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Changes in Canada Pension Plan: *Increased Flexibility for Retirees*

These days, some Canadians want to retire early, while others want to keep working past 65. Many more wish to ease into retirement by continuing to work part-time. Regardless of individual circumstances the following changes will impact most Canadians.

On May 25, 2009, The Minister of Finance outlined proposed changes to the Canada Pension Plan (CPP)¹. The goal, according to a Department of Finance paper released to coincide with the announcement is to “better reflect the many paths people take to retirement” and to “provide greater flexibility for older workers to combine pension and work income if they so wish; modestly expand pension coverage; and improve fairness in the plan’s flexible retirement provisions.”² These changes were included in Bill C-51, which received Royal Assent on December 15, 2009.

These changes, which will become effective between 2011 and 2014, will benefit workers to differing degrees depending on their age, history of earnings and their ability or desire to work past age 60. If you are currently collecting CPP retirement, disability or survivor benefits or will begin collecting your pension prior to 2012, you will not be impacted by these changes unless you are a CPP recipient who continues to work.

Canadians contributing to or receiving a Quebec Pension Plan (QPP) should refer to the following website, as the two plans are very similar but not identical.

http://www.rrq.gouv.qc.ca/en/programmes/regime_rentes/Pages/regime_rentes.aspx

¹ The Plan operates throughout Canada, except in Quebec, where the Quebec Pension Plan (QPP) provides similar benefits.

² http://www.fin.gc.ca/n08/data/09-051_1-eng.asp

How it works:

1) Pension Adjustments for early and late CPP pensions

Possibly the biggest change is an increased incentive to wait to collect until you are 65, or at the latest, age 70. Currently, the age for Canadians to begin receiving CPP benefits is age 65, as with Old Age Security. It is possible to opt to receive early CPP, as early as age 60, even if you continue to work.

Age CPP pension commences	Current Pension Adjustments	New pension adjustments				
		2012	2013	2014	2015	2016 and thereafter
60	-30%	-31.2%	-32.4%	-33.6%	-34.8%	-36%
65	0%	0%	0%	0%	0%	0%
70	+30%	+34.2%	+38.4%	+42%	+42%	+42%

There is a catch: a reduction of benefits. The early pension reduction will be increased, over a period of 5 years starting in 2012³ to 0.6% per month for each month that the pension is taken before age 65. The late pension augmentation will be gradually increased to 0.7% per month for each month that the pension is taken after age 65, up to age 70. This will be phased in over a period of 3 years, starting in 2011⁴.

2) Continued CPP participation while receiving benefits

Currently, CPP contributions are no longer paid once you begin receiving a CPP retirement pension, or once you reach age 70, whichever is earlier. With the changes enacted, a person under 65 who chooses to receive CPP benefits may continue working and thus continue to earn CPP benefits, but will be required to continue contributing to CPP to age 65. Your employer will also be obligated to continue contributing as well. Currently, employees over age 65 who work while receiving a CPP pension can no longer contribute to the CPP. These employees, as of 2012, will be able to voluntarily elect to make CPP contributions until age 70. If a pensioner elects to contribute, his or her employer will also be required to contribute.

Although this could cost working retirees hundreds of dollars more a year in payroll deductions, these contributions will result in increased retirement benefits, even for persons already receiving the maximum pension amounts. Employees will receive an additional CPP pension benefit of up to 2.5% of the maximum CPP pension. This could represent, in current dollars, 2.5% of \$10,905 or \$273⁵ for those at existing maximums. The exact amount depends on the earnings level of the contributor. Additional CPP pension 'purchased' in any one year will commence in the following year, subject to any applicable early retirement reduction. The effective date of this measure is 2011.

³ 0.52% in 2012, 0.54% in 2013, 0.56% in 2014, 0.58% in 2015, 0.60% in 2016 and thereafter.

⁴ 0.57% in 2011, 0.64% in 2012, 0.70% in 2013 and thereafter

⁵ The maximum retirement pension in 2010 is \$934.17 (\$11,210 per year) at age 65.

3) Change in calculating average career earnings

CPP uses a career average calculation which allows for certain years of low or no earnings to be disregarded in arriving at average earnings. If you take the CPP at age 65, the span of your career is considered to be 47 years. If the CPP is taken at age 60, the span of your career is considered to be 42 years. Currently, 15% of an employee's potential working career may be disregarded. Under the proposed rules, the drop-out percentage will be increased as follows:

- to 16%, in 2012. This would allow a maximum of 7.5 years to be dropped, based on a working career of 47 years (age 18 to 65)
- to 17% in 2014. This would allow a maximum of eight years to be dropped. This provision will help more Canadians come closer to the maximum CPP pension, especially those for whom 2008 and 2009 were not the best years. This change will also increase the average CPP disability and survivor pensions, which are based on the retirement benefit calculation.

4) Removal of the Work Cessation Test

Under current rules, in order to qualify for a CPP benefit before age 65, you must not earn more than a certain amount in the month the CPP pension commences or the month before. Currently this amount is approximately \$900. This earnings test is referred to by the government as the "Work Cessation Test". Under the new rules, the Work Cessation Test will be removed for employees who commence their CPP pension in 2012 and later. However, as discussed earlier, employees under the age of 65 will be required to continue to contribute while working in return for an increased benefit.

Summary - *What all this means*

Some analysts interpret the changes as a disincentive to early retirement. Others see these changes as an attempt on the part of the Government to gradually alter behavior and encourage Canadians to remain at work longer. The nature of the changes may shift the advantage to retiring later if you need more years to qualify for a maximum benefit, but not if you need extra income right away.

Your financial advisor can help you work through the process of deciding when to begin receiving your CPP benefits. During this discussion please keep these topics in mind:

- Your earnings history under the CPP, the dropout provisions and phase-in reductions.
- Total sources of income in retirement beyond the CPP. The early retirement decision for many Canadians involves much more than just considering CPP. If you are a member of a Defined Benefit plan there may be an incentive to defer retirement. If, as an increasing number of Canadians, you are a member of a Defined Contribution plan, or are funding your retirement with RRSPs, you could have an incentive to delay retirement to grow your portfolio to your desired level.

- Your goals regarding retirement, and the amount of retirement income which will be needed to make those dreams reality.
- Whether you need to live on CPP income, or whether you can afford to invest it. If you have the ability to invest your CPP income, that would actually encourage you to start your CPP early and not wait until 65. Using a Tax-Free Savings Account (TFSA) can help you maximize your CPP benefits. Contribution rates remain at 9.9% but changes may be in the wings. Federal and provincial policymakers are expected to make recommendations for changes in the near future.

For more information, speak to your financial advisor, or log on to the CPP website at:

<http://www.servicecanada.gc.ca/eng/isp/cpp/cpptoc.shtml>



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