

THE PENSION SYSTEM IN CANADA: A SUCCESS TO FOLLOW?

Maria A. Szczur

Former professor,
the Warsaw Academy of Finance, Poland

INTRODUCTION

The establishment of an effective and stable system of income security for old age has become a challenge for many countries in recent decades, especially for those belonging to the group of highly developed economies. In Poland also an attempt has been made to change the pension system, and to find solutions to ensure a socially (and politically) acceptable level of income for the population at the post-productive age, while at the same time guaranteeing the long-term financial stability of the system.

The fundamental reform of the pension system, implemented in 1999, introduced solutions which have in recent years undergone significant changes. They primarily concerned the growing financial imbalance of the system, as well as fears about the possibility of covering the Social Insurance Fund's (FUS) deficit in the long run. In this context, it is not surprising that one looks for models in other countries, especially those which were able to avoid the financial imbalances challenging the public pension system. One of the references in this context is the pension system operating in Canada.

The resemblance in some important aspects of Poland and Canada, in relation to the pension system (including the percentage of people at post-productive age), should encourage us to undertake an analysis of the possibilities of transposing into Poland some of the solutions which have successfully been applied in Canada. On the other hand, there are significant differences between the two economies, and this does not allow for any simple transposition of Canadian solutions into Poland.

This paper presents the Canadian pension system, with a particular emphasis on its public component.

THE ORIGIN AND EVOLUTION OF THE PENSION SYSTEM

At the beginning of the twentieth century the Canadian federal government began to look into the question of retirement security for its citizens. This issue was a fundamental element of the construction of the Canadian welfare state.

In the early twentieth century, the federal government established a voluntary contributory pension scheme (Canadian Government Annuities Act), similar to a certain extent to the current Canadian programs known as RRSP (Registered Retirement Savings Plans), which gave people the opportunity to acquire life-long annuities guaranteed by the government. Since most Canadians did not pay contributions to the program, its impact on the level of pension savings was minimal.

The issue of social security arose in the debate of the Federal Parliament for the first time in 1906. However, it was only in the 1920s that the political and social situation (the negative social effects of urbanization and industrialization) made the authorities show interest in the solution to the issue of pensions. During this period new parties appeared on the political scene, especially the Labour Party, whose platform emphasized the necessity of strengthening social security, including pensions.

The first act of the federal government regulating the sphere of pension provision was the Old Age Pension Act of 1927. Under this Act a non-contributory pension system was established, to be financed by general taxation, and which would guarantee a small monthly pension to all those Canadians who met the conditions specified in the Act.

The pension system introduced by the Act of 1927 had some disadvantages (from the point of view of the beneficiaries). The statutory retirement age was 70, while the public systems of other

countries usually specified 65. Both this fact and the level at which the maximum benefit was set, provide evidence of the great caution of the federal government, and of a conservative approach to social security in the days before Keynes¹.

The condition which entitled one to a benefit was meeting the income criterion, which led to a negative social reactions. At the provincial level, the authorities that administered the program, whose cost was shared with the federal government, assessed the income situation of a person on the basis of income, property status, the right of the elderly to a benefit, and the necessary amount of additional support for family members. Different provinces applied different methods of income assessment, and this generated significant regional discrepancies in access to benefits. These discrepancies deepened during the Great Depression.

Already during World War II, a debate commenced over the development of the welfare state in peacetime (Marsh, 1943)². The implementation of a program designed to improve the pension system extended over several years. In 1951, the Federal Parliament passed a law on pensions (Old Age Security Act). The existing system was replaced by a universal pension plan. Instead of benefits being dependent on the income criterion, every Canadian over 70 received a monthly check for C\$40. The Act was a turning point in the history of the Canadian welfare state. At the same time, new provisions also came into force, granting assistance to citizens aged 65–69 having low incomes. Under the Old Age Assistance Act this was, however, dependent on the income test.

In 1965, when the Liberal Party held power, not only was a compulsory contributory program – Canada Pension Plan (CPP) – established; also instituted was the universal (common) Old Age Security Programme (OAS), and, one year later, in 1966, the Guaranteed Income Supplement (GIS) followed. The benefits were indexed in relation to the cost of living up to a maximum of 2% per year. Two years later, the statutory retirement age under OAS was lowered from 70 to 65.

Since the mid-1970s, the financial stability of the pension system has been of particular concern to the federal government. Due to Canada’s economic situation, there has been a renaissance of the residual approach in debates on social security. In 1989, B. Mulroney’s conservative government abandoned the principle of the universality of OAS, announcing the introduction of a provision concerning the obligatory return of surplus means (claw-back) on the part of wealthier seniors. These solutions remain in force today.

In recent years, debates over pensions have focused on the need to find solutions to the problems generated by the baby boomer generation reaching retirement age. As a result of the increase in birth rates between 1946 and the mid-60s, Canada underwent a population explosion. The strong influence this generation has had on the country’s politics, culture and economy, continues to be stressed up to the present.

As a remedy for this generation’s pension problems, the statutory retirement age is to increase to 67, starting from 2023. Those supporting the raising of the retirement age (2012) argue that this is necessary to maintain the financial viability of the OAS program. In their view, the change is necessary for “the program to remain on the path of solvency.”³ In the decade between 2011 and 2020, more than 4 million Canadians will retire, while in the 2020s their number will exceed 5 million (Young, 2012).

As baby boomers are gradually leaving the labor market, the average life expectancy is increasing, resulting in an increase in the length of the pension collection period. Consequently, there is a growing need for OAS funding in the long term. By raising the statutory retirement age from 65 years to 67, the Canadian federal government planned to save up to C\$10 billion annually. At the moment, there are 4.4 workers for every retired person. In future, this ratio is expected to fall to 2.5, which means that *the*

*number of people contributing to their retirement account will fall by half, while the number of pensioners receiving benefits will be three times higher in the coming decades*⁴.

On the other hand, some analysts argue that raising the retirement age is not necessary. For example, a Ministry of Finance report stated in 2009 that the OAS program is financially balanced and self-sufficient. According to K. Page, even though the growth in the number of 65+ year-olds exerts pressure on OAS expenditure, a change in the statutory retirement age of a few years will not yield substantial savings for the government. Critics of the increase of the retirement age have also pointed out that the peak of the problems linked to entry of the baby boomer cohort into the retirement age will occur in the period after 2030. The decision to raise the retirement age will affect primarily seniors with low incomes, who will be forced to wait another 2 years for the OAS retirement. In response to these arguments, however, the federal government claims that raising the age will help keep the OAS program on the path of solvency.

The current federal government of Prime Minister Justin Trudeau announced the withdrawal of the decision to gradually increase the statutory retirement age to 67, because – according to the government – this will not solve this difficult and complex problem. Instead of extending the age, what is proposed is the implementation of a more comprehensive strategy: major investments into infrastructure to stimulate the economy, the promotion of a healthy lifestyle, and the adoption of measures to intensify and improve cooperation between the elderly and the young.

These actions are primarily aimed at protecting the poorest pensioners who are between 65 and 67 years of age, and who with no access to OAS retirement would have become recipients of social assistance. A return to the retirement age at 65 will, in particular, benefit single women over 65, one third of whom live in poverty. As many as 90% of Canadian women over 65 used to work in their lifetime (in 1976 this percentage was less than 60), and 9% of them continue to work even after reaching the statutory retirement age. The proposed new strategy does not specify, however, how precisely a healthy lifestyle is to be encouraged, and nor does it provide any detail on the cooperation between seniors and young people. Many experts suggest, however, that young people will pay for this change, since it will lead to an increase in the tax burden. When the OAS program was established, the statutory retirement age was 70, while the average life expectancy of women was 76 and for men 69. Only in 1965 was the legal retirement age lowered to 65.

THE CONSTRUCTION OF THE SYSTEM

The Canadian system of income provision following the cessation of economic activity consists of several parts. As in many other countries, it is founded on the basic public system, the proceeds of which are supplemented by additional benefits from the private component (see: Table 1). The public plan (which is used by almost all citizens after reaching retirement age) consists of two parts: 1) the Old Age Security Program, which applies universally and to everyone and 2) the Canada Pension Plan / Quebec Pension Plan, which takes the form of insurance, according to which the benefit is directly related to the performance of work and the payment of contributions.

Table 1. *Construction of the Canadian pension program*

Pillar I	Public	Old Age Security Program – OAS
Pillar II	Public	Canada Pension Plan/ Quebec Pension Plan – CPP/QPP
Pillar III	Private	Occupational Pension Plans
		Registered Retirement Saving Plans – RRSP

Source: author’s own.

The intention of the founders was to provide a relatively low but commonly available benefit drawn from the public basic system, on the assumption that citizens will commonly (albeit on a voluntary basis) secure their additional benefits from other sources of income having reached old age, such as occupational programs and private pension plans. The latter exist in various forms, usually under the regulation of federal or regional (provincial) legislation.

In Canada – a country for many years associated with Great Britain – in the course of building the social security system, including pension, elements of both a social provision and insurance models were used. Thus, on the one hand, we are dealing with a relatively low universal pension (OAS), which virtually all citizens receive, and a private pension that is dependent on labour income programs (CPP/QPP), which are mandatory for those who are employed. On the other hand, we are dealing with complex additional and complementary systems, which are accessed voluntarily. CPP/QPP programs combine the philosophy of a welfare state which looks after the citizen (mandatory participation) and individual forethought (benefits depend on individual choices).

PENSION SECURITY PROGRAM (OAS)

The pension security program, called Old Age Security Program – OAS, has been operating since 1952 (Old Age Security Act of 1952). It is the largest program run by the federal government, financed from federal taxes. In the current fiscal year, i.e. 2015/2016, the government plans to spend more than C\$44 billion on the OAS, while providing payments to 5.6 million beneficiaries (*Canada...*, 2016). Once citizens meet the conditions specified in the Act, they are entitled to the following benefits: (a) a general social security pension (Old Age Security Pension – OAS), (b) a guaranteed supplementary income (Guaranteed Income Supplement – GIS), (c) family benefit (Allowance for the Survivor) and (d) a widow's pension benefit.

Table 2. *Benefits provided by OAS, 2016*

Type of OAS benefit	Maximum monthly benefit, C\$	Income criterion, C\$ annually
Pension at the age of 65	570,52	does not apply
Guaranteed Income Supplement (GIS)		
A single person	773,60	max 17 304
OAS pensioner's spouse	512,96	max 22 848 (shared income)
Spouse of a person not receiving OAS	773,60	max 41 471 (shared income)
Spouse receives a benefit	512,96	max 41 472 (shared income)
Benefit	1 083,45	max 32 016 (shared income)
Family benefit	1 213,00	max 23 328 (shared income)

Source: www.esdc.gc.ca [access 20.04.2016].

Universal pension from OAS program

The most important benefit of the program is the OAS pension (OAS). Obtaining the right to this benefit is completely independent from the fact of being gainfully employed. Neither does qualifying for it require the cessation of employment. This benefit is universal, and becomes available once the following conditions are fulfilled⁶:

- Completion of 65 years of age (regardless of gender⁶);
- Canadian citizenship or documentation of legal residence in Canada at the time of applying for a pension; and
- Residing in Canada for a minimum of 10 years in the period after the completion of 18 years of age⁷.

The possibility of postponing retirement for up to 60 months has existed since July 2013, resulting in a right to a higher benefit: the amount of the pension increases by 0.6% for each month of deferral, which can yield up to 36% increase in pensions when retiring at 70 years of age.

The amount of the universal pension depends on the length of residence in Canada. For each year of residence in Canada (the maximum period taken into account is 40 years after the completion of 18 years of age), the holder receives 1/40 of the applicable maximum pension in a given year. The amount of the pension is subject to indexation every quarter. To be eligible for the full OAS pension, one of the following conditions has to be met: residence in Canada for at least 40 years after the completion of 18 years of age; or having being born before 2nd July 1952 and having lived in Canada for a period of time between age 18 and 1 July 1977; or living in Canada for 10 years immediately before applying for the pension.

In the first quarter of 2016, the OAS pension amounted to a maximum of C\$570.52 per month, this figure accounting for about 13% of the average gross wage in this period⁸. In annual terms, the maximum benefit from the program was (in 2015) C\$6,786.90. In this program, all those who have resided in Canada for 40 years or more receive the same benefit amount regardless of income earned during their working lives.

Although the OAS pension is universal, not all those eligible actually receive it or, if they do, they receive it a reduced amount. Despite the fact that anyone who meets the condition of residence and age acquires the right to the pension, wealthiest individuals are obliged to return (claw-back) all or part of the OAS pension at the time of the annual income tax return.

Persons receiving the total net income in excess of the threshold set for the fiscal year (e.g. in the fiscal year 2015/2016 it amounts to C\$71,592 per year – including the OAS pension – which is more than 150% of the average annual earnings) are required to pay back 15% of the excess. If, in turn, the annual income exceeds the next threshold (in the current fiscal year it is set at C\$115,716, which is almost 2.5 times the average annual wage) one has to return the amount equal to the total OAS pension⁹. The OAS pension is indexed at a quarterly rate of increase in consumer prices, and is subject to personal income tax governed by general principles.

Guaranteed Income Supplement

The Guaranteed Income Supplement – GIS – was introduced in 1967 as an addition to the universal pension. To qualify, a person must be an OAS pensioner and, in addition, meet the income criteria. The amount of GIS allowance depends on the individual income, marital status and the age of the partner. Table 2 shows the amount of maximum annual income entitling one to receive additional GIS, as well as the average and maximum benefits depending on a beneficiary's circumstances and status.

The income test is applied once a year on the basis of the beneficiary's annual tax return (taking into account the partner's income). This test assesses all income taxed under personal income tax, except for the OAS pension, the GIS supplement and family benefits. The GIS supplement is also fully indexed in line with the CPI, but, in contrast to the universal pension, it is tax-free. On the other hand, it is subject to reduction relative to an increase in family income above the level of the OAS pension: the benefit is reduced by 50 cents on every dollar of additional income.

Family benefits

As part of the OAS two more benefits are paid: an allowance and an allowance for the survivor. To qualify for the survivor's allowance after the death of the partner, a person must be aged 60–64, a Canadian citizen now living in Canada, or having lived

in Canada for at least 10 years in the period after the age of 18, and whose income does not exceed the limit in any given year (cf. Tab. 2). In the case of remarriage, entitlement to a survivor's allowance is lost. Upon completion of 65 years of age, the person is entitled to the universal OAS pension instead of the survivor's allowance. The amount of the survivor's allowance depends on the income of the previous year.

The allowance, in turn, is a form of income support for an OAS pensioner's spouse who has not yet reached the retirement age (60–64) and whose income is low. This benefit was introduced in 1975 and was originally called a widow's allowance. To qualify for this allowance, in addition to the income criterion, one must meet the following conditions:

- Age 60–64;
- Resident of Canada or legal residents at the moment of receiving the benefit; or
- Having lived in Canada for at least 10 years after the age of 18;
- The spouse collects, or is entitled to collect, a pension from the system and the GIS supplement.

OAS Program: a summary

The OAS pension program – along with its supplements – is the basic source of income for Canadians after the end of their professional activity. The basic service is universal and is designed not so much to replace the income of working life, as, above all, to protect pensioners against poverty. It indeed fulfils this function effectively. The poverty rate among seniors in Canada decreased from 21.4% in 1980 to 5.2% in 2011, and to 3.7% in 2013¹⁰. This rate is among the lowest in the world.

For several years now, discussions on changing the OAS system have been underway in Canada, mainly owing to concerns about its long term funding. It is estimated that, if the real level of benefits is to be maintained, the cost of financing the OAS program will double by 2030. On the other hand, given the increasing importance of other elements making up the pension system (CPP/QPP, and other additional and complementary programs), it is expected that the rate of private savings will grow, which in turn will translate into higher income for people at retirement. As a result, the number of persons entitled to the GIS allowance will decrease. Currently, about 36% of people aged 65 and older collect a full or partial GIS benefit. The OAS benefits, on the other hand, are collected by more than 5.6 million people and they (the universal pension and GIS allowance) amount to about 30% of the average wage. This ratio has remained relatively constant over the past 25 years. Compared to the mid-60s, when the GIS supplement was introduced, this ratio has increased by about 7 percentage points.

The expenditure necessary to cover the OAS pension benefits depends on three factors: the number of people at retirement age, changes of the level of benefits, and the proportion of persons entitled to the guaranteed income supplement (GIS). In 2012–2013 this expenditure stood at more than C\$40 billion, which represents approximately 2.5% of Canada's GDP. In the current financial year, the planned spending is set at C\$44.1 billion. According to forecasts issued by the Office of the Superintendent of Financial Institutions, by 2030 the share of benefit expenditure in the GDP will increase to 3.17% with price indexation, and up to 4.39% with wage indexation. The latter scenario represents an almost double increase in spending (relative to GDP) within the last 30 years.

THE RETIREMENT PLAN OF CANADA/QUEBEC

The first work on the Canadian public contributory pension plan was carried out at the federal level in 1957–1963. The project was developed in detail in 1963–1965. Then followed

a phase of proposal negotiations and arrangements with the provincial authorities. In view of the opposition coming from the Quebec province, there arose a need to amend the Constitution of Canada. It was agreed that the relevant legislation enacted in 1965 would come into force from January 1966.

Originally, the Canada Pension Plan (CPP) was designed as a pay-as-you-go system, in which the contributions were set at such a level that it was possible to finance current pensions and other benefits, as well as being able to maintain the CPP Reserve Fund at the amount of the two-year benefit expenditure. Any surplus funds were to be used to grant loans to provincial governments and to invest in non-marketable securities issued by both the federal government and the provinces.

Initially, the contribution was set at 1.8% of gross salary, while a maximum salary limit subject to contribution was introduced. In subsequent years, with changes in the demographic and economic situations, the contribution amount was increased in order to cover the current expenditure on benefits and to generate a surplus to be accumulated in the Reserve Fund. In the early 1990s it transpired, however, that if such policies and the pay-as-you-go mechanism of the CPP funding were to be maintained, it would lead to a significant increase in the contribution standard (to 10.1% by 2016 and 14.2% by 2030). This would occur as a result of various factors threatening the financial balance of the program (demographic changes, an increase in life expectancy, changes in the amount of benefits, an increase in the number of disability benefits). It was also indicated that as soon as 2015, a danger of exhausting the CPP Reserve Fund could arise. As a result of intensified work on the reform, and after long and extensive public consultation, the federal government proposed changes to guarantee the long-term financial viability of the program, namely:

- A gradual increase in contributions from 6% (in 1997) of the remuneration to 9.9% in 2003;
- The introduction of a hybrid (mixed) funding mechanism for the CPP program, i.e. the launch of an additional potential source of income for the CPP program in the form of investment of the surplus; a purely pay-as-you-go mechanism is supplemented by an equity investment mechanism; it was assumed that in 2014 new income from this source will cover 20% of the planned CPP liabilities; in subsequent years the share of the equity component is to grow until it reaches 30% in 2025 (the CPP Reserve Fund will equal 30% of the pension system "commitments"); the investment income is to be used, in particular, to finance benefits paid at that period of time when the baby boomer generation acquires the right to benefits;
- Introduction of the principle that all the financial consequences of legislative changes in the CPP (e.g. related to new benefits or increasing the existing ones) will be financed entirely from capital gains;
- The establishment of the CPP Investment Board – CPPIB – whose task is to manage the CPP fund;
- Introduction of the principle that every three years the CPP and CPPIB situation and status shall be reviewed and evaluated;
- Introduction of the principle of continuous search for ways to reduce the administrative and operating costs of the CPP.

The Canada Pension Plan – CPP – and the Quebec Pension Plan – QPP – came into force in 1966. They are public plans in which participation is compulsory for all engaged in professional activity who are over the age of 18. These are insurance programs, not social security plans; therefore both the acquisition of pension rights and their amount depend on contribution payments and the level of earnings achieved during a working life. Benefits, for the most part, are funded on a pay-as-you-go basis. In recent years the equity component of the system has played an increasingly important role.

There has been a systematic increase in the number of beneficiaries and amounts of expenditure. In the period 2012–2015, the number of beneficiaries increased by half a million, and expenses by about C\$5.5 billion. In 2015 5.3 million Canadians (representing approximately 95% of the population aged 65 and older¹¹) received the CPP benefits, the value of these benefits reaching C\$38.7 billion. The number of retirement benefits paid was in excess of 4.6 million (amounting to nearly C\$30 billion), the number of family benefits reached a million (1.1 million for the surviving spouses and 70 thousand for children), while their value amounted to almost C\$4.5 billion. The number of disability benefits (for those unable to work and their children) exceeded 330 thousand, and their value reached C\$4.2 billion.

CPP and QPP programs are managed by the federal government (and its regional agencies), as well as by the authorities of each province. The CPP is directly administered by the Human Resources and Social Development Canada office. Any changes to the rules governing the CPP require the approval of 2/3 of the Canadian provinces, representing at least 2/3 of the country's population (this is a more stringent requirement than the one used when introducing amendments to the Constitution). In addition, in line with the relevant provisions of the Constitution, each province is responsible for the pension insurance of the population living in its territory. Therefore, individual provinces have the freedom to establish their own retirement plans.

Financing

The CPP program uses a mixed financing mechanism, or a combination of capital system and pay-as-you-go. In the Canadian system the benefit amount is not dependent on the financial yield from the CPP investment.

The intention of the founders of the CPP was to create a financially stable system. The contribution amount was set at a level which not only provided for the payment of all current benefits, but also gave an opportunity to accumulate the reserves necessary to stabilize the system over time.

Despite unfavourable demographic changes, contributions collected remain fully sufficient to cover the current payments: in the fiscal year 2014–2015 C\$45 billion of contributions was collected, whereas the payment of benefits amounted to C\$38.7 billion. It is expected that this situation will continue into 2019. From the annual surplus the CPP Fund's assets are supplied, which should bring additional income (or loss) on investment. At the end of 2015, the net assets accumulated in the CPP Fund amounted to C\$264.6 billion (CPP Investment Board, 2015).

In contrast to the benefits provided by the OAS program, both programs – CPP and QPP – are financed by contributions. The contribution, which at present amounts to 9.9% gross wages (it has remained at the same level since 2003), is financed in equal parts (4.95% each) by the employee and his/her employer, and, in the case of the self-employed, by the insured him/herself.

The base amount of the contribution is limited both minimally (Year's Basic Exemption – YBE) and maximally (Year's Maximum Pensionable Earnings – YMPE). Earnings exceeding the designated level for a given year are not subject to contributions. In 2015 the maximum annual basis (YMPE) amounted to C\$53,600 (about 110% of the average annual salary). The YMPE level is subject to annual indexation relative to the increase in the average salary. Those, in turn, who in a given fiscal year have not reached the minimum level in earnings (YME) (from 1997 – C\$3,500 per year) are exempt from having to pay contributions. People over 70, or those who receive a pension or an annuity, are also exempt.

The obligation to pay contributions begins at the age of 18 (or 1 January 1966) and ends when the insured begins to draw

a pension, or reaches 70 years of age, or dies. People receiving disability benefits, or those who for a period of time do not have any income, or for whom the income generated in a given year is lower than C\$3,500, do not pay contributions. Since 2012 a solution has been in place whereby a person who, while receiving a pension, continues to work and pay the CPP contributions, this money is not included in the contribution period, but redirected into a special fund from which post-retirement benefits are financed.

The collection of CPP contributions is organised by the Canada Revenue Agency – CRA). Its tasks include setting the limits to, and verification of, both earnings subject to contributions and the accrued financial means.

The federal Minister of Finance, together with the finance ministers of each province, assesses the functioning of the CPP program every three years in order to formulate conclusions and recommendations regarding the level of contributions and benefits. This assessment also takes into account the recommendations made by the Chief Actuary in the report published every three years¹². All legislative amendments concerning the level of benefits guaranteed by the CPP program, as well as the standards of contributions and the CPP investment policy, can only be made by legislation which requires the approval of at least 2/3 of the Canadian provinces, representing 2/3 of the population of Canada.

The current mechanism of financing the CPP program which was introduced after 1997, as well as other changes in the rules of the program operation, have resulted in a decrease in the share of those pension obligations which are not covered by capital. This, in turn, has stabilized the contribution levels and allowed for a fairer distribution of the pension costs among the generations. During the transition period, the burden of contributing will still be spread unevenly (since current contributions are used to finance the benefits of current retirees, as well as to accumulate the capital for one's own future retirement).

As part of recent reforms, the federal government has earmarked a separate account for the CPP program (CPP Account) within the federal budget. The account records all the financial operations of the program: contributions, interest, pensions and other benefits paid, as well as administration costs. It also records transfers to and from the CPP Investment Fund and the CPP Investment Commission. The CPP assets do not constitute a portion of the federal budget.

In 1997, an Act of Parliament established the Canada Pension Plan Investment Board – CPPIB. It is an independent body whose sole purpose is to generate income from investments to support the financial stability of the CPP in the future.

Under an agreement made between the federal government and the CPPIB, any surplus, even short-term, generated by the CPP, is transferred to CPPBI. Since September 2004, the CPP has transferred to the CPPIB from 100 million to 1.2 billion Canadian dollars every week. At the end of the month, in turn, C\$1.5 billion to 2 billion Canadian dollars was transferred to finance benefits.

Since 1997 a professional asset management entity has been in place; the investment strategy implemented (given the net proceeds from contributions amounting to C\$68.5 billion) has allowed for an increase in the CPP fund value from C\$36.5 billion in 1998 (the value of inherited government bonds) to the current level of C\$264.6 billion, which is invested in various securities in global markets (CPP Investment Board, 2015).

The CPPIB remit is regulated according to the provisions of a separate legal act (ibid). The purpose of its operation is the investment of the CPP Fund assets in such a way as to achieve maximum investment returns without having to take excessive risks. The Act does not impose any specific limitations on the types of securities or investment guidelines. The finance ministers – of both the federal and provincial governments – organi-

ze the CPP Fund, but do not define the strategy of investing its assets.

The independence of the CPP Investment Board is regulated by law. The CPP Fund assets may only be used to finance the payment of benefits provided for by the CPP program, as well as to pay the costs of administering the scheme. To earn the public trust, the CPPIB operates in a responsible and transparent way: it informs the public on the applied investment policy, periodically issues information about the results achieved, and operates strictly within the law.

Every three years, the Chief Actuary of Canada investigates whether the revenues accrued from contributions are capable of maintaining the financial stability of the CPP program over the next 75 years. In these analyses, the Actuary takes into account, inter alia, the following factors: the growing base of contributions and earnings, the increase in the number of beneficiaries as compared to the number of employees owing to the baby boomer cohorts entering retirement in relation to increasing life expectancy.

In the latest assessment (December 2012), the Chief Actuary states that, given that the contribution is set at 9.9%, it is possible to maintain the current level of benefits. The analyses were carried out on the assumption that the assets of the CPP Fund will yield a compound rate of return of 4% per year above inflation (measured by the CPI). Based on long-term forecasts, the Chief Actuary estimates that income from contributions should be able to finance 75–80% of future benefit expenditure, with the remaining part being covered by the investment income.

According to the Chief Actuary's estimations, income from contributions will continue to exceed the expenses until 2023. It is expected that only after 2023 will income from the CPP Fund investment be required to supplement the income from contributions (CPP Investment Board, 2015).

Prior to 1998, the CPP Fund assets consisted exclusively of bonds issued by federal authorities and the authorities of Canadian provinces and territories; these bonds were not traded on the open market. In 1999, the CPPIB began to operate on the open capital market. Many programs were launched in order to bring a high long-term return on investment. In 2004, active investment in stocks commenced, and the Fund purchased its first infrastructure assets (highways, ports, etc.). In 2005, all restrictions on investing in foreign securities were lifted and, since that time, the share of investment in both developed and emerging markets has increased.

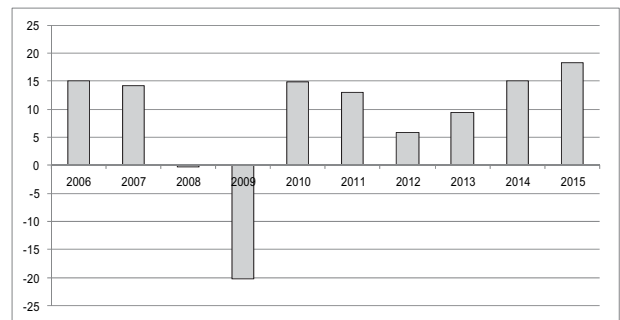
This diversification allowed the CPP Fund to reduce its dependence on the current situation of the Canadian economy and financial markets. In 2006, the investment policy changed significantly. The CPPIB moved away from a strategy based on securities and stock exchange indices in the direction of a more active approach. This made it possible to look for more profitable investments. In the period 2009–2014, the CPPIB entered into the market of private debt, intellectual property, land and various industry branches.

Acting in the best interest of its policyholders and beneficiaries, the CPPIB invests its assets with the aim of achieving the highest possible rate of return. Decisions on investments take into account the financial situation of the CPP program and its ability to meet its obligations. As of 31 March 2015, the net assets of the CPP Fund totalled C\$369.6 billion, of which C\$264.6 billion was managed by the CPPIB.

In recent years, the country has seen a distinct change in the CPPIB investment strategy. The CPPBI focuses on the maximum diversification of the portfolio, both in terms of asset classes, the geographical directions of investment, as well as an active and passive investment policy. Lately, there has been a tendency to increase the share of foreign securities in the portfolio (more than 40% in 2015). In the near future the CPPIB intends to further increase interest in securities issued by emerging markets

(5.9% in 2015). The share of private securities has grown from 4.3% in 2005 through 23.6% in 2010, to 40.6% of total assets. During the ten years of its existence the CPPIB achieved an average annual rate of return of 8.0% (see Figure 1) or 129.5 billion of cumulative investment income (CPP Investment Board, 2015).

Figure 1. Net rate of return of CPPIB Fund nominally as of 31 March, %



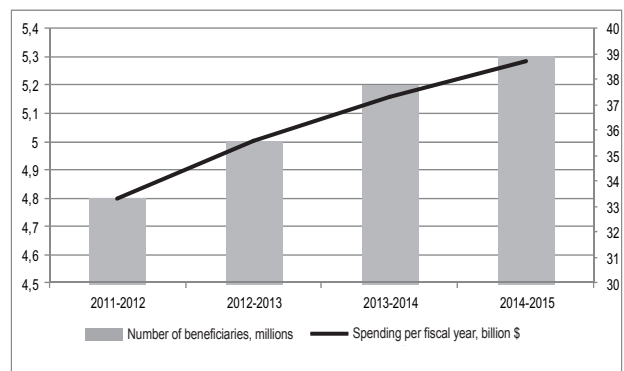
Source: author's own on the basis of CPP Investment Board, 2015.

Benefits

The following benefits are guaranteed under the CCP: pension, disability benefit, family benefit and death benefit. In addition, the program also finances rehabilitation services which aim to restore the ability to work. The number of beneficiaries is growing from year to year, as does expenditure on benefits (Figure 2). The major part of the expenditure covers pensions, which at the moment account for more than 3/4 of the total CPP spending (Figure 3).

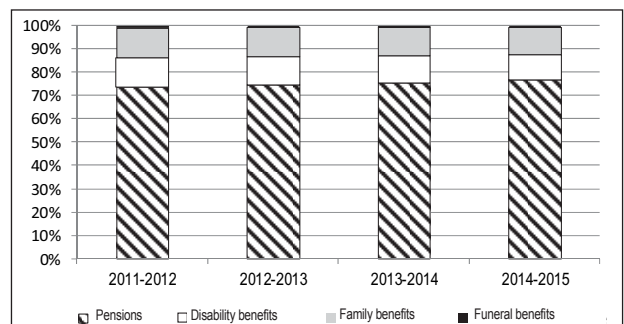
Since 1973, all benefits financed from the CPP program have been fully indexed relative to the increase in the cost of living (CPI). They are subject to tax under both federal taxes and local general taxation principles.

Figure 2. CPP beneficiaries and spending over fiscal years



Source: author's own on the basis of Annual Report of the Canada Pension Plan of: 2011–2012, 2012–2013, 2013–2014, 2014–2015.

Figure 3. Structure of CPP expenditure according to types of benefits



Source: as in Figure 2.

Pension dependent on wages (CPP)

The retirement pension provided by the CPP is a monthly benefit designed to replace about 25% of the average salary of the person during the entire working life, while, at the same time, the amount must not exceed a maximum limit established for a given year. The condition for acquiring the right to the pension is attainment of the retirement age and having paid contributions for at least one calendar year during the entire contribution period. This period is defined as the period from age 18 to 70, or the moment when the pension started to be drawn upon, depending on whichever comes earlier.

Beginning from 1984 in the case of the QPP program, and from 1987 for the CPP, one may apply for early retirement after reaching 60 years of age. Since the statutory retirement age is currently 65 (Guest, 1997), this benefit, awarded on the completion of 60 years of age and before the age of 65, is reduced by 0.5% for each month missing for a beneficiary to be 65 years old¹³. On the other hand, the level of benefits paid increases for each month of deferral until retirement over the limit of 65 years of age¹⁴. The CPP program is characterized by high flexibility (freedom to choose when to retire and no obligation to stop working).

Upon completion of 65 years of age, the CPP program guarantees the payment of pensions of a fixed amount. When determining the level of benefit to which a person is entitled, the earnings of the entire period of employment (insurance) are taken into account. The basis for this calculation are the earnings for the contribution periods without the months when:

- a) the person drew a disability benefit,
- b) the person brought up children up to 7 years old, when the remuneration was zero or was lower than the average annual salary,
- c) the person completed 65 years of age but before being awarded of the pension,
- d) not included are also 15% (as of 2014 17%) of the remaining months of low or no income due to unemployment, illness, etc¹⁵.

In the course of their working life, employees experience interruptions of work for various reasons, which result in zero or low wages. From 2012 onwards, the number of years for which earnings amounted to zero or were very low, and which are not automatically taken into account at the calculation of the retirement benefit, rose to 8.

Next, the ratio is calculated of earnings generated in each month of the contribution period, to 1/12 of the maximum annual earnings which in a calendar year constitute the basis for the pension (YMPE – Year's maximum pensionable earnings) for the same period of time. The calculation takes into account indicators which are not greater than one. The earnings which in one month of the contribution period exceed 1/12 of the YMPE for the same contribution period, can be added up to another month of the same calendar year in which earnings were lower than 1/12 of the YMPE. This results in an increase in the basis of retirement benefit.

Wages earned during the entire period of work are discounted to determine their present value. First, the mean value is calculated from the relationship of individual earnings to YMPE in each year of the contribution period¹⁶. Next, the mean number is multiplied by 25% to obtain the amount of the annual allowance. Thus, the pension of a person who earned an average salary in his/her working life replaces 25% of these earnings. In 2015 the maximum possible level of newly granted pensions amounted to C\$1,065, while the average pension at that time was C\$543.05 (*Annual Report 2014–2015...*, 2015).

Family benefits

A family benefit, also called the survivor's pension, is provided to the widow/widower of a deceased insured individual, as

well as to children who remain dependent on them. The amount of the benefit depends on the age of the widow/widower, and on whether the person is entitled to his/her own benefit from the CPP program. The survivor's pension consists of two parts: the basic pension (the same amount for all the eligible, in 2015 it was C\$453), and a portion which is derived from the benefits the deceased received or would have received. Persons under the age of 35 are not entitled, unless they raise children and, in the case of persons aged 36–45, the benefit is reduced by 1/120 for each month missing for the entitled person to complete 45 years of age. Children of the deceased CPP program participants are entitled to a flat-rate payment until the age of 18, or 25 if they study.

Disability benefits

The survivor's pension is intended to partially replace the earnings of CPP insured who cannot work owing to a serious and long-term disability. In 1997, the rules determining the granting of disability pensions were tightened: a person applying for this benefit must account for at least a four-year CPP contribution period in the past 6 years¹⁷ before disability. The pension consists of two parts: a basic benefit paid as a lump sum to all workers with disabilities, and a part which depends on wages, i.e. 75% of the pension due to that person based on the contribution period ending at the commencement of disability. In 2015, the maximum amount of disability benefit was C\$1,264.59, and the average amounted to C\$866.53 per month.

Post-retirement benefits

In 2012, a post-retirement benefit was introduced. It allows pensioners receiving a pension at the maximum level, who remain professionally active and pay the CPP contributions, to earn extra income. The number of persons receiving this benefit is growing from year to year; from 450 thousand in 2013 to 755 thousand in 2015, and the average amount of the post-retirement benefit was C\$11.84 per month.

PRIVATE PENSION PLANS AND PROGRAMS

Pensions funded by the pension capital accumulated in private programs and pension plans are an important addition to the benefits derived from the CPP program¹⁸, which is compulsory for all the employed and self-employed.

Joining the programs and private pension plans is voluntary for employers and employees. The federal government and the provincial authorities are only responsible for the establishment of a legal framework for their operation. The operation of private programs and pension plans is regulated by legal acts of individual provinces: they were first introduced in Ontario (1965), Quebec (1966) and Alberta (1967). The first federal legislation dates back to 1967 (the so called Pension Benefit Standards). Later, these regulations have been amended several times, with the latest changes introduced in 2012.

The most common form of supplementary pension schemes are Occupational Pension Plans: over 40% of employees participate in them. They usually operate as defined benefit plans (DB) (over 60%). However, in recent times, the defined contribution (DC) plans have dominated among the newly created plans.

The law allows for a variety of forms by which these programs and private pension plans can operate. However, the use of tax relief is possible only in the case of Registered Pension Plans (RPP) or individual Pooled Registered Pension Plans (PRPP). To take advantage of tax relief on the contributions paid and profits generated from investments, the plan must be registered with CRA (Canada Revenues Agency) and meet the formal requirements set out in tax law (Tax Act).

Employees participate voluntarily in pension plans sponsored by employers (except in Manitoba). Retirement plans such as the PRPP are a new form of individual savings for retirement made available for employees and the self-employed.

One can also come across unregistered plans. They are known as Retirement Compensation Arrangements (RCAs) and Supplement Employee Retirement Plans (SERPs). These pension plans are typically created for executives (high-income employees) of companies, and they offer an option to pay contributions in excess of the limits set by the tax regulations. The RPP plans operate as separate trusts, or can be administered by insurance companies. Both public and private sector employees may participate in the RPP plans.

An employer may also establish separate RPP plans for individual groups of employees. Discrimination on the basis of age, sex or marital status is prohibited. These plans are funded by contributions from employees and employer contributions paid in their name. Tax regulations specify contribution standards and the maximum annual rate of the contribution¹⁹.

In the period 2001–2010, the percentage of people under the protection of RPP-type plans fell to 32% of the workforce. In the following few years, a slight increase of this percentage was to be observed. Significantly more public sector workers (80%) are covered by such programs than private sector workers (25%). According to the assessment of M. Townson of the Canadian Centre for Policy Alternatives, over 11 million workers do not belong to any program or private retirement plan, and the pension from both public systems does not provide for a fair standard of living (Nurenberg, 2015).

A frequently occurring form of private retirement savings plans in Canada are the individual Registered Retirement Saving Plans (RRSP), introduced in 1957. In their case, as well, only a registration with a special tax service register allows for tax relief: contributions paid into an RRSP-type plan are deducted from the income tax base (PIT), while the income from investment is tax exempt. Tax law also determines the maximum limit of the annual contributions to an RRSP plan. In the case of persons who also subscribe to any occupational pension schemes, this limit is lower. The limit from a given tax year may roll over into the following years.

CONCLUSION

The three-pillar Canadian system provides the opportunity to achieve two objectives at the same time: securing an income for citizens at old age, and ensuring the financial stability of the system.

The OAS program guarantees the citizens' retirement pension at a level which protects them against poverty. The pension

from the compulsory contributory program CPP/QPP depends on earnings, with a maximum replacement rate of 25% of the average of gross earnings. Benefits from the two pillars generate a long-term replacement rate, which is relatively high for low income groups and decreases proportionally to the increase in income of the person entitled.

The third pillar comprises voluntary occupational schemes and pension plans, as well as individual savings plans. Although the desire to participate in such programs is decreasing, the average income of Canadians aged 65+ is amongst the highest in the OECD countries, and the poverty rate is among the lowest. These effects have been achieved with lower public and total expenditure on pensions by comparison with other OECD countries²⁰.

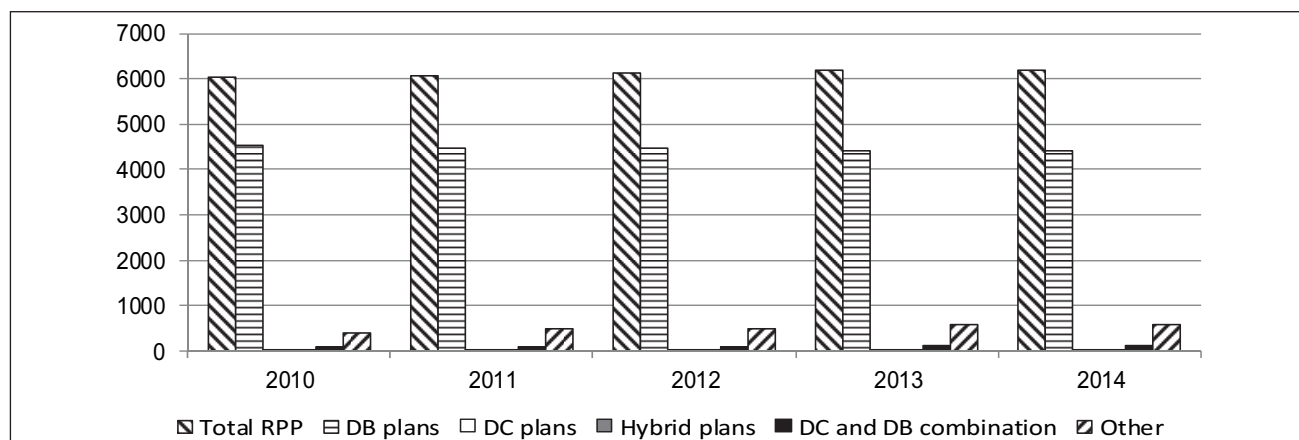
Table 3. *Basic indicators of the Canadian system of old age income security*

Indicator	2014	About 2060
Person's statutory retirement age, years	65	67
Net replacement rate, for average income	-	47,9
Contribution rate	9,9	-
Total retirement security expenditure, % GDP	7,6	-
Public retirement security expenditure, % GDP	4,3	-
Public debt, % GDP	96	-
Employment rate 55–64, %	(M) 65,0 (F) 56,0	-
Poverty rate among elderly, 65+, %	6,7	-
Further life expectancy at 65, years	(M) 18,4 (F) 22,3	-
Replacement rate	0,28	-
Fertility rate	1,6	-

Source: OECD 2015c.

J. Trudeau's proposal to revoke the decision to raise the retirement age is viewed by experts as a major mistake. When the OAS system was designed, the retirement age was 70 years of age, and the further life expectancy was 11 years. In 1967 the age was lowered to 65 years, and the average pension was paid for an average of 15 years. Today's 65-year-olds will live an average of 20 years (as pensioners). Since the average life expectancy will continue to extend, so will the period of benefit payment. In addition, the group of the "pension funding" employees will become less and less numerous. In 2015 one in 6 Canadians was 65+ years old. Recent forecasts indicate that by the year 2036, this ratio will be 1:4 (Steele, Wagman, 2016).

Figure 4. *Number of RPP members (in thousands)*



Source: author's own on the basis of: www.statcan.gc.ca [access15.04.2016].

According to M. Williams, the Canadian pension system is not prepared to meet the challenges of the evolving demographic processes. It is necessary to upgrade the system so that citizens are obliged to save for their retirement in order to be able to generate income at an appropriate level in the long term.

Currently, 68% of Canadians do not participate in any private plan or pension scheme. And those who do subscribe to such programs often avail themselves of the possibility of withdrawing part of their savings before retirement age. In other words, Canadians do not save enough to ensure their own financial security after retirement. On the other hand, according to M. Williams, the OAS and GIS systems provide benefits at a level sufficient to protect against poverty, as evidenced by the low poverty rate among people aged 65+ (Williams, 2015).

In 2013 the federal government rejected a proposal for changes to the CPP/QPP which would have involved raising the threshold of earnings subject to pension contribution, and/or then introduction of a higher replacement rate. The priority now is to improve the functioning of private pension plans and programs, as well as to increase the adequacy of pensions for employees with average incomes (by reducing the restrictions on the transfer of savings from program to program, and by reduction of fees, etc.).

The construction of pension systems in Canada and Poland has always been different and remains so now, owing to different historical circumstances and the economic conditions in which these systems were developed. Both systems are multi-pillar designs, with the individual pillars of the public part differing in character, function and financing mechanisms.

The Canadian system includes a social security pillar which is a universal, all-citizen pension, financed from general taxation. The benefits generally provided by these systems are relatively low, and their main goal is to protect against poverty. Moreover, the benefits usually differ only minimally, or are paid in a lump sum of the same amount to all those entitled. Therefore, it is necessary to supplement their retirement income from additional sources. It is no different in Canada: the basic OAS benefit is a maximum of C\$570.52 (first quarter of 2016), which is only about 13% of the average monthly salary.

If supplemented by the maximum amount of the GIS for a single person, the first pillar pension increases to C\$1,354.12, i.e. almost 30% of the average monthly salary. As part of the social security system, benefits of this kind also play a redistributive role.

Poland has never had, and does not have now, a separate pension pillar based on social security which provides a citizens' pension. In what is known as the old pension system, the so-called social component of the pension formula served a similar function (which amounted 24% of the base amount as specified by law, i.e. of the average salary, as specified by the last indexation of benefits).

The social security component was supplemented by a part of the pension which depended on earnings during the period of economic activity (an individual base and the contributory and non-contributory years). The so-called new system benefit does not contain a social security part²¹.

- In the construction of the financing mechanism for the mandatory parts of the pension system, both Canada and Poland decided on a mixed solution: pay-as-you-go, combined with partial capitalization. In the Polish case, the mechanisms of the first and second pillars were differentiated. Although pensions from the first pillar are financed as a pay-as-you-go system (FUS), the Demographic Reserve Fund (DRF) which was also formed may be regarded as a residual equity component.

The second pillar is a component of the pension system which is loosely associated with the first pillar. The relation between the two has not been consolidated even after the introduction in 2014 of amended rules for the operation of OFE [Open Pension Fund]. In the case of Canada's second pillar – the CPP

and QPP programs – we have to do with mixed financing, initially with a small capital element in the form of the Reserve Fund. However, as a result of measures taken in 1996, the amendments are systematically extending the component of pensions financed by capital investment.

Meanwhile, in Poland, owing to the difficult situation of public finances and, above all, the state budget, decisions were taken which have resulted in a significant decrease in the Demographic Reserve Fund (DRF) assets. They mark the reduction of the already "residual" equity component. Also, a reduction in pension contributions transferred to open pension funds (OFE) will lead to a decline in the capital pillar of the Polish system, and therefore a decline in the share of the capital component of pensions. This stands in direct opposition to the current trend in Canada, where the importance of the capital component of the public pension system is increasing from year to year.

In all OECD countries, except for Poland, in 2014 the assets of pension funds increased in value. In Poland, due to the reversal of the mandatory funded system (the transfer of domestic sovereign bonds into the public social security system), the value of pension fund assets fell by about 50%. In 2014, the accumulated assets of the Canadian pension funds occupied the 4th place among the OECD countries (in value terms). In all OECD countries in 2014, all pension funds recorded positive rate of returns (from 1.3% in the Czech Republic to 16.7% in Denmark). The average rate of return in OECD countries was 6.4%, while in Canada it was 5.1%. Generally, the pension fund assets are dominated by stock securities and bonds. In the case of Canada, shares represent approximately 25% of the assets of pension funds, while bonds and other debt securities represent about 40%, and the remainder being other types of assets (e.g. real estate or investments in infrastructure) (OECD, 2015b)²².

- It is worth noting that the work on pension system reform in Canada was taken relatively early, when there was still some leeway (in the years 1995 to 1996, while the potential threat would occur in 2019) and enough time to prepare effectively to confront the impending threats.

- Recently in Poland, more and more voices have been calling for a new reform of the pension system, proposing as a model the Canadian system of old age security. Is it possible to adapt the Canadian solutions to Poland? Undoubtedly, the solutions applied in the public components of the Canadian pension system, mainly in the funding mechanisms of CPP and QPP programs, should be considered as an attractive way to reduce public spending on pensions, and to ensure the financial stability of the system. However, this is done at the expense of transferring the burden of having to ensure a retirement income on individual citizens²³.

In addition, the reconstruction of the Polish old age income security system along the lines of the Canadian system, seems to be socially unacceptable owing to the relatively low level – compared to Poland – of the public guarantee for old age security. In Canada, the public pension programs (OAS and CPP/QPP) are supplemented by pensions from both supplementary and complementary systems. Over 60% of Canadian employees accumulate savings for retirement collectively or individually. However, in Poland, concern for the latter, i.e. private complementary saving systems – such as PPE (Employees' Pension Plans), IKE (Individual Pension Accounts) or IKZE (Individual Accounts for Pension Security) – is relatively minimal, despite the fact that appropriate regulations have been in place since 1999 (approximately 2.5% of economically active workers are members of the PPE, and about 8% are saving in IKE or IKZE) (KNF [Polish Financial Supervision Authority] 2015, 2016).

¹ C\$20 in 1927 translates into about C\$270 today.

² As well as the *Green Paper* drafted in 1945 by Prime Minister Mackenzie King's federal government.

- ³ Service Canada website.
- ⁴ Diana Finley, Minister for Human Resources, responsible for OAS in Prime Minister Harper's government.
- ⁵ The criteria cited apply to benefits in full amounts. There is also the possibility of obtaining benefits at a reduced amount, paid to persons who do not fully meet the condition regarding the period of residence in Canada.
- ⁶ Starting from 2023, the statutory retirement age is planned to be gradually raised to 67 years; this level will only be reached in 2029. The change will affect those born after 31 March 1958.
- ⁷ One can also be entitled to the allowance in the case of being subject to the social security system of the country that Canada has a relevant agreement with.
- ⁸ The average weekly wage in the first quarter of 2015 amounted to C\$959,32. See: www.jobbank.gc.ca [access 21.04.2016].
- ⁹ Source: www.esdc.gc.ca [access 19.04.2016].
- ¹⁰ Source: www.esdc.gc.ca [access :19.04.2016].
- ¹¹ Cited only for comparison. The beneficiaries include not only people at retirement age.
- ¹² The regulations provide that the Chief Actuary is required to draft an actuarial report at any time if the Parliament is working on a bill that could affect the financial situation of the CPP and the assessment contained in the last report.
- ¹³ Since 2012, the rate of the adjustment (reduction) of benefits has been rising. In 2014 it amounted to 0.56 for each month of drawing a benefit early, which makes retirement at the age of 60 translate into a reduction of 33.6%. Respectively, in 2016, since the figure is now 0.6, the benefit in such a case will be lower by as much as 36%.
- ¹⁴ In the years 2011–2013 the correction rate rose from 0.7 in 2011, through 0.6 in 2012, to 0.7 in 2013.
- ¹⁵ The last three exemptions cannot be used to reduce the length of the contribution period of less than 120 months, after taking into account the period of disability.
- ¹⁶ Until 1998, pensions were indexed in line with the average YMPE changes over 3 years prior to receiving benefits. For benefits receivable from 1998 this period was extended to four years, and for benefits starting from 1999, to 5 years. These changes resulted in a reduction in the level of benefits.
- ¹⁷ Instead of 2 of the last 3 or 5 of the last 10 years, as specified in the previous act.
- ¹⁸ A CPP pension may maximally be equal to 25% of the average monthly salary throughout one's professional career.
- ¹⁹ In the case of defined-contribution plans (DC), the contribution is equal to 18% of an employee's salary, but not more than C\$24,270 per year (2013).
- ²⁰ In 2013 the share of total retirement spending in GDP amounted to 7,6%, and of public expenditure 4,3%.
- ²¹ In discussions in the Legislative Commission for Labour and Social Security Law, working under the guidance of Professor T. Zielinski in the 1990s, there appeared a proposal for a state pension, but because of the potential burden on public finances the idea was abandoned.
- ²² Assets of Pension Funds in 2014 topped USD 25 trillion in OECD countries.
- ²³ In 2012, the GBP share in financing pensions, calculated in accordance with the OECD method, amounted to, respectively: Canada – 4,5%, Poland – 11,8%, OECD mean value – 7,8%.

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SUMMARY

The similarity between Poland and Canada, in such aspects as are important from the point of view of the pension system (including the percentage of people at post-productive age) encourages to undertake an analysis of the possibility of transposing into Poland the solutions successfully applied in the other country. On the other hand, there are significant differences between the two economies, which do not allow for a simple transfer of the Canadian solutions to Poland. The paper presents the Canadian pension system, with a particular emphasis on its public part.

Keywords: Canada, pension system, social security

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