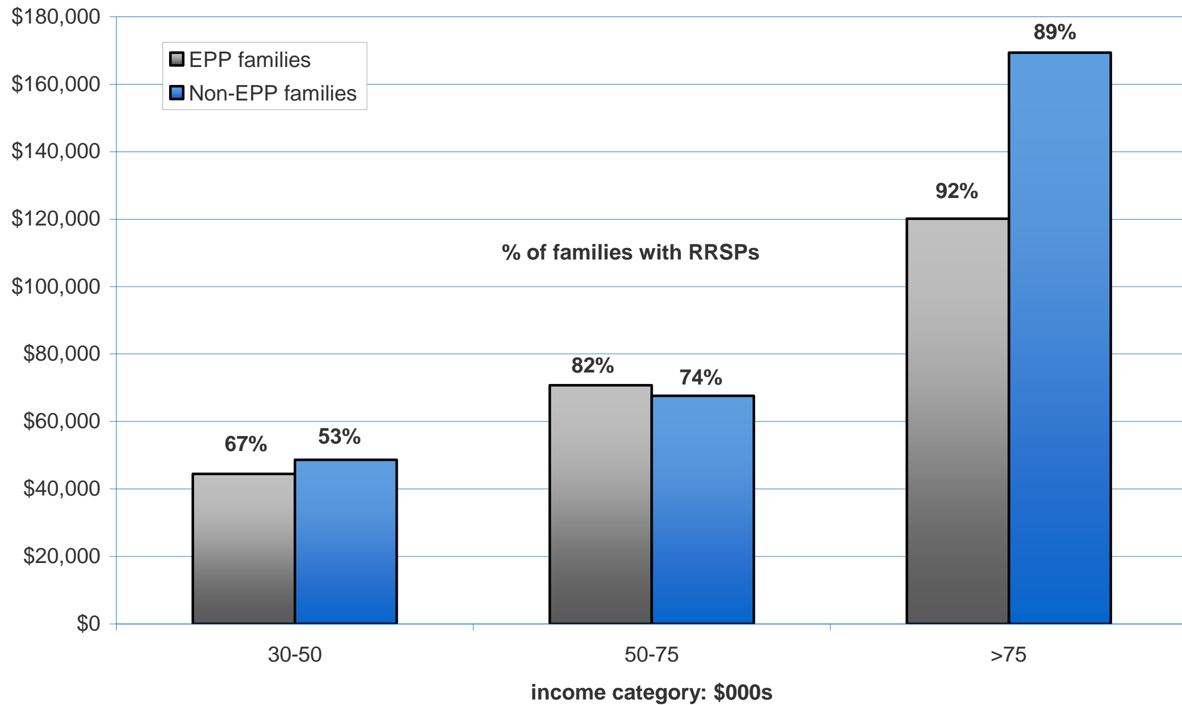


Figure 5 below looks at the same investment behaviour, but by income category rather than age. Once again, non- EPP families are less inclined to have investments in RRSPs but the gap between the two family types shrinks considerably as income increases. For the highest income, greater than $75,000, non-EPP families are not only as inclined to hold RRSP assets as EPP families, they hold considerably more assets in such investments.

This suggests that the results in Figure 4 are very much driven by the fact that non-EPP families tend to be younger and earn lower incomes than their EPP counterparts.

FIGURE 5

Actual Investments in RRSPs and Other Retirement Assets



How families respond to savings needs and opportunities

The primary method by which Canadian families save for retirement individually is via the Registered Retirement Savings Program (RRSP) which has been in existence for five decades. On the one hand, the numbers associated with the RRSP look impressive – contributions in 2007 totalled $34 billion by 6.3 million individuals, for an average of $5400 per contributor. These contributions amounted to about 42% of the new RRSP room acquired that year. On the other hand, it appears that only 29% of those who had RRSP room in 2007 made a contribution and 86% of the total accumulated RRSP room remained unused as of 2007. To put RRSP contributions in context, they are about equal to the $35 billion in premiums collected each year by the CPP.

TFSA

In 2009, the federal government introduced a new form of tax-assisted savings, the Tax Free Savings account into which every Canadian 18 years of age or over, regardless of income, can deposit $5,000 per year with full flexibility to take funds out of the TFSA when needed and redeposit later into the TFSA, without losing the TFSA room. While the RRSP is clearly designed as a retirement savings vehicle, with some later adjustments to provide more flexibility, the TFSA is a flexible product that encourages savings over a family's lifecycle, including for retirement purposes.

The TFSA has been in existence since the start of 2009. According to an Ipsos Reid survey, a total of almost 3.6 milllion accounts have been set up in the first six months of 2009, with a total of $12.4 billion deposited –

the average is just over $3400. End of year totals for the TFSA overall should be well above the figures cited above.

We can put this in context in a number of ways. In 2007, 6.3 million Canadian taxfilers put $34 billion into RRSPs. To date, the take up rate for the TFSA is about 57% of that for the RRSP. Total deposits equal about 36% of the total 2007 RRSP contributions. This however understates the magnitude of these contributions because a dollar put into a TFSA can be withdrawn free of tax whereas a dollar put in an RRSP will attract tax once withdrawn.

Observations

The concern over inadequate savings has two distinct components. Are Canadians as a whole saving enough? *and* are there certain groups of Canadians who are not saving as much as their peers? Linked to this is of course the question about whether Canadians should be automatically enrolled in savings plans.

Canadians save for retirement by being compelled to contribute to the CPP and in this context they, and their employers, contribute $35 billion per year in premiums. Canadians are also encouraged to save for their retirement by having access to a tax assisted vehicle (RRSPs) and in this context they contribute $34 billion per year. The distribution of retirement benefits associated with the CPP is very different from that associated with RRSPs but the lesson is clear that Canadians can be encouraged individually to save as much as they can be compelled to save through a program that has generally acceptable costs.

Moreover, the TFSA suggests that Canadians might individually be as likely to sign up for a savings vehicle as they would be to participate in an automatic enrolment supplemental plan. What needs to be addressed through further research is whether it addresses the needs of those families for whom inadequate savings is a concern.

The analysis above has been performed at a fairly high level because of the nature of the data available. Nevertheless, there are some areas that have been identified that should be pursued as policy makers seek to get Canadians better prepared for retirement and there are others that indicate more research is needed:

1. Net worth is an appropriate way to judge the financial security of families over their life cycles. It is, however, a macro variable and at certain stages of the life cycle the composition of the net worth is an important consideration. At retirement, for example, liquidity of assets takes on a more important role and an assessment of preparedness for retirement needs to look at that.

2. There are savings gaps for some families. Families without an EPP tend to have a lower net worth than families with an EPP. They compensate to some degree by increasing net savings in other ways but it tends not to be sufficient to close the gap. Is this due to a lack of financial planning or insufficient incentives to save?

3. One form of savings may be a substitute for another. Families with an EPP may reduce their net savings in other ways because they have different needs. Consequently, if individuals are

automatically enrolled in a supplemental plan, it should not be assumed that every dollar of contribution leads to an extra dollar of net worth.

4. Families in the upper income brackets do not appear to be penalized by not having access to an EPP. They seem to be able to fully compensate in other ways for the lack of an EPP.

5. RRSPs appear to be unattractive to a wide range of Canadians who do not have access to an employer sponsored pension plan, yet this is precisely one of the target groups for the RRSP. RRSPs appear not to be popular amongst those with lower incomes and the young. While these are, in many respects, precisely the groups who would find the TFSA attractive, data from an Ipsos Reid poll indicated that, initially, the TFSA was most popular amongst Canadians aged 55 to 64 years.

6. The take up rate for the TFSA has to date been quite strong when compared to the well established and well known RRSP. It has the potential to represent a significant addition to the basket of tax-assisted savings vehicles. Before pursuing other reforms, we need to know if the TFSA represents an addition to savings in general and the RRSP in particular or if it is just a substitute. Secondly, we need to know if it is attractive to those family configurations that need to increase their savings either because they do not have access to an EPP or because they do not invest in RRSPs.

7. The government has created a number of tax-assisted savings vehicles that some individuals find attractive. Another approach that should be considered is to more broadly reduce the tax on savings even outside of these vehicles.