Alberta Federation of Labour

THE ASSAULT ON PENSIONS IN CANADA: FORECLOSING ON THE FUTURE

PART ONE: INTRODUCTION

Pensions are an extremely difficult subject. To be fully versed in the topic requires a wide range of knowledge and skills – from actuarial assessments and financial forecasting to a bewildering array of investment parameters and vehicles, and subtle benefit and plan differences. Pension discussions are often so focused on tiny, yet critical details that even interested and committed union members cannot follow them. To complicate things further, many people avoid discussion of pension issues for the same reasons that they don't want to pick out their caskets or burial plots – they just don't want to think about the inevitability and consequences of aging.

As a result, labour leaders and activists have generally misunderstood how critical and central pensions are to working people and unions. The prevalent notion seems to have been that the system was working fine, so it didn't need a lot of attention.

Now, however, the classic employment pension plans are under attack by both public and private sector employers in Canada, the United States and Great Britain. When that attack is coupled with the recent campaign questioning the sustainability of the Canada Pension Plan, complacency about pensions is the last thing labour can afford.

PART TWO: BACK TO THE BASICS – WHAT DO WE WANT?

When the topic of retirement income and pensions comes up, labour must always get back to the basics. What do we want – and why do we want it?

Pensions exist as a consequence of the way employers have traditionally treated workers in Canada. Workers were, and still are, treated as disposable commodities in the labour market. Once a worker was no longer capable of peak productivity, they were replaced by younger workers who were. Inevitably, older workers reached the stage where they could not secure any kind of employment.

For generations of Canadians, this meant senior years of unemployment, filled with financial hardship and increasing psychological desperation and physical suffering.

The fundamental objective of pensions and retirement schemes for workers has

always been the capacity to retire with dignity after giving the prime years of your life to productive labour.

Retiring with dignity is not an ambiguous term. It implies being able to afford decent housing, food, clothing, transportation and proper health care. It means enjoying your senior years free of deprivation or the fear of poverty.

Financial planners recommend replacing approximately 70 to 80 percent of one's working income in retirement. Another measure of retirement success could simply require staying above an agreed-upon poverty line (e.g. the Stats Canada Low Income Cut-off Line).

PART THREE: THE CANADIAN RETIREMENT SYSTEM

The Canadian retirement system has been described as a three–legged stool, with the legs representing the Canada Pension Plan/Old Age Security; an employer pension; and personal savings respectively.

A. The Public Component

The Canada Pension Plan (CPP) is the basic, universal, mandatory contributory pension available to all employees in Canada who have made valid contributions to the Plan. The CPP is financed by contributions from employers and employees on all employment income. The contributions cover only income up to the Year's Maximum Pensionable Earnings (YMPE) – which is adjusted every year for inflation.

When a person who has worked in Canada and contributed to the plan retires they will receive a monthly retirement pension from CPP that is based upon their Canadian employment income over their lifetimes. This pension is fully indexed to inflation. It is designed to provide about 25% of the earnings you paid contributions on.

In tandem with the CPP, there is also Old Age Security (OAS) for persons with low income and a further benefit, the income-tested Guaranteed Income Supplement (GIS) for seniors with low or limited incomes.

Old Age Security was created in 1952, as a result of political pressure from labour and other progressive groups. It was designed to prevent absolute poverty among seniors and is available to all permanent residents – but you must apply for it. Full entitlement ($471.76 per month) is based on residency in Canada for 40 years after the age of 18 – otherwise it is pro-rated. The flat benefit is indexed to inflation, taxable and "clawed back" when your income reaches a given amount.

The Guaranteed Income Supplement is an anti-poverty top-up for the OAS. It is only available to low income seniors (currently, income less than $32,592) and must be applied for every year. It is fully indexed and not taxable. Both OAS and GIS are funded out of general federal revenues.

The Canada Pension Plan is funded from current payroll deduction and was, from its inception in 1966, a pay-as-you-go plan. This was partially

modified in 1998 with provision for a CPP investment fund to generate long-term income to the plan.

The maximum monthly pension provided by CPP as of October 2004 was $828.75 for a single person retired at age 65. Importantly, the average CPP pension in October 2004 was substantially less – $456.92 per month.

If CPP were the only source of retirement income, an average single pension recipient would be entitled to a further $804.45 a month from OAS/GIS producing an annual income of $15,628.44. A maximum CPP single pensioner would earn a further $618.45 per month from OAS/GIS for an annual income of $17,366.40.

The National Council of Welfare estimates that to remain above the Stats Canada before-tax low-income cutoff in Edmonton or Calgary for 2004, a single person would need to earn $20,101.

In simple terms, a single pensioner in Edmonton receiving the *average* CPP and OAS/GIS payment would need another $400 to $500 income per month from other sources like investments, other pension income or a job to be lifted above the poverty line.

B. The Employment Component

If the critical role of union in creating employment pension were not already well known, a simple comparison of provincial unionization rates with the rate of persons with employment pension plans would make it absolutely clear.

Outside of management pension plans, the vast majority of Canadians who have defined benefit pension plans are those who have unions.

Province	% of workers covered by a RPP 2002	Union Density % 2003
Newfoundland	50.9	38.2
Sask.	49.0	34.3
Manitoba	46.1	34.9
Nova Scotia	41.8	27.4
Quebec	40.5	37.6
New Brunswick	39.9	32.4
Ontario	39.3	26.8
B.C.	37.9	32.4
PEI	32.6	28.3
Alberta	**32.7**	**22.4**

Unions have had to fight long and hard to secure defined benefit pension plans for their members. In the 1940s and 1950s large scale job actions were taken to win pension plans.

Improvements to pension plans have always come at a cost at the bargaining table. From a labour perspective, all pension plans and their assets are simply deferred wages. Workers have given up current wage and benefit demands at the bargaining table to secure pensions and pension improvements. Pension funds are the property of workers – not employers.

Most union negotiated pensions are defined benefit (DB) plans. In this kind of plan, the pension a worker earns is a specific guaranteed benefit upon retirement. This benefit can take various forms: for example a certain amount of income for each year of service, or a percentage of the best years' earnings multiplied by their years of service.

Pensions are closely regulated by various laws, including the Income Tax Act. These laws even limit the maximum levels of benefits a pension plan can offer. Under this maximum, the very best defined benefit pension plan would offer workers 2% of an average of the three best year's income they earned and multiply it by years of service. So, for example, if a worker averaged $40,000 in their best three years and they had been with the employer for 30 years, they would receive a pension of [.02 * $40,000 * 30] $24,000 per year.

One of the key advantages of the defined benefit plan is that there is no risk to the worker for plan funding – the pension is guaranteed and it is generally the employer who is responsible for any funding shortfall in the plan.

For many years, union negotiating focused simply on upgrading or improving the level of benefits in their pension plans. Automatic cost-of-living adjustments and extended survivor benefits are examples of key improvements.

Another common form of pension is a defined contribution (DC) plan. These work much like an RRSP. The employer (and sometimes the employee) contributes to the plan, which establishes an individual pension account for each employee. Plans where only the employer pays are called "non-contributory" and plans where employees also pay are called "contributory".

In a unionized environment the contribution rates and some of the features of the plan are negotiated. Sometimes the money in the accounts is managed by a pension committee or by the employer. In many cases, the employee will be offered a choice of different investment opportunities such as mutual funds.

C. Personal Savings

The final leg of the retirement income tripod is personal savings. As with the other two legs of the system, there is

a built in inequality favouring high-income earners. The more you earn, the higher your CPP and employment pension will be and the more likely you will be to be able to save extra money for retirement through RRSPs or other investment devices.

Even so, most Canadians have very little in the way of savings once their debts are subtracted from their assets. In many cases, the net worth of an individual is simply the amount of equity they have in their home – which is no solution to an income shortfall during retirement. The use of reverse mortgages does allow individuals to make use of their home equity for retirement income – but does so at the expense of possible intergenerational transfer of wealth through "inheritance" or even the use of such funds to finance nursing home fees later in life.

PART FOUR: THE ASSAULT ON PENSIONS

The Canadian retirement system, despite its obvious drawbacks, contained the framework upon which a truly effective retirement income system could have been constructed. The Canada Pension Plan, with some adjustments, could provide a much more secure and equitable retirement income to all Canadians. Improvements in the coverage and benefit levels of employment pension plans are always a possibility during negotiations.

However, both of these two pillars of the Canadian retirement system are now under attack.

A. Canada Pension Plan Undermined

There was a carefully orchestrated campaign against the Canada Pension Plan that raised biased and occasionally hysterical allegations that the CPP was unsustainable. Basically, the argument went, because of the aging of the "baby boomers", there would be too many retired drawing benefits for the current generation to sustain.

The critics of the CPP, led by the Reform Party and the National Citizens Coalition (Stephen Harper's old home), wanted it shut down and converted into a defined contribution (DC) plan.

They claimed that the younger generation would refuse to support the Canada Pension Plan and that the CPP would go bankrupt – leaving thousands of seniors destitute. And, despite all the evidence to the contrary, these forces have not given up. Last year, the Alberta government was seriously considering a proposal published by the Fraser Institute to drop out of the CPP and create an Alberta Pension Plan. Of course, the underlying text was that this new Alberta plan would be a defined contribution plan – not a defined benefit plan.

The real truth is that CPP contributions have been rising in recent years in response to the coming demographic shift. At current contribution levels, the CPP is provably sustainable and actuarially sound until well after the "baby boomer" bulge of retirements.

It may soon be possible to start considering improving the benefits in the Canada Pension Plan. Note that CPP only covers about 25% of earnings, whereas Germany provides a pension of 75% of earnings, and Sweden covers an astonishing 90% past work income.

However, previous attempts to expand and improve the Canada Pension Plan have run into strong opposition from Canada's powerful private pension and financial service organizations. In a September 2004 CLC submission to the Canadian Association of Pension Supervisory Authorities, the CLC noted that "[in both the late 1960s and the late 1980s] the pension industry lobbied hard, and successfully, for a system in which the publicly administered pensions would play a modest role, and ample room left for workplace pensions."

B. The Assault on Defined Benefit Pension Plans

Defined Benefit (DB) plans are what most unions strive to negotiate for their members. During the 1950s and 1960s these pension plans became entrenched in large businesses in North America, in public sector plans even extending to medium and some smaller businesses.

However, beginning with the economic stagnation of the early 1970s and through the 1980s, many employers began to eye the steadily growing pension funds as a source of revenue.

There was out-and-out theft – as in the illegal $400 million dollar loans British media mogul Robert Maxwell took out of his employees' pension fund. There were terminations of healthy plans in order to grab surpluses. There was also a growing tendency by employers to seek contribution holidays and to try to shift liabilities to employees.

One of the most pernicious attacks on defined benefit plans came in the form of skewed plan assumptions made by employers in order to make plans appear better funded than they actually were. These ranged from overvaluing assets to false retirement age assumptions and use of other actuarial sleight-of-hand to reduce employer contributions. This was particularly true in the United States where several major corporations defaulted on their pension obligations and turned over responsibility and debt from their plans to a federal agency. United Airlines, Bethlehem Steel and Consolidated Freightways are examples of how 'legal' pension assumptions can still bankrupt plans to the benefit of corporations and the detriment of workers. According to New York Times report, "A year shaved off an estimate here; a decimal point's difference can significantly reduce a company's pension obligations on paper. The company can save millions of dollars in pension contributions." NY Times November 12, 2003

Many employers took advantage of the huge increases in fund assets created by the boom stock markets of the 1990s to reduce contributions, take contribution holidays, or even to

plunder "surpluses" from the funds. Then, when the market fell after the 'dotcom' speculative bubble burst in 2001, pension funds were suddenly in serious deficit positions. One 2004 study by the Certified General Accountants Association of Canada estimated that 59 per cent of Canadian defined benefit plans were in deficit as of December 31, 2003, and that an additional $160 billion was needed to cover those deficits.

For workers who are depending upon these plans for secure retirements, the threat of corporate insolvency leading to bankruptcy and loss of pension benefits is very real.

An equally serious challenge to defined benefit plans, however, came in a direct effort by many private sector employers and some public sector employers to convert their defined benefit plans to defined contribution (DC) plans.

What is wrong with DC plans?

The worker faces four kinds of significant financial risk in a defined contribution plan. First, there is investment risk. If the investments don't do well, the worker's retirement income suffers. Second, there is interest rate risk. If the interest rates are low at the time the worker retires, the pension savings will buy less annuity income. Thirdly, there is inflation risk. The longer you live in a fixed annuity, the less your income is worth in real buying power. Finally, there is a lifespan risk: the longer you live, the greater the risk you run of exhausting your funds.

There are several more drawbacks to defined contribution plans from a worker's perspective. One of the supposed attractions of defined contribution plans is that individuals can have a say in investing their pension funds. However, upon closer examination, this is actually a drawback to DC plans.

In *Profitable Prudence: The Case for Public Employer Defined Benefit Plans*, a research paper published by the Pension Research Council at the Wharton School of Business, authors Gary W Anderson and Keith Brainard note that:

"For instance, DC plans are seen as an unreliable vehicle for ensuring financial security in retirement to the extent that investment risk is borne solely by individual participants; this is exacerbated when plan participants are poor investors. A study prepared by the Nebraska Public Employee Retirement System (PERS) found that from 1983 to 1999 that system's DB plans generated an average of 11 percent annually, but the system's DC participants paid returns of only 6 percent."

The same study also found that 68% of terminating DC participants cashed out their savings – rather than retaining them in a retirement account when they changed jobs. This is a second great weakness of DC plans – what pension specialists call "leakage". The problem is that workers all too often take advantage of the possibility of cashing in their savings – leaving them with little or nothing upon retirement.

Another problem with defined contribution plans is the expense of administering them. The California Public Employees' Retirement System (CalPERS) published a research brief in December 2004 that pegged the average administrative costs for DC plans at 2 percent of assets. By contrast, the cost for administering the DB plan at CalPERS, which at $178 billion is the largest pension fund in the United States, was only 0.18 percent of assets.

There is no question that Defined Benefit plans are far, far superior to Defined Contribution plans from a workers' perspective. Why then are employers increasingly promoting Defined Contribution plans?

Why the assault on defined benefit plans?

That there is a concerted attack on defined benefit pension plans is a given. Right now there is a strong push by Republicans (supported by Governor Schwarzenegger) in California to shut down CalPERS. Every public sector and private sector defined benefit plan in Alberta and Canada is at risk.

The question needs to be asked, why now?

There are several business trends that are currently undermining DB plans. Employers are outsourcing and using more temporary and term employees. This means that many workers move more frequently between employers and occupations than they used to – making pension plan continuity difficult to maintain. There is also increasingly low spending on in-house training by employers – which again produces more dependency on short term, outside help. Finally, there is a complete lack of HR policies to hire or accommodate older workers – exacerbating the pressure of an aging population on pension plans.

There is however, another larger but shadowy reason for increasing employer antagonism to defined benefit plans.

Defined benefit pension plans have become the largest pools of investment capital in the world. By 1999 employment pension schemes around the world were estimated to have reached a global value of $13 trillion. World GNP in 1999 was estimated at $28 trillion and the worldwide value of stock markets at $23 trillion. Even small pension funds are worth hundreds of millions of dollars. There are thousands worth more than $1 billion.

So long as the financial institutions – money managers, investment banks and brokers – are in control of those funds – then the financial benefit is being accrued largely by the corporate sector.

But, there has been increasing effort by labour and working people generally to exert more control over the way their pension funds are invested. This is evident throughout the developed world and is notable in the creation of labour sponsored ethical investment funds and other programs aimed at ethical business behaviour. The Canadian Labour Congress is currently co-sponsor of a

major initiative, the Pension at Work group, that is promoting increased labour control over pension funds and ethical business behaviour.

Labour wants their pension fund managers to start taking responsibility for the direction and behaviour of companies in which they are majority shareholders and to exercise their votes and account for their voting practices. Job creation, environmental policies, and other social issues would become boardroom issues if labour succeeded in this endeavor.

Given this burgeoning movement for more labour control over pension funds, is it any wonder that financial institutions now want to convert both public and private sector defined benefit plans to defined contribution plans? In defined contribution plans individual investors have neither the expertise nor control of enough funds to have any influence over investment decisions or corporate behaviour.

A second indication of how seriously the corporate sector sees this as a threat is the current move to insist that all pension fund administrators and trustees be actuarial or investment "specialists" – a rather blatant attempt to cut union activists out of these roles. This is a serious threat to union aspirations to greater control over pension funds. Labour must find a way to arm their own pension activists with qualifications that are unimpeachable.

PART FIVE: CONCLUSION AND RECOMMENDATIONS

There is no question that labour has been slow to react to the attack on the Canada Pension Plan and the ongoing undermining of defined benefit pension plans in the public and private sectors.

To respond adequately, labour is going to have to recruit and train a new, larger core of pension specialists and activists. And, we are going to have to increase cooperation and information sharing between all unions – both public and private sector on pension issues. Finally, we are going to have to educate our own rank-and-file about the critical importance of maintaining and improving defined benefit plans, improving defined contribution plans where they already exist, and defending the Canada Pension Plan.

To that end, the Alberta Federation of Labour shall:

1. **Strike an ad hoc committee on pensions.**

2. **Ask that Committee to:**

   a. **Bring together pension activists from the private and public sectors to discuss pension issues, trade information, plan campaigns around pension issues, and report to and advise the Alberta Federation of Labour Executive Council on important developments in the pension field.**

b. **Collect information on, monitor and plan union responses to changes or proposed changes to pension legislation in Alberta and Canada.**

c. **Maintain contact with union pension activists in the rest of Canada, including organizations like the Shareholder Association for Research and Education (SHARE) and Pensions at Work.**

d. **Work with the CLC, with union educators with post-secondary educational institutions, and other expert organizations to establish a serious program of pension education leading to a recognized certification for union trustees on pension plans, and for union pension activists.**

e. **Establish and recommend action on areas of joint concern for public and private sector pensions – for example, the defense of DB plans.**

f. **Form alliances with seniors' groups and other interested organizations to campaign on pension issues**

g. **Campaign to defend/strengthen the CPP.**

h. **Support union efforts to gain joint trusteeship of pension plans.**

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