Reforming Canada’s Retirement Income System for Canadians Living on Low Incomes

Canadians are familiar with the message that they should be saving for retirement. We know from statistics on savings invested in registered education savings plans (RESPs) that receive the income-tested Canada Learning Bond that Canadians living on low incomes can and do save. But *should* Canadians living on low incomes be saving for retirement? Will their retirement savings provide a net benefit or be offset by the loss of other income-tested benefits?

This is one issue that was raised in three recent reports on Canada’s retirement income system. In February of this year, the National Institute on Aging published “Improving Canada’s Retirement Income System: A Discussion Paper on Setting Priorities” by Keith Ambachtsheer and Michael Nicin. The other two are companion reports published in June 2019 by the Council on Aging in Ottawa: Bob Baldwin, “Canada’s Retirement Income System: A Reform Agenda” and Peter Hicks, “Retirement Income Policies: Reform Pressures over the Coming Decade”.

A second issue raised in these reports is how an increase in the official retirement age, i.e., the age of eligibility for pension benefits, will affect workers earning a low wage. Will they be able to work longer or are their jobs more likely to be too physically demanding than higher wage workers? If they are not working, does this mean that they will spend more time on comparatively lower provincial social assistance benefits?

These two issues and others raised in the reports that are of particular relevance to Canadians living on low incomes are summarized below. All three reports highlight the importance of consulting with a broad range of stakeholders on both problems with the current system and any proposed reforms. Any consultations should make an effort to engage anti-poverty community organizations and academics to ensure that any changes to the current system improve, rather than harm, financially vulnerable Canadians. Current poverty levels among seniors are highest for unattached people, especially women, immigrants and older seniors.

This summary is not intended as a comprehensive review of Canada’s retirement income system, its current problems, or potential reforms. Rather, having recently done some interesting quarantine reading on this topic, we wanted to share this summary.

Current system: Negative effect of retirement savings on the Guaranteed Income Supplement

All three reports agree that, overall, Canada’s retirement income system ranks well internationally. One problem with the current system noted in all three is the complexity of the system. One aspect of this complexity is understanding the interaction of different components of the system. These components include private retirement savings in registered retirement savings plans (RRSPs), workplace pensions, the Canada Pension Plan (CPP), Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). Generally, these components complement each other; however, in the case of income-tested benefits, sometimes an increase in one component does not result in a net gain to the beneficiary. Baldwin expresses a general concern that governments pay too little attention to the interaction of the different components of the system.

One important interaction noted in all three reports which disadvantages seniors living on low incomes is the interaction between private retirement savings and GIS.[1] The problem is that 50 cents of GIS benefits are clawed back for every dollar of income beyond a small exempt amount, and then 75 cents after a second threshold is reached. Withdrawals must be made from a RRSP starting no later than age 71. This clawback also applies to any employment income earned after 65. This problem has been somewhat alleviated by an increase in the amount of exempt earnings from $3,500 to $5,000 and a partial 50% exemption for the next $10,000 earned, but the clawback beyond that is still 75%. A level of income that makes lower income seniors ineligible for GIS may have other knock on effects, such as ineligibility for provincial health benefits.

This negative interaction leads Baldwin to argue that government reliance on GIS rather than OAS to increase the minimum income guarantee to seniors creates a disincentive for low-income earners to save for their own retirement. To put it another way, low income Canadians who put aside their own savings do not necessarily come out ahead, because they lose out on GIS. Furthermore, as noted below, as Canadians live longer, many are choosing to work past 65. It is important to ensure that Canada's retirement income system is not forcing seniors living on a low income to keep working, but equally the system should not punish low income seniors to continue working by choice.

This negative interaction might suggest that Canadians living on low income should be advised against saving for retirement. Stapleton advises Canadians living on a low income to save in a TFSA rather than a RRSP, since withdrawals from a TFSA will *not* trigger a clawback.[2] Baldwin raises another issue around encouraging private retirement savings, which is whether retirement saving is "habit forming". If it is, then, he argues, incentives should focus on getting people started on saving, rather than ongoing tax benefits, which do not benefit low income earners. He suggests that low income earners could be incentivized to save by converting the tax deduction for RRSP contributions to a tax credit. Another mechanism for encouraging savings among low income earners, not discussed in any of the three reports, is a matched savings program, similar to the Canada Education Savings Programs used to encourage education savings. Matched savings programs have also been used by community organizations as a financial empowerment intervention. More empirical research is needed to determine whether retirement saving is habit forming and whether matched savings programs are effective in helping to encourage this habit.

[1] See also John Stapleton, "Low Income Retirement Planning: Four Things to Think About" (2020), online: https://openpolicyontario.s3.amazonaws.com/uploads/2020/02/Low-Income_Maximizing-GIS_-Determining-OAS-and-GIS-booklet_2020.pdf, cited by Ambachtsheer and Nicin on this point.

[2] See Stapleton, *ibid*. Stapleton makes an exception for cases where contributing to an RRSP between 65 and 71 will lower taxable income below the threshold to receive GIS.

On the broader issue of private retirement savings, Ambachtsheer and Nicin raise the potential mismatch between the “investment responsibilities” of Canadians to save for their own retirement and their (in)ability to do so. The extent to which these responsibilities exceed Canadians’ investment capabilities is exacerbated by lack of skill “and temperament” of financial advisors. In their reports, Baldwin and Hicks both note the need to take a broader view of the retirement income system to include services such as long-term care – an issue currently in the spotlight following the outbreaks of Covid-19 in these homes. The concern raised by Ambachtsheer and Nicin suggests that the regulation of financial advisors also needs to be part of this broader picture. Taking this into account is complicated, however, by the fragmented regulation of financial advisors across provinces and regulatory agencies.

Proposed reform: Raising the age of eligibility for retirement benefits

All three reports note that Canadians are working longer. Hicks puts the new median age of retirement at 68. For this reason, Baldwin and Hicks argue that the official retirement age, i.e., the age of eligibility for pension benefits, should be raised to align better with the age at which Canadians are actually retiring, but with important caveats to protect vulnerable groups. Ambachtsheer and Nicin note that “arguments can be made on both sides” of this debate. Currently Canadians in the bottom income quintile earn *more* income in retirement, which is why any package of reforms to raise the retirement age would need to offset the losses to this group.

Baldwin and Hicks both argue that raising the retirement age would create savings in the system that could be redirected to Canadians living on low incomes. Baldwin argues that any increase in age of eligibility for OAS should be offset by keeping GIS at 65. Hicks argues that the status quo is contributing to income inequality given that the people retiring later tend to be better educated and higher paid, who have maybe five years, from 65 to 70, when they are earning both pension and income from work. He argues that raising the pension eligibility age, with enough notice, would alleviate this problem, offset by similar reforms proposed by Baldwin, e.g., keeping GIS eligibility at 65 or even lowering it to 60.

Many Canadians will remember that there was a past attempt to raise the official retirement age. Any future reform on this issue will have to be done carefully, in consultation with all stakeholders, with the caveats offered by Baldwin and Hicks to protect financially vulnerable Canadians in mind.

Other issues

The concerns driving Ambachtsheer and Nicin’s report are the aging population and the decline in coverage of workplace pensions, combined with lower returns on savings in this era of low interest rates. Baldwin points out that the decline in workplace pension coverage might be overstated, because it does not include employees who participate in group RRSPs, but he is concerned that the contributions rates to the increasing number of defined contribution pensions means that the retirement savings of many Canadians will fall short. Ambachtsheer and Nicin note that the decline in workplace pensions applies mainly to men – coverage for women has increased slightly. Hopefully, this will lead to a decrease in poverty rates among single elderly women – a particularly vulnerable group highlighted in Hicks' report – in the coming decades.

The decline in workplace pension coverage is made more problematic given the low rates of personal retirement savings: Ambachtsheer and Nicin cite a Broadbent Institute report that median family savings for Canadians entering retirement without a workplace pension is only $3,000. This likely explains the significant drop in income for some middle income earners when they enter retirement noted by Hicks.

With respect to poverty alleviation, Hicks notes that the current retirement income system does pretty well if poverty is defined as material deprivation; it performs less well if it is defined as social exclusion, in part because GIS and OAS are indexed to the consumer price index and not to wages, which will result in a growing income gap between retired people and working people.

Both Baldwin and Hicks discuss the interesting philosophical and moral question of intergenerational fairness of the system. Both agree, however, that these concerns should not drive retirement income system reform. They argue that while a proposed change to the retirement income system might appear to benefit seniors at the expense of workers, these are likely to be countered by other things like transfers of technology and wealth (eg appreciation in property values) from older to younger. Ambachtsheer and Nicin ask whether raising the official age of retirement can be done in a way that is fair intergenerationally. They also cite the current economic challenges facing younger workers, including the growth of the 'gig' economy, and how this will affect their ability to accumulate private savings for retirement.