policy

Pensions and the Economic Crisis

December 2008

The current economic crisis has placed pressure on the retirement security of Canadian workers and pensioners.

In the last year workers and pensioners have seen the value of their retirement savings erode as stock markets plunge.

A sensible response to this situation is required. But we need to be clear from the outset what the real problems are.

The Problem of Declining Coverage

As worrisome as the situation is for those with a pension, it is even worse for those without any pension coverage, and there are far too many Canadians without a pension plan other than the Canada Pension Plan (CPP).

Only 38 percent of the Canadian labour force, about 5.7 million workers, belong to a pension plan. Close to 10 million Canadian workers do not have a private pension plan. These workers must rely on their own individual savings, through Registered Retirement Savings Plan (RRSP) contributions or other means, for their retirement security. In 2007, there were 6.3 million Canadians who contributed to an RRSP yet over half of the contributors were members of a pension plan. This means that there were approximately seven million workers – or about 30 percent of households – in Canada in 2007 without a pension plan or RRSP savings. The annual contributions Canadians make to RRSP plans are also very small. In 2007, the mean contribution for all Canadians was just under $2,400.

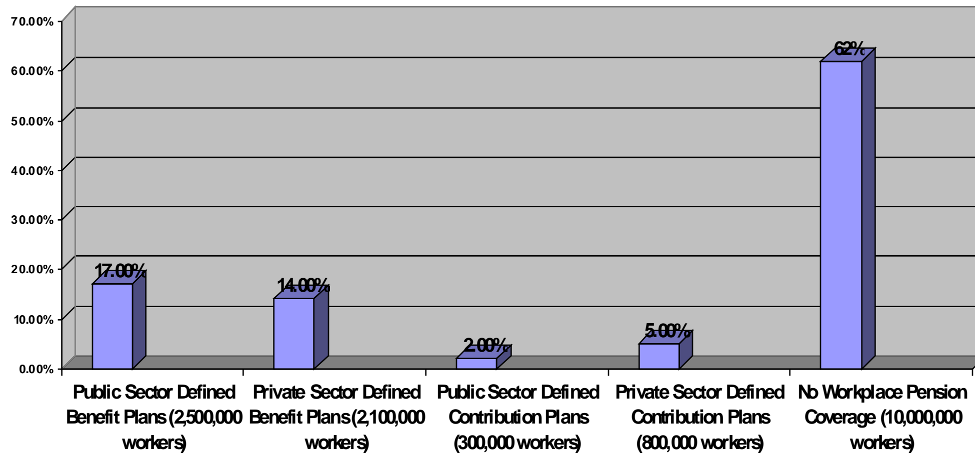
RRSPs promote an approach to investing that favors stocks and bonds held in commercial accounts, many of which are gouging Canadians through the highest management fees in the world. Many Canadians pay a fee as high as 2.5 percent before they see a one cent return on their investment. As the financial market implodes, the risks and the costs of this approach are becoming all too clear.

Canada is facing a real crisis as individual workers are being left to fend for themselves in retirement – especially in the private sector where 75 percent of its workers have no pension plan. More and more working Canadians will be forced to rely solely on our public pension system in their senior years. The combined CPP and OAS yearly income is approximately $16,000; if that's all retired workers have to live on, they will be facing a bleak retirement.

If government policymakers continue to ignore this crisis, we are going to have an increasing number of seniors living in poverty in their retirement years which undoubtedly will place increased pressure on our public pension system and increased costs to taxpayers. Indeed, the gradual decline of the retirement income system costs provincial and federal governments by reducing tax revenues and increasing social spending.

There are however viable policy options the federal and provincial governments must consider to avoid this pensions crisis and to ensure that all Canadians will be in a position to retire with financial security and dignity.

Pension Plan Coverage in Canada - 2007



Strengthen Canada's Public Pension System

Increase public pension benefits

First and most important is a critical need to improve our public pension system.

Canada's universal public pension system, Old Age Security (OAS) and Guaranteed Income Supplement (GIS), a sub-program of OAS which targets low-income seniors, offer a basic level of income security for Canada's seniors. They are especially important for lower and middle-income seniors who are less likely to have been able to accumulate private retirement savings during their working lives, and less likely to have worked in jobs that provided private pension plans.

Benefit levels for OAS and GIS are inadequate, despite the fact that many Canadian seniors depend on OAS and GIS as their sole source of income.

In combination, OAS and GIS provide a minimum income floor for older Canadians. For the single elderly, the floor currently amounts to $13,635.96 per year (as of January 2008). This is $3,934 below the 2006 low income line for a single person in a large urban centre. For an elderly couple, the minimum income guarantee is $23,107 (as of January 2008), which is $1,723 above the 2006 low income line for a large city.

As is commonly the case elsewhere, too, the single elderly in Canada are overwhelmingly women.

The 2005 and 2006 federal budgets increased GIS benefits by seven percent but this amounted to $39 per month for individuals and $58 per month for couples. The 2008 federal budget allowed GIS recipients to earn more in paid employment without penalizing their public pension earnings, and increased the value of disability pensions. These were positive steps, but more must be done.

In order to strengthen public pensions for the most vulnerable seniors in Canada, GIS rates must continue to increase each year beyond the rate of inflation so that minimum benefits provided by a public pension system provide Canadian seniors with incomes above the poverty line. For example, an increase in GIS benefits of eight percent would add $800 million to the overall annual cost of our public pension system.

Expand the Canada Pension Plan

As one of the largest pension plans in the world, CPP certainly has the capacity to provide a greater proportion of Canadians' retirement income. Because it is national in scope, it has the benefit of many investment staff members with skills who can ensure a well diversified portfolio. It can offer economies of scale with lower administration costs and investment management fees. For Canadian workers, it provides them with less risk, greater certainty, portability and increased benefits like spousal benefits, death benefits, disability benefits and inflation protection.

Recently the Alberta/British Columbia Joint Expert Panel on Pension Standards in its final report recommended the establishment of a creation of an Alberta/British Columbia DC plan for Albertans and British Columbians who currently have no access to a pension plan. In October 2008 a Pensions Review Panel in Nova Scotia recommended the establishment of a similar plan for that province. While these could be relatively positive responses, depending on how those plans are actually structured, this kind of piecemeal provincial response is no substitute for a national response.

We need to expand our national public universal workplace pension plan, the Canada Pension Plan (CPP). This policy direction was recently identified as being worthy of further study by the Ontario Experts Commission on Pensions in its final report released November 20, 2008.

There are few incentives in Canada for employers to create pension plans, despite the obvious economic benefits for employers dependant on the retention of a qualified and skilled workforce in an increasingly

competitive labour market. In fact, disincentives exist to discourage employers from setting up their own plans. Employers with pension plans now pay exactly the same CPP premiums as those without plans. They assume legitimate administrative costs as well as necessary requirements set out in federal and provincial pension legislation, including funding and solvency obligations.

It's unfair that employers who do not provide a pension plan pay the same CPP premiums as employers who do provide a pension plan to their workers.

Legislation governing CPP should be amended to require employers without workplace pension plans to pay additional CPP premiums. The extra money would be used to pay improved CPP benefit coverage to employees to cover any years they work for employers without a workplace plan. For example, during this time employees would earn CPP benefit coverage equal to 50 percent (as opposed to the current 25 percent) of the average Canadian industrial wage.

This proposal would create an incentive for employers to provide pension plans. Employers would have a choice – they could contribute to a workplace pension plan, or pay higher CPP premiums – either way, it would ensure that employers rightfully contribute to ensuring their workers are able to retire with financial security and dignity.

Promote Superior Defined Benefit Pensions

The most superior type of workplace pensions in Canada are Defined Benefit (DB) plans, where workers are promised a certain monthly benefit from their pension. The amount of the benefit is determined according to a formula based on the worker's salary, age and years of service. The plans are required to set money aside to pay promised benefits.

Defined Contribution (DC) plans, on the other hand, cannot guarantee any specific benefit upon retirement. In these types of plans, money is put aside by the employer, and usually the employee, into a retirement savings account. The benefit a worker receives at retirement is determined by the value of the savings account and whatever that amount can buy in a monthly benefit.

People with a DC plan who are facing retirement now are entering their

retirement years with a savings account that has been seriously eroded as a result of the current economic crisis. The value of invested funds has decreased to the point that retirees in the latter half of 2008 are beginning retirement with accumulated retirement savings accounts which are worth a great deal less than they anticipated.

DB plans are the most common workplace pension plans in Canada. Approximately 70 percent of workers in the public sector are covered by DB plans and about 20 percent of private sector workers are covered by DB plans. The other five percent of private sector workers who have pension plans belong to a DC plan.

For the last several years we have seen a move by some private sector employers to get rid of their DB plans in favour of the inferior DC plans. Moving from a DB to a DC plan transfers the entire risk of inadequate retirement income from the employer to the employee. That's why employers are pushing this trend. Although the move to drop DB plans has slowed in Canada, the current economic crisis may see that trend emerge again.

Consideration should be given to create incentives through our tax system that encourage employers to have DB plans.

Jointly trusteed plans are better managed and funded

As a result of the economic crisis, there are funding deficits emerging in DB plans. However, those plans that are jointly trusteed are not facing nearly the same level of difficulty. In a jointly trusteed pension plan, the responsibility for the financial health of the plan is shared equally between the employer and the union membership. Jointly trusteed DB plans in fact contribute to improved funding because they reduce the level of exposure to deficiencies. In jointly trusteed plans both the employer and workers (through their union) are responsible for funding half of any deficiencies that arise with respect to their plans.

Jointly trusteed plans make it much more difficult for employers to shed their responsibilities for liabilities in plans. In fact, joint trusteeship obligates trustees to deal with liabilities in the near future and not decades from now.

The Current Economic Crisis

Appeals for pension funding relief

Many large private sector employers recently have been appealing to government for relief from their legislative funding requirement. Under most pension legislation in Canada, governments require plan sponsors that are not fully solvent to accelerate contributions to those plans in order to bring them to a fully funded level, typically amortized over a five-year period.

They argue they face possible financial devastation if required to immediately make enormous contributions to their pension plans to fund shortfalls. Several threaten that unless they get funding relief, they will convert to an inferior DC plan, or abandon the DB pension plan altogether.

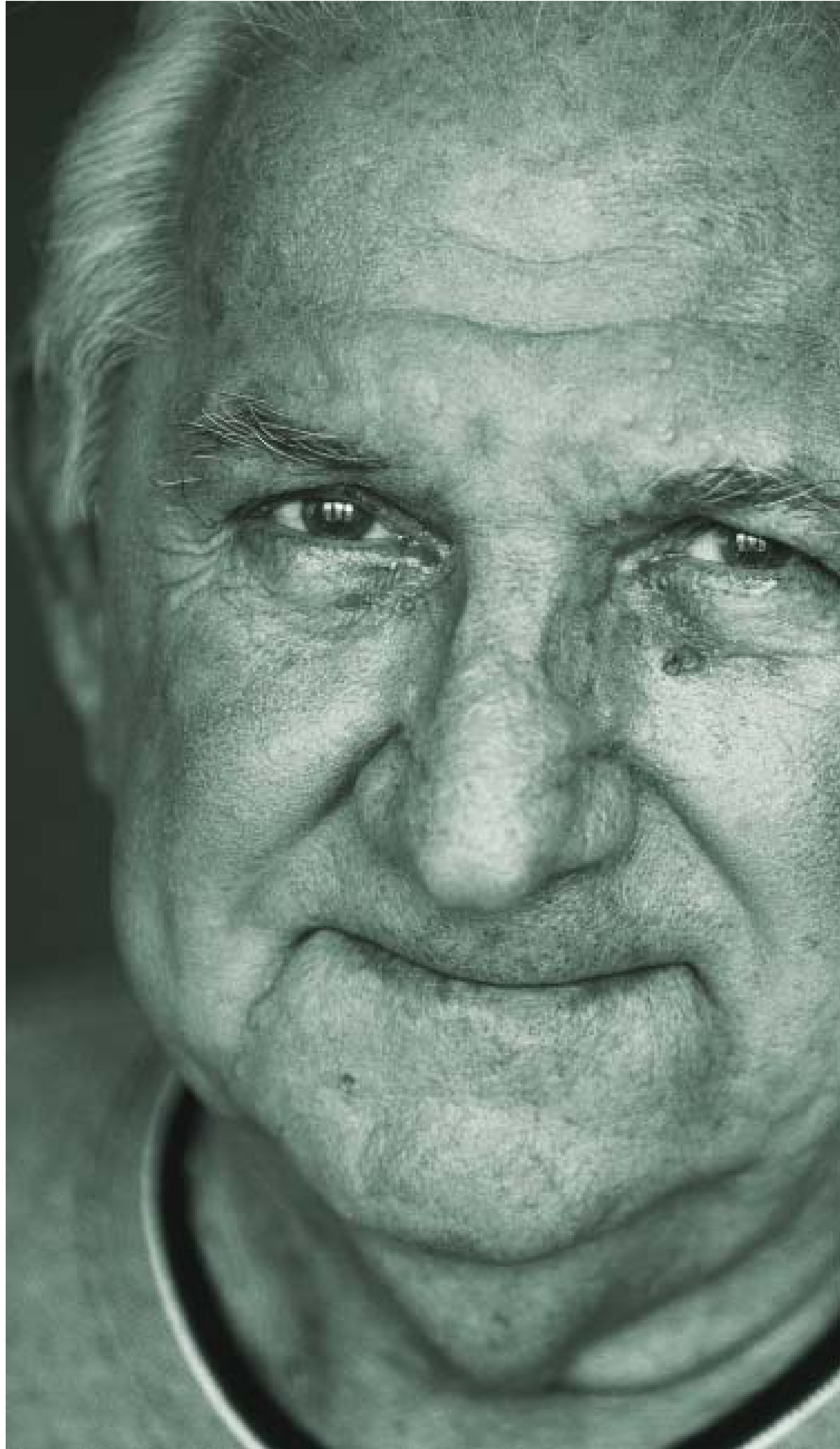
Not all pension funding problems caused by market downturn

Certainly many companies are currently faced with increased obligations to fund pension plans, although we have reason to be suspicious about their claims. During the good economic times of the 1980s and 1990s, many companies used their pension surpluses generated by high investment returns to take regular contribution holidays, and even take cash out of the plans. And during the good economic times, many companies falsely claimed they could not afford to maintain their pension plans, when in truth what they meant was that they chose not to, because they would rather the money go to other things like paying for the CEO's stock options or even exorbitant CEO pensions.

Temporary funding relief with conditions

There's no question that the recent market collapse has decreased the value of pension funds, and in some cases that may be to a critical degree. Companies due to have new valuations of their pension plan are at risk of having to fund their pension plans based on severely deflated stock prices, triggering large cash contributions. So it makes sense to consider a temporary extension of the time lines to some companies to help them resolve a plan deficit. Similar exceptions have been allowed on a temporary basis under federal legislation earlier in this decade and policy makers should again consider allowing a temporary legislative response to the current economic volatility of the markets.

But there are risks to this approach, especially for the workers whose pension plans could be in jeopardy if the current market downturn continues for an extended period of time. If these extensions are to be



granted, it is critical that workers be protected from these risks. It has to be a two-way street – a solution that gives employers funding relief but does not jeopardize benefit security.

Minimizing risk to workers

To minimize the risk to workers, the following legislative conditions should apply to granting an extension to the five-year amortization of solvency funding:

- Any request to extend the five-year amortization should be considered on a case-by-case basis and approved by the appropriate pension regulator;

- Requests would have to be in the best interests of plan members and require approval of the bargaining agent, and the retirees. (If there is no bargaining agent, the proposal would require the support of a member representative and/or the active members);

- The pension regulator should have flexibility regarding the amortization period but it must not extend beyond 10 years;

- There must be minimum contributions made each year to the plan to make up for the solvency deficiencies;

- The financial viability of the company should be considered with the union having full access to corporate financial records and any plans for restructuring; and

- As a condition of getting the approval of the bargaining agent, the employer must be prepared to negotiate with the union to give it a greater say in the administration and management of the plan including joint trusteeship and shared ownership of any future surpluses.

These legislative conditions would help protect the benefit security. Given the magnitude of the current economic crisis, they alone will not ensure workers are fully protected.

Pension plans need protection now

In the short term, the federal government and provincial governments must ensure workers' pension plans are fully protected. Governments need to guarantee that pension funds will not go under.

If our federal government can use public funds to help stabilize Canada's financial institutions during difficult economic times, then it should be

able to ensure pension plans that workers rely on for the retirement security are protected. This would provide important economic stimulus while guaranteeing that workers retire in dignity.

The federal government would not be called upon to provide every dollar of every pension fund. Rather, it would only be guaranteed to make up the shortfall, if any pension plans that are given a temporary extension are still unable to meet their solvency requirements.

A national Pension Benefit Guarantee Fund

Any legislative extension of the solvency period for companies must be accompanied by the establishment of a national Pension Benefit Guarantee Fund (PBGF) encompassing all Canadian jurisdictions. This could be funded in several ways – one way would be to set up a tax on stock market and financial transactions, as several countries have done. The percentage paid in tax would be extremely minimal, but the amount generated is quite significant.

A PBGF is not just a response to deal with today's troubled plans; it would provide insurance for current and future situations.

This would go a long way toward protecting the most superior pension plans in Canada – a vital goal that needs to be maintained if we're to protect the financial retirement security of current and future Canadian workers. While it will take some time to get this system up and running, provincial governments and their pension regulators must begin now to work with the federal government on this policy initiative.

The Need for Better Regulation of Canada's Private Retirement Savings System

The current economic crisis has certainly showed the desperate need for greater regulatory oversight of all financial institutions, especially those which are responsible for overseeing the retirement savings of Canadians.

The irresponsible financial decisions made by many institutional investors without any serious government oversight or transparency has had devastating consequences for Canadian retirees and those who are about to retire. The most vulnerable are those Canadians who invested directly in the markets, in equities, mutual funds, and other financial instruments. Most of those Canadians who contribute to a DC pension plan or an

RRSP are in this situation. As individuals, they personally carry all of the risks.

Added to that, the Canadian mutual fund industry charges the highest fees in the Western world. When you are paying 2.5 percent plus in fees every year, it can take a third or more off your retirement savings in the long run. The banks are among the largest mutual fund brokers and the mutual fund industry is largely self-regulated. This has only exasperated the problem.

Effective regulation and transparency

Federal and provincial legislators need to strengthen the regulatory system governing banks and other financial institutions that are responsible for managing the retirement savings of millions of Canadians. Governments must ensure greater transparency in the structure and content of investment products.

We also need better rules and more transparency on investment fees in this country. Governments must demand better labeling of financial products that the mutual fund and insurance industries sell. There should be reasonable limits set on administration costs for pensions, be they RRSPs or larger workplace plans.

A National Pension Reform Summit

Several organizations including retiree groups and pension plan sponsors have recently called for a National Pension Reform Summit to be held in early 2009 and attended by all the ministers who have legislative and regulatory responsibility for pension matters as well as the key pension stakeholders. The summit would address a range of pension issues, including the steady decline in the number of Canadian workers covered by workplace pension plans.

We support this call and believe it would be an excellent opportunity to begin a national debate involving all pension stakeholders on how we can deal with Canada's declining pension coverage crisis. Central to the discussion must be an expansion of our public pension system and a national legislative and regulatory framework that protects and promotes quality DB pension plans.