Canada Pension Plan undergoes changes

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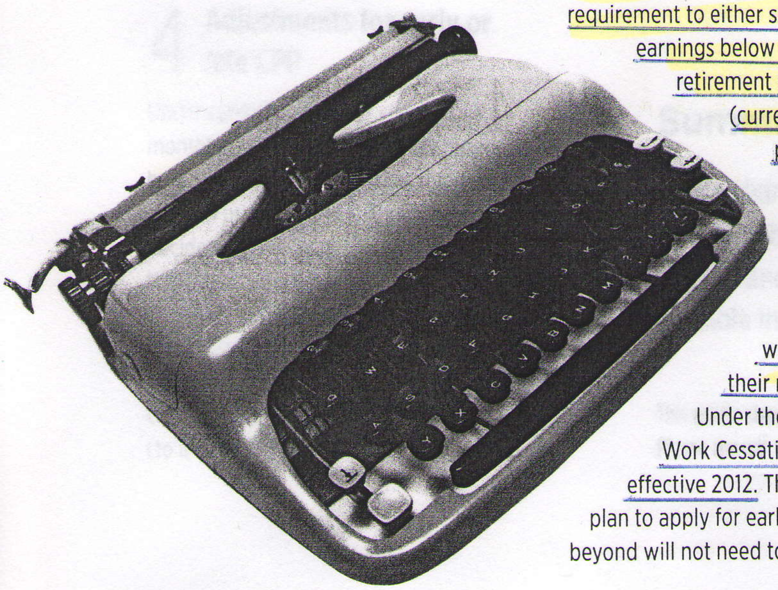
As a financial advisor, a major part of your role is to help ensure your clients have an adequate income stream in retirement. The income stream is generally provided through a combination of Canada's public pension system (including Old Age Security [OAS], Canada Pension Plan [CPP] and for some, the Guaranteed Income Supplement), plus income provided by employer pension plans or personal savings (i.e., RRSPs, TFSAs, among other savings). Changes announced in May 2009 (and legislated in December 2009) to the Canada Pension Plan program should help increase the amount clients collect from CPP in retirement and thus narrow the retirement income gap.



What are the changes?

There are four changes to the program that will begin to come into effect in 2011. The changes will be phased in gradually. Clients who receive CPP benefits prior to 2011 (i.e., retirement, disability or survivor) will not be affected by most of the changes. Here are the changes and how they will impact your clients.

1 Removal of the Work Cessation Test

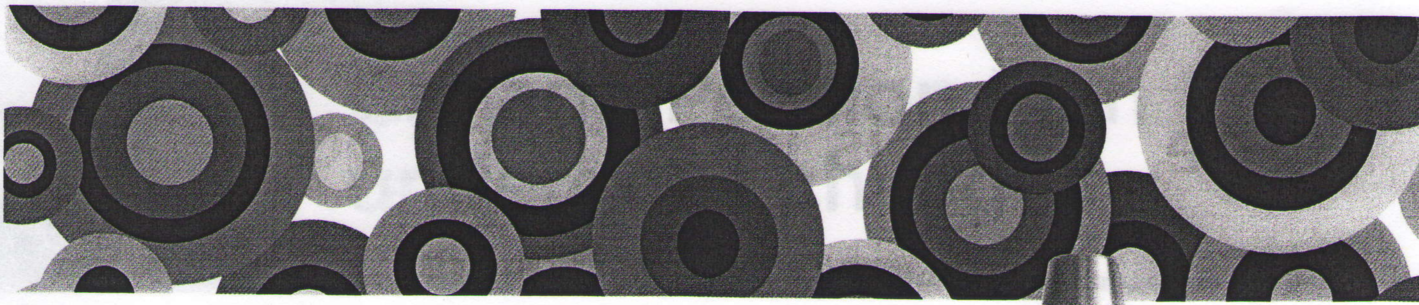
Your clients are eligible to collect their CPP retirement pension at age 65 provided they have contributed to the plan. They may however apply early and begin collecting a pension as early as age 60. Currently, if your clients apply for the CPP retirement pension between the ages of 60 and 64, there is a requirement to either stop working or reduce earnings below the monthly CPP retirement pension maximum (currently $934) for a period of two months. This is known as the Work Cessation Test. After that, your clients can return to work without impacting their retirement pension. Under the new legislation, the Work Cessation Test is removed effective 2012. Therefore, clients who plan to apply for early CPP in 2012 and beyond will not need to reduce their hours worked or have any interruption in earnings. This is a positive change for everyone involved, including those who have a steady stream of income that cannot easily be altered (e.g., financial advisors who collect trailing commissions).

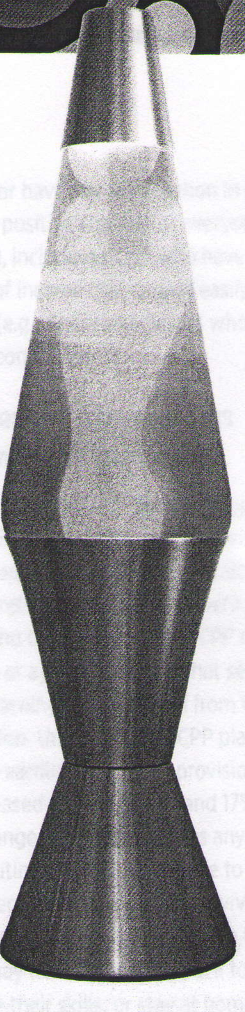
2 General low-earnings drop-out increased

Currently, the general low-earnings drop-out provision removes 15% of your client's low income earning years from the calculation of their retirement pension benefit. For a client who begins to collect a CPP retirement pension at 65, it means that seven years of low earnings are removed from the benefit calculation. Under the new CPP platform, the low-earnings drop-out provisions will be increased to 16% in 2012 and 17% in 2014. This change positively impacts anyone contributing to CPP and eligible to collect a retirement, disability and/or survivor pension. It also helps clients who decide to take time away from work to go back to school, improve their skills, or stay at home to care for a family member.

3 Pensioners to contribute to CPP

Under the current regime, your clients are not required to make contributions to CPP once they begin collecting retirement benefits. As a result, they are not able to increase their pensions going forward. The new rules will require any clients collecting a CPP benefit under the age of 65 and still





working to continue making contributions to CPP (along with their employer). Additional contributions made in a given year will increase the benefits collected beginning the following calendar year. This is the case even if your client is already entitled to the maximum monthly pension benefit. As for clients over the age of 65 and still working, they will have the option of making further contributions to CPP if they so desire and wish to increase future benefits.

It appears that this change in the program will affect new pensioners, as well as others who are already receiving CPP benefits under the age of 65. Your clients who are currently under the age of 65, still working and collecting an early retirement pension may be required to make further contributions to the CPP under these new rules.

4 Adjustments for early or late CPP

Under current rules, your clients' CPP monthly retirement benefits are reduced by 0.5% for every month that the pension is taken prior to age 65. Thus, if your client decides to take his or her pension at age 60, their basic pension benefit is reduced by 30%. Likewise, they may also delay collecting the benefit to as late as age 70. In this case, the pension is adjusted upwards by an equivalent 0.5% for every month the pension is delayed (to a 30% maximum).

Under the new rules, the early pension reduction will gradually be increased to 0.6% (by 2016), starting in 2012. This results in a maximum reduction of benefits by 36%. The late pension augmentation will be gradually increased over a period of three years starting in 2011 to 0.7% for every month the pension is delayed and could improve the monthly benefit by as much as 42%.

These rules seem to provide an incentive for your clients to delay the collection of the monthly benefit beyond age 65. And, although it seems like there may be a disincentive to start early due to the lower monthly benefit amounts, keep in mind that these clients, if still working, will be required to make further contributions to CPP and will be eligible for higher benefits in subsequent years. ■

Summary

These changes will generally result in your clients being eligible to collect higher benefits from CPP. As a result, this will affect your financial projections going forward for your clients, as well as possible investment strategies for their personal assets.

This article should not be construed to be legal or tax advice, as each client's situation is different. Please consult your own legal and tax advisor.