DC INTEGRATION WITH CPP:

UPCOMING REFORMS A 'CONVENIENT TIME' TO CONSIDER MORE COMPLEX DESIGN

By Glenn Kauth

Defined benefit pension plans have long included formulas for integrating the Canada Pension Plan into their contributions and benefits design. But with CPP contributions set to rise in 2019, the question of integration will be a consideration for the sponsors of defined contribution pension plans as well.

CPP integration isn't a particularly common feature of defined contribution plans. But some, including the University of British Columbia's faculty pension plan, do include provisions for taking CPP contributions into account.

In its case, the university's plan, upon its inception all the way back in the 1960s, envisioned fully offsetting any CPP premiums paid by both employees and the employer. While the prior iteration of the plan provided for contributions of 10 per cent by the university and five per cent from employees, they would contribute less once the CPP took effect in 1966. With the initial CPP formula of 1.8 per cent from each of employers and employees, that meant the university's plan would require contributions of 8.2 per cent and 3.2 per cent, respectively, for earnings above the basic exemption and below the year's maximum pensionable earnings. For earnings below the basic exemption and those above the annual CPP threshold, contributions to the university's plan would revert to 10 per cent and five per cent, respectively.

As governments gradually looked to increase CPP contributions, the faculty association began expressing concern about the impact on the university plan given the integration formula. As such, the plan design changed in 1989 to keep the contributions at 8.2 per cent and 3.2 per cent, regardless of any increases under the CPP formula. That framework remains in place today.

CPP contributions, of course, are on track to rise to 5.95 per cent (from the current 4.95 per cent) from each of employers and employees by 2025. The CPP enhancement also provides for additional contributions for those with incomes above the year's maximum pensionable earnings. So with CPP contributions going up, what are some of the options for rejigging defined contribution pension plans?

A range of options

One of the simplest ways to consider integration is to decrease contributions to the company's plan in line with the CPP changes. So with the CPP rate rising by a percentage point by 2025, employers could simply lower the contribution rate to their defined contribution plan by that same amount. Doing so would offset the increased CPP costs for both workers and employers.

While many defined contribution plans operate on a relatively simplified basis by providing for employer-employee contributions of, say, five per cent each, the approach may not always be ideal. As Michelle Loder, a partner at Morneau Shepell Ltd., points out, the approach provides for full CPP and workplace pension plan coverage for lower-income employees who earn less than the year's maximum pensionable

COMBINED EMPLOYER/ EMPLOYEE CONTRIBUTION INCREASES UNDER THE CPP ENHANCEMENTS

2019	0.3%
2020	0.6%
2021	1%
2022	1.5%
2023	2%

The above contribution changes apply to income up to the year's maximum pensionable earnings. For income above that threshold and up to a projected $82,700, a combined premium of 8% will apply once the CPP changes take full effect in 2025.

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earnings. For those earning above that threshold (currently $55,300), they don't get CPP coverage on their full income. Thus, the lower-income employee may, in fact, have a higher replacement rate in retirement.

Loder notes integration in many defined benefit plans typically does consider CPP coverage. The theory, she says, is that members would need less from their workplace pension to replace income up to the yearly earnings threshold since they'd also be receiving CPP benefits. They'd thus get more from their workplace pension in order to replace earnings above the threshold.

Loder acknowledges that defined contribution plans have typically been less explicit about the income replacement rate they're aiming to provide. But she encourages plan sponsors to consider the issue, even if they don't communicate it to employees. That may mean setting out a replacement rate within a certain range, she says, suggesting the CPP expansion represents a "convenient time to look at it now."

Opportunities and challenges

So what does integration in the defined contribution context look like? Loder gives the example of a plan that provides for a two per cent matched contribution up to the year's maximum pensionable earnings and then four per cent for income above that threshold. While that would look different from the current approach typically used in defined contribution plans, Loder notes it would still represent a uniform formula.

> **"It would be the same formula for everyone.**

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"It would be the same formula for everyone," she says, adding that even the current approach provides for different overall contributions given variations in employee earnings.

"Even five per cent of pay, the dollars are different," she says.

While Loder acknowledges the approach would involve introducing more complexity to the plan and would mean some communications challenges, she says it does have the potential to reduce disparities in replacement rates. At the same time, she suggests it's an opportunity to improve members' understanding of how the CPP works and the premiums they pay.

But Corey Vermey, director of pensions and benefits at Unifor, isn't so sure about the prospects for integrating defined contribution plans with the CPP. The big challenge, he suggests, would likely be from employers around increasing the complexity of the plan.

"It may be daunting," he says, noting he hasn't seen defined contribution formulas that integrate the CPP so far.

And when it comes to the general question of more straightforward CPP integration by offsetting the increased premiums with corresponding decreases to the defined contribution plan, Vermey says discussions about that issue have largely died down.

"That conversation seems to have stopped," he says, suggesting the drawn-out implementation phase of the CPP enhancement means employees won't see much improvement to their benefits for a long time.

And beyond that issue, he says concerns about retirement adequacy remain even with the CPP enhancements.

"It won't be the full answer, especially with respect to DC," says Vermey, noting the union would consider the adequacy of the plan and the replacement ratio it provides when it comes to looking at proposals to offset the increase in CPP premiums.

"I think it will be situational," he says, suggesting defined contribution plans typically haven't fully addressed the additional costs of funding retirement caused by factors such as increased longevity. And rather than seeing any trend towards CPP offsets, Vermey says he has seen more of a move towards increased contributions.

Additional considerations

Beyond the question of offsets and integration is the fact that the CPP itself is about to become more complex. In addition to raising contributions by one per cent on earnings below the year's maximum pensionable earnings, the CPP enhancements include a move to introduce a new coverage bracket.

As a result, employers and employees will contribute four per cent each on income falling within the year's additional maximum pensionable earnings bracket, which the government projects will be $82,700 by the time the CPP changes take full effect in 2025.

While that introduces an additional wrinkle to Loder's idea of integration above the year's maximum pensionable earnings, she notes employers could keep things simple by providing for a higher contribution rate above the new income threshold. As she points out, the CPP reforms aim to replace 33 per cent of income, up from the current 25 per cent, on earnings up to both thresholds.

Loder suggests that regardless of what employers decide to do about the CPP, it's useful to consider the goals of the plan, including whether the idea is to provide for equality of outcomes or equal contributions.

"Even if they don't change, it's a good exercise for plan sponsors to have gone through," she says.

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