NO
Pension
Panic

THE REAL PENSIONS CRISIS

It's all about coverage—not funding

NATIONAL UNION OF PUBLIC AND GENERAL EMPLOYEES
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issues menu

The sky is falling says who

LATELY, THE business sections of newspapers have been full of stories talking about the pension funding "crisis" in Canada and around the world. The headlines have been alarming: "Pension Shortfalls Threaten to Explode …" "Pension Plans Face $225 Billion Shortfall …" "Companies' Pension Shortfalls Could Destroy Retirement Dreams …" "A Time Bomb is Ticking in Pension Plans …".

Those who are signaling the alarm about the so-called "crisis" primarily come from the pension and investment industry and the corporate financial sector. They continuously have been warning us that the future of workplace pension plans is in jeopardy; that the sky is falling!

These alarmist headlines are likely to scare many working people and their families. After years of paying into a decent workplace pension, they might be now asking whether their pension plan will be able to provide them with financial security in retirement. They probably want to know what's happening to their pension. Is it safe? Is the sky really falling?

This answer is no, the sky isn't falling. This is in large part a manufactured crisis, designed to attack quality workplace pensions and allow employers to abrogate responsibilities to their employees.

Big money interests are working hard to create a pension crisis

Defined Benefit Pension Plans under attack

A carefully calculated move to undermine Defined Benefit plans

THE SO-CALLED "crisis" with private workplace pensions ostensibly involves a specific kind of pension plan—defined benefit (DB) plans. Such plans are the most common pensions in Canada. They are also easily the most superior.

A DB plan defines and guarantees a specific pension amount to the worker upon retirement. The benefit is determined according to a formula based on the worker's salary, age and years of service. DB plans are required to set money aside to pay promised benefits.

The funding crisis that we keep hearing about is calculated to justify a move away from this DB style of pension plan to a defined contribution (DC) plan, where the employer and often the employee set aside a specific amount of money—a defined contribution—every month.

At retirement, the worker has an account balance which is completely dependant on how much has been put into the fund and how these contributions have grown over time as they have been invested. By definition there cannot be a "funding crisis" with a DC plan—the employee is entitled to his or her account, and only to his or her account. But there can ofen be a "pension crisis", under a DC plan, as the amount available may not be nearly sufficient for a decent retirement.

simply the best

Clear advantages to a Defined Benefit Pension Plan

THERE IS really no comparison between a defined benefit pension plan and a defined contribution plan. The best form of pension is always going to be a defined benefit plan.

Of course, defined contribution plans are certainly better than no plan at all, for most workers—but they are unable to deliver the same level of benefits that a defined benefit plan can.

Less Risk / Greater Certainty

A DB plan provides less risk to a worker and greater certainty on how much pension income the worker will have in retirement.

Moving from a DB to a DC plan transfers all the risk to the employee

The reason for this is that a DB plan is first and foremost a pooled resource under which, if there is a shortfall in the fund, the employer as a plan sponsor must at least help make up the shortfall to ensure the promised benefits are available.

A DC plan is simply an accumulation of money, with no promised benefit.

If the DB plan is short of money, the employer has to cover, or share in the task of covering, the shortfall with the workers. If the DC plan does not provide enough for a decent retirement the employee is simply out of luck.

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 like it so much.

Additional Benefits

DB plans can provide for a number of benefits in addition to the basic pension, including enhanced early retirement benefits, survivor benefits beyond those required by legislation, portability, disability benefits and inflation protection.

While DC plans can also provide benefits in addition to retirement income, these additional benefits must be purchased by each individual at the time of retirement and will significantly reduce the monthly income available to retirees.

Lower Administration Fees

Because DB plans are centrally managed, the cost of administering the pension fund is shared among all beneficiaries, so less of the funds needed to pay retirement benefits are taken up by investment management fees.

In a DC plan, especially an individually managed plan, a larger proportion of an individual's account is absorbed by investment management fees charged by the pension industry, leaving fewer funds available for retirement income.

DC plans offer a source of added profits to the pension industry

Most moves by employers to a DC plan also transfer the administrative cost to the individual worker. This potentially huge source of profits for the investment industry explains why they are so active in the push for conversion of DB plans to DC.

Guarantee

A DB plan offers a guaranteed income for life to retirees.

A DB plan pays benefits for as long as a retiree lives and, in most cases, pays benefits to a surviving spouse for as long as he/she lives.

A DC plan carries no certainty that the benefit will be paid for the retiree's entire life; the retiree faces the real possibility of outliving the so-called retirement "nest egg."

The only way to ensure a lifetime of benefits is to purchase an annuity, but an annuity comes at a real cost and reduces the monthly payments available. Purchasing an annuity with survivor benefits is even more expensive and reduces the retirement income available.

At a time of increasing life expectancies, DC plans provide no guarantee that they will have sufficient assets to cover living longer than expected.

DB plans are the best form of pension plans for workers. Workers are assured a certain retirement income for the rest of their lives and the risks and responsibilities associated with providing that guaranteed retirement income either rests with the employer or is shared equally between the employer and the workers. This is in large part why corporate employers want to eliminate DB plans in favour of DC plans. By doing so, they are reducing corporate risks and corporate responsibility to their workers.

If the value and effectiveness of workplace pensions is reduced, the result will be greater poverty among Canadian seniors, and increased pressure to substantially improve our public pension system.

The global corporate agenda: Downloading pension liability and risk to workers

THE ATTACK on DB pensions is not something we are experiencing just here in Canada; it's happening around the world. It's part of a larger attack on the wages and benefits of workers through corporate globalization.

There have been world-wide structural changes to our economy in the last several years in favour of capital and profits and away from social spending and workers' incomes. The attempts to undermine DB pensions have to be seen in this light.

The objective of the global corporate agenda with respect to workplace pensions is to download the pension liability and the funding risk onto workers—by replacing DB plans with DC plans and having workers individually responsible for their own retirement income in the form of individual savings accounts.

Major corporations in the U.S. and Canada have already converted their DB plans into DC plans like IBM Corp., Motorola Inc., Lucent Technologies Inc., Verizon Communications Inc. and most recently Nortel Networks.

There is a peristent push from employers to convert to DC plans

This agenda, however, has not been limited to the private sector. In Latin America and Eastern Europe, there has been a substantial trend toward converting publicly funded universal pension plans to a system of individual savings plans / accounts. This trend has been advocated and assisted by the World Bank, and it has led to massive increases in poverty among retired workers.

In the United States, a recent proposal from President Bush to redirect a portion of Social Security pension contributions to individual investment accounts encountered heavy weather even from his own ranks and has been quietly dropped. Thankfully, the investment industry's persistent lobbying for the individual investment accounts option versus traditional universal public pensions has been blunted in recent years by a better understanding of the consequences for retirees.

There still remains, however, a strong push in the U.S. by employers, both private and public sector, for the conversion of DB plans to DC plans. In the public sector, 14 states have already adopted some form of compulsory or voluntary conversion to defined contribution plans and legislation in an additional 12 states has been proposed to convert DB plans to some form of a DC plan.[1]

overstated

The extent of financial shortfall in DB plans is 'challenging, but manageable'

It's important to look behind the headlines

THERE IS no disagreement that some of the large private sector industries are currently experiencing some formidable challenges when it comes to the funding of employer DB plans. But the extent of the problem has been massively overstated.

We have been constantly bombarded with DB bad news in the last several years by the financial industry. There have been a lot of stories in the news about underfunded pension plans. The Certified General Accountants Association of Canada estimated that up to the end of 2004 the shortfall in Canada's DB pension plans had grown $30 billion in one year to $190 billion.[2]

The Office of the Superintendent of Financial Institutions (OSFI) is the federal body that oversees federally regulated pension plans. In November 2005, the OSFI reported that an estimated 72% of federal DB plans were less than fully funded as at June 2005, compared to 53% in December 2004, although on average the funding shortfall was less than 10%.[3]

The OSFI described the situation as "stable but fragile". At that time OSFI stated that it had 50 out of the 370 DB plans it oversees on its "watch list"[4], down from the 60 it reported six months prior.

Added to that, there have been the high profile stories in recent years implicating the DB pension funding shortfall as being a significant factor in the bankruptcy or near bankruptcy of major private sector employers like Algoma Steel Inc., Stelco and Air Canada.

The DB pension deficits that are reported sound like big numbers, and a lot of bad news. But, it is important to look behind those headlines and numbers to see what this means.

explained

What's behind the current DB funding shortfall?

THERE ARE various reasons for the sudden funding crisis in DB pension plans.

Contribution Holidays

Many of the employer sponsored DB pension funds are in a deficit position because through the 1980s and 1990s, employers used the surpluses generated by high investment returns to take regular contribution holidays, and even take cash out of the plans, rather than contributing and leaving the money to fund those years when investment returns did not meet the pension plan's liabilities. Because investment returns were so consistently good for so long, corporate financial executives got used to pension plans being very cheap, if not free, or even a source of cash.

Employers treated themselves to contribution holidays

In June 2005, Shareholder Association for Research and Education (SHARE) published a study, which looked at the relationship between contribution holidays and plan funding for federally registered and British Columbia registered DB pension plans. The study compared contribution holidays taken by active DB pension plans between 1994 and 2003 against their respective current funding deficits. Findings indicated that lost revenue from contribution holidays would have played a significant role in mitigating the current funding deficits for many pension plans assessed on a growing-concern basis. Of the 42 significantly underfunded DB pension plans in the study, 45% would have completely eliminated their current actuarial deficit if contribution holidays had not been taken.[5]

Stock Market Downturn

DB pension deficits also arose partly because of the downturn in stock markets after the overheated technology sector crashed in the late 1990s and poor market returns in 2001 and 2002. This is still having a lingering effect on plan investments, even though the markets have since rebounded. In fact, in November 2005, the OSFI reported that strong equity market performance in the preceding six months made a positive contribution of about three percentage points to those DB plans regulated by the federal agency.[6]

Unexpected Return to Low Interest Rates

If long-term interest rates rise as little as 1 or 2%, the apparent funding deficits in most plans will disappear

Another reason is partly because of very low interest rates in Canada during most of the past decade (which make it more expensive to pay for future pensions). Many plans underperformed and failed to meet their assumed returns based on assumed interest rates ranging from 6% to 7% or even higher, which never materialized.

When the valuation rate of interest for funding purposes was increased beyond 4.0%, plan sponsors prematurely accounted for higher investment returns before they had actually occurred.

The current and apparently stable low interest environment represents a return to normal interest rate cycles and the current environment should not have been regarded as a surprise. It is, however, worthy to note that if long-term interest rates rise as little as 1-2%, the apparent funding deficits in most plans will disappear.

Change in Actuarial Methods

An important factor impacting the deficit position of many DB plans, which is not often mentioned by the pension industry, is the change in actuarial methods introduced by the actuarial profession in February 2005. The change in actuarial methods, adopted by the Canadian Institute of Actuaries, revises how solvency liabilities are calculated.

Among other things, the new standard makes the calculation of those liabilities more sensitive to prevailing market interest rates versus using rates more in line with historical norms.

According to OSFI, this change lowers the solvency rate of DB plans under its jurisdiction by seven percentage points.[7] The solvency of plans hasn't changed as much as the method of calculating that solvency.

The solvency of plans hasn't changed as much as the method of calculating that solvency

These external factors had been compounded by massive restructuring and many layoffs in large workplaces in the manufacturing sector with long established DB plans.

The growth in the average age and service of the active workforce, coupled with significant increases in the number of retirees compared to active workers, has added further pressures on the funding of DB plans; although this has been widely foreseen and has been compensated for in plan funding.

better

Jointly trusteed DB Pension Plans are better managed and funded

THERE ARE funding deficits in both public sector and private sector DB plans. But, those plans that are jointly trusteed, especially in the public sector, have not faced nearly the same level of difficulty.

In a jointly trusteed pension plan, the responsibility for the financial health of the plan is shared equally by the employer and the union representing its members. In fact, jointly sponsored DB plans contribute to improved funding because they reduce the level of employer exposure to deficiencies.[8] 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.

The National Union and its components have been an international leader in this field. We were among one of the

Jointly sponsored DB plans reduce the level of employer exposure to deficiencies

first unions to demand greater control in how our members' deferred wages were invested, and several of our components were the first unions in Canada to gain joint control of our members' pension funds. Our first major victory in this area was with OPSEU, where after ten years of campaigning on the issue, OPSEU was able to achieve joint trusteeship of their public service plan in 1994, one of the largest pension plans in Canada. Since then BCGEU, HSA BC and MGEU have fought hard for, and achieved, joint trusteeship of some or all of their members' pension plans. There is a commitment from the governments of Prince Edward Island and Newfoundland and Labrador to move to joint trusteeship of their employees' plans; and, active campaigns undertaken by Components of the National Union to achieve joint trusteeship in Nova Scotia, New Brunswick and Alberta. It is, therefore, likely that the joint trusteeship model of plan governance will be the dominant model within the public sector in the next decade.

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 move in several provinces to joint trusteeship, over the last decade, has therefore been a significant factor in reducing liabilities of public sector pension plans.

For example, the OPSEU Pension Trust, which has $12 billion in assets, is in its 11th year as a jointly trusteed plan and is the only public sector plan in Ontario that has not had to increase contributions. Another example is the jointly trusteed Manitoba Health Employees Pension Plan that has a requirement that in the event the plan is not adequately funded, there must be either a decrease in benefits or an increase in contributions. In order to deal with an underfunding problem in 2005, a deal was reached through collective bargaining to increase contributions by 1.8% for both employer and employees.

It also should be noted that the four large public sector plans in British Columbia are jointly trusteed and remain in a significant healthy position. In a jointly trusteed plan, employers and workers share the risk of underfunding and the benefit of surplus. This sharing reduces the scale of any underfunding that an employer must confront and, therefore, reduces the volatility of their pension liability.[9] Joint trusteeship of a pension plan ultimately leads to a more secure and stable funding situation.

far from bare

The pension funding cupboard isn't bare

IN THE public sector, the financial health of pension plans has greatly improved in the last three years as Canada's provincial governments have taken advantage of an improved budgetary position to bolster their contributions. A July 2006 report from CIBC World Markets notes that special payments being made against pension liabilities, in many cases with borrowed money, have placed public sector plans on a firmer long-term footing and have helped to trim future debt-servicing costs.[10]

The current focus on pension shortfalls coincides with a generalized improvement in provincial finances, according to the CIBC World Markets report. In the past, budget deficits constrained government efforts to shore up pensions, but today's improved fiscal situation of governments provides a more accommodative backdrop for special pension payments.[11] The report notes that solid investor demand for high quality provincial bonds has allowed governments to make debt-financed pension payments without unduly pressuring provincial interest rate spreads.[12]

Record corporate profits give the lie to claims employers can't make pension payments

The report cites the governments of Newfoundland and Labrador, New Brunswick, Prince Edward Island, Quebec and Manitoba for making special payments against pension liabilities in the last year.

With respect to private sector pension plans, any claim that pension plans in Canada are facing a "funding crisis" is getting less persuasive by the day.

First and foremost, corporate profits in Canada have reached record levels as a percentage of GDP, ridiculing the notion that the great majority of plan sponsors are without means to address financial shortfalls in their pension plans.

Canadian non-financial corporations are hoarding stores of liquid cash, often at the expense of required pension funding

In fact, a study in the April 2006 edition of the Canadian Economic Observer documents the growth of a massive corporate surplus in Canada, reaching a "record net lending position of $80.6 billion by 2005."[13] The study explains that Canadian non-financial corporations are holding massive stores of liquid cash in their accounts, often at the expense of capital improvements and shortfalls in pension funding.[14] These companies may not have funded their pension plans, but it's certainly not because they can't afford to.

Secondly, astounding growth in pension fund assets, and pension investment returns, certainly don't help reinforce the pension industry's position that the pension plan cupboard is essentially bare.

During the last several years, the assets in Canadian pension funds have undergone fairly healthy growth. In fact, the rising asset value of pension plans in Canada outweighed the impact of the increase in liabilities experienced in the last five years.

Statistics Canada reported that in September 2006, the value of trusteed pension funds was $836.8 billion during the first three months of 2006, a 4.7% rise over the fourth quarter of 2005. Since 1995, fund assets have more than doubled in value, while in the last five years they have grown more than 30%.[15]

Fund revenues during the first quarter of 2006 amounted to just under $28 billion and expenditures $9.5 billion, for a net cash flow of $18.9 billion.[16]

Contributions were at $9.9 billion, of which $7.6 billion was made by employers, the result principally of special payments for unfunded liabilities.[17]

Employer contributions have been on the rise since 2001. Up to that time many employers had been taking a contribution holiday because their pension fund investments were doing very well. For the third straight year, annual contributions have exceeded benefits paid out.

In its April 2006 issue, Benefits Canada reported that the value of all Canadian pensions recently eclipsed the $1 trillion mark. Further still, the rate of return on pension investments has increased, averaging 9% in 2005 and 2004, double the rates during the "bear market" years of 2001 and 2002.[18]

The extent of Defined Benefit Pension coverage in Canada

THE PENSION and investment industry often quotes the fact that the DB plans are in decline in Canada. The Association of Canadian Pension Management (ACPM), representing over 700 pension plan sponsors and managers, cites that during the period from 1992 to 2003, the percentage of the Canadian workforce covered by DB plans, declined from 44% to 34%.[19]

It's very clear that the percentage of the workforce that is covered by a pension plan has declined—from 45.1% in 1992 to 39.9% in 2003.[20]

If we look at the decline of DB plan coverage by sector for the same period, coverage for Canada's public sector employees fell from 91.5 % to 79% and coverage for Canada's private sector fell from 28.7% to 20.5%.[21]

Much of the large decline in DB pension plan coverage in the public sector during that period can be attributed to massive government restructuring causing direct public sector employment in Canada to shrink by 10% in 10 years through outright cuts, offloading and privatization. There were 2.8 million public service employees in 2002, compared with 3.1 million in 1992.[22]

Since 1992, the proportion of DB plans of all pension plans rose steadily

What the pension and investment industry fails to mention is that since 1992, the proportion of DB plans of all pension plans rose steadily—from 67.7% in 1992 to 73.4% in 2002 to 76.7% in 2004.[23] In fact the number of DB plans jumped by a third within two years, from 2,234 in 2002 to 2,929 in 2004.

The number of workers covered by DB plans in Canada also increased by nearly 11%—from 3,620,000 in 1992 to 4,012,000 in 2004. While the actual number of workers covered by DB plans increased by nearly 400,000, the proportion dropped—from 94% in 1992 to 87% in 2004. The reason for this has been the growth of the Canadian workforce, especially with respect to the number of contingent workers in those sectors which generally are not unionized and have not traditionally provided pension coverage.

During that period (1992 to 2003), Canada's total workforce grew by 2.7 million workers, or 25%—with the majority of new jobs being part-time, temporary or other forms of contingent work. Over one third of the Canadian workforce is now employed in contingent work and it is estimated that approximately only 15% of those contingent workers participate in a workplace pension.

In comparison, the proportion of DC plans, as a percentage of all pension plans, dropped from 31.3% in 1992 to 17.1% in 2002 to 13.8% in 2004 even though the actual number of plans rose from 521 plans to 530 plans from 2002 to 2004. The number of workers covered by DC plans increased by 22% during the period from 1992 to 2004. However, in actual numbers, this only represented an increase of 41,000 workers—from 187,000 in 1992 to 228,000 in 2004. The proportion of workers covered by DC plans has remained steady at about 5% since 1998.

The biggest crisis is not the gradual disappearance of DB plans, but the declining pension coverage for new members of the Canadian workforce. If this trend continues it is going to place increased pressure on our public pension system as the primary source of income for a growing proportion of Canadian seniors. This really points out the critical need for a national policy focus on how best to ensure that all Canadians have financial security in retirement.

Year	Defined-Benefit					Defined-Contribution				
	Funds	%	Members '000	%	Assets ($millions)	Funds	%	Members '000	%	Assets ($millions)
1992	2,300	67.7	3,620	94.7	244,489	1,064	31.3	187	4.9	7,585
1993	2,210	68.0	3,672	94.4	298,231	926	28.5	136	3.5	6,523
1994	2,302	71.4	3,668	93.6	296,979	767	23.8	139	3.5	6,734
1996	2,316	73.1	3,565	93.1	397,533	672	21.2	147	3.8	9,919
1998	2,228	75.2	3,378	90.3	478,928	514	17.4	178	4.8	13,270
2000	2,354	73.7	3,537	88.0	553,658	554	17.4	196	4.9	15,378
2002	2,234	73.4	3,930	88.1	512,223	521	17.1	226	5.1	17,713
2004	2,929	76.7	4,012	87.1	631,606	530	13.8	228	4.9	18,062

Source: *Trusteed Pension Funds* in **Perspectives on Labour and Income,** Statistics Canada: January 2006, Vol. 7, no. 1 **Note:** Other types of pension plans (i.e. – a combination of both DB and DC) are not included in this table.

conclusion

THE EVIDENCE and current data available certainly contradicts the claim that Canadian pension plans are in a state of crisis.

Pension plans went through a rough period in the first part of the decade, but the high rate of return on investment in the last three years certainly has helped bridge the pension funding gap. In many cases employer and employee pension contributions have increased in recent years. However, much of these increases have been necessitated by employer contribution holidays taken in the 1990s. We are not out of the woods yet in terms of dealing with funding shortfalls of DB pension plans. The dramatic growth in pension assets and corporate profits indicates, however, that today's pension shortfalls are manageable and will be resolved in due course.

For the most part, the so-called "funding crisis" of pensions in Canada is a manufactured crisis. Many large corporate employers are using this manufactured crisis to abrogate responsibility to provide quality pension plans for their employees so that they have some guarantee of financial security in retirement. They are failing to be part of the solution to ensuring Canadians can retire with financial security and dignity.

This manufactured crisis is nothing more than a smoke screen to avoid the real pensions crisis in Canada—the increasing percentage of a growing Canadian workforce that has no pension coverage—as previously noted, less than 40% of Canadian workers are covered by a pension plan.

The debate in Canada must focus on the real pensions crisis. It's not acceptable for a large segment of corporate Canada to off-load its responsibility onto individual workers for their financial security in retirement. This ultimately will lead to having more and more working Canadians living in poverty in their retirement years and will place increased pressure on our public pension system. A secure, enjoyable retirement should be the right earned by workers for decades of contributions to one's community and Canada's economy.

The dramatic growth in pension assets and corporate profits indicates that today's pension shortfalls are manageable and will be resolved in due course

If we, as a society, do not soon address the private sector's failure to provide decent workplace pensions for Canadians, we will be guilty of allowing a real and a bigger pensions crisis than what is purported to exist now

The labour movement must recommit itself to achieving pension plans for workers not covered by a workplace pension plan, and where there are pension plans, they must be defended. Any attack on workplace pensions must be seen as an attack on the wages of workers. Workplace pensions are not a "gift" from employers; they are owned by workers in that pensions are deferred wages of workers.

Access to a workplace pension is a critical factor in overcoming seniors' poverty and DB plans are the best type of pension plans to achieve this. DB plans, therefore, should be promoted and encouraged through public policy.

It's critical that unions continue the push for joint control over members' pension plans. We have proven that having an equal voice at the pension governance table is the surest way of ensuring that members' pension plans are protected and secure.

Consideration should also be given to the expansion of our public universal workplace pension plan, the Canada Pension Plan. CPP is one of the largest and most healthy pension plans in the world; by 2010 it's anticipated to become the largest pension plan in the world. Contributions to the plan are expected to exceed benefits paid until 2022, providing a 16-year period before a portion of the investment income from the CPP reserve fund is needed to help pay CPP benefits. CPP certainly has the capacity to provide a greater proportion of Canadians' retirement income beyond the 25% of their average annual earnings and increase benefits beyond the current maximum of 25% of the average Canadian industrial wage ($42,100 in 2006), as it does now.

An increasing percentage of working Canadians are coming closer to retirement as the bulging baby boom generation ages. If we, as a society, do not soon address the private sector's failure to provide decent workplace pensions for Canadians, then we will be guilty of manufacturing a real and a bigger pensions crisis than what is purported to exist now.

notes

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[23] The data in this section is contained in Trusteed Pension Plans in Perspectives on Labour and Income (Statistics Canada: January 2006, Vol. 7, no. 1).