

Indexation explained

What is indexation, why is it important, and how does it work in a jointly sponsored pension plan (JSPP)?

i JSPPs: Pension plans where governance and risk are shared equally between members and employers.

WHAT IS INDEXATION?

Indexation is a value-added benefit.

It is an adjustment made to pension payments to help keep pace with cost-of-living increases.

Indexation is also referred to as a cost-of-living adjustment (COLA) or inflation protection.

There are two types:



Conditional indexation

Pension adjustments depend on certain factors, such as the financial health of the plan, or a funding policy.



Guaranteed indexation

Pension adjustments are automatically applied each year, regardless of the plan's financial health.

WHY IS INDEXATION IMPORTANT?

The cost of living is rising and pensioners are living longer.

Cost-of-living increases

Indexation helps pensioners maintain purchasing power throughout their retirement.

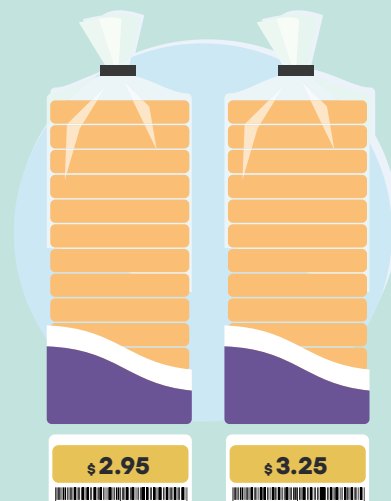
Inflation in Canada has risen by more than

70%
over the past
24 years



Indexation adjustments are often set to match (in full or in part) price-tracking indicators, such as the Consumer Price Index (CPI).

The CPI tracks changes in the overall cost of goods and services purchased by Canadian households. Each month, [Statistics Canada](#) reviews the prices of these items and compares them to the previous month to measure inflation.



Longer retirements

The average length of retirement in Canada has increased over time.

1980

10.5 years²

Average retirement age: 64.6³

2023

16.6 years⁴





Average retirement age: 65.1⁵

Canadian women are expected to live 4.4 years longer than men.⁴



Let's look at the financial impact of a longer retirement. For illustrative purposes, we'll compare someone retiring in 1980 whose retirement lasts for 10 years with someone retiring in 2023 whose retirement lasts for 16 years. In both situations assume:

- \$3,000 monthly pension payments
- No indexation to their pension
- \$2,000 average monthly expenses
- 3% average yearly inflation

Someone retires in 1980	Someone retires in 2023
 BY 1990 (10 YEARS LATER) \$2,687.83 Average monthly expenses	 BY 2039 (16 YEARS LATER) \$3,248.85 Average monthly expenses
 Pension remains \$3,000 by 1990 SURPLUS OF +\$312.17 per month compared to a surplus of \$1,000 in 1980	 Pension remains \$3,000 by 2039 DEFICIT OF -\$248.85 per month compared to a surplus of \$1,000 in 2023



Indexation helps maintain purchasing power, which contributes to economic growth

In 2023, \$42B in defined benefit (DB) pension payments for 1.23M Ontarians fueled more than \$60 billion in economic activity, including spending, taxes, and buying and selling goods within Ontario.⁶

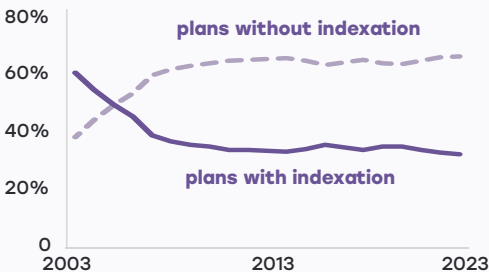
INDEXATION TRENDS

Indexation is declining within the Canadian pension plan landscape. One of the primary factors is due to the high cost and risk of guaranteed indexation.

High cost, high risk

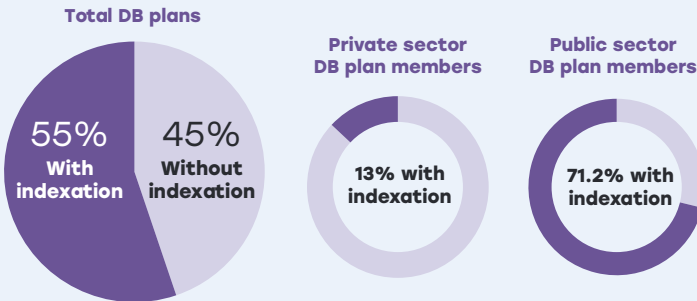
Over the last 20 years, there has been a continuous decline in Canadian plans providing any type of indexation.

Canadian pension plans with vs. without indexation⁷



Full guaranteed indexation is expensive. It can increase a plan's liabilities by 20-40%.

Today, nearly half of members across all defined benefit (DB) pension plans in Canada do not receive any type of indexation to their pension.⁸



Despite indexation becoming less common in pension plans, many JSPPs still offer it. How do they do it?

A sustainable design: conditional indexation

Pension benefits are conditionally adjusted based on a percentage of inflation, for example, up to 75% of the increase in the CPI.

Once pension benefit increases are provided, they never decrease.

For example, if a monthly pension benefit of \$1,000 in 2023 was adjusted to \$1,030 for 2024, it will not be less than \$1,030 in 2025 and the following years.

How conditional indexation works:



A plan has the capability to pause...



...and unpause indexation...



...to ensure the long-term health of the plan remains stable.



In some cases, a plan will make up for a previous pause by granting additional indexation in a future year.

Conditional indexation vs. guaranteed indexation

As pension plans experience market fluctuations, their funding levels are measured by plan actuaries.



Liabilities are greater than assets



Guaranteed indexation provides increases, but may need extra funding (e.g. through contribution increases)



Conditional indexation pauses increases and reevaluates when funding improves



Assets are greater than liabilities



Guaranteed indexation provides increases



Conditional indexation provides increases and may include catchups on prior pauses

Conditional indexation helps ensure...

- pensioners maintain purchasing power
- pensioners continue to receive their pension benefits for life
- the plan remains cost-efficient and sustainable
- contributions remain stable and predictable

A sustainable design: bigger is better

Compared to a single employer pension plan (SEPP), a multi-employer plan like a JSPP offers:

- ✓ greater efficiency in plan administration,
- ✓ access to higher return investment opportunities that enhance plan sustainability and stability, and
- ✓ a wider base of employers and plan members to spread costs and risks.



These aspects contribute to the ability of JSPPs to provide indexation.

A PROVEN MODEL



Many of Ontario's large JSPPs follow the world-renowned **Canadian Pension Model**⁹, which has proven to deliver economies of scale, strong long-term performance, and stability.

How else does a JSPP compare to a single employer pension plan (SEPP)?

	SEPP	JSPP
Scale of assets Access to private markets and investments that hedge inflation.	✗	✓
Joint governance Equal employee and employer say in plan design, funding, and administration.	✗	✓
Risk balance Funding and contribution rate stability due to the pooling of assets, costs, and risks.	✗	✓
Investment management Broader diversification opportunities, access to new types of investments, and better fees, transparency, and investment control.	✗	✓

Want more information? Explore these resources to learn more.

[Consumer Price Index: Statistics Canada](#)

[Inflation calculator: Bank of Canada](#)

[Key inflation indicators: Bank of Canada](#)

[CPP and the Consumer Price Index: Government of Canada](#)

[OAS payments: Government of Canada](#)

1. [Consumer Price Index in Canada, Jan 2000 – Nov 2024: Statistics Canada](#)
2. [1980 life expectancy in Canada: Statistics Canada](#)
3. [1980 average retirement age in Canada: Statistics Canada](#)
4. [2023 life expectancy in Canada: Statistics Canada](#)
5. [2023 average retirement age in Canada: Statistics Canada](#)
6. [Economic growth: The Conference Board of Canada](#)
7. [Canadian pension plans with vs. without indexation: Statistics Canada](#)
8. [DB plan members in Canada receiving indexation: ACPM](#)
9. [The Canadian Pension Fund Model: Beath, Alexander / Betermier, Sebastien et al. \(2021\)](#)