



# Benefits

CANADA

## Why we need a lifetime retirement saving limit

James Pierlot with Faisal Siddiqi | November 10, 2011



Born in 1946, the first wave of Canada's baby boom generation will be 65 years old in 2012. If they haven't saved enough for retirement, it's too late to start. But many workers in the baby boom generation will remain in the workforce for some time to come. The baby boom peaked in 1959 and ended in 1964, so workers born during this period have between 10 and 20 years to save for retirement.

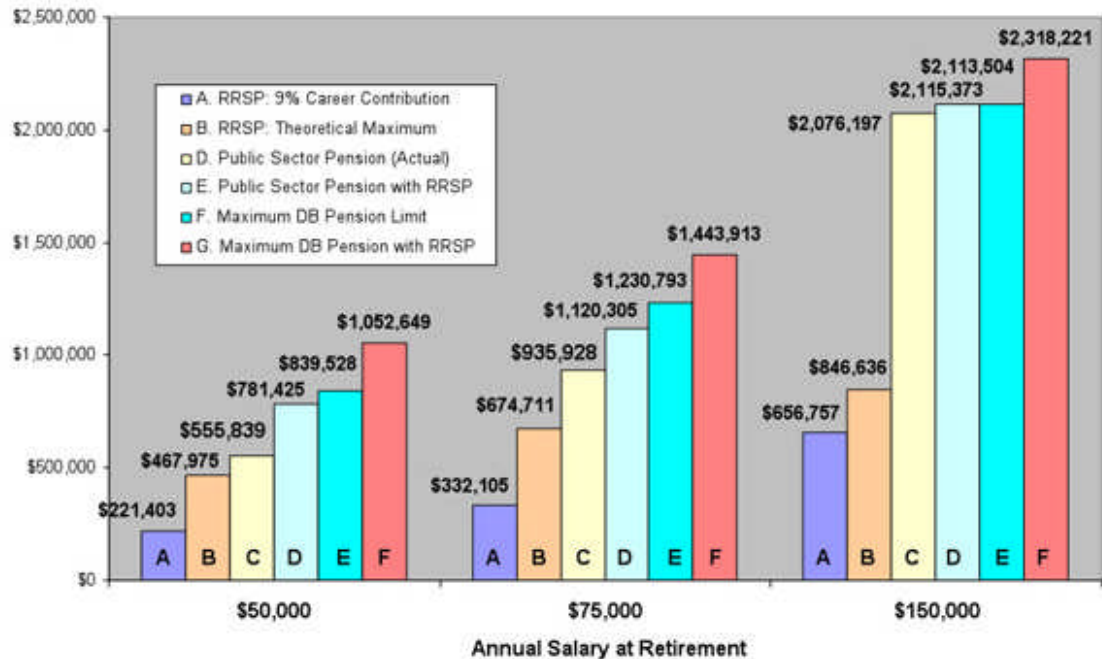
Unfortunately, saving for retirement is becoming more difficult. From 1977 to 2007, DB pension plan membership dropped from 31% of private sector

workers to 16%. Today, more than 12 million of Canada's 17.5 million workers do not participate in a DB plan. With declining DB pension coverage, low interest rates and increasing life expectancy, pensions are harder to accumulate—and more expensive. Even workers who delay retirement will need to save more to maintain their living standards in retirement.

But can they? For many workers saving in RRSPs and DC pension plans, the answer is no, because contribution limits are too low. To demonstrate this, we developed a model that shows the retirement savings accumulations possible under Canada's tax rules for retirement saving from 1974 through 2011. Figure 1 shows some of the output from this model.

**Figure 1**

**RRSP / Pension Values**  
35-Year Career | Retirement at Age 60



The workers shown in Figure 1 retire at age 60—the midpoint between median public and private sector retirement ages—with salaries of \$50,000, \$75,000 or \$150,000 at the end of 35-year careers. The DB values reflect the cost of pensions with 3% fixed-rate indexing and a 2/3 spousal survivor benefit, determined using group annuity purchase rates as at January 2011. Two kinds of DB values are shown, with and without the RRSP savings each plan member could have accumulated:

1. the value of pensions actually provided to federal public sector workers; and
2. the value of maximum DB pensions permitted under the *Income Tax Act*.

The values for workers saving in RRSPs (which are similar to the savings possible in DC plans) show best-case scenarios: each worker contributes annually and earns a compound net return of 5% per annum. In practice, this almost never happens because most workers saving in RRSPs experience periods of low earnings or unemployment, do not earn a 5% return over the long term, and delay contributions to later in their careers. This means that workers saving in RRSPs cannot realistically hope to accumulate even half the retirement wealth of career members of DB pension plans.

**What about unused RRSP room?**

Statistics Canada reports that at the end of 2010, new and carry-forward RRSP contribution room totalled \$670 billion. This sounds like a lot, but it averages out to only \$38,000 for each of Canada’s 17.5 million workers. Moreover, most of this unused contribution room is held by low-income workers who would be better off saving for retirement in tax-free savings accounts, to avoid claw-back of the Guaranteed Income Supplement when RRSP savings are withdrawn. The available evidence indicates that middle and higher-income workers are using all their RRSP contribution room—and do not have enough.

**The solution: A lifetime retirement-saving limit**

To give all workers the opportunity to save enough, Canada’s annual, income-based retirement saving limits need to be replaced with a lifetime accumulation limit that will provide all Canadian workers the same retirement saving room now

available only to career members of DB pension plans. The principal features of a lifetime accumulation limit would be as follows:

Pension and RRSP accumulations would be limited to an indexed amount, with no annual limits on contributions or benefit accruals.

Contribution room would be restored by investment losses and withdrawals—as current tax rules now permit for DB plans and tax-free savings accounts, respectively.

Penalty tax would apply to pension and RRSP accumulations exceeding the limit.

The key benefit of a lifetime accumulation limit is that it will provide the catch-up retirement saving room that Canada's aging workforce needs. It will also level the playing field as among members of different types of DB plans, and as between DB plan members and those who save for retirement in RRSPs and DC plans.

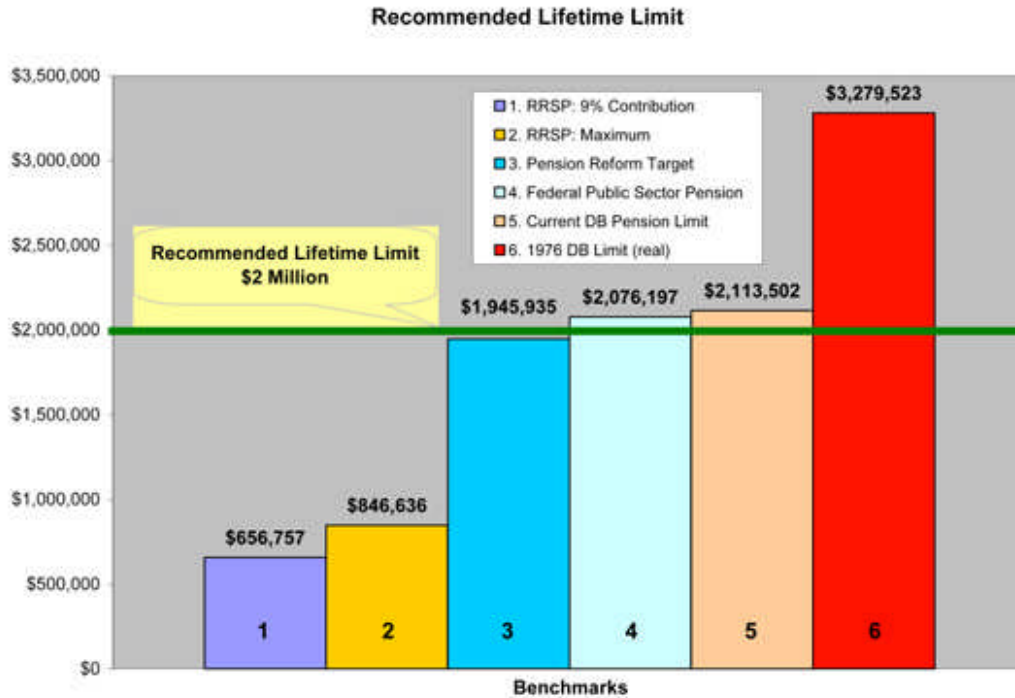
### **How much should the lifetime limit be?**

A lifetime limit should allow for adequate pension income, but should not permit excessive tax deferral. Below, we suggest six benchmarks for a lifetime limit, each determined by reference to career-end pension or RRSP values for workers with 35-year careers who retire at age 60:

1. RRSP savings for a high-income earner who contributes 9% of earnings annually.
2. RRSP savings with annual contributions at the RRSP maximum dollar limits.
3. The value the target pension recommended by studies leading up to the 1990 reform of Canada's pension tax rules: 70% of 2.5 times the YMPE.
4. The pension value for a federal public sector worker earning \$150,000.
5. The value of the maximum DB pension permitted by current tax rules.
6. The value of a pension at the 1976 tax limit of \$1,715 per year of service, adjusted to reflect wage inflation from 1976 to 2011 at 2.5% per year.

Figure 2 suggests an accumulation limit of \$2 million—approximately the value of the maximum DB pension now permitted under the *Income Tax Act*. This will be more saving room than many workers need, but it is necessary to ensure that all workers will have enough. Lower-income workers will not use contribution room they do not need—as is now the case with unused RRSP contribution room. Of course, a lifetime limit could be set at a lower amount (e.g., \$1 million) but this would prevent many current DB plan members from continuing to accumulate pensions.

### **Figure 2**



### Conclusion

It is clear that that Canada’s current tax rules are preventing many workers from saving enough in their RRSPs and DC pension plans to maintain their living standards in retirement. As Canada’s workforce ages, the problem will worsen. Workers will have less time to prepare for retirement, and the savings gap will increase between a fortunate minority with career membership in generous DB plans and everyone else.

Major reform is urgently needed. Replacing Canada’s current pension and RRSP limits with a lifetime accumulation limit will ensure that every worker will have an equal opportunity to accumulate a good pension.

*This article is based on Legal for Life: Why Canadians Need a Lifetime Retirement Saving Limit, published by the C.D. Howe Institute on Oct. 27, 2011.*

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