

PENSIONS IN PERSPECTIVE

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Supporting adequate pensions and retirement with dignity.

Welcome to the fourth edition of Pensions in Perspective, a newsletter that addresses issues of pension design and promotes innovative ideas about how to provide adequate retirement income to Canada.

In each issue, there will be a mix of commentary, an In the News segment, Facts and Figures about pensions, and a look at what politicians are saying. The newsletter is published four times a year, and all issues will be posted on the HOOPP website and the blog of the Alliance for Retirement Income Adequacy, which can be found at ariapensions.ca



Pension expert Dussault favours CPP expansion

By John Devine

A defined benefit (DB) pension plan is the most effective means of providing secure retirement income. That has been said before, and when the former chief actuary of the Canada Pension Plan (CPP) adds his voice to this assertion, he's part of a chorus of expert opinion that have identified the values of the traditional pension model.

However, this hasn't stopped many corporations from abandoning their DB plans for more individual savings-type models, including defined contribution (DC), a trend Bernard Dussault finds sad but one that's unlikely to be reversed.

The solution, he told the Alliance for Retirement Income Adequacy (ARIA), is both available and simple. A bigger CPP and Quebec Pension Plan (QPP) would fill the gap being created by the loss of so many DB plans, and would provide secure income to all working Canadians during their retirement years.

"The CPP and QPP are doing a very good job in terms of retirement security, and they could be expanded. About two-thirds of Canadian workers are not covered by an employer pension plan, they just have the CPP/QPP and the Old Age Security (OAS)/ Guaranteed Income Supplement (GIS). And because the CPP/QPP and the OAS/GIS provide only 25 per cent of average indexed-adjusted salary at retirement, that could be increased."

Dussault proposes increasing ultimately the 25 per cent benefit rate to as much as 70 per cent, but initially to 50 per cent; the first bump would require increased employee and

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FACTS AND FIGURES

- Only 38 per cent of Canadians made RRSP contributions in 2011. The average amount contributed was \$4,670, up from \$4,538 the year before. Source: *BMO Financial Group*
- In the UK, only 9 per cent of private sector workers have a defined benefit pension plan. While 23 per cent are covered by defined contribution plans, the rest have no plan at all. Source: *Office for National Statistics*
- Canadians over age 60 have accounted for more than one-third of the net gains in the workforce since 2009. Source: *Statistics Canada*
- Only three in 10 Canadians feel they will be “fully engaged” in retirement – not working – by age 66. The rest expect they will have to keep working. Source: *Sun Life Financial*

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employer contributions each of three per cent, to the maximum yearly amount, on top of existing contributions.

Canada, he says, has good retirement programs in the CPP/QPP, OAS/GIS. The GIS, he continues, is effective at reducing senior poverty levels, but the program could be revamped along with a reduction in OAS benefits.

“In 1996 the government tried to introduce what they called the Seniors Benefit, which was a very good idea because it would have moved a big part of the OAS toward the GIS, using the plan mainly for poverty purposes rather than just giving a gift to all Canadians who are 65 and over a grant based solely on a residency test.”

And his take on recent suggestions that age eligibility for the OAS be increased from age 65 to 67 may come as a surprise, he adds.

“Some people might be surprised by my reaction to that, but I’m talking on my own behalf. Because people are living longer, working longer and they start working at a later age, this is not a bad idea.

“But on top of that, I always thought that the OAS program should be revamped, because it’s a benefit that’s paid only to people who have (lived) in Canada for a certain number of years. It’s not based on a financial right or financial need.”

Dussault cites two reasons behind the private sector shift from traditional DB pension plans to DC: the expense of them and administrative complexity. But there are options to consider other than simply abandoning the plans, he offers.

“If the DB plan was too expensive, then rather than going to a DC plan, the sponsoring employer could consider reducing the scope of the DB plan.”

The other solution on hand, he reiterates, is an expansion of the CPP/QPP.

“There are some other pension experts like me who are pressing the federal and provincial governments to expand the CPP/QPP, which would go a significant way to address this issue.”

Ideally, companies would continue to offer their own retirement plans, which when coordinated with the CPP would give employees a clear idea of their probable retirement income.

DC plans, he says, could produce an uneven retirement landscape where one retiree, because of investment results, lives well, while another, because of poor returns or extended longevity, does not.

“With a DB plan, everybody is getting the promised retirement income ... and nobody really loses provided the plan is solvent.”

An expanded CPP/QPP would also benefit all Canadian workers, particularly younger Canadians by securing during a longer contributory period adequate income for their retirement.



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Making DC plans mandatory for workers with access to them would improve participation levels, but wouldn't necessarily lessen investment market risks, explains the former chief actuary, who adds he's not a big fan of the government's new Pooled Retirement Pension Plan (PRPP) model.

"I don't see how PRPPs could improve the financial security of Canadian workers, because it's not mandatory and it is a defined contribution plan having the same weaknesses as any DC plan."

The single most important change the government could make to improve the retirement horizon would be to expand the CPP/QPP, contends Dussault.



"Any expansion of the CPP/QPP would be the best and most important thing to do. The GIS is already well designed – it does not provide an extraordinary amount of minimum income, but it does a very decent job by moving needy seniors out of misery, though not out of poverty. And, the OAS could be, as was attempted in 1996, better combined with the GIS to give more to the poor and stop giving it to people who don't really need it."

He's also not big on hybrid plans, merging elements of DB and DC plans.

"It's not entirely going to a DC plan, but whatever is converted to DC is not good. A DB plan is the best way of dealing with retirement security, which is meant to be achieved with a pension plan."

While he doesn't see the trend of moving away from DB in the private sector reversing, although there are signs it is slowing, Dussault says the same shift isn't necessarily going to happen in the public sector.

"I am one of those pension experts lobbying the government to have a look at any issue they might have with pension plans, and if the main issue is one of cost, then they should review the scope of their plans rather than move into a DC plan."

And, he adds, it's worthwhile remembering the employers aren't alone in carrying the costs of a plan, with employees contributing through payroll deduction.

When the members contribute, they then share the burden, he says.

How much income a person will need in retirement is an open question, but Dussault says 50 per cent of income at retirement should be enough for most people. An expanded CPP/QPP would gradually do that, and would cover one component of a retirement plan's 'three-legged stool' that's increasingly missing, a company pension, with the other two being the OAS/GIS and personal savings plans.

"The CPP/QPP are mandatory and they cover essentially all Canadian workers. They are DB plans with disability and survivor benefits. They are very well designed plans ... as good as I've seen anywhere."

John Devine writes for ARIA, the Alliance for Income Adequacy. Follow ARIA on Twitter or visit the blog at www.ariapensions.ca

WHAT THE POLITICIANS ARE SAYING

"But what we have to be clear on is that we are not looking at (Old Age Security) changes that are going to affect people that are currently in retirement or approaching retirement."

Prime Minister Stephen Harper, in an interview with the National Post

"When the forestry industry vanished, so did a lot of seniors' pensions... the money they thought would be there when they retired is gone, vanished into thin air because the pensions were never properly funded."

Sarah Campbell, MPP, Kenora-Rainy River, NDP

"Because salaries account for most of that education funding, we're going to be asking all those working in education to do their part to help us slow down spending."

Premier Dalton McGuinty, discussing a proposed wage freeze for Ontario teachers (CBC.ca)

IN THE NEWS

Defined contribution plans “fatally flawed”

Defined contribution pension plans – often touted as a cheap alternative to traditional defined benefit plans – are “fatally flawed,” writes Gerry Wahl in the Canadian Investment Review. DC plan members face a number of hurdles, including the risk that they’ll outlive their money, having to work longer in life to be able to afford to retire, and having to make all the investment decisions about their pension plan.

Wahl calls the plans “undefined plans,” since members don’t know what they’ll get out of them until right before they apply to retire.

Employers have “moral responsibility” regarding retirement

Regardless of what type of pension plan an organization has, employers have a “moral responsibility” to ensure that their employees can retire.

So says Laurence Fink, chief executive of global investment firm, writing in the Financial Times.

“That responsibility is not absolved when companies shift from defined benefit to defined contribution plans,” he writes. “With either type of plan, employers should provide more transparency about the income employees can expect in retirement.”

Defined benefit is far from dead: McDaniel

Kip McDaniel, editor-in-chief of aiCIO Magazine, sees parallels between print journalism and defined benefit pension plans. While observers predict both will one day disappear, the opposite is true.

“Forty years from now... there will still be trillions of dollars in defined benefit capital invested in the markets, and thus moving them,” he writes. To ensure a healthy survival, he suggests DB plans look to a liability driven investing model, and adopt the governance structures of Canadian and Dutch DB plans.

Traditional DB plans the best: NYC comptroller

The defined pension plan model is cost effective, provides superior investment returns, and delivers income security in retirement, says New York City Comptroller Tom DiNapoli.

In an interview broadcast on the program Capital Tonight on YNN, DiNapoli, a critic of defined contribution plans, says that DC brings financial uncertainty to its members. That is why he is philosophically opposed to replacing traditional DB plans with DC, 401(k) plans.



Short-term thinking not the answer: Bolduc

Pension plans should be viewed through “a long-term lens,” says Denis Bolduc of the Canadian Union of Public Employees, speaking to the Montreal Gazette.

Many critics of defined benefit plans call their benefits “over-generous,” and point to the severe impacts the economic downturn of 2008 had on many plans. However, says Bolduc, it’s often forgotten that employees pay into these plans as well – and are responsible for funding shortfalls. Current deficits should not be used as an excuse to slash benefits, he says.

Links to referenced articles:

Canadian Investment Review article

<http://www.investmentreview.com/expert-opinion/dc-plans-fatally-flawed-5763>

Financial Times article

<http://www2.blackrock.com/content/groups/global/documents/literature/1111159866.pdf>

aiCIO Magazine article

http://ai-cio.com/channel/NEWSMAKERS/Letter_From_the_Editor-in-Chief__Defined_Benefit/Magazines_Are_Not_Dead_Yet.html

Capital Tonight

<http://www.capitaltonight.com/2012/02/dinapoli-says-he-holds-a-philosophical-position/>

Montreal Gazette

<http://www.montrealgazette.com/business/Pension+deficits+aren+fault+public+sector+workers/6188754/story.html>



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Pensions in Perspective

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