

## How the New Canada Pension Plan Rules may affect you

**T**he federal government has introduced some important changes to the Canada Pension Plan (CPP), which will start to take effect in 2011.

### Background and Current Rules

The CPP is a public pension plan that provides retirement income to Canadians (except in Quebec, where the Quebec Pension Plan (QPP) provides similar benefits). CPP payments are made monthly and adjusted annually for inflation. The CPP is funded by contributions from working Canadians and their employers. The 2010 contribution rate is 9.9% of the employee's earnings between \$3,500 and the Year's Maximum Pensionable Earnings (YMPE), which is \$47,200 in 2010. Contributions are split equally between employees and employers; self-employed people must pay both the employee and the employer shares.

The CPP retirement pension is based on the number of years a person has worked and contributed to the CPP as well as on their earnings level, up to a maximum amount. The maximum annual retirement pension in 2010 is \$11,210 (or \$934.17 per month). The calculation of a person's CPP retirement pension is based on that person's career average earnings during his/her contributory period<sup>1</sup>, but an adjustment is made to the calculation to exclude certain years of low or no earnings. This "general

low earnings drop-out" has the effect of potentially increasing a person's CPP retirement pension notwithstanding years of unusually low earnings for whatever reason.

Although the CPP retirement pension normally begins on a person's 65<sup>th</sup> birthday, there is flexibility to start receiving the pension as early as age 60 or as late as age 70. Adjustments are made to reduce or increase the pension amount for taking early CPP or postponing the receipt of CPP. In addition, to start taking CPP before age 65, there is a "work cessation" requirement, i.e. you have to either stop working or significantly reduce your earnings in order to receive CPP before age 65.

### Overview of Changes

The changes were introduced as a result of the regular review of the CPP that the federal, provincial and territorial finance ministers undertake every three years. They are intended to modernize the CPP to better reflect the different paths people take to retirement, as well as to improve the financial sustainability of the CPP.

**THE FOLLOWING CHANGES WILL NOT AFFECT YOU IF YOU ARE ALREADY RECEIVING OR WILL START RECEIVING CPP BENEFITS BEFORE THE CHANGES COME INTO FORCE:**

**Gradual increase in the general low earnings dropout rate.** As noted above, this "drop-out" percentage allows a certain number of years with low or nil earnings to be excluded from the CPP

(1) A person's CPP contributory period starts at age 18 and ends when he/she starts receiving the CPP retirement pension or disability pension, turns 70, or dies (whichever happens first).

## How the New Canada Pension Plan Rules may affect you

pension calculation. Currently the general low earnings dropout rate is at 15%. This rate will rise to 16% in 2012 and further to 17% in 2014. This change will be especially beneficial to people who have experienced work interruptions for a variety of reasons during their careers.

### **Elimination of the work cessation test.**

Beginning in 2012, it will no longer be necessary to stop working or significantly reduce earnings in order to qualify for early CPP retirement benefits (before age 65). This will be especially helpful if you plan to phase into retirement by gradually reducing work hours, as the CPP benefit can provide supplemental income during this transition period.

**Actuarial adjustments for early and late take-up of CPP.** To reflect the actual actuarial costs by creating greater incentives to postpone receiving CPP:

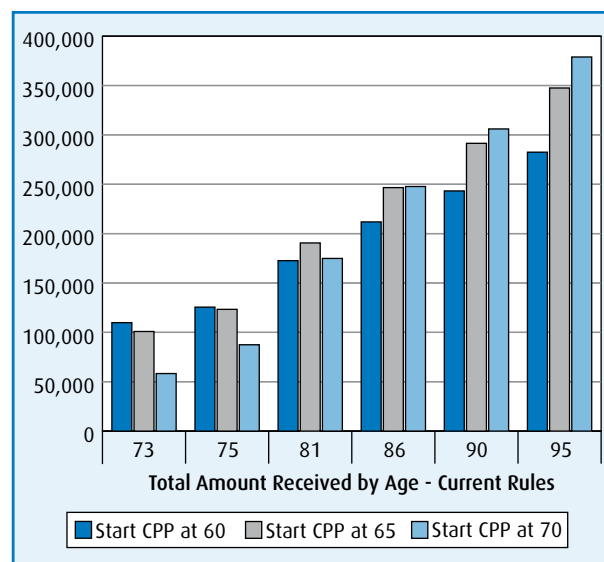
- The augmentation percentage for late take-up of CPP will be gradually increased from 0.5% to 0.7% for each month that CPP is taken after age 65. The changes will be phased-in over 3 years commencing in 2011.
- The reduction percentage for early take-up of CPP will be gradually increased from 0.5% to 0.6% for each month that CPP is taken before age 65. The changes will be phased-in over 5 years commencing in 2012.

Once these changes are fully implemented, your CPP benefit may be increased by up

to 42% (vs. the current 30%) or reduced by up to 36% (vs. the current 30%), depending on when you start collecting.

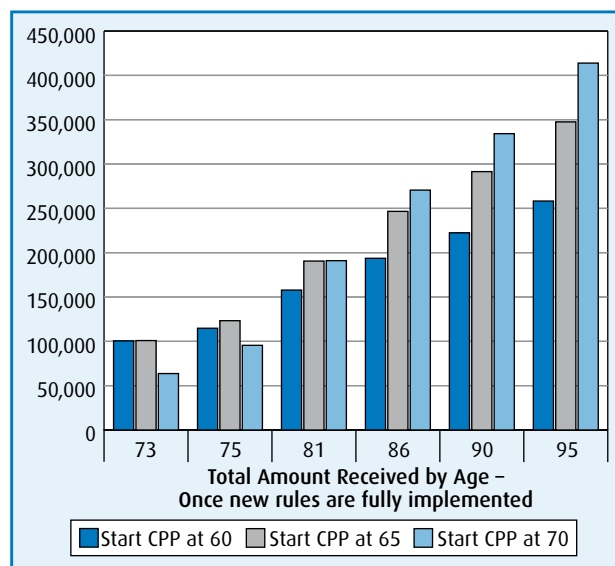
The following graphs compare the total income stream you will receive under the current rules and the new rules at various life expectancies, depending on when you start taking CPP (assuming you are entitled to the 2010 maximum retirement pension).

It can be seen that, under current rules, taking the CPP at age 60 gives you an advantage until approximately age 75, while delaying CPP until age 70 only gives you an advantage after age 85.



Once the new rules are fully implemented, however, taking the CPP at age 60 only gives you an advantage until age 73; while delaying CPP until age 70 will give you a higher total income stream once you attain age 81.

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### Additional assumptions:

- Full implementation of the early CPP reduction and late CPP augmentation changes (i.e. on or after 2016).
- Any future cost-of-living adjustments to the CPP retirement pension are ignored.
- The potential effect of any additional benefit that may arise from CPP contributions made while receiving CPP benefits are ignored.
- The CPP pension income received is not assumed to be invested.

These changes should therefore be considered if you are thinking of receiving CPP in the next few years. However, your decision will also depend on other

important considerations, such as the need for the CPP income and availability of other retirement income sources, life expectancy, income tax implications and the ability to invest the CPP payments.

### THE FOLLOWING CHANGE MAY AFFECT YOU EVEN IF YOU ARE ALREADY RECEIVING CPP BENEFITS:

#### Contribution to CPP while working.

Currently, once you are receiving CPP retirement benefits, you are no longer required to contribute to CPP even if you return to the workforce. Beginning in 2012, however, CPP recipients who are under 65 years of age and still working will be required to contribute to CPP (with matching employer contributions). After age 65, you may voluntarily elect to make CPP contributions, and if you do so, your employer will also be required to contribute. These additional contributions to CPP while receiving benefits will result in higher CPP benefits.

The CPP is only one source of your retirement income. For more information on the changes to the CPP and how they may affect you in the context of your overall retirement plan, please consult your BMO Nesbitt Burns investment advisor.

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