work life

Canadian Centre for
Policy Alternatives
Manitoba Office

Take the Politics out of Pensions

In a new Canadian Centre for Policy Alternatives MB report on Manitoba's public-sector pensions *(Pensions in Manitoba: What's Working, What's Not),* author Hugh Mackenzie dispels many myths about public and private sector pensions. He anchors his analysis in the context of Canada's retirement income policy and its three main players: Old Age Security (OAS) and the Guaranteed Income Supplement (GIS); the Canadian Pension Plan (CPP); and, workplace based pension plans.

Mackenzie takes us through a brief history of OAS/GIS and CPP, starting with the introduction of the CPP and the private pension regulatory system in the 1960s. Today the Canadian Pension Plan Investment Board oversees a largely successful CPP, managing its asset base of $280B, one of the largest sovereign wealth funds on the planet. He notes that OAS/GIS has dramatically reduced the senior poverty rate in Canada.

Unfortunately, the workplace pension system has failed to meet the expectations of policy makers. This failure is due in part to the inability and/or refusal of private sector employers to meet the needs of their employees and in part to structural changes in the economy that undermine the rationale for single employer sponsored pension plans.

In contrast, public sector employers have largely fulfilled their commitment to provide sufficient income for retirees. But increasing pressure from the private sector is threatening the viability of public sector pensions, and that could have derogatory effects on the economy over all. The main threat is in the push to convert Defined Benefit (DB) pension plans to Defined Contribution (DC) plans.

Defined Benefit vs Defined Contribution Pension Plans

Both the employer and employee contribute to a DB pension plan which pays an employee a set monthly amount upon retirement, guaranteed for life or the joint lives of the member and spouse. The benefit can be indexed to inflation. The amount paid is normally calculated using a formula that takes into account the participant's years of service and retirement age. The benefit amount is usually either a flat amount per month per year or service or an amount based on earnings prior to retirement.

Under a DC pension plan the employer and the employee make contributions to the employee's account during employment, but there is no guaranteed retirement benefit. The benefit is determined by the accumulated contributions and investment earnings of the plan. Once the account is depleted, no further payment is made. In other words, a pensioner can outlive a DC pension, making them much riskier than DB plans.

According to a recent study by the Boston Consulting Group (BCG), the bulk of pension payments paid out from the four DB plans they studied came from returns on investment of the pooled resources in the plans. BCG also found that retirees with DB pension plans are far less likely to rely on the federal government's Guaranteed Income Supplement and that they provide important stimulus to the economy, with spending by pension recipients between $56 – $63 billion/year. DB pensioners annually pay between $14 - $16 billion in taxes.

Mackenzie explains that DC plans have higher fees, lower returns and more risk than DB plans. He points to research showing that large DB plans outperform large DC plans, partly because of differences in the fees charged and the fact that DC plans have to invest more conservatively and therefore earn a lower return. The overwhelming advantage of DB plans comes from pooling longevity risk and asset risk.

205 - 765 Main St.

Winnipeg, MB

R2W 3N5

204•927•3207

lynne@policyalternatives.ca

www.policyalternatives.ca

Oct 25, 2017

ERROL BLACK CHAIR
EBC
IN LABOUR ISSUES

"The main threat is in the push to convert Defined Benefit (DB) pension plans to Defined Contribution (DC) plans."

In other words, DB plans are better placed to protect pensioners regardless of how long they live and DB plans can maintain a stable mix of assets that protect against market volatility. DC plans and even more so, self-directed RRSPs, do far worse at protecting pensioners' interests.

If your pension strategy is simply to invest in RRSPs through an investment firm, by the time you retire an estimated 45 per cent of your savings will have been paid to mutual fund managers. Canada has the highest mutual fund fees in the world.

Private Sector Workers Losing Ground

Given the superior performance of DB plans, it is unfortunate that so few private sector workers have access to them. According to Mackenzie, in 2015 only 26 per cent of Manitoban private sector workers had a pension and two thirds of those plans were DC plans. Only one in ten private sector workers has a DB plan.

Those without a DB or DC plan, almost 75 per cent of all private sector workers, are on their own in the RRSP system, and it tends to be the higher income earners who contribute to RRSPs. Mackenzie notes that "Significant numbers of Canadians withdraw substantial amounts from RRSPs prior to retirement" leaving them ill prepared to finance their non-working years.

DB Pensions = Smart Public Policy

As of 2015, 89 per cent of Manitoba's public sector workers were covered by a pension plan, with 77 per cent in Defined Benefit (DB) plans and 12 per cent in Defined Contribution (DC) plans. Of increasing concern is the growing tendency of governments to consider converting DB plans to DC plans.

Mackenzie provides evidence that the economic sustainability 'crisis' in public sector pension plans is fiction, claiming that the crisis for public sector pensions is political, not economic. By erroneously placing the public plans in the same environment as the private, critics have concluded that the problems private plans face will occur in the public sector.

In fact if the Manitoba government were to convert DB plans to DC, benefits paid would decrease dramatically but there would not be a corresponding saving to the government. Based on the experience of Alaska, Michigan, West Virginia, Nebraska and Saskatchewan when they converted from DB to DC, long term pre-existing unfunded liabilities would continue to grow for decades and the cost to government would almost certainly increase. When Minnesota, Wisconsin, Nevada, Texas and New York City considered switching from DB to DC plans, they all found that it would have cost the employer too much and would have delivered insufficient retirement income to their employees. None made the switch.

Mackenzie's report provides compelling and detailed evidence on the need to preserve DB plans where possible and to shore up options for the millions of Canadians who are stranded without workplace pension plans of any sort. He clearly cuts through the faulty logic of undercutting public pensions in the name of saving money.

Lynne Fernandez holds the Errol Black Chair in Labour Issues at the Canadian Centre for Policy Alternatives, MB

References available upon request.