Alberta Federation of Labour

THE LOOMING CRISIS IN RETIREMENT INCOMES

Across the developed world populations are ageing, creating economic and public policy challenges for governments. Alberta is certainly no exception to this trend. As increasing number of citizens approach retirement age, the issue of retirement income – how retirees will support themselves – is becoming critical. If society fails to make adequate provision for pensions or other forms of retirement income, an epidemic of poverty among senior citizens is likely in the foreseeable future.

The situation in Alberta is especially serious – a briefing document released by the Alberta/B.C. Joint Expert Panel on Pension Standards[1] says that:

> *Fidelity Investments estimates Canadians are currently on track to replace only 50% of their pre-retirement income once they retire. British Columbia and Alberta results were the lowest in the country, at 47% and 45% respectively.*

If Albertans have the lowest retirement savings rate in Canada, part of the reason is the sad state of pensions in our province. A discussion paper released by Alberta Employment and Immigration (updated in August 2008) points out that:

> *Pension coverage has been in decline in Canada since the early 1990s. Only approximately 40% of workers in Canada belong to an employer-sponsored pension plan through their place of work.*[2]

Once again, the situation is even worse in Alberta, where less than 33% of employed workers are covered by a Registered Pension Plan (RPP) offered through the workplace, and for private sector workers the figure is just 18.3%.

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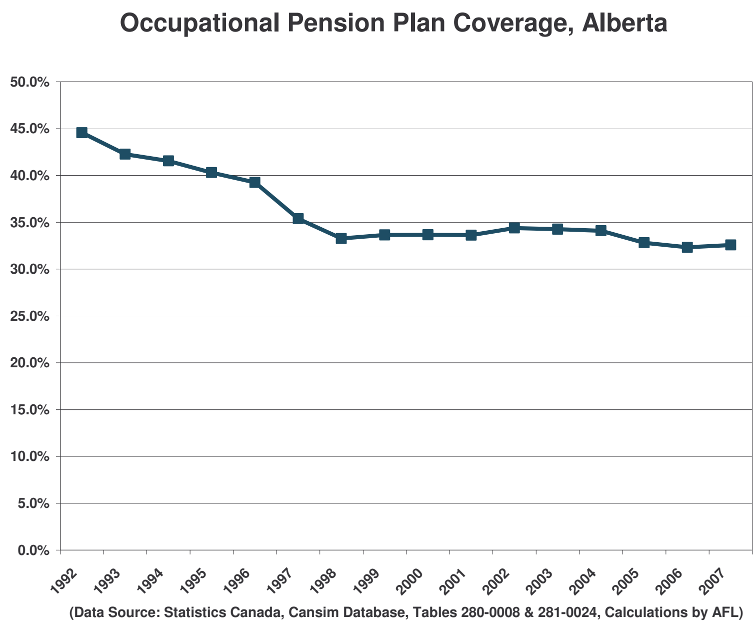
[1] Alberta/BC Joint Expert Panel on Pension Standards, "*Quick Facts on the Retirement Income System and Pension Plans*", p. 3, December 2007, http://www.ab-bc-pensionreview.ca/reference/quick_facts_retirement_income_system_pension_plans.pdf.

[2] Alberta Employment and Immigration, "*Mature Workers in Alberta and British Columbia: Understanding the Issues and Opportunities*", p.16, http://employment.alberta.ca/documents/RRM/PC_mature_workers.pdf.



There are several reasons for this decline in pension coverage, but a major factor is the low and falling rate of unionization. A study released in 2007 by Statistics Canada examined declining registered pension plan (RPP) coverage between 1986 and 1997 and concluded that:

> *The numbers strongly support the notion that de-unionization tended to reduce RPP coverage.*

and that:

> *…evidence strongly suggests that both de-unionization and employment shifts toward low-coverage sectors played important roles.*[3]

While other trends (notably shifts in employment and the decline of manufacturing industries) played their part, it's simply a fact that workplace pensions (especially higher-quality defined benefit pensions) are rapidly becoming a thing of the past in non-union companies, and unless the rate of unionization rises, we can be expect further declines in pension coverage.

SOURCES OF RETIREMENT INCOME

Registered Pension Plans come in two basic forms: Defined Benefit (DB) and Defined Contribution (DC) plans.

[3] René Morissette and Yuri Ostrovsky, "Pensions and retirement savings of families," Statistics Canada, *Perspectives on Labour and Income*, Winter 2007, p. 43.

How Pensions Work

DB pensions pool contributions from employers (and, in some cases, employees) and invests these pooled funds in various kinds of financial assets. When an employee retires, the pension fund pays a specific benefit (usually based on years of service and pre-retirement income).

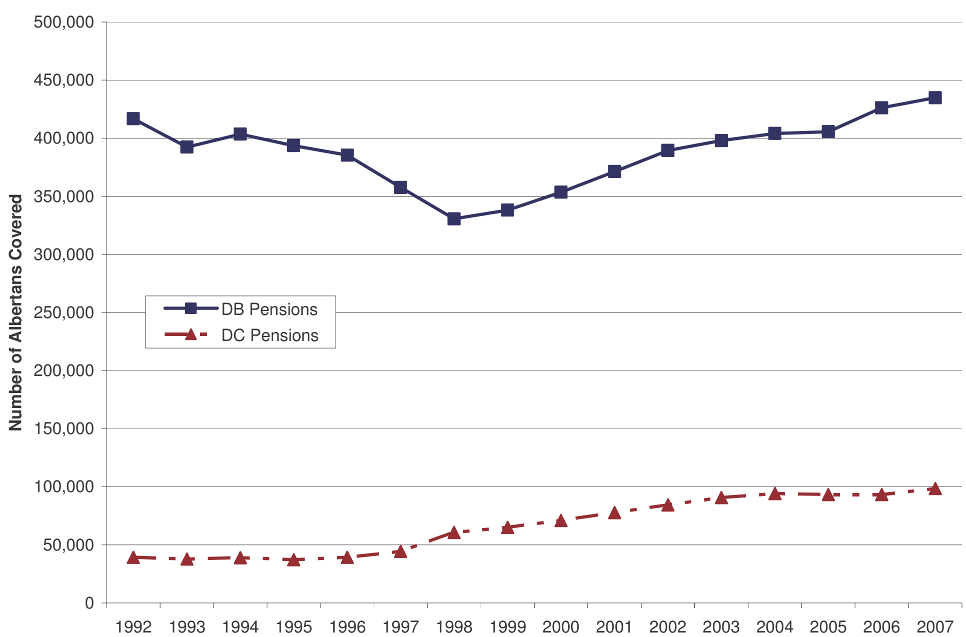
DC plans, by contrast, work much like RRSPs. Contributions are assigned to an individual pension account. The actual money is pooled and invested but the returns on investment are credited to the individual pension accounts. When the employee retires, the funds in his or her pension account are used to buy an annuity which provides a retirement income.

DC pensions force individual employees to bear the risks of market meltdowns (like the current crisis) and interest-rate volatility. Since the amount of annuity income from a given amount of retirement savings sinks when interest rates go down, an employee who retires when rates are low may find he/she struggling to survive on an inadequate retirement income.

DB pensions are by far the more efficient and reliable way to provide retirement incomes. Because financial risks are shared by all members of the plan and, to some extent, spread across time, these kinds of pension plans have an important "insurance" element.

In Alberta, the majority of workers covered by occupational pensions participate in DB plans.

Occupational Pension Coverage in Alberta



(Data Source: Statistics Canada, Cansim Database, Table 280-0008)

In the last few years, economic and demographic trends have put stress on our retirement income system. Since the turn of the century, rates of return on most kinds of financial assets have been poor. With the current collapse in equity markets, of course, investment returns have fall catastrophically. At the same time, extremely low interest rates increase the cost of purchasing annuities which means that it costs pension plans more to guarantee a given level of retirement income. Finally, Canadians are living longer than ever before. This means their retirement savings, whether they take the form of a pension benefit or simply an RRSP, have to provide income for a longer period.

For the majority of Albertans who do not have an occupational pension plan, the news is even worse. Individual RRSPs do a relatively poor job of providing a retirement income. Many, if not most, working people can't afford to make the level of contributions required and the lower their income, the harder they find it. In addition, mutual funds (the main investment vehicle for RRSP owners) provide poor returns, especially in Canada. In part, this simply reflects the poor investment climate mentioned above, but there is one other important factor: Canada has by far the highest mutual fund fees among developed countries.[4] A 2006 study of almost 47,000 funds from 18 countries found that "Canada is the single highest fee country by far." These fees are about 150% higher than similar fees in the U.S.

Caught between insufficient savings rates, poor investment returns and extortionate mutual fund fees, the future looks bleak for growing number of Albertans without a registered pension plan. With large numbers of "baby boomers" approaching retirement age, the stage is set for a serious rise in poverty rates among senior citizens.

WHAT WON'T WORK: THE RIGHT-WING PLAN FOR PENSION REFORM

The pension industry is, for all intents and purposes, employer dominated. Even though some unions have sought and achieved joint governance of their pension plans, the policy pronouncements of pension consultants, professional pension managers and even, to a lesser extent, actuaries, reflect the views, priorities and interests of employers. Over the last two decades, employers have come to view occupational pensions as expensive threats to the corporate bottom line. It's not surprising, then, that in the current atmosphere of crisis, the industry is promoting a number of "reforms" to the pension system that clearly reflect an employer agenda.

[4] See, for example: *Choosing to be Different: Time for the Mutual Fund Goose to Go On a Diet*, Phillips, Hager & North Investment Management Ltd., https://www.phn.com/portals/0/pdfs/ArticlesandAdvice/ExcerptsFromQuarter/Q207_ChoosingToBeDifferent.pdf.

PRIVATE SECTOR OCCUPATIONAL PENSION PLANS
Access to Surplus

One proposal to "save" defined benefit pension plans is to allow employers to take money out of these plans when they are in surplus (when there is more money in the pension fund than is required to pay for the total benefits thus far accrued by plan members). The argument goes something like this: since employers bear the risk of maintaining the pension fund – if the pension plan has an unfunded liability, the employer is normally responsible for making up the funding shortfall – they should also reap the reward when the fund is in surplus.

This line of reasoning is superficially persuasive, but a closer look reveals several problems:

- Neither surpluses nor unfunded liabilities are "real" – they represent the balance of future assets and liabilities projected forward by as much as 40 years. These estimates can and do vary, depending on the economic and other assumptions that underpin them.

- Employers frequently have the ability (and have used it in the past) to "create" surpluses by employing optimistic assumptions in valuing pension plans. Allowing these employers access to surplus then creates large future unfunded liabilities that may bankrupt the plans.

- Employers already have the ability to access surplus by taking a "contribution holiday," where they put no money into the pension plan until the surplus falls below a certain level. The difference between this and the "access to surplus" proposed is that they can't take all the surplus at once.

Workers and unions oppose allowing employers easier access to pension surpluses for a number of reasons:

1. Unions have always taken the position that the money in pension funds is deferred wages – it belongs to the workers and should be held in trust to guarantee them the best retirement income possible.

2. In 1984 Conrad Black tried to remove $56 million of surplus from the pension plan at Dominion Food Stores. The courts forced him to return most of the money, but this and later examples of employers plundering pension funds have sensitized unions to the problem of employer malfeasance.

3. Allowing employers to access pension surplus creates what economists call a "perverse incentive." It encourages employers to use pension funds for corporate rather than pension purposes. As one pension commentator noted recently:

   "*However, viewing DB pension plans as cash flow management tools runs contrary to the purposes for which tax incentives to fund pensions are provided,*

> *and it conflicts directly with the employer's fiduciary duties to the pension plan. Unfortunately, this view has a strong hold on actuaries and corporate finance professionals and lies at the heart of the 'asymmetry' arguments that plan sponsors unfairly bear all the risks of pension funding.*"[5]

Unions find it especially problematic that proposals to relax rules governing employer access to plan surplus are advanced in the name of encouraging employers to offer occupational DB pension plans. We believe that, on the contrary, such measures serve to undermine the pension system.

Principles vs. Rules Based Legislation

Unions are also skeptical of suggestions that rules-based pension standards can be replaced by a more flexible principles-based system that would eliminate so-called "red tape." Pensions are, by their very nature, complex things. Similar efforts at "deregulating" complex systems have contributed to the recent collapse of financial markets – a scenario we don't want to see repeated in the area of pensions.

PUBLIC PENSIONS

A proposed solution to the declining trend in pension coverage is an expansion of public pensions. One possible way of doing this is to improve the Canada Pension Plan in ways that will be discussed later in this paper. A much less desirable method would be the introduction of a new supplementary pension plan with poor design features.

Unfortunately, proposals of this kind are circulating in the pension industry, and have recently been featured in the reports of government-sponsored "expert panels" in Alberta[6] and Nova Scotia.[7] Such a plan would have the following elements:

1. Defined contribution – no specified benefit;
2. Auto-enrollment with employer and employee opt out; and
3. Contribution rates that are very low or are not specified at all.

A pension plan with the above features simply won't do what it is needed: significantly improve pension coverage and provide sufficient retirement income for Albertans. The proposal is flawed in several respects.

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[5] Greg Hurst, "Lies, Damn Lies, And Canada's Private Pensions Funding Crisis," *Benefit and Pensions Monitor*, February 2006, p. 34.
[6] *Getting Our Acts Together: Pension Reform in Alberta and British Columbia*, Nov. 14, 2008; http://www.ab-bc-pensionreview.ca/panel_report.html.
[7] *Promises to Keep*, report of the Nova Scotia Pension Review Panel, January 27, 2009: https://www.gov.ns.ca/lwd/pensionreview/docs/PensionReviewPanelFinal.pdf .

First, a defined contribution pension just isn't a reliable way to provide a retirement income. DC pension plans lack the risk sharing/insurance feature that defined benefit plans provide and leave participants at the mercy of market volatility. That lesson has been driven home with the recent meltdown of financial and equity markets.

Second, allowing employees and – much worse – employers to opt out means that the plan will not achieve the uptake its proponents expect:

1. Any employer who isn't already offering a pension of some kind to their employees is obviously unwilling to bear the expense of contributing at a meaningful level and will therefore opt out of the SPP unless,

2. The plan features low contribution rates that provide a false sense of security, while not providing a retirement income adequate to prevent poverty in retirement.

Proponents of a Supplementary Pension Plan (SPP) suggest that the way to get around the problem of low uptake is to design the plan to feature "auto-enrollment" – in other words, employees and employers are automatically in the plan unless they make the effort to opt out. Citing "studies," these advocates suggest that auto-enrollment will boost participation in the plan far enough to make a meaningful improvement to pension coverage.

This argument is difficult to accept. Based on a logic similar to the "negative option marketing" employed by TV cable providers, it assumes that most people enrolled (or rather, auto-enrolled) will either like the plan or be too indifferent to bother opting out.

Far from solving the problem of declining pension coverage, a flawed SPP with a low contribution rate might actually serve to undermine existing pension arrangements, providing employers – especially non-union employers – with a way to duck out of workplace pension plans they no longer want to offer.

The Problem with the Employer Agenda

The problem with most of the proposals outlined above is that they represent attempts to generate retirement incomes for workers without imposing costs on employers. That just won't work. The decline in pension coverage in Canada is a result of the general assault on the wages and benefits of workers in this country. That trend won't be reversed by hastily applied public-policy "band-aids."

POSSIBLE WAYS FORWARD: A UNION AGENDA FOR PENSIONS

There are some public policy measures that could be put into effect by federal or provincial governments to address the impending crisis.

1) Improve the benefits offered by the Canada Pension Plan (CPP) and Old Age Security (OAS). This is probably the simplest and most efficient way to remedy the current low savings rate of Canadians. It would benefit the broadest number of Canadians for the lowest cost. There should be two basic elements in such an improvement:

   i) Double the ceiling on the yearly maximum pensionable earnings (YMPE) for Canada Pension Plan contributions. At present, the YMPE (the portion of annual earnings on which contributions are paid and benefits are calculated) is $44,900. Doubling this figure would increase the benefits paid to middle income Canadians. In the U.S., the equivalent figure for Social Security is $92,000 a year; and

   ii) Increase the premium rate for the CPP until it provides a benefit that replaces 50% of pre-retirement income. Employers who already offer an occupational pension plan to their workers could be exempted from participating, provided this plan is actuarially equivalent or superior to the CPP.

2) Establish a fund to insure pension benefits, similar to the Ontario Pension Benefits Guarantee Fund or the Pension Benefit Guarantee Corporation in the U.S.

3) Reform the federal *Bankruptcy and Insolvency Act* (BIA) to make pension plans with solvency deficiencies secured creditors in the event of employer insolvency. At present, when an employer declares bankruptcy, the pension plan is an unsecured creditor. If the plan has a solvency deficiency, this generally means a reduced pension for participants and retirees.

In the final analysis, efforts to defend the retirement incomes of Albertans and other Canadians will succeed only if they are founded not on the benevolence of government or employers, but on the organization and mobilization of union members and their fellow citizens. The best assurance of genuine improvements to public pensions is a strong grass-roots campaign that harnesses the energies of ordinary Canadians. And the best way to push for improved coverage from occupational pensions is to expand union membership and power to bargain better pensions.

The demographic and economic trends threatening our retirement income system are real, but they aren't the whole story. The real problem is one of political will: if we want Canadians to enjoy retirement with dignity, we have to be prepared to fight for that cause.
As always, the real lesson for unions is: "educate and organize."

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