Upcoming changes to the Canada Pension Plan (December 2010)

For most Canadians, the Canada Pension Plan (CPP) represents a significant source of anticipated income during their retirement years—for some, perhaps even the majority of their income. As a result, changes to that Plan are of interest to just about every adult Canadian, especially those who are approaching retirement.

Retirement has changed a lot over the past few decades and especially over the past few years, as the baby boomers approach retirement age. While retirement used to be an "all-or-nothing" proposition—one either worked full-time or not at all—this is no longer the case. Many Canadians now approach retirement on a more gradual basis, shifting to a part-time schedule in anticipation of retirement, with many more intending to work on a part-time basis after their official "retirement" date.

The changes in Canadians' retirement patterns have meant changes in how CPP benefits are calculated and structured, and some of those changes will come into effect on January 1, 2011. Generally, the changes provide an incentive to working Canadians to put off receiving CPP benefits as long as possible, and a hindrance to those who perhaps planned to begin collecting such benefits at the first opportunity. They also provide already-retired Canadians who return to the work force, on either a part-time or full-time basis, with the opportunity to increase their CCP benefits by making additional contributions to the Plan. It's important to note, as well, who won't be affected by the upcoming changes. Canadians who are already receiving CPP benefits, unless they plan to return to the work force in the future, won't see any change to their current benefits or benefit entitlements as a result of these new rules.

To make sense of the changes, a bit of background is required on just how the Canada Pension Plan works. Each employed and self-employed Canadian contributes to the Canada Pension Plan during his or her working life, at a rate set by law. For 2010, that rate is 4.95% of earnings, to a maximum of $2,217. For employees, the employer contributes an equivalent amount, while the self-employed must contribute both the employer and employee portions.

For each recipient, the amount of the monthly pension is generally based on the amount of contributions made between the age of 18 and the date on which CPP benefits start to be paid, to a maximum (for 2010) of $934 per month. That pension amount is what the individual would receive if CPP pension payments started at age 65. However, Canadians who contribute to the CPP can begin to receive monthly payments from the plan as early as age 60, or can postpone receiving pension payments until as late as age 70. Where a person chooses to begin receiving payments before they turn 65, pension amounts are reduced, under current rules, by 0.5% for every month before age 65 that the individual chooses to begin receiving CPP. Conversely, where someone chooses to put off receiving CPP payments until after the age of 65, the amount of the monthly pension is increased by 0.5% for each month that pension payments are deferred.

Changes to the CPP to be phased in between 2011 and 2016 will provide a financial incentive to delay receipt of the CPP until after age 65 and will impose a greater cost on those who choose to begin receiving the pension before that time. Specifically, the 0.5% by which the pension amount payable is increased for each month that receipt is delayed after age 65 will itself increase—to 0.57% for 2011, 0.64% for 2012 and 0.70% for 2013. On the other side of the coin, where an individual chooses to begin collecting CPP before age 65, the current reduction of 0.5% for each month before age 65 that pension payments start will also increase—to 0.52% for 2012, 0.54% for 2013, 0.56% for 2014, 0.58% for 2015, and 0.60% for 2016.

While those percentages don't sound like they represent much change, the cumulative effects can be significant. In 2010, an individual who chooses to put off receiving CPP payments until the age of 70 receives 30% more than he or she had would have at age 65. Once these changes are fully implemented in 2013, a person making the same choice will receive 42% more than if he or she had taken the pension at age 65. The difference is smaller for those who choose to accelerate pension payments to age 60, but is still significant. Currently, a person who elects to begin receiving payments at age 60 will receive 30% less than if they had chosen to wait until age 65. By 2016, a person making the same choice will receive 36% less than someone who waited until age 65 to begin collecting their pension.

Some changes are also planned for how the pension receivable by each person is calculated. Under current rules, each person's average earnings between age 18 and their retirement date (known as the "contributory period") is totalled and then 15% of their lowest earning years are "dropped out" of the calculation. In practical terms, that meant that up to 7 years of the person's lowest earnings were "dropped out" from the calculation of average earnings. The balance was then used to calculate CPP entitlement for that individual. Beginning with the 2012 year, the percentage of low or zero income years that are excluded from the calculation will be increased to 16% in 2013, and 17% in 2014. The effect of the change will be to increase the amount on which CPP entitlement is based, and consequently, the amount of pension receivable, subject to statutory maximums.

While CPP recipients may continue to participate in the workforce (as an increasing number of retirees do), they may not, under existing rules, contribute to the CPP. However, beginning in 2012, CPP recipients under age 65 who continue to work will be required to continue contributing to the CPP, while those who are between the ages of 65 and 70 will have the option of contributing. Any additional contributions made while receiving CPP will, of course, increase the amount of CPP which the individual receives, through the new Post-Retirement Benefit.

Finally, where an individual wants to begin receiving CPP before age 65 but also wants to continue working, he or she must stop working or significantly reduce his or her earnings for a two-month period before beginning to receive CPP—a small but potentially inconvenient interruption in income. Starting in 2012, this rule will no longer apply.